The Nigerian Economic Summit Group

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# BUDGETING IN NIGERIA: ARE WE ON THE RIGHT TRACK?

NESG Policy Brief: January 2017


## Summary

The 2017 budget of N7.29 trillion is a vital fiscal tool that has the potential to support the economy. However, implementation of the budget is crucial to its success. Revenue generation needs to be enhanced through the blockage of leakages, improving tax efficiency and implementing clear fiscal reforms that support the business environment and therefore non-oil revenue. The Nigerian government must remove unnecessary recurrent items from the budget; reduce debt servicing cost and channel resources to high priority projects. Going forward, the following are essential in ensuring improved budget impact in Nigeria:

- Disclosure of budget performance
- Legislating the budget process
- Reviewing the procurement process
- Monitoring and evaluation


## Introduction

The 2017 federal government (appropriation bill) budget presents an expenditure of N7.29 trillion (US$18.2 billion). The budget comprises a capital component of N2.24 trillion representing about 30% of total expenditure, while recurrent budget amounts to N5 trillion. The budget aims to continue Nigeria's diversification and job creation efforts with emphasis on agriculture, manufacturing, solid minerals and services.

For an economy with contracting GDP (-1.6% in 2016), increasing unemployment rate and rising debt servicing/revenue ratio, it is no doubt that a budget of such magnitude has the potential to ameliorate the economy which has experienced series of shocks in the past two years. We believe, therefore, that the impact of the budget to stimulate economic activities would depend largely on three main factors: the attainment of key assumptions of the budget, efficiency of the budget process and the implementation of the capital expenditure (capex).

## 2017 Budget Assumptions: How realistic are they?

The 2017 budget assumes crude oil price to average US$42.5 per barrel (pb) in the year, while output would average 2.2 million barrels per day (mbpd). In our view, crude oil price will remain around US$50pb for the most part of the year, due to strong global demand as well as the cut in global oil output by both OPEC and non-OPEC countries led by Saudi Arabia and Russia.

This optimistic outlook for crude oil price also led the National Assembly to increase the benchmark price to US$44.5pb in the Medium-Term Expenditure Framework (MTEF). With this, it is expected that the budget benchmark price would be further adjusted to reflect current realities in the global market. The lower budgeted benchmark price, however, is positive for Nigeria as it guarantees more dollar inflows into the excess crude oil account. While we believe that the budget assumption of $42.5pb of crude oil is likely to be achieved in the year, we hold the view that the assumption for output is overly ambitious. Crude oil revenue projection increased by 144% to N2 trillion, from N820 billion in the 2016 budget. This is on the backdrop of a positive outlook on crude oil price and anticipated peace in the Niger Delta region.

The increase in projected crude oil revenue sends signals of optimism of the government in resolving issues in the sector. Yet it presents some inherent risks such that any disruption in crude oil production, which is likely in 2017 would lead to a revenue shortfall and consequently result in an underperformance of the budget. In addition, current reforms in the oil industry relating to the new funding mechanism for Joint Ventures, issue and renewal of marginal fields licenses among others could create uncertainties for oil revenue projection in the budget.

### Nigeria's 2017 Budget Assumptions

| | 2017 | 2016 | Variance |
|---|---|---|---|
| Oil production (mbpd) | 2.2 | 2.2 | 0.0% |
| Crude Oil Price per barrel ($) | 42.5 | 38.0 | 11.8% |
| Projected GDP growth (%) | 2.5% | 4.4% | -43.2% |
| Average exchange rate (N/US$) | 305 | 197 | 54.8% |

Source: Ministry of Budget and National Planning

# What are the lingering issues?

## Rising cost of governance

Like in previous years, the 2017 budget showed an 18% increase in recurrent expenditure, which, in other words, is the cost of running the government. Recurrent expenditure has consistently trended upwards for a number of reasons. First, is the rising cost of personnel and overhead components. In the 2017 budget for instance, allocation for personnel and overhead costs rose by 8.8% and 41% to N1.86 trillion and N230 billion respectively from the figures in the previous budget. Service wide votes, travel expenses, sitting allowances of board members of government agencies, maintenance cost and ghost workers continue to be a major challenge, contributing a significant share of recurrent budget.

