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The government requests \$5.2 billion from the World Bank Group to finance power sector infrastructure investment. The financing will facilitate the government's Power Sector Recovery Plan (PSRP), but will not address sector bottlenecks including distribution company mismanagement. The national assembly passes the 2017 budget, five months into the Nigerian financial year. The Central Bank of Nigeria (CBN) denies media reports that it has relaxed the prohibition on importers of 41 items from accessing foreign exchange.

Government seeks \$5.2 World Bank financing for power sector investment

Power, works and housing minister **Babatunde Fashola** said on 10 May that the government is seeking \$5.2 billion from the **World Bank Group**.¹ Financing difficulties had previously forced President **Muhammadu Buhari** (2015-present) to modify his overly ambitious forecasts for improved capacity and supply, damaging his credibility. Before the 2015 general election, Buhari had pledged to increase power output from annual average of 3,600 megawatts (MW) to 20,000 by the end of his first term in office.² However, production has often been lower than under Buhari's predecessor, President **Goodluck Ebele Jonathan** (2010-2015), who liberalised the sector in November 2013. Production is depressed because of irregular gas supply due to dilapidated infrastructure and pipeline attacks in the **Niger Delta**, and because of low water levels at hydropower stations. The distribution network also remains underinvested with the state-owned **Transmission Company of Nigeria** struggling to secure requisite financing due to its own debt levels.³ In July 2015, the Buhari administration revised its production target downwards to 6,500MW.⁴

Fashola said initial disbursements from the World Bank Group would begin in June and July.⁵ The **International Finance Corp (IFC)** will invest \$1.3 billion in power projects and electricity distribution companies; the **Multilateral Investment Guarantee Agency** \$1.4 billion for gas and solar power programmes; and the World Bank \$2.5 billion to improve power distribution and expand transmission capacity.⁶ It is unclear if the budget's 564 billion naira (N) (\$1.8 billion) reserved for power projects includes the World Bank financing. Much of this spending will take place under the government's **Power Sector Recovery Plan (PSRP)**.⁷ The World Bank and vice president **Yemi Osinbajo** jointly prepared the PSRP, which the government launched in March.⁸ The PSRP projects that the sector will require approximately \$1.5 billion annual investment between 2017 and 2021 to be viable.⁹ The PSRP projects that a viable functioning electricity sector will result in increased growth of \$29.3 billion annually during this period.¹⁰ The PSRP is principle-based rather than providing specific policy steps and objectives.

¹ Bloomberg, 10 May 2017.

² Source, analyst, Lagos

³ Source, analyst, Lagos

⁴ Source, analyst, Lagos

⁵ Bloomberg, 10 May 2017.

⁶ Bloomberg, 10 May 2017.

⁷ Bloomberg, 10 May 2017.

⁸ Bloomberg, 10 May 2017.

⁹ PSRP, Mar 2017.

¹⁰ PSRP, Mar 2017.

*"The PSRP is not too specific in some instances as regards actual steps to be taken to achieve targets; nevertheless the important thing is that it sets things in motion and will allow for funds to be released by the donors, mainly the World Bank and **African Development Bank** which will help to catalyse further investments from the private sector, both foreign direct investment and local investment."*¹¹

Financing alone will not address the structural bottlenecks in Nigeria's power sector.

*"I am strongly opposed to the federal government's plans to borrow externally for the power sector reform programme. While Nigeria's power sector requires enormous financial investment to upgrade and build new infrastructure, especially the power transmission lines, unfortunately the government is yet to demonstrate the financial discipline and institutional capacity required to ensure that the funds will be effectively utilised for the implementation of the reform programme. Most of the distribution companies are still a cesspool of corruption."*¹²

The PSRP's immediate priority is to introduce cost-effective tariffs, in part to secure increased levels of private investment, especially in struggling distribution companies. The **Nigerian Electricity Regulatory Commission** is working to simplify the price setting formula and, with the **Central Bank of Nigeria (CBN)**, to protect tariffs from exchange rate fluctuations. Fashola acknowledged that a successful tariff regime depends on a steady exchange rate.¹³ A new tariff formula for both industrial and commercial users is expected in July.¹⁴ However, the power sector has warned that tariff revisions alone will be insufficient without broader regulatory reform.

