Achieving Fiscal Discipline in Nigeria

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EXECUTIVE SUMMARY

Nigeria's fiscal landscape is marked by a complex interplay of economic, social, and political factors. Its heavy reliance on oil revenue has led to a volatile fiscal environment due to fluctuating global oil prices. This dependency exposes Nigeria to external shocks and vulnerabilities. Challenges include inadequate revenue mobilisation, inefficient public expenditure management, rising public debt, and widespread corruption. Fiscal discipline is essential for economic stability, sustainable development, poverty reduction, and long-term prosperity.

Fiscal discipline means managing public finances wisely for sustainability, reduced deficits, controlled debt, and efficient resource allocation. It involves measures like balanced budgets, transparency, debt sustainability, and adherence to fiscal rules.

Since 1999, Nigeria's fiscal trends show challenges in primary balance, revenue, spending, and debt. Corruption remains a major obstacle, evident in low rankings.
Policy suggestions include transparent budgets, medium-term plans, debt management, fiscal rules, revenue diversification, and anti-corruption efforts. These steps enhance accountability, growth, and long-term prosperity.

In conclusion, Nigeria must enact comprehensive reforms for responsible spending, revenue diversification, transparent governance, and anti-corruption measures to achieve fiscal discipline and economic success.

INTRODUCTION

Nigeria's fiscal landscape is characterised by a complex interplay of economic, social, and political factors. The country heavily relies on oil revenue, which has led to a volatile fiscal environment due to fluctuating global oil prices. This dependency has exposed Nigeria to external shocks and created vulnerabilities in its fiscal position. Furthermore, the country faces challenges such as inadequate revenue mobilisation, inefficient public expenditure management, rising public debt and pervasive corruption.

Sound fiscal discipline is crucial for the country's economic stability, sustainable development, social development, poverty reduction, and long-term prosperity.

Fiscal discipline refers to the prudent management of public finances, encompassing measures aimed at maintaining fiscal sustainability, reducing fiscal deficits, controlling public debt, and ensuring efficient allocation of resources.

This document aims to provide an overview of Nigeria's fiscal situation, analyse the key issues affecting its fiscal health, and emphasise the critical importance of fiscal discipline for the country's sustainable economic growth and development.

STANDARDS MEASURES OF FISCAL DISCIPLINE

Fiscal discipline involves responsible management of public finances, encompassing revenue generation, expenditure control, and debt management. It's evaluated using standard measures that correspond to diverse fiscal discipline theories. Key measures include:

Budget Deficit and Budget deficit/GDP Ratio: The budget deficit/GDP ratio is a commonly used measure of fiscal discipline, as it reflects the size of the budget deficit relative to the size of the economy. (Blanchard & Leigh, 2013).

Public Debt and Public debt/GDP Ratio: The public debt/GDP ratio is another commonly used measure of fiscal discipline, as it reflects the size of the public debt relative to the size of the economy. (Alesina & Perotti, Fiscal adjustments in OECD countries: Composition and macroeconomic effects[4], 1996).

Primary Balance: The primary balance measures the government's ability to meet its current obligations without incurring additional debt. It is the budget balance excluding interest payments. A positive primary balance indicates stronger fiscal discipline.

Budget Variances: The difference between the budget figures (expenditure and revenue). Expenditure variance could be synonymous with the government's ability to control its spending, while Revenue variances indicate the ability of the government to generate revenue beyond budget.

Transparency, Accountability and Corruption: Openness and public disclosure of government financial activities and decisions are essential to promote fiscal prosperity. Lack of which thereof can foster corruption. Promoting transparency and accountability [5] and combating corruption strengthens responsible fiscal management, enhancing fiscal discipline's foundation.

Other measure or indicators of fiscal discipline is timeliness in budget approval, sustainability of Social Welfare Programs, and Long-Term Fiscal Planning.