Another major contribution to the high recurrent expenditure is the rising debt servicing obligation. Owing to a high interest rate environment, Nigeria currently spends more on debt servicing which adds severe burden on government revenue.

In the 2017 budget, debt servicing amounted to N1.66 trillion as high as 23% of total budget expenditure and 33% of total expected revenue of N5 trillion. In other words, for every N100 earned as revenue, Nigeria will spend N33 on debt servicing. If we do nothing about the rising debt profile, it is expected that this debt servicing component will continue to rise to an unsustainable level in the medium term and may hit N2 trillion in the 2018 budget. As the share of debt servicing in the annual budget increases, the fund available for the provision of infrastructure and other social amenities becomes smaller.

The rising cost of governance implies that 95% of the government's revenue would be used to finance overheads, pensions, personnel costs and debt servicing.

## Complex budget process limits performance

Some of the more serious issues associated with Nigeria's budget are structural in nature, hence the prolonged cycle of poor capital budget performance despite changes in government administration. As a matter of fact, Nigeria operates a complex budgetary system, characterized by delays and inefficiencies, which often limits budget performance. For instance, since the year 2000, it takes an average of 130 days to pass the appropriation bill into law, from when it was presented to the National Assembly (NASS) by the President.

By this, the National Assembly requires an average of 4 months and 10 days to pass each year's budget. Historically, most budgets are usually presented to the NASS within the last two months (November and December) preceding the budget year, while only 3 annual budgets have been presented in October since 2000. In most cases, the budget is passed 4-6 months into the budget year, therefore, limiting the performance period and rate of implementation of capital projects.

## Procurement hurdles largely responsible for poor capex performance

In addition to the late passage of the budget, Nigeria's procurement process is also responsible for delays and poor implementation of capital projects. Key challenges facing the procurement process in Nigeria are highlighted below:

- Non-compliance with provisions of the Procurement Act of 2007 by MDAs
- Corruption
- Undue political interference in the bidding process
- Improper documentation
- Capacity challenges of procurement staff
- Mismatch between budgetary allocations and actual releases
- Delays in processing and approval of request for "No objection" by the BPP.

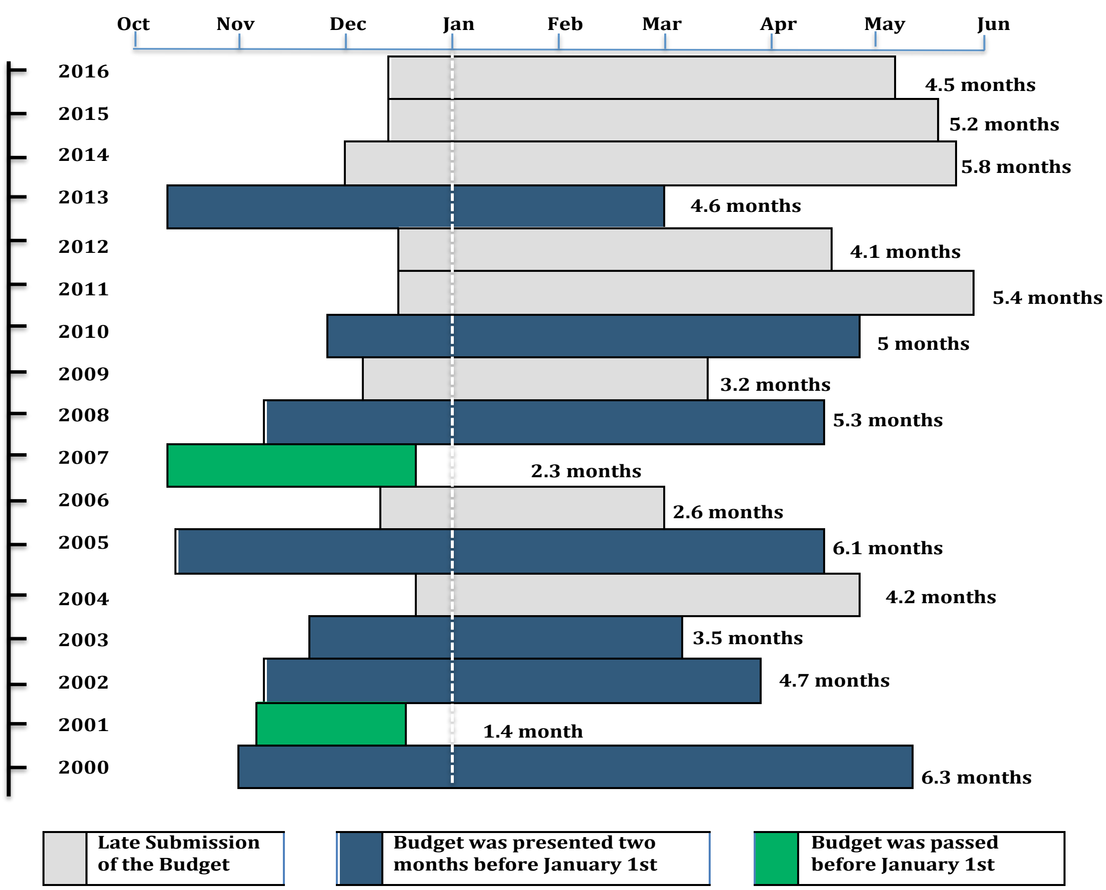
These challenges continue to plague the procurement process, resulting in poor implementation of capital projects, year in year out. It is no surprise that capital projects, which rely on the procurement process remain the hard hit and most underperforming aspect of the budget, while recurrent expenditure is usually well implemented.

