

2017 CABRI CONFERENCE

WHEN THE PURSE IS EMPTIER – MANAGING THE BUDGETARY IMPACT OF MACRO-FISCAL SHOCKS



MANAGING
BUDGETARY
PRESSURES

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1: MANAGING BUDGETARY PRESSURES – THE 2017 CABRI CONFERENCE

THE CONFERENCE

The ninth CABRI Conference was held in Ouagadougou, Burkina Faso, from 7 to 9 March 2017. Attended by 69 officials from 26 African countries, it examined how governments can prepare for and manage extraordinary budget shocks that threaten budget stability and the financing of service delivery.

Budgetary pressures are an unavoidable consequence of allocating scarce resources between potentially limitless societal needs. Ministries of finance routinely contend with budgetary pressures during the preparation and approval of public budgets, as well as when managing ordinary deviations from planned revenues and expenditures during the year. Countries with stronger budget institutions are better able to manage this year-to-year budgetary pressure than countries with weaker systems – that is, more fragmented budget processes and less robust revenue and expenditure forecasting, cash management, in-year control, and accounting and reporting systems.

The conference's focus, however, was neither on these routine pressures, nor on how to build the strong budget institutions needed to best manage them. Rather, the overarching question for the 2017 CABRI Conference was

how governments can better prepare for and manage extraordinary pressures that either arise suddenly or build up over several years, without veering towards unsustainable debt or disrupting service delivery. It aimed to explore successful ministry of finance strategies for managing these pressures and achieving budget credibility. Key to understanding the pressures is that context matters.

The sessions were structured to allow senior budget officials to reflect on the budgetary pressures they have faced, how they managed them and what they learnt. Almost all the conference sessions presented a country case study followed by contributions from other countries from the floor. Sessions that followed this structure focused on managing the impact of natural and man-made disasters on countries' revenues and expenditures; managing the impact of macroeconomic shocks on

countries' revenues; and managing large budgetary demands that have built up over years.

A fourth set of pressures – the pressures that result from the realisation of off-budget contingent liabilities – were discussed through a fictitious case of a large bailout for a public water utility company. Participants had to identify what their responses would be and discuss how the case reflected experiences in their countries.

These substantive sessions were bookended by an introductory panel discussion that considered why many African countries are vulnerable to budgetary pressures and the importance of managing them, and a concluding session that examined common responses and approaches to being better prepared for crises. A copy of the conference programme and all materials can be found at www.cabri-sbo.org.

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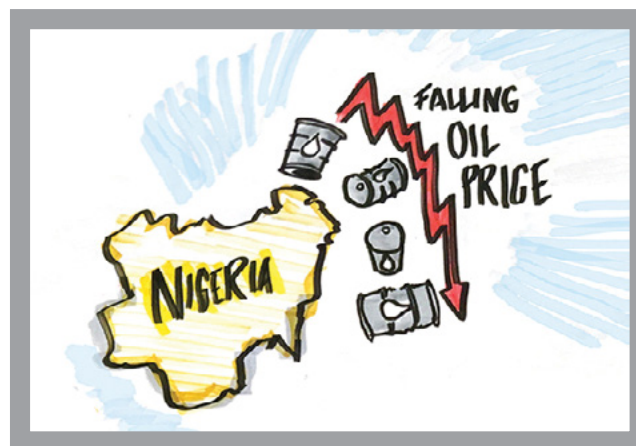


2: WHEN THE PURSE IS EMPTIER – MANAGING THE BUDGETARY IMPACT OF MACRO-FISCAL SHOCKS

MANAGING NIGERIA'S BUDGET WOES DUE TO THE FALLING OIL PRICE

“ A combination of lower production volumes caused by disturbances in oil production and a significant decline in international oil prices created a substantial shock for the country, which had always depended on oil revenues.

– Ben Akabueze, Director General of the Budget Office for the Federal Republic of Nigeria



THE COMMODITY CRASH: REDUCTION IN NIGERIA'S FISCAL SPACE

Resource-dependent countries are particularly vulnerable to macroeconomic shocks, most notably those resulting from fluctuations in commodity prices. The Federal Republic of Nigeria, with a maximum crude oil production capacity of 2.5 million barrels per day, ranks as Africa's largest producer of oil and the sixth largest oil-producing country in the world. The Nigerian economy is heavily dependent on oil

revenue, and fluctuations in the production and price of oil have placed significant pressure on the fiscus.