*"While the government should be lauded for taking steps to address the liquidity challenges in the sector through internal and external funding, the critical challenges facing the sector need to be addressed in the first instance – debts owed by government ministries/agencies, lack of an effective contractual, institutional and governance framework in the sector, lack of effective performance management of the distribution companies. Without addressing these issues then it will simply be a case of the federal government attempting to plug holes in a fast leaking boat and is unlikely to achieve the intended objectives."*¹⁵

Fashola was especially critical of distribution companies, claiming that their poor performance would have dragged down the entire power network without the N701.9billion (\$2.23 billion) intervention fund that the CBN established in January.¹⁶ The fund has allowed the government to subsidise generating companies owed outstanding payments by distribution companies. In 2016, distribution companies only paid 27% of the N331 billion (\$1.05 billion) they owed to generating companies due to unpaid bills, dilapidated infrastructure, electricity theft, and attacks on gas pipelines.¹⁷ The PSRP is equally critical of what it describes as the market indiscipline of the distribution companies, claiming that between 2015 and 2016 they increased the proportion of cash they retain rather than releasing it to generating companies or investing in infrastructure.¹⁸ However, distribution companies have pushed back on government attempts to have greater control over distribution company revenues:

"Any attempt to centralise or escrow distribution company revenue accounts will be tantamount to nationalisation or expropriation of the distribution companies. It will also send very wrong signals to domestic and international investors that Nigeria is not fully open for private sector investment and that we are still partial to the old habits of nationalisation, preventing the

¹¹ Source, industry analyst, Lagos

¹² Source, energy policy expert, Lagos

¹³ Bloomberg, 10 May 2017.

¹⁴ Source, analyst, Lagos

¹⁵ Source, power sector consultant, Abuja

¹⁶ Bloomberg, 10 May 2017.

¹⁷ Guardian, 13 Feb 2017.

¹⁸ PSRP, Mar 2017.

injection of the cheap and sorely needed capital that is critical to the rehabilitation and improvement of the electricity infrastructure.”¹⁹

The government instead has looked to reduce pressure on the generation companies by introducing the eligible customer policy, which allows them to sell power directly to end-users.

“While the intervention fund is a short to medium-term palliative measure for beleaguered industry players, certainty and consistency around both implementing cost reflective tariffs as well as market structure especially on the newly announced eligible customer policy will be essential to unlocking the unrealised potential of the power market in the long term.”²⁰

In fact, credit from international financial institutions will do more to reassure generation companies.

“The project pipeline is likely to grow now that transmission and other gaps including market liquidity are being addressed. Funding to be obtained from the World Bank and African Development Bank will incentivise developers to put their projects in motion without the fear that generated power could be stranded due to evacuation constraints or generated power would not be paid for by offtakers.”²¹

Broader regulatory reform remains a medium-term goal.

“It is interesting to note that the power ministry has just advertised for consultants to review and amend power sector laws and guidelines as well as to develop policies. I imagine that these are all geared towards making the operating environment much more developer and investor-friendly as well as to address some of the gaps which industry players have identified since the sector reforms kicked in.”²²

The outlook for the electricity sector is more positive, due to improved gas supply in the Niger Delta on the back of improved security in the region. This will encourage investment in gas-fired power stations. However, the longer-term picture is less certain. Tariff changes are necessary to allow distribution and generation companies to meet their costs, and reduce their dependence on government subsidies. Unions are likely to oppose these tariff changes, thereby deterring investment and the political backing for necessary institutional reform.

