Fiscal Policy Options in COVID-19 Environment

With the increasing effects of COVID-19 pandemic, it is very evident that Nigeria is not immune from the global slump in demand and fall in commodity prices. Since the oil windfall of the 1970s, the trajectory of Nigeria's economy has been driven around the price and production movements, and Nigeria's growth pattern has followed these paradigms. The current COVID19 pandemic with over 2.5m cases has killed 178,000[1] persons and would definitely engender a fiscal and monetary crisis for Nigeria.

After the oil price slump in 2014, Nigeria went through a painful process that resulted in a recession and the country has not been able to advance beyond a 2.27% growth rate.

Nigeria's vulnerability started with a sudden slump in oil prices. As at February 16, 2020, Brent oil prices still traded at $58 per barrel but reached a decade low of $22 per barrel on March 22, 2020. Nigeria's signature oil blend, Bonny Light, has been sold at a discount to the reference oil price showing the supply glut in the market[2]. An oversupply of oil cargoes in the market has created a situation where Nigeria's banner oil "Bonny Light" was sold at $12 per barrel on April 17, 2020[3]. The current challenges are exacerbated by the diplomatic tussle between the three main oil producers - Russia, US and Saudi Arabia - which control 40% of global oil production. The oil producers have not been able to adhere to production cuts which has boosted oil prices since the slump in 2014. However, the recent OPEC agreement might boost prices in the near term but might not be significant due to huge global inventory & slump in demand.

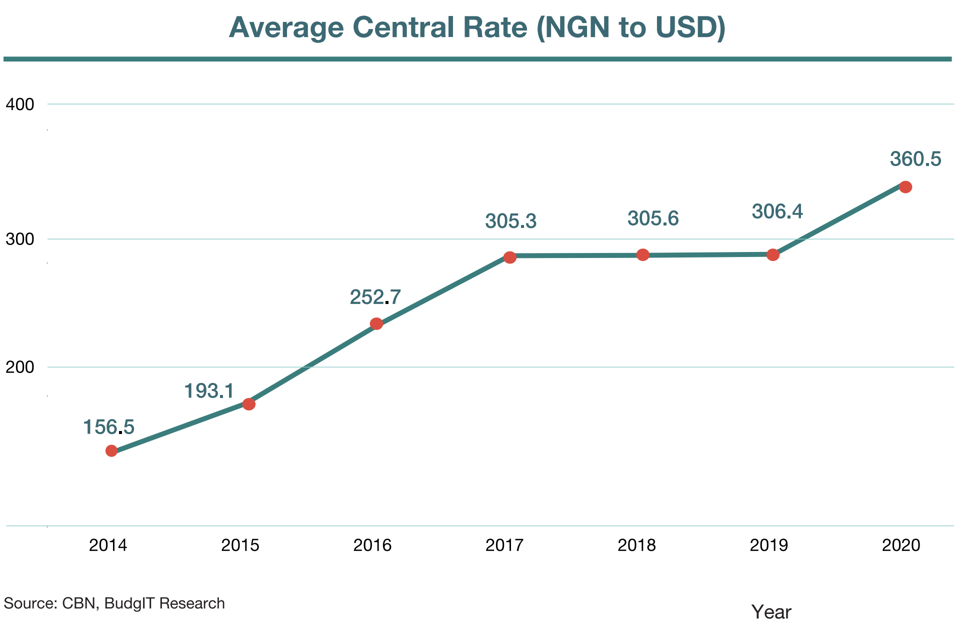
After the oil price slump in 2014, Nigeria went through a painful process that resulted in a recession and the country has not been able to advance beyond a 2.27% growth rate. Nigeria dithered on monetary policy options such as currency devaluation which triggered the capital outflows and collapsed demand across the Nigerian economy. A fallout of the global slump is the crash in oil prices and with the oil sector accounting for 8.91% of Nigeria's GDP and 90% of Nigeria's export value in 2019, this also has a huge spillover effect on public revenues (especially at sub-national level).