TRENDS OF FISCAL SITUATION IN NIGERIA SINCE 1999

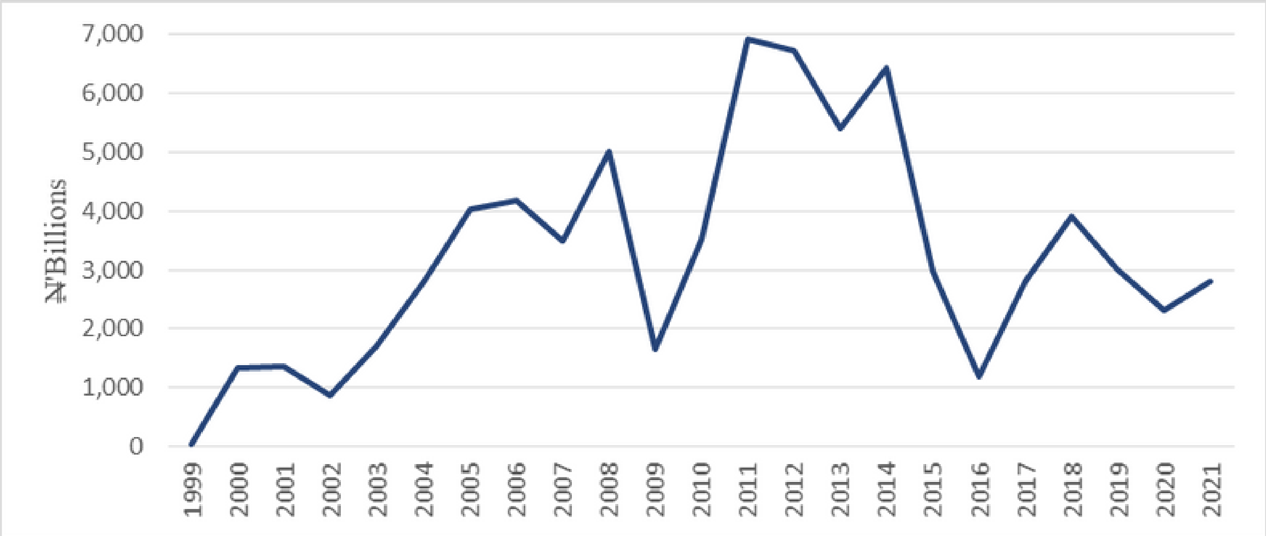
Since the return to democratic governance in 1999, Nigeria's fiscal situation has experienced various trends that reflect the country's economic challenges, policy decisions, and external factors. Below is an overview of some key trends in Nigeria's fiscal situation since 1999.

OVERVIEW OF FISCAL BALANCES

The primary balance is an important indicator of a country's fiscal health and sustainability. It reflects the difference between a government's total revenue (excluding borrowing) and non-interest expenditures.

A positive primary balance indicates that the government generates enough revenue to cover its non-interest expenditures. In contrast, a negative primary balance suggests that the government relies on borrowing to fund its operations. For Nigeria, the primary balance has been influenced by factors such as oil price volatility, revenue diversification efforts, public expenditure patterns, and fiscal policy decisions.

FIGURE 1:PRIMARY BALANCE (GOVERNMENT REVENUE MINUS GOVERNMENT EXPENDITURE(LESS DEBT SERVICING).



