MACROECONOMIC FRAMEWORK OF THE 2018 FEDERAL GOVERNMENT BUDGET: ASSUMPTIONS AND PROJECTIONS

By
Mike I. Obadan, Ph.D, fnes, fssan, fimec
Professor of Economics
University of Benin

and

Chairman
Foundation for Education & Development
Benin City, Nigeria

A Presentation at ICAN Budget Seminar in Lagos, 8th December, 2017
1. INTRODUCTION

The 2018 Appropriation Bill, having being presented by the President to the National Assembly, it is important to examine it with a view to determining the realism of its elements and pointing out the conditions / proffering suggestions for success.

This presentation focuses on the macroeconomic framework, in particular the assumptions and projections on revenue and broad expenditure categories. To this end, it is structured to cover the following issues:

- The budget assumptions and parameters;
- Size and structure of the budget; and
- Revenue projections – oil and non-oil

2. BUDGET ASSUMPTIONS AND PARAMETERS

The 2018 budget is predicated on a number of key assumptions as set out in the 2018 – 2020 Medium-Term Expenditure Framework and Fiscal Strategy Paper. They include the ones in Table 1, relating to GDP growth rate, oil price benchmark, oil production target, average exchange rate, fiscal deficit, and inflation rate.

Table 1: Key Assumptions and Parameters in the 2017 and 2018 Budget

<table>
<thead>
<tr>
<th>Parameters</th>
<th>2017</th>
<th>2018</th>
</tr>
</thead>
<tbody>
<tr>
<td>Benchmark Oil Price (US $)</td>
<td>42.50</td>
<td>45.0</td>
</tr>
<tr>
<td>Projected Oil Production (mbpd)</td>
<td>2.20</td>
<td>2.3</td>
</tr>
<tr>
<td>Average Exchange Rate</td>
<td>N305/$1.0</td>
<td>N305/$1.0</td>
</tr>
<tr>
<td>GDP growth rate (%)</td>
<td>3.02</td>
<td>3.5</td>
</tr>
<tr>
<td>Fiscal deficit (% of GDP)</td>
<td>-2.18</td>
<td>-1.77</td>
</tr>
<tr>
<td>Inflation rate (%)</td>
<td>12.92</td>
<td>12.4</td>
</tr>
</tbody>
</table>

The assumptions and parameters are crucial as they underpin the revenue projections. So far, in 2017, only the exchange rate and oil price targets have been met. Oil production, growth and inflation assumptions/targets have not been met.
GDP growth rate of 3.5 percent in 2018 compared to 3.02 in 2017. This is critical for the realization of non-oil revenue projections. Non-oil revenue derives from the major types of taxation which are related to the tax bases: imports, exports, sales, company profit, personal income and consumption. These are all tied to the gross domestic product (GDP) or national income. Increasing the national income should lead to increases in the tax bases.

The issue though is whether the GDP growth rate of 3.5 percent can be achieved considering that projections by international organisations are much lower. For example, The IMF’s World Economic Outlook, October 2017, estimates Nigeria’s GDP growth rate for 2018 as 1.9 percent.

However, the pace of recovery of the economy after the country had exited recession in the second quarter of 2017 is quite encouraging, moving from the negative growth of -0.91 percent in the first quarter to the positive growth of 0.72 percent in the second quarter to 1.4 percent in the third quarter. The growth performance was due to the good performance of prices in the world oil market. Thus, if the forces of growth which brought the country out of recession prevail in 2018, the realised growth rate could be near the projection.

**Benchmark oil price.** The projected benchmark oil price is $45.0 per barrel. Considering the current oil market conditions and the decision on November 30 by the Organisation of Petroleum Exporting Countries (OPEC) to extend production cuts to December, 2018 (as part of the global efforts to eliminate excess oil supply in the international market), the benchmark price appears to be on the conservative side. Prices are likely to be much higher in 2018. Indeed, estimates by some international organisations are more optimistic: World Bank ($60.0), IMF ($48.5), OECD ($50.0), and EIA ($54.1). The average of all these is $53.1 per barrel. Thus, there is scope to raise the budget benchmark price. If the National Assembly decides to do this, it should, however, not provide a basis to increase the overall size of the budget. Rather, it should provide room to reduce the projected fiscal deficit and/or boost savings in the Excess Crude Account.