[1] at April 22, 2020
[2] https://oilprice.com/Latest-Energy-News/World-News/Price-War-Hits-Africas-Largest-Oil-Producer.html
[3] https://www.bloomberg.com/news/articles/2020-04-17/nigeria-s-banner-oil-hits-12-millions-of-barrels-remain-unsold

When oil price slumps

1. Currency Devaluation

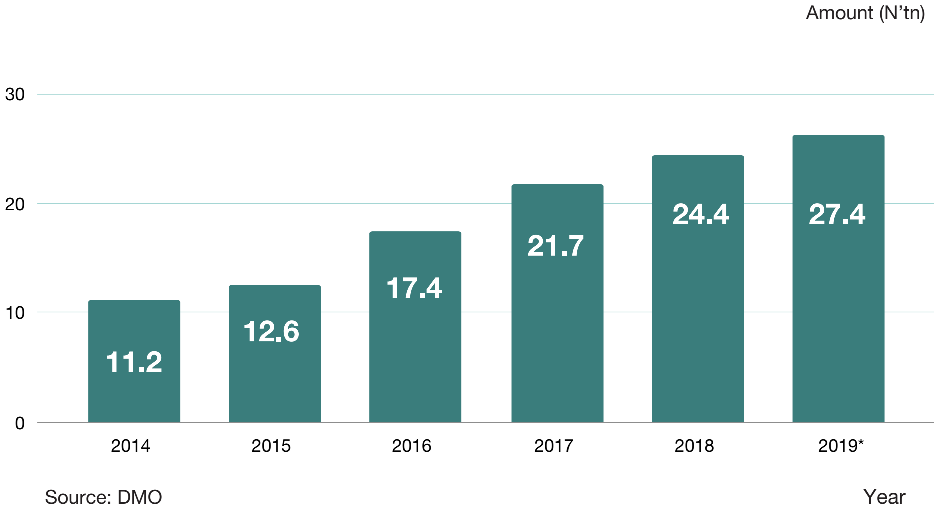
Perennial evidence has shown that the fall in oil prices would lead to devaluation of Nigeria's currency. Nigeria's balance of trade has always fallen to negative with slump in oil prices due to the dependence on oil exports. Nigeria's Central bank has technically devalued the currency with the "official" rate now at $360 to the USD.



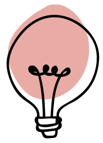
2. Debt Spike

Nigeria has a weak revenue outlay with revenue to GDP at less than 10%. Despite being Africa's largest economy, it has not been able to mobilize resources from its citizens, due to the huge informal nature of the economy, shallow formal private sector space, difficulty in tax payments, multiple tax regimes, high incidence of poverty and poor citizen data structure. Nigeria government has resorted to debt through expansion of public debt in recent times. Over $15bn was borrowed from the international markets and FG external debt has grown from $7.34bn in 2015 to $23bn in 2019. It is expected that Nigeria will take another $7bn debt from multilateral organizations such as the World Bank, International Monetary Fund and African Development Bank.

Total Public Debt



Source: DMO

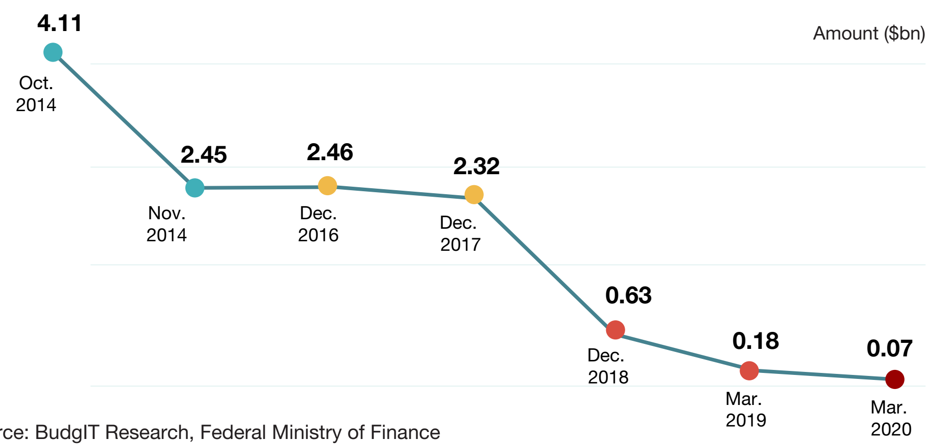


Recently, $150m has been withdrawn from its stabilization fund meant to meet projected shortfalls for June FAAC distribution.

