Review Of The 2011Appropriation Bill

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LIST OF ACRONYMS

Bill	Appropriation Bill 2011

BOF	Budget Office of the Federation
CBN	Central Bank of Nigeria
CIT	Companies Income Tax
DMO	Debt Management Office
DSA	Debt Sustainability Analysis
ECA	Excess Crude Account
EXCOF	Executive Council of the Federation
FCT	Federal Capital Territory
FGN	Federal Government of Nigeria
FMF	Federal Ministry of Finance
FRA	Fiscal Responsibility Act
FRC	Fiscal Responsibility Commission
GDP	Gross Domestic Product
IMF	International Monetary Fund
MBPD	Million Barrels Per Day
MDAs	Ministries, Departments and Agencies of Government
MDG	Millennium Development Goals
Minister	Minister of Finance

MPR	Monetary Policy Rate
MTEF	Medium Term Expenditure Framework
MTSS	Medium Term Sector Strategy
NASS	National Assembly
NEEDS	National Economic Empowerment and Development Strategy
NNPC	Nigeria National Petroleum Corporation
PPP	Public Private Partnership
RCP	Reference Commodity Price
SGF	Secretary to the Government of the Federation
VAT	Value Added Tax
VGF	Viability Gap Fund
USD	United States Dollars

EXECUTIVE SUMMARY

The general terms of reference of this Review of the 2011 Appropriation Bill are:

- To review the 2011 Appropriation Bill as presented by the President highlighting areas of concern with a view to providing the FRC with a clear template for its input into the legislative approval of the Bill.

- To review the Bill submitted by the President with a view to highlighting areas of strength and weaknesses.

- To review the Bill in the light of the FRA including the procedural issues, MTEF, previous macroeconomic forecasts and their results, extant macroeconomic indicators and prevailing social and economic conditions.

The Bill is reviewed through desk study of its provisions and relevant national and international literature on budgeting and the MTEF. It indicates areas in need of further clarification, amendments and alignments with available fiscal data and trends. The Appropriation Bill is based on the following macroeconomic assumptions: oil production of 2.3mbpd and benchmark oil price of $65pb; a real GDP growth rate of 7%; target inflation rate of 10% and exchange rate of N150 to 1$USD; a fiscal deficit of N1,389.76 billion amounting to a deficit of -3.62% of the GDP resulting from a projected expenditure of N4,226.19billion and a retained revenue of N2,836.43 billion. The projected expenditure comprises of N196.12billion for Statutory Transfers, N542.38 for Debt Service, N2,481.71 for Recurrent (Non-Debt) Expenditure and N1,005.99billion for Capital Expenditure. This represents an 18.1% contraction from the N5,159.66 billion budgeted in the 2010 Amended and Supplementary Budgets.

THE Bill was presented late in the year to the NASS, specifically on December 15 2010 arising from the late preparation and presentation for legislative approval by the executive of the 2011-2013 MTEF. NASS restricted itself to the consideration and approval of the following in the MTEF; benchmark oil price and daily oil production benchmark, non oil revenue assumptions, exchange rate and general expenditure projections. This is not the full picture of the MTEF. Growth projections, interest rate, inflation rate, sectoral indicative envelopes, etc, were not reviewed. Also the available indicative envelopes were only for capital expenditure as the executive did not provide overall indicative envelopes comprising the recurrent and capital projections for year 2011. Neither the Appropriation Bill nor the accompanying documents provided the evaluation of results of programmes financed through budgetary resources in the year 2010 as required by section 19

(d) of the FRA. The Appropriation Bill is accompanied the Fiscal Target Appendix containing the target inflation rate, target fiscal balances, GDP growth rate and exchange rate of the naira. It however has nothing on development targets. Fiscal targets and balances are different from development targets which ideally should include targets on the right to an adequate standard of living including targets on the attainment of the MDGs, job creation, targets for the rights to adequate housing, health, education, access to water, etc.