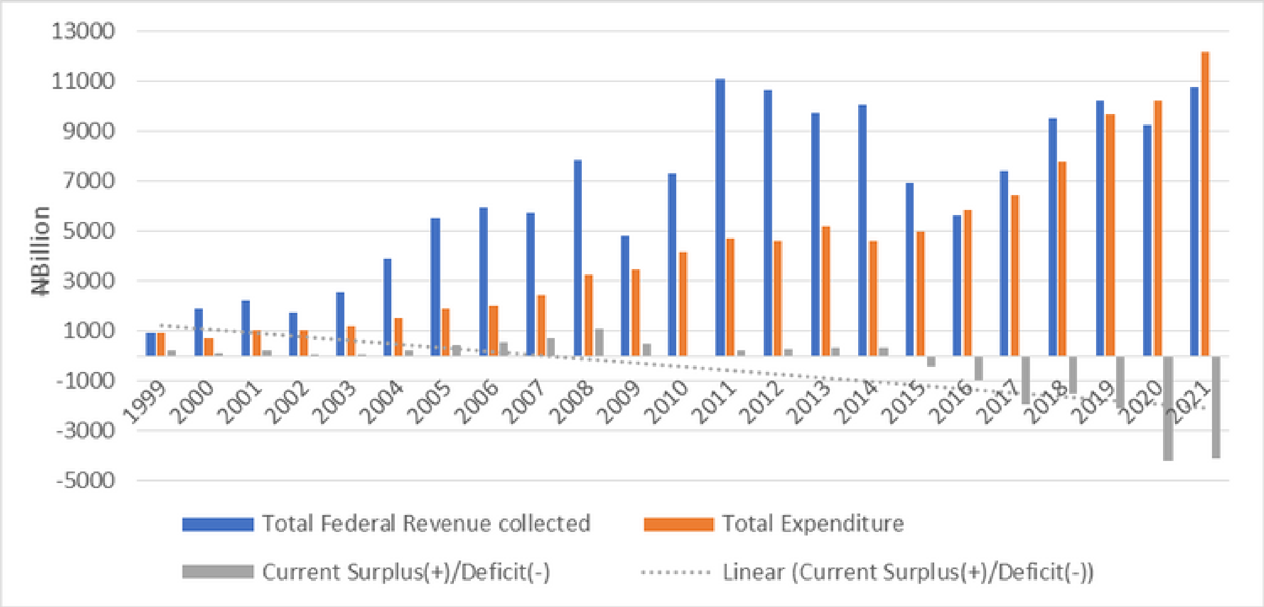
SOURCE: CBN STATISTICAL BULLETIN, 2023

The figure above indicates that the primary balance has been positive, indicating the government is generating enough revenue to cover its non-interest expenses. While this has maintained an upward trend, it experienced a dip in 2009 and 2016 as government revenue declined due to the global financial crisis, a decline in global oil prices, and a decrease in oil production. More recently, since 2015, the trend has been exceptionally low, with an average of N2.5trillion, when compared with previous periods, 2010-2015, where it stood at N5.3 trillion and N3.5 trillion in 2007-2010 period and N2.2trillion in 1999-2007 period.

The increase in the 2010-2015 period was occasioned by the hike in oil prices, which started in 2010 and peaked in 2012 but was still significantly high in 2014 and 2015.

In conclusion, the primary balance trends illustrate the complex interplay of economic factors, global events, and revenue sources in Nigeria's fiscal landscape. The analysis emphasises the importance of sustainable revenue generation, economic diversification, and long-term fiscal strategies to ensure fiscal discipline and stability. Figure 2, however, provides an overarching view of the federal government finances.

FIGURE 2: GOVERNMENT REVENUE, EXPENDITURE AND SURPLUS (DEFICIT)



SOURCE: CBN STATISTICAL BULLETIN, 2023

Similarly to Figure 1, The revenue trend demonstrates an overall upward trajectory, punctuated by notable spikes from 2011 to 2014. The growth rates vary across periods: 30 percent during 1999-2007, 11 percent during 2007-2010, 10 percent during 2010-2015, and 3.5 percent during 2015-2021. The average revenue growth over the entire period stands at approximately 16 percent , highlighting sustained expansion. Recent years, however, saw a decline in revenue due to lower global oil prices.

Conversely, the total expenditure trend depicts a consistent increase, with varying growth rates: 14.5 percent during 1999-2007, 20 percent during 2007-2010, 7 percent during 2010-2015, and 15 percent during 2015-2021. These trends collectively reflect an average growth rate of 13 percent in expenditure over the analysed period. The revenue and expenditure trends showcase the dynamic nature of fiscal management in response to economic changes. Striking a balance between revenue growth and expenditure control, while diversifying revenue sources, is essential for maintaining fiscal discipline and achieving sustainable economic growth.