3. Savings Stagnation

During the oil price slump in 2009, Nigeria had over $20bn in Excess Crude Account which served as a buffer to mitigate the economic fallout. In 2014, Nigeria did not have such luxury as gains from excess crude earnings were either spent on fuel subsidy payments or shared by all tiers of government. Nigeria had $2.1bn in the Excess Crude Account which has slumped to $70m as at February 2020. The $1.9bn assets under the Nigerian Sovereign Investment Authority would be under threat as subnational governments face huge liquidity challenges. Recently, $150m has been withdrawn from its stabilization fund meant to meet projected shortfalls for June FAAC distribution.

Excess Crude Account Balance

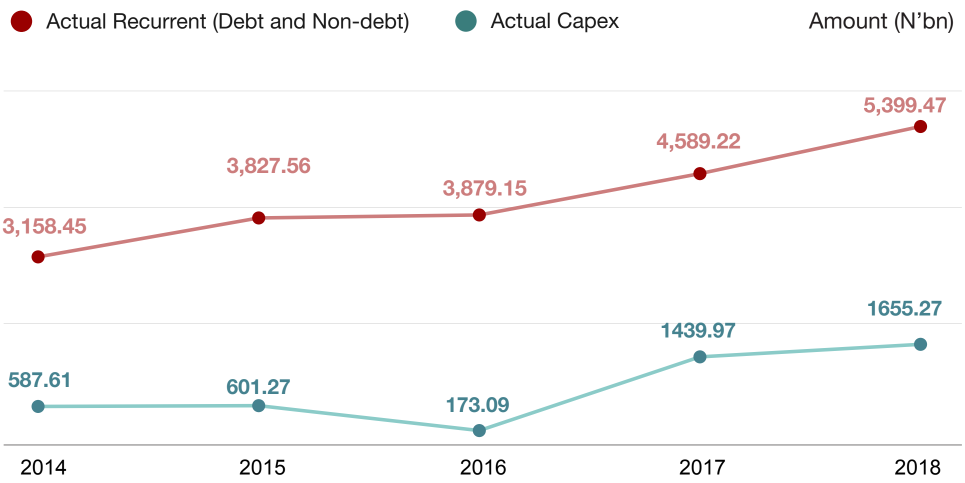


Source: BudgIT Research, Federal Ministry of Finance

4. Capital Expenditure Slows

Nigerian government has not shown readiness to make adjustments to recurrent expenditure, mainly salaries, overheads and debt servicing costs. Nigerian government is not ready to implement the Oronsanye report that would have led to rationalization of government workers and statutory agencies such as the National Assembly and also Ministries aren't ready to rein on their costs. Nigeria's recurrent costs have grown from N3.15tn in 2014 to N5.4tn in 2018, a 71% growth in 5 years. With the looming fiscal crisis, recurrent expenditure will lead in terms of priority and would impact ability to deliver capital expenditure. We state that Nigeria's recurrent costs might reach at least N6.5tn in actual terms by 2020.

Actual Recurrent (Debt and Non-debt) and Actual Capex

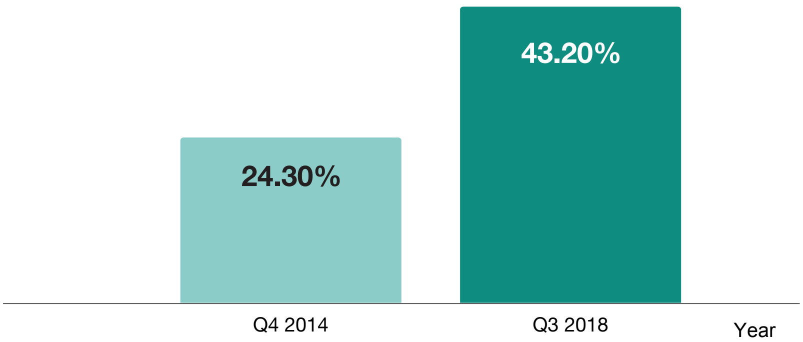


Source: BudgIT Research

5. Weak Growth & Rise in Unemployment

Slowdown of activity and possible another looming recession might deepen the current employment challenges. Nigeria underemployment and unemployment rates combined have risen from 23.4% in 2014 to 43.2% in 2019. Slowdown of activities which might also significantly affect the services, real estate and ICT sectors.