The overview of the Bill shows that revenue from Federal Government's share of the Federation Account has been increasing since 2009 and it is projected to increase further over the medium term. Projections for VAT are also increasing. Revenue peaked in 2010 and decreased by 10.80% in 2011 and there is a projected increase of 8.59% in 2012. On the expenditure side, statutory transfers have been increasing while recurrent (non-debt) expenditure took a quantum leap of 116.53% in 2010. However, the proposal for 2011 seeks to reduce recurrent non debt expenditure. Projection for capital expenditure grew exponentially in 2010, but has generally not matched the growth in recurrent expenditure over the four years 2009-2012. There is an unhealthy relationship between the deficit and the revenue. The deficit as a percentage of the revenue has averaged 49.39% between 2009 and 2011- an unduly high percentage. The debt service obligation increased between 2009 and 2010 and has maintained an even keel between 2010 and 2011. The budget has consistently been on deficit financing with the deficit exceeding the 3% of GDP rule in the FRA. Generally, Nigeria has been spending more than it earns.

Oil production is stated at 2.3mbpd in the Bill while NASS had approved 2.25mbpd in the MTEF. The benchmark price for oil is stated at $65 which is the same as the approval in the MTEF. The RCP has implications for budget implementation and accrual of resources to ECA. The first is that if the commodity price falls below the RCP, Federal, State and Local Government budgets will be totally distorted and will become un-implementable in view of the fact we have fully drawn down the resources in ECA. The second issue is that the new RCP will decrease the level of accruals to the ECA at a time ECA needs to be replenished. The Bill does not contain a clear cut articulation of the expected inflows into the ECA. Rather, it contains FGNs share of ECA in the sum of N152.98 billion. The MTEF had proposed a hedging strategy providing FGN with the option of transferring risks associated with downside movements in the oil price to a third party. With the payment of a premium, FGN can purchase a hedging solution such as put options, cap and floor agreements, no cost collars amongst others which would guarantee government earnings below a floor, such as the benchmark price, while allowing us to reap the gains from higher oil prices. Non oil revenue projections in CIT and VAT are realistic and realizable while the projections for Customs and Excise may be difficult to meet.

The deviations between the MTEF's approvals and the Bill's Expenditure Framework are detailed in Table A below:

Table A: MTEF Versus Budget's Expenditure Framework

Item	**MTEF (Billions)**	**Appropriation Bill (Billions)**
FGN Revenue	2,405.23	2,836.43
Statutory Transfer	179.78	196.115
Debt Service	517.07	542.381
Recurrent MDA (Non Debt)	2,849.66	2,481.705
Capital Spending	1,083.44	1,005.989
Aggregate Expenditure	4,629.95	4,226.191
Deficit as a % of GDP	-4.49%	-3.62%

The expenditure breakdown for 2011 shows that social sectors like education and health got 11.56% and 8.03% as against the international benchmarks for developing countries of 26% and 15% respectively. Agriculture and natural resources despite its huge contributions to GDP and employment generation got a paltry allocation of 3.30% of the budget. Defence, Police Formations and Command and the Office of the National security Adviser representing internal and external security demands got a total of 24.65% of proposed 2011 spending. The National Assembly and Presidency got 3.79% and 1.34% respectively. The allocations to the foregoing sectors (with the exception of education, health and agriculture) are excessive and can be reduced and channeled to other sectors in need of increased funding.

Recurrent (non-debt) expenditure at 58.72% of the overall budget is also very high and the reduction of the recurrent vote, particularly the overhead vote which is crowding out capital investments can start with the two key institutions that should lead the reform of fiscal governance in Nigeria to wit: the Presidency and the National Assembly.

There has been a progressive decline of the capital budget in the last three years. From a budgeted figure of 34% in 2010 to 23.8% in 2011 is a huge decline. Thus, the capital expenditure failed to support any of the four pillars of the budget as the budget failed to optimize capital spending by rationalizing recurrent expenditure. Rather, the budget rationalized capital expenditure from 34% in 2010 to 23.8% in 2011. The implication of the low capital votes is that Nigeria will most likely miss the development targets of Vision 20:2020 and the MDGs. When the capital votes of education, health, agriculture and water resources, works, power, transport, lands and housing, aviation, Niger Delta, Defence and Mines and Steel are put together, they only amount to 94.7% of the debt service vote. Capital supplementation envisages the establishment of a National Job Creation Scheme with a seed capital of N50billion and all memoranda submitted to EXCON regarding procurement contracts from MDAs are to indicate the local employment content implication of the project.