## Nigeria's 2017 Budget Breakdown

| | 2017 | 2016 | Variance |
|---|---|---|---|
| Revenue (N Trillion) | | | |
| Aggregate Revenue | 4.9 | 3.9 | 28.0% |
| ▪ Oil Revenue | 2.0 | 0.8 | 142.7% |
| ▪ Non-oil Revenue | 1.4 | 1.5 | -5.5% |
| ▪ Independent Revenue | 0.8 | 1.5 | -46.4% |
| Expenditure (N Trillion) | | | |
| Aggregate Expenditure | 7.3 | 6.1 | 20.4% |
| ▪ Capital Expenditure | 2.1 | 1.6 | 24.4% |
| ▪ Non-debt Recurrent Expenditure | 3.0 | 2.7 | 12.5% |
| ▪ Debt Servicing | 1.8 | 1.5 | 20.0% |
| ▪ Statutory Transfer | 0.4 | 0.4 | 0.0% |
| Budget deficit (N Trillion) | 2.3 | 2.2 | 4.5% |
| External borrowings (N Trillion) | 1.1 | 1.0 | 9.2% |
| Internal borrowings (N Trillion) | 1.3 | 0.9 | 38.9% |
| Fiscal deficit (% of GDP) | 2.1% | 2.2% | -0.9% |

Source: Ministry of Budget and National Planning

## Budget Presentation and Assent Timeline




Source: NESG Research

# Available Policy Options

## Private sector capital, long-term external financing required to reduce debt servicing cost

Presently, about 70% of Nigeria's debt profile consist of domestic loans. Increased borrowing from the domestic market to finance the fiscal deficit will likely increase debt servicing cost and crowd-out private sector lending. To address this challenge, two options are available. First, the government must explore every option to leverage on private capital to finance infrastructure development, thus, reducing the need to borrow. Alternative funding models such as public-private partnerships, concessions, etc. should be considered. Second, Nigeria could secure long term external loans to rebalance the current debt profile. With a low external reserves and a huge exchange rate premium, the fiscal environment requires injection of funds from abroad to stimulate economic activities and provide stability in the foreign exchange market.