Under and Unemployment



Source: National Bureau of Statistics

6. Sub-National Governments

In our research in 2016, it was evident that 29 out of 36 states could not meet recurrent bills as at when due. Also, 34 out of 36 states in Nigeria have their internally generated revenue of less than N100bn. Based on BudgIT research, as at 2017 fiscal numbers, 17 out of 36 states do not have the required revenues to meet expenditure. The reduction in FAAC payments will also have large implications for the states as the FG has the cushion to borrow from the CBN applying a "ways and means" approach. In our view, these 17 states are the most vulnerable to oil price shocks if they don't significantly revise their recurrent expenditure.

"However, as we create the enabling environment for the economy to grow, we must ensure a skilled and healthy workforce is developed to benefit from these investments, and the expected adjustments to the global supply chain. We must optimise our population by preparing for the future of work. From early stage education, to technical and vocational training, and digital skills training, we should equip our young people with the skills needed to take jobs in the Fourth Industrial Revolution."

Kayode Fayemi
Governor of Ekiti State
Chair, Nigeria Governors Forum

Ability of States to meet Recurrent Expenditure

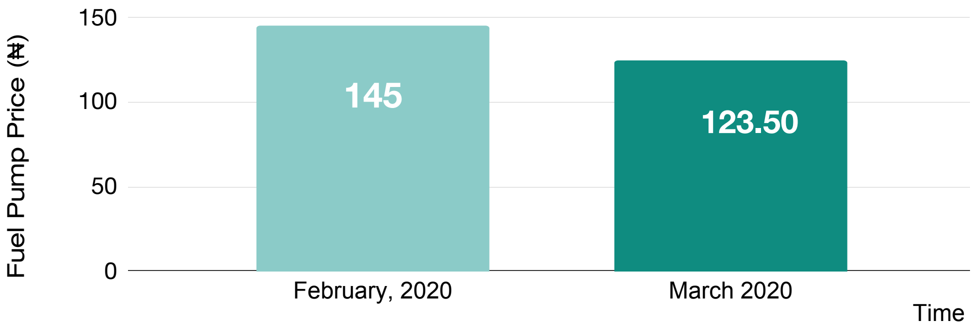
States	Average Monthly recurrent expenditure (N'bn)	Average Monthly Revenue (N'bn)	Recurent Surplus / Deficit (N'bn)
Lagos	16.65	38.12	21.46
Rivers	11.03	19.24	8.21
AkwaIbom	9.41	14.68	5.28
Kano	6.59	9.5	2.91
Kaduna	4.8	6.88	2.08
Cross River	3.13	5	1.88
Anambra	3.63	5.11	1.47
Imo	3.66	5.08	1.42
Ogun	8.31	9.63	1.32
Kebbi	2.93	4.02	1.09
Enugu	4.33	5.4	1.07
Ebonyi	2.5	3.56	1.06
Nasarawa	3.49	4.05	0.55
Katsina	4.68	5.16	0.48
Borno	4.05	4.5	0.46
Zamfara	3.35	3.79	0.44
Yobe	3.32	3.71	0.39
Sokoto	4.84	4.97	0.13
Edo	6.22	6.33	0.11
Bayelsa	11.46	11.38	-0.09
Benue	4.86	4.62	-0.24
Jigawa	5	4.75	-0.24
Bauchi	4.93	4.6	-0.33
Delta	16.74	16.22	-0.53
Niger	5.16	4.57	-0.6
Gombe	4.44	3.73	-0.7
Ekiti	5.09	4.14	-0.95
Kwara	5.87	4.79	-1.09
Taraba	5.04	3.87	-1.17
Osun	5.45	4.23	-1.21
Abia	6.44	4.98	-1.46
Adamawa	5.59	4	-1.59
Ondo	7.45	5.81	-1.64
Plateau	6.26	4.53	-1.73
Oyo	8.41	6.22	-2.19
Kogi	7.42	4.66	-2.75