The FGN's oil revenues decreased in 2015 and 2016 because of a sharp decline in the oil price and concurrent decrease in oil production.

The global price of oil fell from US\$110 per barrel in January 2014 to US\$29 per barrel in January 2016. This dramatic decrease in price was the result of excess oil supply associated with an economic slowdown in emerging markets and a reduction in US oil imports.

As seen in figure 1, from a peak of 2.5 million barrels per day in 2013, Nigerian oil production declined to 1.4 million barrels per day during 2016. This was due not to the international market situation, but to pipeline vandalism and oil theft by the militant Niger Delta Avengers.

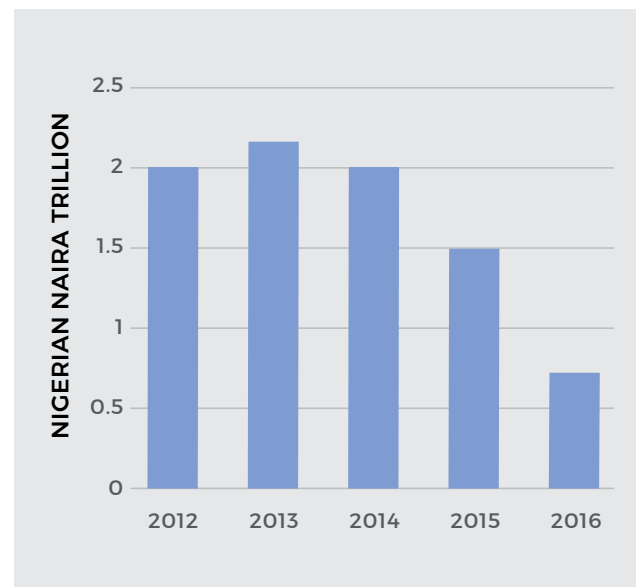


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The concurrent reductions in oil price and production led to a 63% decline in oil revenue in Nigeria between 2014 and 2016 in naira (this decline is even more notable when one accounts for the naira's devaluation). Despite the increase in non-oil tax revenue over this period, this has had a significant impact on the Nigerian economy: in the decade up to 2014, oil revenue accounted for 70% of total revenues for the FGN.¹³ The decline in oil revenue, shortage of foreign exchange, and restriction on imported inputs for manufacturing and agro-industry have contributed to a dramatic decrease in Nigeria's GDP. The Nigerian economy, which grew at an annual average rate of 7% between 2004 and 2014, grew 3% in 2015 and contracted by 1.5% in 2016.

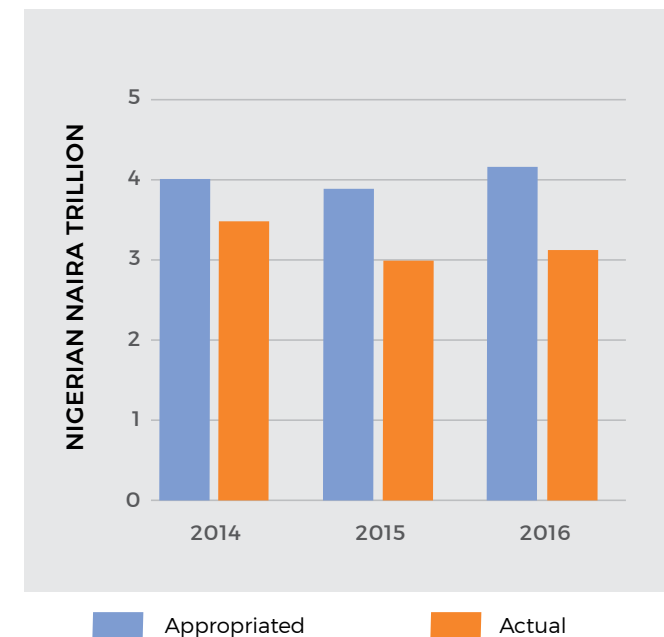
As seen in figure 2, the economic slowdown also negatively affected revenue collection, and actual revenue has fallen short of projected revenue since 2014. In September 2016, revenue was 25% less than pro-rated projections.