The deficit is -3.62% of the GDP which contrasts with the MTEF approval of -4.49% of the GDP. The percentage of retained revenue to overall budget is 67.11% while the percentage of deficit to overall budget is 32.89%. The deficit financing sources are as stated in the Table B below:

Table B: Sources of Deficit Financing

Deficit Financing Source	**Amount N Bn**
Privatisation Proceeds including the sale of NITEL	242.21
FGN's share of Signature Bonus	132.31
Sharing from Stabilisation Account	150.00
Domestic Borrowing	865.24
Total	**1,398.76**

There are unresolved issues about whether expectations from Privatisation and Signature Bonus will materialize and even if they materialize, it would be contrary to the FRA (sections 41 and 53) to use the proceeds to fund recurrent expenditure. Domestic borrowing is listed as a source of funding the deficit to the tune of N865.24billion in the Revenue and Expenditure Framework[1]. At N150 to 1USD, this amounts to $5.768bn. But N865.24bn exceeds the recommendation of the DSA 2011[2] on money to be raised from domestic sources. The DSA recommends a maximum sum of N639billion to be borrowed from domestic sources and $2.84billion from external sources. Although, this is less than the N1,346.58 borrowed in 2010, the implication is that the public sector will continue its crowding out effect on access to credit by the private sector and banks will continue to be risk averse. Finally, the projected total external and internal debts do not

[1] At page C-6 of the Documents Accompanying the 2011 Budget to the National Assembly.
[2] Report of the Annual Debt Sustainability Analysis, 2011 at pages 31 to 32.

seem to correspond with the reality of facts in terms of the existing quantum of debt and recent new approvals by the legislature. The 2011 budget recognized that the government will provide guarantees for private sector driven infrastructure projects in the power, transportation and housing sectors, etc and estimates the guarantee in 2011 to be within the range of $3billion to $5billion.

The real GDP growth rate is projected at 7% for 2011 in the Fiscal Target Appendix. However, the MTEF and the Documents Accompanying the 2011 Budget did not contain an evaluation and analysis of the macroeconomic projections for the three preceding financial years. This is a failure to comply with section 11 (3) (a) of the FRA as an analysis of previous forecasts against their actual performance could have revealed the binding constraints on growth with a view to articulating strategies to address them. The rates of growth projected for 2011 falls short of the 13.8% envisaged in Vision 20:2020.

The Bill sets the target inflation rate at 10% against the MTEF's approval of 9% while the exchange rate in the MTEF and in the Bill is set at N150 to the USD. The inflation rate as at October 2010 is 13.4%, down from the 13.9% recorded in December 2009. The formula used in arriving at the inflation rate for the budget is unknown considering that there is no major shift in the prevalent economic variables between October 2010 and the year 2011. However, the expansionary fiscal policies being pursued in 2011 and in the medium term and the fact that the bulk of the monies are voted for recurrent expenditure makes the realization of the 10% inflation rate doubtful.

The MTEF and the budget contained no projections on interest rates or strategies to reduce the spread between lending and deposit rates for the medium term. With a prevailing 12 months deposit interest rate of 3.97% payable by banks to depositors and savings deposit rate of 1.43%, the current high prime lending rate of 16.50% and the maximum lending rate of 22% is nothing but usury. This cannot be justified considering that banks before the banking crisis were paying depositors interest rates averaging 7.92% per annum and yet had maximum lending rate of 18.23% per annum in 2007. Credit to the public sector grew exponentially while credit to the private sector recorded less than 4% growth between 2009 and 2010.

The Review ended with the following recommendations:

RECOMMENDATIONS

Preparation of MTEF and Budget

- The Minister and the BOF should start the process for the preparation of the next MTEF by February. This will allow adequate time for the MTSS sessions, consultations with states, relevant stakeholders and the listed federal agencies.

- The MTEF should be forwarded to the EXCOF for endorsement on or before June.

- The MTEF as endorsed by EXCOF should be forwarded to NASS in July or as soon as it is endorsed by EXCOF, whichever is earlier.

- NASS should hold public hearings and allow popular inputs into the MTEF before its approval in accordance with section 48 (2) of the Act to ensure transparency during the preparation of the MTEF. NASS should consider all provisions of the MTEF and not merely limiting itself to the benchmark price and quantum of oil production, etc.

- Budget preparation should commence as soon as the MTEF is endorsed by NASS and the Bill should be presented by the President to NASS not later than the first week of September.

The Budget Year and the Capital Budget

- The Legislature should endeavour to pass the budget by December of the preceding year and before proceeding on their Christmas and New Year vacation. The commencement of implementation early in the year will lead to increased capital budget implementation.

- NASS should stop acceding to executive requests to extend the budget year to March of the following year.