Source: BudgIT Research based on States' 2017 Financial Reports

7. Decrease in Fuel Prices & Cost-Push Inflation

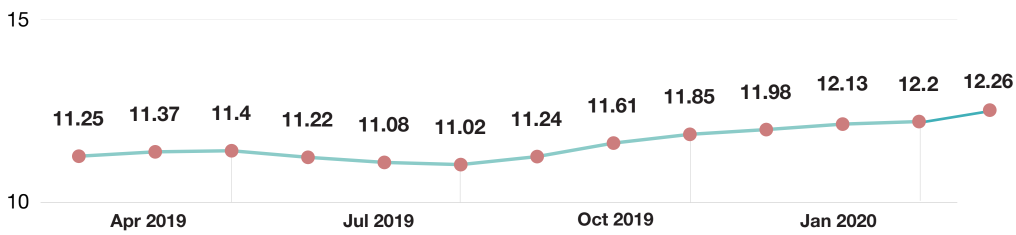
Nigeria has gone through reductions of fuel prices in the last two weeks and it signals that price adjustments will be made. However, while this might have an immediate effect on cost of living, other items that are imported will suffer increased prices due to exchange rate effect leading to inflation continuously at double-digit. Nigeria's inflation rate for March at 12.26% remains the highest in 23 months and this will be interesting to watch as the effect of currency devaluation and slump in domestic demand occur.

Fuel Pump (PMS) Price



Source: BudgIT, Newspapers

Inflation Rate Nigeria YoY (%)



Source: NBS

Policy Response

We are are of the opinion that requesting for rapid cuts in cost of governance or optimizing for efficiency cannot be solely about cuts in overhead cost

A review of the government options shows there is an interest on the CBN to delay payment of private sector debt, expand N50bn funding for hotels, aviation and MSMEs, restructuring of loans in agriculture and manufacturing and N500bn fund for health services and products.

FG plans to borrow $7bn from multilateral funders and has revised its oil production targets to 1.7m barrels per day and also benchmark price to $30 per barrel. The fundamental question here is to look into the cost of governance and analyse where changes can be made. We are of the opinion that requesting for rapid cuts in cost of governance or optimizing for efficiency cannot be solely about cuts in overhead cost. It is important to interrogate what constitutes government spending. Based on the 2018 Actual spending, 38% of total spending is used for payment of salaries, 40% for debt servicing and 8% for overhead. Directly asking for cuts in overheads might not result in significant changes, but it is important to take a surgical look at elements in the other approaches that might optimize public revenues.

	2018 Actual Spending	Projected 2020 Actual Spending
Statutory Transfers	456	400
Personnel Costs	2090	2500
Pensions	197	300
Overhead Costs	177	150
Special Interventions Programs	144	200
Special Accounts	303	-
Other Service Wide Votes	324	350
Debt	2161	2,700
Recurrent Expenditure	5396	6,600

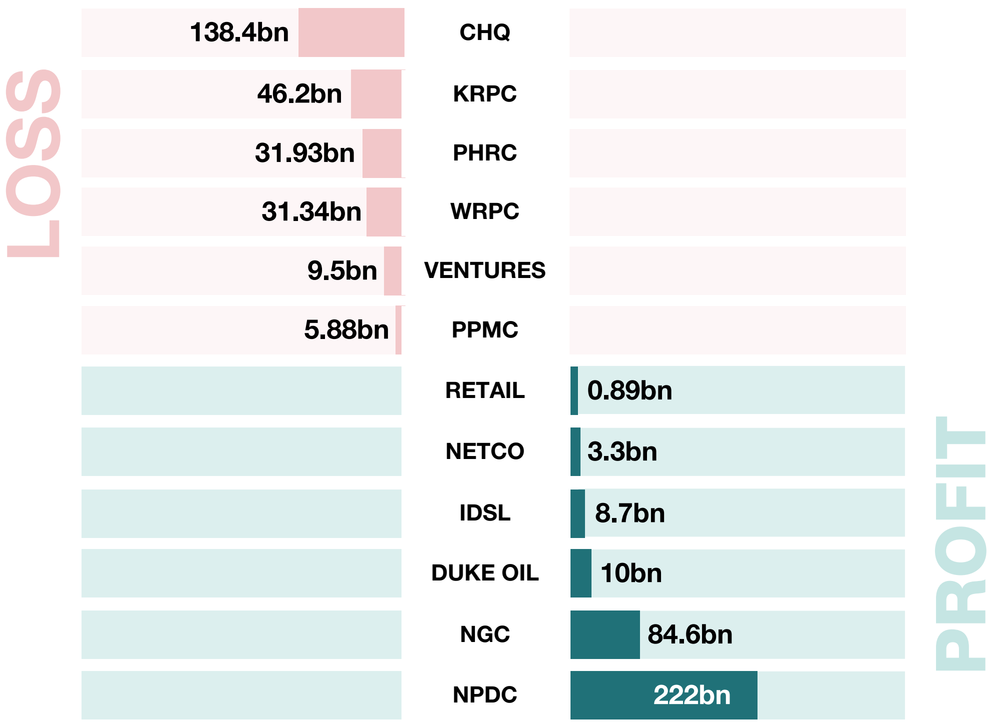
Source: BudgIT, Budget Office of the Federation