**Oil Production.** The projection for 2018 is 2.3 mbpd compared to 2.2 mbpd in 2017. The average production in 2017 is 1.88 mbpd (86% of the budgeted 2.2 mbpd) even though the NNPC informs that the current production capacity of the country is more than 2.3 mbpd. Shortfalls have been due to Niger Delta region security-related factors and vandalisation of key export infrastructure.
Also, the constraint imposed by OPEC strategies is real. At its meeting on November 30, OPEC took a decision to cap the output of Nigeria and Libya at 2017 production levels. In light of the above, the oil production target is on the optimistic side. But it could be less so if the government is able to minimize the security risks in the Niger Delta region.

Although President Buhari’s peace initiative in the Niger Delta, executed by the Ag. President, has yielded notable results, the recent threats to resume militancy activities in the region give cause for concern. Therefore, the government should do the needful to ensure peace and stability in the region through robust engagement of stakeholders. It is in the interest of the economy that peace and stability should be fully restored and sustained in the Niger Delta region.

**Exchange rate.** The exchange rate projection remains at the same level as in 2017: N305 : $1.0. This seems to be realistic, considering the current efforts of the Central Bank of Nigeria (CBN) to stabilise the market exchange rate through the supply side. The strategy has so far worked well. For some time now, the exchange rate has hovered around N360.0 : $1.0.

**Inflation rate.** This is projected at 12.4 percent compared to 14.8 percent projection by the IMF. The IMF’s projection seems more realistic considering that as at October, 2017, the actual inflation rate was 15.91 percent. No doubt, there has been a sustained process of disinflation for some time now, reflecting the efficacy of the monetary measures and the fact that the triple shocks to prices in 2016 – sharp depreciation, increase in petroleum product prices, and electricity tariffs – and the continued waning of their effects. But if the expansionary 2018 budget is fully implemented, it may push consumer prices up, especially if the budget implementation does not result in productivity improvement.

**Fiscal Deficit.** This is projected at 1.77 percent of GDP in 2018 compared to 2.18 percent in 2017, suggesting an improvement. The fiscal deficit reflects the weakness of the primary balance. The deficit will be financed by domestic borrowing (N849.5 billion), external borrowing (N849.5 billion), and privatisation proceeds (N306.0 billion). The financing with external borrowing raises concerns, more so as the external debt stock of the country has been rising in a very worrisome way.
Overall, sustained peace in the Niger Delta region, sustenance oil price recovery and improved joint venture production would boost government revenue and have a positive impact on fiscal deficit reduction.

3. SIZE AND STRUCTURE OF THE BUDGET

The size of the proposed 2018 Federal Government budget at N8.612 trillion, is 16 percent higher than the 2017 budget (N7.424 trillion). It maintains the expansionary stance of the past two budgets and it is very much desired considering the recession that plagued the economy in the past two years.

In its “Growth Generating Adjustment Scenario” contained in its Article IV Consultation Report on Nigeria, April 2017, the IMF envisages a tightened fiscal policy and a tighter monetary policy to help reduce inflation.

However, at this early phase of the country’s exit from recession, there is need to accelerate economic recovery and growth. To this end, monetary easing and fiscal stimulus, as represented by the 2018 budget, are required to stimulate aggregate demand, in particular, public and private investment.

One thing though is that merely increasing the development component of the budget on paper is not enough. The poor capital budget implementation in 2017 (50% or less by the end of the year) attests to this. Therefore, capital budget implementation needs to commence early. This requires the National Assembly to do the needful to allow capital budget implementation to start early.

The broad expenditure projections in the budget still show a dominance of recurrent expenditure (non-debt and debt related expenditure) (Table 2). The non-debt recurrent expenditure (personnel and overhead costs) (43%) is still very high indicating high cost of governance. The debt related recurrent expenditure is also very high at 26 percent.

But the projected aggregate capital expenditure of N2.652 trillion or 30.8 percent of the total budget is largely adequate considering the past implementation experience. If over 80 percent of the expenditure is realized, such spending is efficient, devoid of grand corruption, the impact on infrastructure provision and other growth enhancing activities will be significant. It would
contribute to providing a conducive environment for growth. The million naira question is: what impact will be made by the capital budget in the situation in which implementation is done in a few months of the year, revenue shocks occur and implementation capacity is weak?