National assembly passes long-overdue budget

The national assembly passed the 2017 budget, five months into the financial year, on 11 May.²³ The delay in the budget’s passage is indicative of continued public financial management challenges under Buhari. The budget targets government revenue of N4.9 trillion (\$15.5 billion).²⁴ The budget sets government expenditure at N7.44 trillion (\$24.5 billion), 23% larger than the N6.06 trillion (\$19.1 billion) budget in 2016.²⁵ Inflation partially explains this increase; however, it is notable that the revenue figure differs from that in Buhari’s speech introducing the budget in December 2016 (see *ARC Briefing Nigeria January 2017*). In Buhari’s speech, revenue was set at N7.30 trillion (\$23.1 billion).²⁶ The budget includes N2.99 trillion (\$9.5 billion) for non-debt recurrent expenditure, N1.84 trillion (\$5.8 billion) for debt servicing, and N2.18 trillion (\$6.9 billion) for capital expenditure.²⁷ The main capital expenditure recipients will be power (24%), transportation (12%) and housing (4.5%).²⁸

¹⁹ Source, distribution company executive, Abuja

²⁰ Source, power project developer, Abuja

²¹ Source, power project developer, Abuja

²² Source, industry expert, Lagos

²³ This Day, 11 May 2017.

²⁴ This Day, 11 May 2017.

²⁵ This Day, 11 May 2017.

²⁶ This Day, 11 May 2017.

²⁷ This Day, 11 May 2017.

²⁸ Vanguard, 15 Dec 2016.

Observers have welcomed the increased expenditure. There are, however, implementation risks. Capital expenditure projects in Nigeria continue to struggle from project delays and government revenue shortfalls.²⁹ The finance ministry reported on 12 May that capital spending in the 2016 budget year reached N1.2 trillion (\$3.8 billion) in 2016.³⁰ Public sector calls for pay rises and increased payoffs to militants in the Niger Delta will put upwards pressure on recurrent expenditure at the expense of capital expenditure in 2017/2018. Buhari's office confirmed on 6 May that the government has trebled its budget for the 2009 **Presidential Amnesty Programme (PAP)** in the Niger Delta.³¹ The presidency said the government would imminently release an additional N30 billion (\$98.5m) and an extra N5 billion (\$15.8m) in the future.³² Until 2016, the annual budget for the PAP was N20 billion (\$63.4m).³³ The budget projects a deficit of N2.50 trillion (\$7.9 billion), approximately 2.2% of GDP.³⁴ The government will borrow N2.36 trillion (\$7.5 billion), with N175.9 billion (\$557m) from international markets and N1.488 trillion (\$4.7m) from domestic.³⁵ Economists have warned that the high level of domestic borrowing may indicate depressed levels of international interest, and could result in increased domestic interest rates.³⁶

The budget is predicated on an estimated benchmark oil price of \$44.5 per barrel, crude output of 2.2 million barrels per day (bpd), and an exchange rate of N305 to the dollar.³⁷ The only assumption that the national assembly changed during the budget's passage was the price of oil, which was originally \$42.5 per barrel.³⁸ The revised oil price estimate remains conservative. However, the production target may be overly ambitious amid continued Niger Delta militancy and policy uncertainty. Senate president **Bukola Saraki**, a possible challenger to Buhari (see *ARC Briefing Nigeria April 2017*), called on the government to submit the 2018 budget before the end of September to facilitate its passage before the start of the financial year.³⁹

The budget comes as the economic outlook improves. The **National Bureau of Statistics (NBS)** published data on 23 May showing that the economy contracted 0.52% year-on-year in the first quarter.⁴⁰ The growth outlook is more positive due to a recovery in oil sector production. The NBS also revised the fourth quarter 2016 contraction from 1.30% to 1.73%.⁴¹ Average oil production increased 0.07 million bpd to 1.83 million bpd between the fourth quarter 2016 and first quarter 2017.⁴² The NBS data showed that the non-oil sector grew 0.72% in the first quarter, 1.05% higher than the fourth quarter 2016.⁴³ Growth was driven by activity in the agriculture, manufacturing and transportation sectors.⁴⁴

However, in an indication of continued public financial management difficulties, the senate on 18 May instructed 37 federal government agencies to stop additional capital expenditure until they submit their 2017 budgets for parliamentary approval.⁴⁵ The previous day the senate had passed a motion that accused the government agencies of breaching the **Fiscal Responsibility Act** that requires them

²⁹ Source, political analyst, Lagos

³⁰ Vanguard, 12 May 2017.