10 Policy Options in COVID-19 Environment

1. Unbundling NNPC

Nigeria's State oil company, NNPC, should be an asset to the country but its perennial issues and recent financials show that it might be a liability. Until 2019, NNPC has run at a loss to the Nigerian federation. The refineries and its high cost of corporate headquarters have caused a huge drawback in the healthy financials of the organization. With a low-resourced environment, Nigeria cannot afford NNPC to bleed the nation. It needs to capture the benefits of NNPC subsidiaries such as NPDC (upstream), Duke Oil, Nigeria Gas Company and Integrated Data Services Limited. This is the time to shut down the refineries and also apply organizational review of NNPC operational costs.

2019 NNPC Subsidiary Performance (NGN)



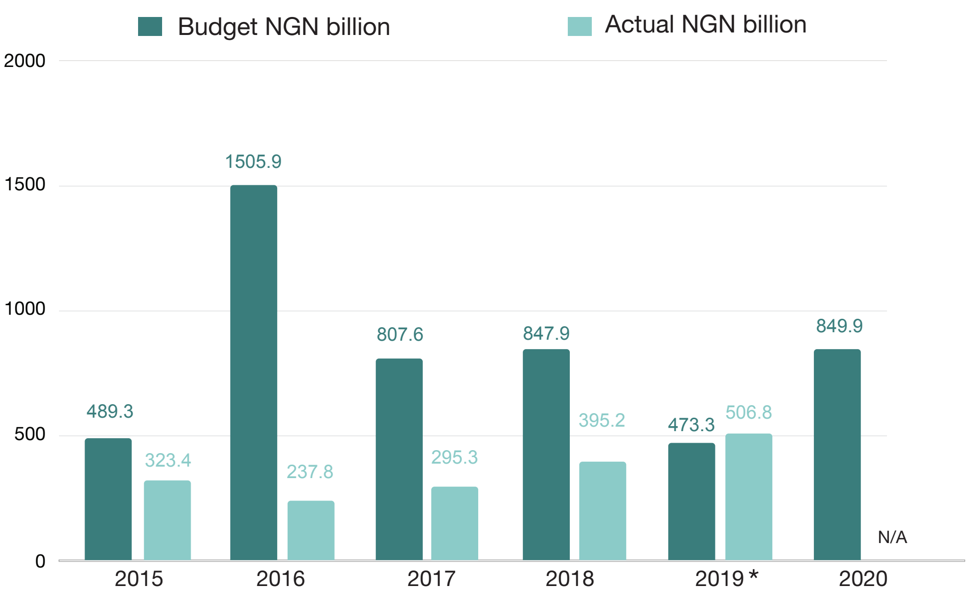
Source: NNPC Operations and Financial Report

Corporate Headquarters (CHQ), Kaduna Refining and Petrochemical Company (KRPC), Port Harcourt Refining Company (PHRC), Warri Refining & Petrochemical Company (WRPC), Petroleum Products Marketing Company (PPMC), National Engineering & Technical Company Limited (NETCO), Integrated Data Services Limited (IDSL), Nigerian Gas Company Limited (NGC), Nigerian Petroleum Development Company Ltd (NPDC)

2. Optimise Independent Revenue Agencies

There is a need to apply immense efficiency to the Ministries, Departments and Agencies under the government which are projected to gulp over N5.3tn in 2020. The Federal Government also needs to review the activities of other independent revenue agencies to ensure that they are optimized to provide resources for the government. The Fiscal Responsibility Act requires agencies to submit 80% of their operating surplus but this will not be optimized with a critical review of costs. FG independent revenue agencies provided N506bn in revenues to FG as at Q3 2019 but can do better through reining in their operational costs and disparate salaries.