Contents of the Appropriation Bill and Accompanying Documents

- In accordance with section 19 (d) of the FRA, the Minister should submit or NASS should insist on documentation evaluating the results of programmes financed with budgetary resources.

- NASS should also insist that the Minister submits other developmental targets as required in the Fiscal Target Appendix. This should include targets on the right to an adequate standard of living including targets on the attainment of the MDGs, job creation, targets for the rights to adequate housing, health, education, access to water, etc.

Revenue Framework of the Bill

- Oil production at 2.3mbpd is realistic and should be retained.

- Although the benchmark price of $65 per barrel should be retained to reduce the deficit, future benchmark prices should clearly articulate empirical methods used in arriving at the benchmark.

- To stabilize national finances, income earned by the country above the benchmark price of oil should be saved in the ECA and there should be a moratorium on sharing resources accruing to ECA during the year 2011.

- Future Bills and the MTEF should clearly articulate the expected inflows into the ECA.

- The proposed hedging mechanism should not be used because premiums will be paid which is extra expenditure on the public purse. Rather, FGN and other tiers of government should properly manage the proceeds of ECA in accordance with the FRA.

- CIT and VAT projections are realistic and should be retained.

- Customs and Excise projections should be downwardly reviewed in line with the experience in recent years.

- FGN Independent Revenue and Unspent balance should be retained as approved in the MTEF.

Expenditure Framework

- NASS should endevaour to re-order the expenditure pattern to ensure that at least 33% of the budget is voted for capital expenditure.

- NASS and the Presidency should lead the way in reducing their recurrent expenditure particularly the bloated overheads. NASS and the Presidency can run efficiently with 50% of their current proposals.

- The full implementation of the Monetisation Programme would facilitate the reduction of the bloated recurrent expenditure of FGN.

- The votes of Defence, Police Formations and Command and the National Security Adviser should also be downwardly reviewed.

- Education and Health sectors should get at least 26% and 15% of the overall budget allocations.

- Allocations to agriculture and water resources should also be enhanced to guarantee its contribution to GDP and employment generation.

Capital Budget Implementation

- The idea of engaging global project management firms should be discarded as they can only lengthen the bureaucracy as conduit pipes of corruption. Rather, FGN should develop the political will and empower the civil service for enhanced capital budget implementation.

- NASS should use its oversight activities to strengthen capital budget implementation.

- Civil society including traditional NGOs, the media, professional associations and the academia should become more interested in capital budget monitoring and reporting, to expose corruption and inertia in government.

- Strong collaboration is recommended between MOF, BOF and the Bureau of Public Procurement if the capital budget is to record appreciable implementation beyond the perennial 50% recorded by the end of every year. And the BPP is called upon to intensify capacity building and opening up the process to more stakeholders who can hold public officers to account.

Job Creation

- The National Job Creation Scheme should be structured and benchmarked in a way that will show its achievements in the number of new jobs created, their sustainability and what they add to wealth creation and national productivity.

- FGN should consider the option of reducing CIT as a means of generating new jobs and benchmark eligibility to benefits from the reduced CIT to new hiring and job opportunities created by companies. A 10% reduction is recommended.

Debts, Deficits and Contingent Liabilities

- FGN should reorder its expenditure to ensure that the proceeds of borrowing are channeled towards capital expenditure and human development. Borrowing for recurrent expenditure is outlawed by the FRA.

- The figures to be borrowed and the quantum of local and foreign debts stated in the Borrowing Programme and the Revenue and Expenditure Framework should be harmonized.

- Borrowing should not exceed the recommendations of the DSA which stipulates N639billion and $2.84billion as the limits of domestic and external borrowing within the financial year 2011.

- NASS should review the sources of deficit financing particularly Privatisation Proceeds considering that the privatization of NITEL has gone awry as the preferred bidder is unable to raise money to pay for the firm. Also available information indicates the expectations from Signature Bonus may not materialize until the passage of the Petroleum Industry Bill.

- NASS should insist on the presentation of a well articulated cost benefit analysis before giving approval to any executive request for borrowing.

- The President and NASS should initiate steps towards the setting and approval of the Consolidated Debt Limit for Federal, State and Local Governments in accordance with section 42 of the FRA.

- FGN should ensure the proper documentation and recording of its contingent liabilities. The available information in the 2011 Bill seems underestimated in view of recent PPP arrangements and documentation from the Infrastructure Concession Regulatory Commission.