In view of the high cost of governance and rather weak non-oil revenue mobilization, the primary balance (surplus) is low at N2,881.0 billion or 2.5 percent of the gross domestic product. This is why there is a fiscal deficit of N2,005.0 trillion when the capital component of the budget is taken into account along with the debt servicing.

**Table 2: Structure of Federal Government Expenditure, 2018**

<table>
<thead>
<tr>
<th>Budget Item</th>
<th>Amount (N' billion)</th>
<th>Percent of Total Budget (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Non-debt Recurrent Expenditure (including recurrent component of Statutory Transfers of N232.0 billion)</td>
<td>3,726.0</td>
<td>43.3</td>
</tr>
<tr>
<td>(Aggregate Statutory Transfers)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Debt Service</td>
<td>(456.0)</td>
<td></td>
</tr>
<tr>
<td>Sinking Fund (to retire maturing bond to local contractors)</td>
<td>2,014.0</td>
<td>23.4</td>
</tr>
<tr>
<td>(Aggregate Recurrent Expenditure – non-debt plus debt-related expenditure)</td>
<td>220.0</td>
<td>2.6</td>
</tr>
<tr>
<td>Capital Expenditure (including capital expenditure in Statutory Transfers of N224 billion)</td>
<td>(5,960)</td>
<td>(69.2)</td>
</tr>
<tr>
<td>Primary Balance</td>
<td>2,881.0</td>
<td></td>
</tr>
<tr>
<td>Fiscal Deficit</td>
<td>2,005.0</td>
<td></td>
</tr>
<tr>
<td><strong>Aggregate Budget Expenditure</strong></td>
<td><strong>8,612.0</strong></td>
<td><strong>100.0</strong></td>
</tr>
</tbody>
</table>

The implications of the broad expenditure projections is the need to work towards significantly improving the primary balance by (i) a strong non-oil revenue mobilisation drive and (ii) rationalising non-debt recurrent expenditure.
Intensification of non-oil revenue mobilization is imperative so as to shield the country from negative oil revenue shocks and raise the non-oil revenue to non-oil GDP ratio which has been too low for capital projects development and debt sustainability.

Non-oil revenue mobilization, along with a continued focus on improving expenditure efficiency and composition, is crucial to create the fiscal space necessary to scale-up capital expenditure and ensure debt sustainability.

Rationalizing non-debt recurrent expenditures – personnel costs and overheads - requires elimination of wastes and corruption from public spending and procurement which would create space for pro-growth spending. Sadly, public expenditure in Nigeria has notoriously been inefficient and ineffective. Other desirable measures to reduce public expenditure include the following:

- Total coverage of MDAs in the Integrated Personnel and Payroll Information System (IPPIS);
- Drastic reduction of salaries and emoluments of government officials, elected representatives and other political office holders;
- Privatization/sale of government enterprises that are not providing meaningful goods and services but are still funded through the budget; and
- Rationalization of parastatals which duplicate functions and have no evidence of viability or value addition.

**4. REVENUE PROJECTIONS**

The Federal Government’s revenue projections for the 2018 fiscal year were based on the assumptions and parameters examined above. Accordingly, the total federally-collectible revenue is estimated to be N11,983 billion, 12 percent more than the 2017 estimates (N10,699.1 billion).

Table 3 shows a comparison of the estimates of revenue available for funding the Federal Government’s 2017 and 2018 budgets. The 2018 estimates reflect increases in the total revenue, oil revenue and non-oil revenue sources. However, the components of non-oil revenue indicate declines in Company Income Tax (CIT) and Value Added Tax (VAT).

The reduction in the projection of CIT may be understandable considering the slow pace of recovery of the production sector from recession. The macroeconomic environment has been too
challenging for the industrial sector. The reduction in the VAT projection is not desirable as more revenue could actually be obtained from this source through broadening the base and increasing the rate to 10 percent.