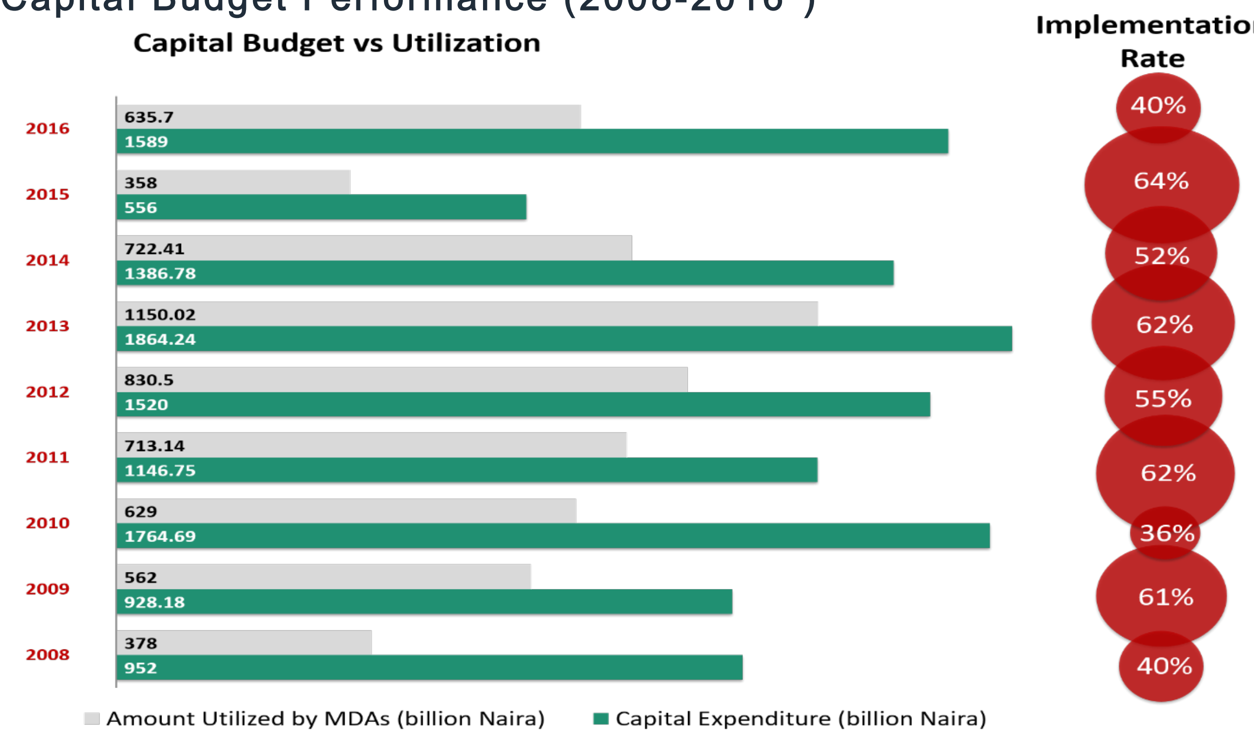
To actualize the second option, Nigeria needs to summon the political will to implement its Debt Management Strategy of 2016-2019 which aims to secure long term external financing, usually accompanied by lower interest payment relative to short term domestic borrowing. The Presidency, with support of the National Assembly must strengthen relationships with multilateral organizations to negotiate the terms of such loan deals which is essential in financing import and FX gaps. More importantly, the utilization of such borrowed funds is crucial and must be well-accounted for by the MDAs. If Nigeria must borrow, we propose that the borrowed funds should be used to finance high-value infrastructure projects such as development of industrial and agro-processing parks and other projects with direct measurable social and economic impacts.

## Reforms are required to enhance revenue generation

To ensure government meets its obligations and reduce the need to borrow, Nigeria needs to implement reforms to improve its revenue profile. We note that while Nigeria's debt to GDP ratio at 17% suggests there is more room to borrow, there is need to boost the revenue, given that debts are serviced with revenue. A look at Nigeria's revenue to GDP ratio, which is around 6% calls for worry, especially when OECD countries' averaged 43% in 2015. Perhaps, this suggests that Nigeria can still perform better in terms of revenue generation, which is essential in financing the country's infrastructure gap. To boost non-oil revenue, Nigeria needs a comprehensive fiscal reform geared towards improving the business environment, supporting priority industries, closing tax loopholes and improving tax efficiency.

The fiscal challenge should no longer be how to share proceeds from crude oil but rather, the focus of the government should be tilted towards how it can Improve revenue from non-oil activities and stimulate private sector development.

## Capital Budget Performance (2008-2016*)




Source: Budget Office of the Federation.
*Data for 2016 covers 9 months into the year (Oct 2016)

The Nigerian government must consolidate on its current efforts to look inwards by enacting growth-enhancing stimulus for production and exporting industries. Clarity of policies is also needed to attract more domestic and foreign investment into key sectors. It is only when private sector activity improves that the government can enhance its revenue generating capacity and potential. On a broader note, we emphasize the significant role of private capital in the economy. The Nigerian government, therefore, must be aware of the fact that government revenue alone cannot give this economy the much-needed impetus for inclusive growth and development. Hence, the government must make the business environment attractive to private capital.