FIGURE 1: NIGERIA'S OIL REVENUE



Source: Budget Office of the Federation

FIGURE 2: FGN BUDGET REVENUE 2014-2016



Source: Budget Office of the Federation

¹³ This dependency is even more marked in terms of foreign exchange earnings, as oil accounts for about 95% of foreign exchange.

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The impact of the crisis may have been less severe if the FGN had been able to draw on its stabilisation fund. Nigeria maintains this fund to protect the economy from fluctuations in oil price and production. In 2009, when the price of oil declined, Nigeria had US\$20 billion in its excess crude account (see Box 2), which holds surplus earnings from oil. The FGN was consequently able to draw on this stabilisation fund through the decline in oil revenue. In 2014, at the beginning of the current crisis, the fiscal buffer was far smaller, with only US\$4.11 billion in the account. Without this buffer, the revenue contraction associated with the oil crisis resulted in an increase in the fiscal deficit to 2.5% of GDP¹⁴ in 2016. The reduction in oil revenue also led the authorities to reduce transfers to this account by 93% in 2015, missing the opportunity to smooth the impact over the period of decline.¹⁵

BOX 2

STABILISATION FUNDS

Sovereign wealth funds serve as a fiscal buffer against economic shocks, such as a decline in the oil price. Oil-dependent economies finance their sovereign wealth funds from taxes on sales of oil and gas. This provides long-term economic stability and allows for the diversification of resources.

Nigeria has struggled to increase its sovereign wealth fund, with state governors citing the lack of legal justification for existing savings mechanisms, including the excess crude account and sovereign wealth funds.

Source: BudgIT (2014) Falling oil prices: An opportunity for reforms

¹⁴ This remains within the 3% of GDP threshold stipulated in the Fiscal Responsibility Act, 2007.

¹⁵ *Ibid.*

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FGN'S RESPONSE: LOOKING INWARDS AND ONWARDS

The FGN's response to the decreased oil revenue has been inward-looking and centred on local actions. It has implemented expenditure controls and bold structural reforms for infrastructure and public services. It has also

“*A coherent and credible package of sustainable economic measures is needed for economic turnaround.*”
– Ben Akabueze, Director General of the Budget Office for the Federal Republic of Nigeria

focused on improving management of resources and identifying new revenue sources to narrow the fiscal deficit and increase reserves.

Expenditure cuts and increases

Significant pressure on the Nigerian fiscus forced the FGN to implement a series of short-term expenditure cuts, particularly in capital allocations, in 2014. In preparing the 2015 Budget, the FGN's plan was to limit the growth in recurrent expenditure as specified in the 2015–2017 Fiscal Framework and Fiscal Strategy Paper. The oil crisis and perennial demands for wage increases limited these

efforts, and recurrent expenditure rose at the expense of capital expenditure.

The 2016 Budget, the first under President Muhammadu Buhari, differed substantially from the 2015 Budget in its distribution of recurrent and capital expenditure. It embraced a countercyclical expenditure model, cutting recurrent expenditure to make provision for higher levels of capital expenditure. Between June and October 2016, 753.6 billion Nigerian naira was released for capital expenditure, one of the highest capital releases in the nation's recent history. Transportation; works, power

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and housing; agriculture; and defence were the largest beneficiaries of this higher capital allocation.

The 2016 Budget also attempted to contain recurrent costs by restricting travel costs, reducing board members' allowances, and eliminating thousands of ghost employees. These efforts are predicted to result in annual savings of almost 180 billion Nigerian naira, which will be diverted to priority areas, such as health, defence and education.

Expenditure and cash controls to promote spending efficiency

An Efficiency Unit has been set up within the Federal Ministry of Finance to review the FGN's expenditure profile and pattern. The unit is tasked with working with ministries, departments and agencies to introduce processes and procedures that will ensure that the government's revenues are efficiently deployed, resulting in value for money and savings.