<table>
<thead>
<tr>
<th>Revenue Sources</th>
<th>2017 (N’ billion)</th>
<th>2018 (N’ billion)</th>
<th>Increase/Decrease (N’ billion)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Federally-collectible Revenue</td>
<td>10,699.1</td>
<td>11,983</td>
<td>1,283.9</td>
</tr>
<tr>
<td>Oil and gas revenue from the Total federally-collectible revenue</td>
<td></td>
<td>6,387</td>
<td></td>
</tr>
<tr>
<td>Total Receipt from Non-Oil sector</td>
<td></td>
<td>5,596</td>
<td></td>
</tr>
<tr>
<td>FGN Total Revenue</td>
<td>5,084.4</td>
<td>6,607</td>
<td>1,522.6</td>
</tr>
<tr>
<td>FGN Oil Revenue</td>
<td>2,122.2</td>
<td>2,442</td>
<td>319.8</td>
</tr>
<tr>
<td>FGN Non-Oil and other sources</td>
<td>2,962.2</td>
<td>4,165</td>
<td>1,202.8</td>
</tr>
<tr>
<td>FGN Share of Companies Income Tax (CIT)</td>
<td>807.8</td>
<td>794.7</td>
<td>-13.1</td>
</tr>
<tr>
<td>Value Added Tax (VAT)</td>
<td>241.9</td>
<td>207.9</td>
<td>-34.0</td>
</tr>
<tr>
<td>Customs and Excise Receipts</td>
<td>277.6</td>
<td>324.9</td>
<td>47.3</td>
</tr>
<tr>
<td>FGN Independently Generated Revenues (IGR)</td>
<td>807.6</td>
<td>847.9</td>
<td>40.3</td>
</tr>
<tr>
<td>FGN Share of Tax Amnesty Income</td>
<td></td>
<td>87.8</td>
<td>87.8</td>
</tr>
<tr>
<td>FGN Various Recoveries</td>
<td>565.1</td>
<td>512.4</td>
<td>52.7</td>
</tr>
<tr>
<td>Proceeds from the restructuring of government’s equity in joint Ventures</td>
<td>-</td>
<td>710.0</td>
<td>710.0</td>
</tr>
<tr>
<td>Sundry Income</td>
<td></td>
<td>678.4</td>
<td></td>
</tr>
</tbody>
</table>

**Source:** President’s Budget Speech to the National Assembly, 7th November, 2017 and 2018 – 2010 Medium Term Expenditure Framework and Fiscal Strategy Paper, August 2017.

Generally, the oil revenue projection is achievable if the current favourable oil price trend in the world market is sustained and production disruptions are minimized through sustenance of the current peace and stability in the Niger Delta region.

However, there are doubts as to the achievability of the non-oil revenue projections. As at the end of the first half of 2017, the aggregate non-oil revenue realised fell short of target by 49 percent, although some components of it, especially CIT, were expected to improve in the remaining part of the year. Indeed, as at September, aggregate revenue collection had improved such that collections were only 14 percent below target, and this was due to shortfall in non-oil revenues.
A very disturbing aspect of the non-oil revenue performance is the underperformance of FGN’s independently generated revenues which reflected a shortfall of 74 percent by September. The budgeted amount is N807.6 billion while the pro-rated amount up to September is N605.9 billion. Out of this, only N155.14 billion was remitted as operating surpluses of state owned enterprises (SOEs).

Many SOEs have continued to abuse / breach the provision of the Fiscal Responsibility Act, 2007. The FRA 2007, Section 22, provides that each government corporation shall establish a general reserve fund, deposit one-fifth of its operating surplus into the fund, and remit the balance (i.e. four-fifths) to the CRF. However, MDAs have generally tended to breach this provision.

Even when the MDAs choose to deposit something into CRF, it is often a pittance compared to the revenue earned, as had been the case of the Joint Admissions and Matriculation Board (JAMB) which was mentioned by President Buhari in his 2018 budget speech. What they deposit into the CRF is arbitrary as there is no approved modality for determining the operating surplus.

Therefore, the FRA would need to be amended to require MDAs to deposit at least 25 percent of their revenue into the CRF instead of 80 percent of their operating surplus which they arbitrarily determine. This will improve availability of funds for budget implementation.

In 2016, the Senate President commenced an initiative to reform the budget process for greater efficiency, an element of which is the amendment of the FRA to make MDAs contribute meaningfully to funding the budget. The Senate President’s initiative should be transformed into law.

Generally, as was pointed out earlier, the growth of the economy is critical for the performance of non-oil revenue sources including corporate income tax, VAT, import taxes, etc. Therefore, if, following the exit of the country from recession, a robust positive growth rate and revival of economic activities are achieved in 2018, they will be very good for the realization of non-oil revenue projections. But the challenge is how to realise the projected growth rate of 3.5 percent in 2018 even though it is lower than the Economic Recovery and Growth Plan (ERGP) projection of 4.8 percent.