³¹ Reuters, 7 May 2017.

³² Reuters, 7 May 2017.

³³ Reuters, 7 May 2017.

³⁴ This Day, 11 May 2017.

³⁵ This Day, 11 May 2017.

³⁶ Reuters, 15 May 2017.

³⁷ This Day, 11 May 2017.

³⁸ This Day, 11 May 2017.

³⁹ This Day, 11 May 2017.

⁴⁰ Reuters, 23 May 2017.

⁴¹ Reuters, 23 May 2017.

⁴² Reuters, 23 May 2017.

⁴³ Reuters, 23 May 2017.

⁴⁴ Reuters, 23 May 2017.

⁴⁵ Vanguard, 18 May 2017.

to submit their budgets to the relevant ministry before the end of the second quarter of every year.⁴⁶ The affected agencies include the CBN, the **Nigerian National Petroleum Corp** and the **Federal Inland Revenue Service**.⁴⁷ The senate gave Osinbajo two weeks to submit the budgets of defaulting agencies.⁴⁸ Saraki led the criticism of the government's failure to comply with the Fiscal Responsibility Act.⁴⁹ Saraki said it was especially serious as the government is attempting to curb corruption and improve fiscal transparency.⁵⁰

The budget's revenue targets are ambitious. Both oil and non-oil sectors are likely to miss their targets due, respectively, to ongoing militancy and exchange rate mismanagement. The government will have to borrow more from domestic and international sources to bridge a larger than forecast deficit. Long-standing distrust between the government and national assembly has previously delayed attempts at economic policy reform. Poor public financial management will remain an obstacle to sustained and broad-based growth.

CBN denies relaxing foreign-exchange restrictions

The CBN denied on 4 May media reports that it has relaxed the prohibition on importers of 41 items from accessing foreign exchange.⁵¹ Policy uncertainty may persist as key government officials continue to put forward different strategies to simplify the complex exchange rate regime to make it more attractive to investors. The CBN released a circular on 3 May stating that importers of items classified as ineligible for foreign exchange can now qualify for hard currency for transactions worth up to \$20,000 a quarter.⁵² Local media reported this as a partial reversal of the import ban first introduced in 2015.⁵³ The **Manufacturers Association of Nigeria** in particular welcomed the move.⁵⁴ The CBN, however, said that this was a misunderstanding of the circular which did not, in fact, refer to the 41 restricted items.⁵⁵ The CBN did not clarify what exactly the circular was referring to, resulting in greater confusion.⁵⁶ Restrictions on the 41 items, which include rice, cement, steel products, roofing sheets, soap, cosmetics, textiles, and foreign bonds, remain in place. Importers still must source foreign currency on the parallel market. This has hampered the manufacturing sector, which is dependent on these imports, and has encouraged inflation. The government remains divided on exchange rate policy. On 1 May, Osinbajo said the government is looking to replace the restricted items list.⁵⁷ Osinbajo proposed a more trade-sensitive framework that considers the need for specific items and locally unavailable raw materials. CBN governor **Godwin Emefiele** said on 4 May that increased oil revenue in recent weeks had allowed the CBN to defend the naira and stabilise the parallel market rate between 380 and 385 naira to the dollar.⁵⁸ Buhari remains opposed to a market-determined exchange rate.

Exchange rate mismanagement will continue to deter non-oil sector economic activity, an additional obstacle to sustained and broad-based growth.

⁴⁶ Vanguard, 18 May 2017.

⁴⁷ Vanguard, 18 May 2017.

⁴⁸ Vanguard, 18 May 2017.

⁴⁹ Vanguard, 18 May 2017.

⁵⁰ Vanguard, 18 May 2017.

⁵¹ Vanguard, 5 May 2017.

⁵² Vanguard, 5 May 2017.

⁵³ Vanguard, 5 May 2017.

⁵⁴ Bloomberg, 5 May 2017.

⁵⁵ Vanguard, 5 May 2017.

⁵⁶ Vanguard, 5 May 2017.

⁵⁷ This Day, 2 May 2017.

⁵⁸ Vanguard, 5 May 2017.

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