This initiative is complemented by sustained use of the treasury single account to monitor the financial activities of Nigeria's 900 ministries, departments and agencies. The treasury single account, which provides a consolidated view of government's accounts, has been implemented at the federal

level since 2015 and is currently being rolled out to states. Its proponents regard it as effective in promoting transparency and providing insight into government's liquidity, which may limit unnecessary borrowing. Treasury single accounts are, however, not risk-free. While they can reduce in-year borrowing needs, they do not eliminate corruption and may serve to increase bureaucracy and delay disbursements of funds.

Improved management of revenue collection

In response to the oil shock, the FGN has acknowledged the importance of diversifying its resources and reducing revenue leakages. It is committed to increasing revenue from the non-oil sectors.

This will be achieved by improving tax compliance through conducting audits of taxpayers' returns to identify under-filing, engagement with non-compliant taxpayers, and enforcement of tax rules. Broadening the tax base will be achieved by increasing registration of informal and formal businesses and creating an enabling environment for small and medium enterprises. Consideration will be given to increasing value-added tax rates and increasing the coverage of taxable products.

The FGN will reduce revenue leakages by tackling trade mis-invoicing for customs, and introducing a single window to drive customs efficiency. The adoption of a single window will make Nigeria's ports competitive in the international trade network and reduce corruption.

The FGN has also been targeting independently generated revenues (receipts collected by government entities). It has sustained an upward trajectory in receipts for independently generated revenues despite continued leakages and incidences of non-remittance of funds.

Expanding energy infrastructure and stabilising oil production

The FGN is working towards expanding power-sector infrastructure and capabilities. This will be central to increasing oil production, which, relative to the externally determined price of oil, is within the control of the authorities.

President Buhari's regime was initially against negotiating with the Niger Delta Avengers, who are responsible for much of the instability in the country's oil production. The FGN has since committed to working with the Niger Delta region to limit infrastructure damage and stabilise oil production.

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This will be achieved through incentive schemes, jobs and investment. President Buhari has agreed to sustain the Presidential Amnesty Programme for the Niger Delta region, whereby government provides vocational training and stipends to former militants.¹⁶

The government has targeted refining petroleum products locally to encourage self-sufficiency. Plans were put in place to reduce petroleum product imports by 60% by the end of 2018. The FGN intends to establish more modular refineries – refineries consisting of easily fabricated and moveable parts – to increase local capacity, reduce imports and employ those involved in illegal refining. Incentives have been implemented for those looking to engage in local refining. These include less stringent requirements than conventional licensing, independence to sell products to the market at market-determined prices, and lack of government interference in day-to-day operations.

The fuel subsidy was removed in 2016 to alleviate fuel shortages and reduce corruption, allowing savings to be directed to priority sectors. It was also seen as another incentive to investors to build oil refineries in Nigeria. An

attempt in 2012 to remove the subsidy led to violent protests across the country and the subsidy's restoration. The removal of the subsidy in 2016 remained controversial due to the subsidy's pro-poor implications. However, during the latest oil crisis, there was more acceptance that removing the subsidy was necessary for alleviating fuel shortages.

The 2017 Budget also ruled out joint-venture cash calls in the oil and gas industries. Joint ventures between the FGN, represented by the Nigerian National Petroleum Corporation, and private operators have allowed the FGN to share exploration and financial risks and costs. However, when the operators have asked the FGN for cash, it has not been forthcoming. This has limited growth in the country's oil and gas industries and led to a build-up of arrears and increasing debt-service costs. Part of the arrangement ruling out joint-venture cash calls is that arrears will be paid within five years through incremental production revenues. This arrangement should allow for cost recovery as the Nigerian National Petroleum Corporation will continue receiving royalties, taxes and profits from its share of joint-venture oil production.

“Promote national prosperity and an efficient, dynamic and self-reliant economy to secure the maximum welfare, freedom and happiness of every citizen on the basis of social justice and equality of status and opportunity.”

*– Ben Akabueze,
Director General of the Budget Office
for the Federal Republic of Nigeria*

¹⁶ A Mustapha (2016) “Oiling Amnesty Programme: Stamping out any form of unrest in the Niger Delta”, Vanguard, <https://www.vanguardngr.com>.