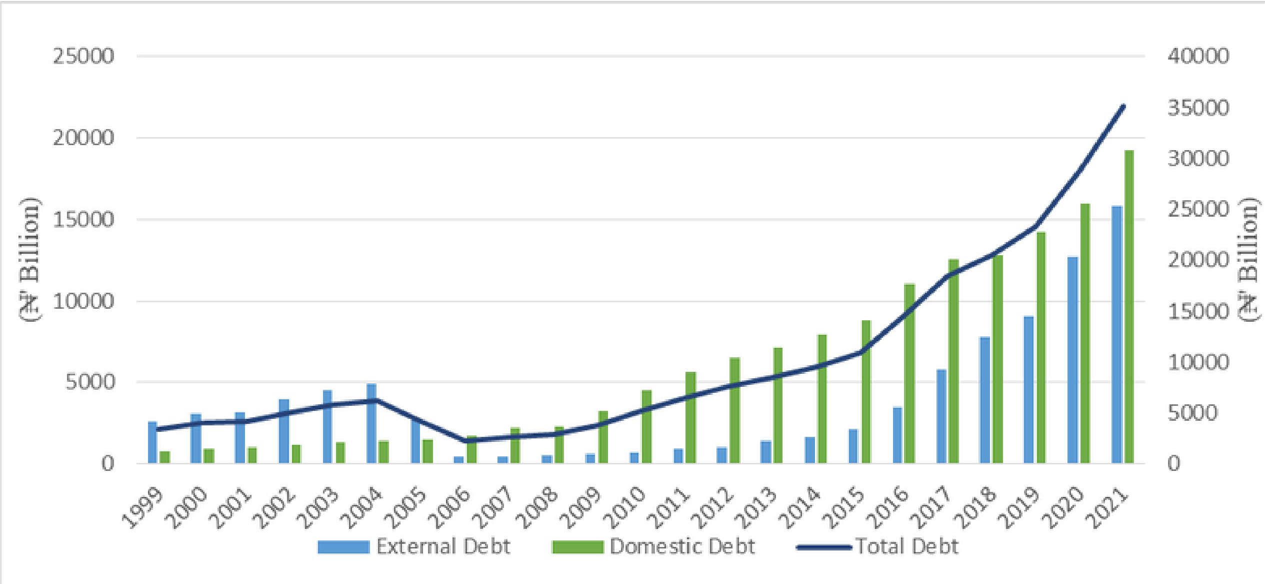
TABLE 1: SUMMARY OF FEDERAL GOVERNMENT FINANCES PER PRESIDENT

Time period	Primary balance-₦Billion	Growth rate of primary balance%	Federal Revenue-₦Billion	Growth rate of Federal revenue%	Total expenditure ₦Billion	Growth rate of total expenditure %
1999-2007	2201.66	523.5%	3394.94	30.19	1424.86	14.54
2007-2010	3416.37	18.6%	6435.59	11.43	3334.82	20.13
2010-2015	5332.54	25.6%	9302.74	10.37	4712.25	6.89
2015-2021	2714.73	5.4%	8545.60	3.50	8175.48	15.14

SOURCE: CBN STATISTICAL BULLETIN, 2023

Similarly, the debt obligation has been a subject of concern due to its impact on fiscal sustainability and economic development.

FIGURE 3: FEDERAL GOVERNMENT DEBT OBLIGATIONS



SOURCE: CBN STATISTICAL BULLETIN, 2023

The figure above, Figure 3, indicates that there is an upward trend in the debt figure, both foreign and domestic. While there was a plunge in external debt in 2006, domestic debt maintained an upward trend. Prior to 2006, the foreign debt stood at an average of 3.5 trillion, while the 2006-2011 period had an average of 600 billion due to the Paris Club debt relief. However, the overall average growth rate of both categories was about 16 percent debt.

The table below shows that the growth was predominant in the 2015-2021 period, with about 40 percent growth in external debt and 14 percent growth in domestic debt, implying an increased reliance on external borrowing. This could have been driven by various factors, such as financing development projects, addressing budget deficits, or responding to economic challenges. But the increase in domestic debt was higher in the 2007-2010 period with almost 30 percent growth rate. This growth rate could be potentially due to the global financial crisis and the need for fiscal stimulus measures.

TABLE 2:SUMMARY OF FEDERAL DEBT OBLIGATION PER PRESIDENT

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SOURCE: CENTRAL BANK OF NIGERIA STATISTICAL BULLETIN, 2023

Overall, the consistent increase in debt levels highlights the importance of prudent debt management to ensure fiscal sustainability. Monitoring debt trends, understanding the drivers of debt growth, and implementing effective debt management strategies are crucial for preventing potential risks associated with rising debt levels. Additionally, the differential growth rates between external and domestic debt underscore the need for a balanced approach to borrowing and managing both categories of debt.