## Legislate the budget process to ensure timely passage of the budget

With regard to budget passage, Nigeria can take a cue from several countries that have enacted policies and legislations to reduce delays in their budget processes. In Singapore for instance, the budget process begins 10 months prior to the budget year which begins on April 1st. The budget is eventually presented by the Minister of Finance to the Parliament in mid-February. After one month of deliberation, the parliament presents the Budget to the President in mid-March for assent.

Similarly, the Unites States budget process involves a law that mandates the President to submit the budget to congress about 8 months before the budget year. Both houses of Congress are therefore obliged to pass the appropriation bill into law before the budget year commences on October 1st. Where the law is not passed, the congress would enact a continuing resolution which provides temporary funding of government operations. Failure to achieve both results in a government shutdown, as experienced in 2013. Thus, the government cannot function until Congress approves spending plans for the fiscal year.

In the case of Nigeria, while the Fiscal Responsibility Act (FRA) mandates government corporations and agencies to submit their proposed expenditure in June of every year ahead of the preparation of MTEF, it does not stipulate when the appropriation bill should be presented to the National Assembly. To ensure fiscal discipline, Nigeria, therefore needs to legislate the budget process and enforce relevant legislations. Furthermore, Nigeria needs a complete review of the procurement process with great involvement of the private sector to ensure transparency, efficiency and swift delivery of capital projects.

## The government must cut frivolous recurrent items in the budget

There is also an urgent need for the Federal Government to cut down frivolous recurrent expenditure which could free up spending by a significant amount. In the 2017 budget for instance, over N22 billion would be utilized for the purchase of computer and related items, while the purchase of vehicles cost over N40 billion. Maintenance costs amounts to over N100 billion in the budget. It is not surprising however, that many of these items were reflected in the 2016 budget and in previous years' budgets. Travel expenses and purchase of office equipment and maintenance costs should be pruned down significantly to reduce the cost of governance and streamline focus on key high-impact projects.

## Disclosure of Information and M&E process must be strengthened

While some achievements have been recorded in the past few years, especially relating to the disclosure of information in the appropriation bill and improved disbursement for projects, more needs to be done. To address the challenge of reoccurring items in each year's recurrent budget, the government should disclose actual amounts spent on specific recurrent components as outlined in the appropriation bill, for transparency and accountability purposes. Already, the FRA empowers the Fiscal Responsibility Commission to "compel any person or government institution to disclose information relating to public revenues and expenditure".

The act also calls for the release of the budget implementation report not later than 30 days after the end of each quarter. The enforcement of these provisions leaves a lot to be desired. Also monitoring and evaluation of capital projects also need to be strengthened to examine budget performance and determine the impact of projects on the larger society. The budget is one of the most vital fiscal policy tool for Nigeria, and the success in its implementation will go a long way to determine whether or not Nigeria would recover from the economic slowdown in 2017.

## What should policy makers do?

- Reduce debt servicing cost by leveraging on private capital to fund infrastructure development and/or summon political will to secure long term external financing, usually accompanied by lower interest payment relative to domestic borrowing. Borrowed funds should be used to finance high-value infrastructure projects
- Federal government must enact comprehensive fiscal reforms geared towards improving the business environment, strengthening non-oil revenue and supporting priority industries. The government must block tax loopholes and improve tax efficiencies
- Federal government and the National Assembly must remove frivolous recurrent expenditure items from the budget
- The government should legislate the budget process to ensure efficiency and reduce delays
- Review the procurement process to hasten development of infrastructure projects while maintaining transparency in the budget process
- Disclose timely, information relating to the performance of recurrent and capital aspect of the budget, as contained in the Fiscal Responsibility Act.
- Strengthen project monitoring and evaluation processes and capabilities of MDAs.

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### About NESG

The NESG is an independent, non-partisan, non-sectarian organization, committed to fostering open and continuous dialogue on Nigeria's economic development. The NESG strives to forge a mutual understanding between leaders of thought so as to explore, discover and support initiatives directed at improving Nigeria's economic policies, institutions and management.


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