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Diversifying the Nigerian economy

The Nigerian government is committed to diversifying the economy to promote recovery and build a dynamic, self-reliant economy that continues to grow without oil revenue. Diversification efforts will also be important for creating jobs outside the oil and gas industry.

The Economic Recovery and Growth Plan and Made in Nigeria campaigns have been initiated to advance agriculture and industry and develop local and small business enterprises. Along with the National Industrial Revolution Plan, these campaigns attempt to redirect production and consumption away from imported goods and services to locally manufactured ones. These efforts will be complemented by the Presidential Enabling Business Council, chaired by the Vice President, which has been mandated to make doing business in Nigeria easier and more attractive.¹⁷

The 2016 Budget included several other initiatives to diversify the economy, including revitalising and expanding agro-processing; stimulating investment in the solid-minerals sector; increasing private-sector investment in tourism, entertainment and sports; and creating high-technology innovation hubs to support growth in the digital and technology sector.

“Pursue economic growth in all sectors with focus on activities that have greater multiplier effects.”
– Ben Akabueze, Director General of the Budget Office for the Federal Republic of Nigeria

Increasing borrowing, but with greater efficiency

Revenue has yet to recover to pre-2014 levels. Nigeria's commitment to countercyclical expenditure and infrastructure investment thus necessitates that its borrowing requirement increase. With a debt-to-GDP ratio of 13.2%, Nigeria has adequate space to increase its borrowing to cover the fiscal deficit.

Under the Federal Ministry of Finance's debt management strategy for 2016–2019, domestic and foreign debt was set to increase. This debt strategy intends to rebalance the public debt portfolio with more external borrowing and by issuing bonds for contractor arrears. External sources will include multilateral agencies, export credit agencies and, potentially, the Eurobond market. The FGN believes that external borrowing is cheaper and avoids the risk of crowding out the private sector; however, the volatility of the naira indicates that debt-service costs may be subject to currency risk.

The debt management office also intends to introduce products to diversify its investor base for government bonds, resulting in cheaper borrowing costs and financial inclusion. The new debt instruments include retail bonds, inflation-linked bonds and domestic Sukuk (Islamic bonds).

Stabilising subnational government finances is another key element of the FGN's plans to stimulate the economy. In June 2016, a conditional budget support programme was introduced, which offered state governments 566 billion Nigerian naira to address their funding shortfalls. To participate, state governments had to subscribe to certain fiscal reforms centred around transparency, accountability and efficiency. Thirty states had received bailouts as of May 2016, while 35 had applied for the Excess Crude Account-backed loans.¹⁸

¹⁷ Minister of Finance (2017) Budget Speech 2017.

¹⁸ Ibid.

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LESSONS FOR NIGERIA'S COMMODITY-DEPENDENT PEERS

Nigeria's fiscus has yet to recover from the oil crisis; it is consequently difficult to assess the impact of all response measures. This section does, however, reflect on key features of Nigeria's response to the crisis, as discussed at the CABRI Conference. It offers emerging lessons from these responses that may prove helpful for countries facing similar pressures. It includes a brief discussion of Chad's response to falling oil revenues to identify common lessons.

Trade-off between short-term and long-term priorities

The FGN's immediate response to the crisis was to cut capital expenditure. This reflects the short-term versus long-term trade-offs that governments must consider when responding to a fiscal pressure. While it was necessary to cut spending in the short term, the FGN recognised that cutting capital expenditure would worsen the country's prospects for both short- and long-term recovery. The 2016 Budget consequently allocated a greater portion to capital expenditure; however, the shortfall was financed by increased borrowing.

It is critical that governments recognise that commodities, including oil, may not recover to previous levels and that this reduction in revenue may become permanent. Once the

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reduction in revenue becomes the country's new normal, prioritising short-term solutions may simply result in further regression.

Nigeria, like Chad (see Box 3), implemented short-term recurrent expenditure cuts and a series of measures to ensure efficient expenditure. While such measures will

have a beneficial effect in the medium term, short-term cuts could carry great costs, including worsening the plight of the poor and destabilising economies.