Growth in the ERGP is expected to be driven by:
• Fiscal stimulus comprising a package of spending to stimulate consumption, and investment by businesses;
• Expected increases in oil prices;
• Increase in non-oil receipts;
• Increase in oil production;
• Resolution of payment arrears, especially Joint Venture Cash Calls;
• Increased growth in agriculture, manufacturing, services and light industries.

If the above are realized to a good extent, the growth projection can be realized, thus providing a basis for the non-oil revenue projections to be realized.

The reality though is that the realization of the non-oil revenue projections will continue to be affected by the pace of recovery of the economy, the performance of the oil market and the efficiency and effectiveness of the various fiscal measures including the last set of upward tariff adjustments.

Until economic activities fully recover and tax reforms begin to yield significant results, the desire to make non-oil revenue the major source of budget financing may remain elusive (Obadan, 2017). Importantly too, the situation whereby growth has tended not to have significant impact on non-oil revenues would need to be addressed with vigorous tax reforms.

Under the circumstance of slow growth of the economy, oil revenue could turn out to be the major non-debt financing source for the 2018 budget as it is for 2017. The oil revenue projections are realizable if the current trends in the world market for oil are sustained or become better and peace in the Niger Delta Region is sustained.

In other words, oil revenue projections based on the assumptions can be realized or even exceeded only if the benchmark oil price per barrel is realized or exceeded and militancy activities in the Niger Delta Region which have hindered realization of the past oil production targets are effectively contained.

Finally, while the current reform initiatives of the Federal Inland Revenue Service, including the Voluntary Assets and Income Declaration Scheme (VAIDS), are commendable, areas of tax reform that can also be explored include the following:

• User charges which had tended to be neglected in the states; they are a potentially important source of revenue;
- Increase in VAT to about 10 percent, especially for non-essential goods and services, i.e., luxury items, and even telecommunications services;
- Property tax. Wealth, real estate, urban land, and social activities such as entertainment, are often not accorded the attention they deserve in tax matters. Yet, wealth tax with variants such as tax on holding wealth, transfer of wealth and appreciation of wealth can yield substantial revenue.
- Broadening the base of some existing taxes, for example, personal income tax, to include a large part of non-wage income, self-employment income, etc, that have tended to be excluded from the tax net.

5. CONCLUSION

The assumptions and parameters provide a basis for the budget projections, especially revenue projections. They are generally realistic to the extent that certain conditions prevail. The growth rate, for example, can be realized if the drivers of growth which brought the country out of recession prevail in 2018, capital budget implementation commences early, and 2017 capital budget implementation is not extended into 2018 while the outstanding projects are rolled over into the 2018 budget. In this way, the 2018 capital budget implementation would not be halted by an extension of the 2017 capital budget into 2018 as has happened in 2017. The oil production target is feasible on condition that the peace and stability in the Niger Delta is sustained.

In the same way, the oil revenue projection is achievable if the current favourable oil price trend in the world market is sustained and production disruptions are minimized through sustenance of the current peace and stability in the Niger Delta region.

However, there are doubts as to the achievability of the non-oil revenue projections. One thing though is that if, following the exit of the country from recession, a robust positive growth rate is achieved in 2018, and economic activities strongly revive, they will be very good for the realization of non-oil revenue projections in a large measure. But then, even though the tax reform efforts of the FIRS are commendable, more still needs to be done to mobilise significant non-oil revenue, especially from operating surpluses of MDAs, user charges, property tax, VAT increase, and broadening the base of some existing taxes.

The broad expenditure projections in the budget still show a dominance of recurrent expenditure, indicating very high cost of governance. They suggest the need to work towards significantly
improving the primary balance by (i) a strong non-oil revenue mobilisation drive and (ii) rationalising non-debt recurrent expenditure. Rationalizing non-debt recurrent expenditures requires elimination of wastes and corruption from public spending and procurement which would create space for pro-growth spending.

Finally, non-oil revenue mobilization, along with a continued focus on improving expenditure efficiency and composition, is crucial to create the fiscal space necessary to scale-up capital expenditure and ensure debt sustainability.

REFERENCES