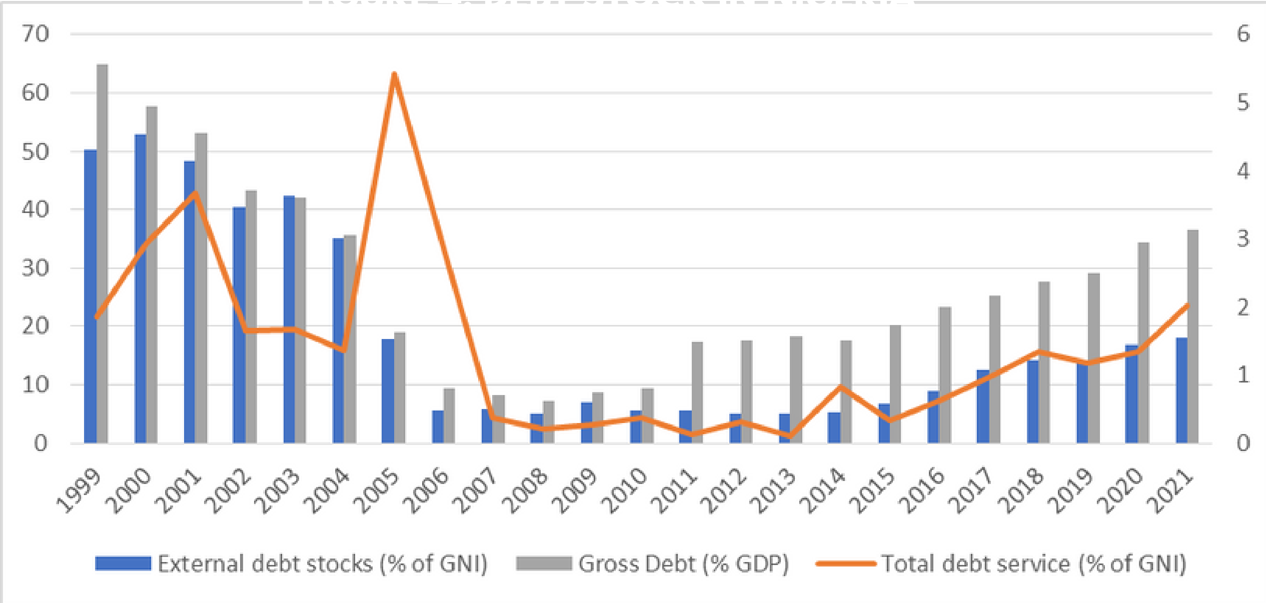
While borrowing in itself is not bad, the question is, how sustainable is the debt, and what are the likely impacts of these debts on the economic well-being of the country? Several theories on debt have highlighted the importance of sustainable debt.

Likewise, Peter Diamond in the 1960s. (Diamond, P.A. (1965) propounds the intergenerational equity theory of debt sustainability. He suggests that current generations should not borrow excessively and leave the debt burden to future generations. While Mancur Olson in the 1960s. (Olson, M. (1965), on the political economy theory of debt sustainability, suggests that political and social factors, such as corruption, political instability, and weak institutions, can affect debt sustainability.

DEBT SUSTAINABILITY IN NIGERIA

Measuring debt sustainability is a complex task that involves assessing a country's ability to service its debt obligations over the long term without risking default or excessive economic instability. There are several factors to consider when measuring debt sustainability, including the size of the debt, the structure of the debt (e.g. the proportion of foreign vs domestic debt), the cost of servicing the debt, and the country's economic growth prospects.

FIGURE 4: DEBT STOCK IN NIGERIA



SOURCE: WORLD DEVELOPMENT INDICATORS AND IMF WEO 2023[1]

The figure above provides an indication of how sustainable and solvent Nigeria's debt stock has been since 1999. The overall average of gross debt to GDP is about 27 percent and is "U" shaped. Implying that it was predominantly highest in the early periods accounting for almost 70 percent of GDP and reached its lowest in 2008 at 7 percent, but has since 2008 been increasing with an average value of 25 percent, in more recent years, it stands at over 36 percent of GDP. This raises concerns about fiscal sustainability. Sustained high levels of debt could potentially limit the government's fiscal space, especially during economic shocks.

The external debt to Gross National Income(GNI)[2] reflects a country's ability to service its external debt obligations. Specifically, it examines the liquidity and shows much of the income generated by Nigerians will be used in paying external debts. Interestingly, this follows a similar trend with debt to GDP but relatively lower percentages.