Budgeted and Actual Independent Revenue (2015 - 2020)

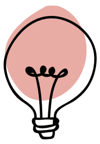


Source: Budget Office of the Federation

*Jan - Sept 2019

3. Rationalisation of Service Wide Votes and other Ad-Hoc spending

Beyond the spending made by ministries which would need a strong prioritization framework, the Nigerian government needs to look at service wide votes such as payment for SDG programmes, Social Investment Programs, Severance Payments, Presidential Amnesty program, Constituency Projects and other spending lines that have no public accountability with respect to funds usage. This classification of projects costs the FG around N500bn in 2018 and it is important to adequately review the impact of these funds.

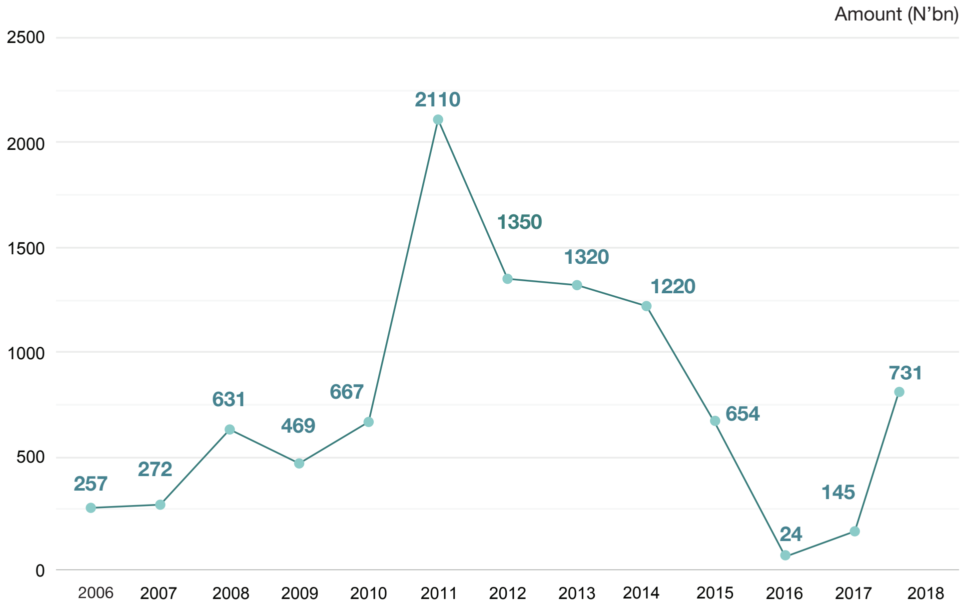


Subsidy has gulped over N10tn in the last thirteen years and these funds could have been used to boost social infrastructure especially health and education infrastructure.

4. Permanent removal of Subsidy under managed framework

While there has been strong resistance in the past for the removal of fuel subsidy, we believe it is high time the Federal Government provided a policy guide on how subsidy/under-recovery will be managed on an ongoing basis. Subsidy has gulped over N10tn in the last thirteen years and these funds could have been used to boost social infrastructure especially health and education infrastructure. This is the time to build civic trust by removing subsidy and applying reform mechanisms such as the unbundling of NNPC and passage of the Petroleum Industry Bill.

13- Year breakdown of Nigeria's oil expenditure on petrol import subsidy (NGN)



Source: Source: PPPRA, Daily Trust

5. Drastic cut in overheads/administrative capital items and prioritization of spending

The combination of the Ministry of Finance together with Budget and Planning provides a genuine opportunity to prioritize public spending for critical elements such as education, health, public welfare and security. The Federal Government needs a tighter grasp on executed projects in Nigeria with rigorous evaluation for efficiency. The Federal Government needs defined metrics to prioritize projects and needs to communicate such to the MDAs. A 25% cut in overhead spending is proposed across all agencies and drastic cut in administrative capital items of cars, photocopy machines, rehabilitation of offices and other elements should kick in.

We also believe that in the interest of Nigeria's fiscal status, there is a need to consider rationalisation of FG staff in the medium term to limit the size of its (especially top-heavy) workforce to mainly essential services and allow injection of young minds into the civil service. It is also pertinent to know that FG budgeted for over 2,000 capital projects and has usually spread its expenditure in multiple inefficient ways, creating several uncompleted projects. In the short term, the Federal Government should streamline its capital projects with a focus on items that are tied to clear economic development, ease for private sector growth and job creation under a priority mechanism defined by the Ministry of Finance, Budget and National Planning.