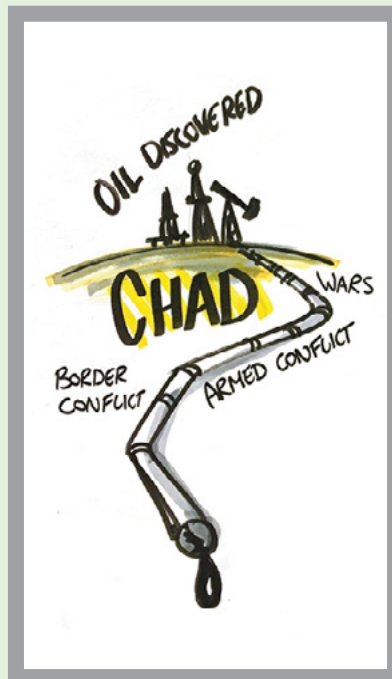
BOX 3

IMPACT OF THE OIL SHOCK ON CHAD'S FISCAL SPACE

Chad began producing oil in 2003, contributing to a more than 100% increase in the country's per capita income over the subsequent decade.

Chad built up significant public resources from its oil operations, which laid the ground for development efforts and initiation of stabilisation funds and funds for future generations. Civil conflict in 2005 and 2008 led authorities to create a new armed division using these reserve funds. The fall in the oil price in 2014 and regional security threats have destabilised Chad's economy and increased budgetary pressure. GDP growth slowed to 1.8% in 2015 (compared to 6.9% growth in 2014), with sectors dependent on public expenditure most affected.

In response to these external macroeconomic shocks, the government initiated significant expenditure cuts, leading to an increase in socio-political tensions. These have included reducing civil servants' allowances by 50%; auditing state agents, payment systems and projects; cutting the state's car fleet; restructuring regional delegations; and limiting the size of the organisational charts of ministries and institutions.



To further rationalise expenditure, supplementary budgets were proposed in 2016 to group all current expenditure under the Ministry of Finance and capital expenditure under municipalities. This was unsuccessful. An attempt to introduce a savings fund was also unsuccessful due to revenue being lower than expected. The authorities have redoubled efforts to diversify the economy and have increased domestic and concessional financing.

To increase tax revenue, the authorities are considering increasing the non-oil tax rate above 9% (the current rate, at 8%, is far lower than the Central African Economic and Monetary Community standard of 18%). Revenue authorities have also proposed actions to improve tax collection, including updating the General Tax Code to improve the transparency of taxation and increase productivity; improving control, recovery and the operationalisation of value-added tax refunds and control over transactions related to value-added tax; gradually reducing tax exemptions; and systematically recovering tax arrears.

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Communication between central government and political and economic actors is critical to the success of response strategies

Political support for the stabilisation fund in Nigeria has diminished, inhibiting the FGN's ability to use countercyclical policies to limit the fiscal impact of crises. In Nigeria, a continuing imperative will be to stress the importance of mitigation measures and sensitise ministries, departments, agencies and state authorities to the extent of the central government's fiscal constraints.

A successful strategy to address any fiscal pressure requires central government to clearly communicate to the public and economic players the long-term risks of not having mitigation measures in place and not responding in a unified way.

Importance of diversifying revenue sources

Nigeria's longstanding dependence on oil exports worsened the fiscal impact of the international oil crisis. Consequently, the FGN is committed to diversifying the economy through advanced industrialisation and increasing productivity of and investment in the agricultural and solid-minerals sectors. The FGN believes that foreign and domestic investment are critical to achieving diversification and has begun a targeted campaign to attract investors and boost market confidence. The success of these diversification efforts is likely to determine when the economy recovers and how future oil shocks are weathered.

Diversification, through developing industry, has also been pursued through more protectionist policies. It is unclear whether this strategy has been effective in reducing fiscal

pressure. Import restrictions on medicine, furniture and food have been met with internal resistance. Manufacturers have argued that these policies limit their access to raw materials and stifle productivity.

In addition to addressing the effects of the commodity price shock, it is necessary for countries to understand whether their interventions are effectively addressing the underlying weaknesses that made them vulnerable to the crisis. Response strategies must be subject to live policy making and adjustments, as one learns what worked and where unintended effects have resulted. While protectionist policies have many downsides, economic diversification across resource-dependent countries will be essential if the decline in commodity prices becomes the new normal.



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