The overall average is about 20 percent, which was highest in the early periods at about 33 percent and lowest in 2006-2016 at about 6 percent. However, the trend has been increasing in more recent years, accounting for about 18 percent in 2021. However, the trend suggest a substantial part of the economy's income goes into servicing external debt, though manageable.

While there is no uniformity in the acceptable minimum threshold (Caner, Grennes, & Koehler-Geib, 2011)[3] establish a threshold of 64 percent of debt to GDP for emerging markets, above which, it will lead to a loss in real GDP. Pattillo et al. (2002) found that higher debt at 35-40 percent of GDP has a marginal negative impact on growth by lowering the efficiency of investment. The third variable in the figure above, total debt service to GNI, it is the country's external debt obligations relative to its income and has severe implications for reduced government spending on social welfare programs and investment (crowding out), higher risk of default, Debt overhang, and vulnerability to external economic shocks.

[2] GNI measures the total income generated by a country's residents, regardless of their location, and includes income earned from both domestic and foreign sources. GNI takes into account the income earned by a country's citizens who may be working and earning income abroad.

[3] Caner, M., Grennes, T., & Koehler-Geib, F. (2011). Finding the Tipping Point—When Sovereign Debt Turns Bad. Policy Research Working Paper No. 5391. Retrieved from https://documents1.worldbank.org/curated/en/509771468337915456/pdf/WPS5391.pdf

A brief overview of the total debt service (percent of GNI) reveals that this has been predominantly low, with an average of 2 percent over the period under review, but this was highest in the early periods at 2.5 percent and lowest in 2007- 2017 period at about 0.4 percent average. However, fluctuations over time underscore the importance of prudent debt management. The variation, with the highest average at 2.5 percent in the early periods and the lowest average of 0.4 percent during 2007-2017, highlights the need to navigate debt service obligations cautiously to prevent adverse effects on development priorities and economic stability.

TABLE 3: AVERAGES OF DEBT OBLIGATIONS PER PRESIDENT

Time period	External debt stocks (% of GNI)	Total debt service (% of GNI)	Gross Debt (% GDP)
1999-2007	33.2	2.4	37.0
2007-2010	5.8	0.3	8.4
2010-2015	5.5	0.3	16.8
2015-2021	13.1	1.1	28.1[4]

SOURCE: WORLD DEVELOPMENT INDICATORS AND IMF WEO 2023

[4] Note: Total debt service (% of GNI) and External debt stocks (% of GNI) are sourced from World Development Indicators, 2023 while Gross Debt (% GDP) is sourced from IMF WEO 2023

FACTORS CONTRIBUTING TO FISCAL CHALLENGES IN THE COUNTRY

Nigeria faces a complex set of factors that contribute to its fiscal challenges, which hinder sustainable economic growth and development. These factors encompass a range of economic, structural, institutional, and governance issues. Here is an overview of some key factors:

Political Factors:

- ***Election Cycles***: Political considerations, particularly during election years, often lead to increased government spending to appease constituents. This can result in fiscal expansion without adequate revenue sources.

- ***Short-Term Focus***: Short political cycles can lead to a focus on short-term gains, with less attention to long-term fiscal sustainability. Politicians might prioritize immediate projects over comprehensive development plans.

- ***Clientelism***: Politicians may allocate resources based on loyalty and patronage rather than sound economic planning, leading to inefficient spending and a lack of fiscal discipline.

- ***Political Interference:*** Political pressures can influence budgetary allocations, leading to the misallocation of resources and an inability to prioritize essential sectors.

Economic Factors:

- ***Dependency on Oil Revenue and Poor Revenue Diversification:*** Nigeria's heavy reliance on oil revenue makes the economy vulnerable to fluctuations in global oil prices. Revenue volatility can lead to fiscal imbalances during periods of low oil prices, further worsened by inadequate infrastructure.

- ***Weak Tax Base:*** The tax system's limited coverage and low compliance rates result in low revenue collection. This hinders the government's ability to finance public expenditures without resorting to borrowing.

- ***Economic Shocks:*** External economic shocks can strain fiscal resources and lead to increased borrowing. Insufficient fiscal buffers can exacerbate the impact of such shocks.

Institutional Factors:

- ***Weak Budgeting Process:*** Inadequate budget formulation and execution processes contribute to fiscal indiscipline. Poor prioritization and lack of expenditure control lead to budget overruns.