It is also pertinent to know that FG budgeted for over 2,000 capital projects and has usually spread its expenditure in multiple inefficient ways, creating several uncompleted projects.

6. Shaving Costs for statutory agencies with commitments for transparency

Nigeria budgets N560bn for statutory agencies in the 2020 Budget but there is no breakdown of the items that constitute the huge funds paid to agencies such as the National Assembly, National Judicial Council, Independent National Electoral Commission and others. These agencies need to be more efficient and also accept cuts and application of efficiency to their operations. Paying funds into "opaque structures" in an environment where public funds are limited due to the current crash in oil revenues can no longer be business as usual.

2020 Budget: Statutory Transfers

Statutory Transfer (N'bn)	
National Judicial Council	110,000,000,000
Niger Delta Development Commission	80,881,610,074
National Assembly	128,000,000,000
Public Complaints Commission	4,700,000,000
Independent National Electoral Commission	40,000,000,000
National Human Rights Commission	2,500,000,000
North East Development Commission	38,101,783,432

Source: Budget Office of Federation Table excludes Universal Basic Education & Basic Healthcare Fund

7. Rethinking Pension Funds & PPPs for Infrastructure

Since its formation in 2015, The government led by President Buhari has prioritized funding infrastructure and 36% of capital expenditure directly by MDAs are managed by Ministries of Power, Work and Housing and Transportation. It is pertinent that FG realizes that it would not be able to access capital funds to complete several projects such as expressways, railways and others without ballooning debt. FG has to think about building a viable framework for infrastructure through participation of the private sector and use of long-term pension funds under a transparent and accountable framework. This is the period to fix policy constraints that inhibit the ability of Nigeria to attract sticky foreign capital inflows.

8. Restructure External debts

Recently, Nigeria has shown interest in taking external debt though it was severely warned about the exchange rate risk of such adventure. While it might be difficult to defer payments on its Eurobond payments, Nigeria can reach agreements with multilateral funders such the World Bank, the Chinese and other financial institutions in deferring its payments. Nigeria needs to find a mechanism to reduce its debt service costs which are expected to reach N3tn by 2021 with the recent currency devaluation.

External Debt in millions of USD	
Year	**Debt stock**
2015	10,718.43
2016	11,406.28
2017	18,913.44
2018	25,274.36
2019	27,676.14

Source: Debt Management Office (DMO)

9. Align Donor Funding Policy to National Priorities

Though funding from donor partners (N36bn in 2020 budget) might seem relatively insignificant to the Nigerian budget, it is important that Nigeria develop a solid Overseas Development Assistance framework to tailor international support to priority areas such as education, poverty alleviation, institutional building, health and also social welfarism. It is crucial for Nigeria to channel funding ideas that can strengthen its governance systems and also improve Nigeria's productivity.

10. Support for sub-national governments linked to productivity

The Federal Government mostly tends to provide support to states during slump in public revenues and such funds are mainly used for payment of salaries. This approach does not incentivize productivity as most states in Nigeria are increasingly dependent on central revenues. Out of the 36 states in Nigeria, at least 22 states will face severe liquidity issues, which means without central revenues they are unable to meet obligations. Nigerian states need to become productive centers with viable enterprises that contribute to the national treasury in form of taxes and other payments. Support for the state government should pay attention to this and not just solely for payment of salaries.

End Note

It is critical to note, that the way out of Nigeria's fiscal challenge can not be solely about optimising existing channels. The Nigerian government has to expand export opportunities especially for the non-oil sector, properly capture citizen data to optimise tax collections and provide a friendly atmosphere for the private sector to thrive. This is a time of utmost efficiency, prioritization of public expenditure and quick policy response as the country will need all its resources to stimulate growth. Beyond the constraints of the fiscal authorities, institutions such as the CBN will also provide support to the Nigerian environment in a managed manner that does not incentivise waste or crowd out intervention by the private sector especially financial institutions. While Nigeria like its peers might resort to "ways and means" due to the current precarious situation to meet its recurrent bills, it must understand that developing an inclusive growth strategy, fixing productivity (infrastructure and human) challenges, easing non-oil export routes and being investment-ready are the important ways to fix Nigeria's perennial challenges.

Recovery in post-COVID-19 environment would only be sustainable if it targets the growth of the private sector with the Nigerian government providing support with investments in social welfare, education, health and security.

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