- ***Poor Accountability:*** Weak accountability mechanisms, including inadequate oversight and transparency, tracking and monitoring of government expenses, enable mismanagement of funds and corruption.

- **Revenue Leakage:** Inefficient revenue collection and administration result in revenue leakage, reducing the government's fiscal capacity.

- **Deficient Debt Management:** Inadequate debt management practices can lead to excessive borrowing, high debt service payments, and diverting resources from essential services.

Structural Factors:

- ***Decentralization:*** Fiscal decentralization can lead to varying levels of fiscal discipline at different levels of government. Some subnational governments might prioritize short-term gains over long-term sustainability.

- ***Fragmented Public Finances:*** The presence of various government agencies and parastatals can lead to uncoordinated spending, duplication of efforts, and lack of overall fiscal strategy.

- ***Civil Service Inefficiencies:*** Bureaucratic inefficiencies, including ghost workers and administrative waste, contribute to wasteful spending and fiscal indiscipline.

- ***Uneven Development:*** Regional disparities in development and income levels create challenges in formulating equitable fiscal policies that address the needs of diverse regions.

POLICY OPTIONS AND WAY FORWARD

Improving fiscal challenge in Nigeria, or any country for that matter, is a multifaceted challenge that requires a combination of policy measures, institutional reforms, and public engagement.

- ***Transparent Budgeting and Reporting:*** Ensure that the budgeting process is transparent, involving multiple stakeholders and providing detailed information about revenue sources, expenditures, and allocations. Transparency in budget processes was pursued by the World Bank SFTAS project, and reasonably, most sub-national governments have significantly improved on this indicator. However, implementing a standardized budget classification system that allows for easy tracking and analysis of government spending will be beneficial.

- ***Medium-Term Expenditure Framework (MTEF):*** Consistent adherence to a comprehensive MTEF that outlines the government's medium-term fiscal policy, revenue projections, expenditure ceilings, and fiscal targets. This framework can promote better planning and reduce ad hoc spending.

- ***Debt Management and Sustainability:*** Establish a clear debt management strategy that prioritizes responsible borrowing, considers the debt-to-GDP ratio, and ensures that borrowed funds are invested in productive sectors while continuously assessing and monitoring the country's debt sustainability to avoid over - indebtedness.

- ***Fiscal Rules and Limits:*** Introduce and enforce fiscal rules that impose limits on budget deficits, public debt levels, and other critical fiscal indicators. These rules can help prevent excessive spending and borrowing.

- ***Independent Fiscal Institutions:*** *Create an independent fiscal council or oversight body responsible for evaluating government policies, assessing fiscal projections, and ensuring adherence to fiscal rules. This institution can provide unbiased analysis and recommendations.*

POLICY OPTIONS AND WAY FORWARD

- ***Public Financial Management Reforms:*** Continuous strengthening of the capacity of public financial management institutions to improve budget execution, monitoring, and auditing processes. Implementing electronic procurement and payment systems to reduce leakage and enhance transparency.

- ***Enhanced Revenue Generation:*** Diversify revenue sources by reducing dependence on oil revenues and expanding the tax base, removing revenue leakages. This can involve introducing new taxes, improving tax administration, and combating tax evasion.

- ***Subsidy Rationalization:*** Gradually phase out or rationalize subsidies on fuel and other essential goods, as these subsidies can strain government finances and promote inefficiency.

- ***Social Safety Nets:*** Implement targeted social safety net programs to protect vulnerable populations during times of economic reform or fiscal consolidation. This can help mitigate the social impact of policy changes.

- ***Political Will and Accountability:*** Foster a culture of fiscal discipline and accountability among political leaders and public servants. Leaders should set an example by adhering to fiscal rules and prudent spending practices.

- ***Engage Civil Society and Media:*** Encourage civil society organizations and the media to play a watchdog role in monitoring government spending, highlighting discrepancies, and advocating for fiscal responsibility.

- ***Capacity Building and Training:*** Invest in training programs for public officials to enhance their understanding of fiscal management, budgeting, and economic principles.

It is imperative to note that improving fiscal discipline is an ongoing process that requires dedication, collaboration, and adaptability. It's important to address the root causes of fiscal indiscipline and tailor solutions to the unique challenges of Nigeria's economy and political environment.

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