

The Role of Fiscal Policy in Promoting Growth

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Background-Motivation

- Recent developments in shale oil and gas in the U.S.A. and the future of oil.
- Establishment of SWF—NSIA
- Continued large infrastructure deficit

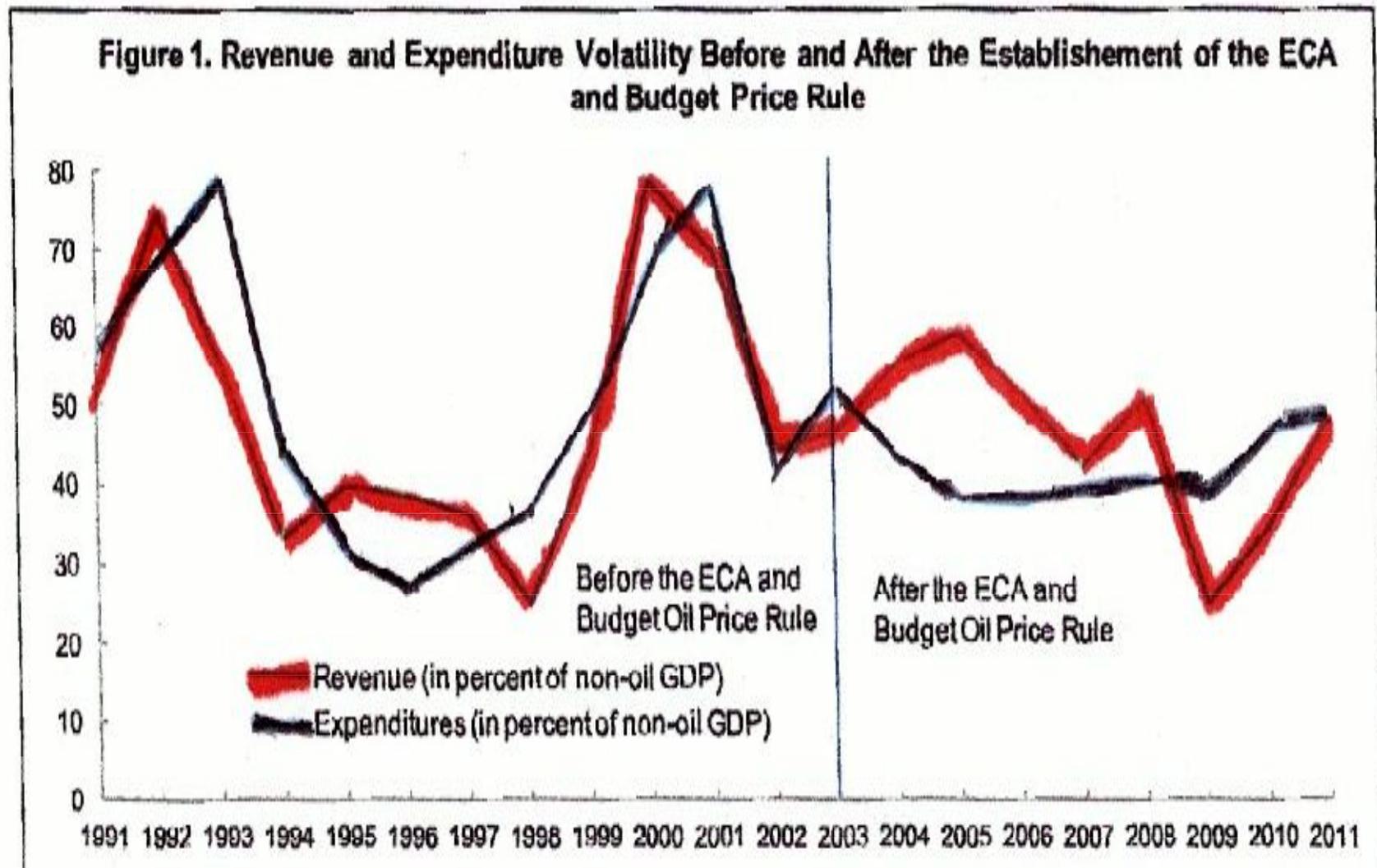
Structure of presentation

- Introduction: How does fiscal policy influence growth:
 - macro-stability and sustainability
 - incentives and disincentives through taxes
 - Service delivery and infrastructure support
- Review of Nigeria's experience with fiscal policy
- Challenges to current system
- Towards a more growth-promoting fiscal policy

Recent experience with fiscal policy

- Prior to 2004 fiscal policy was pro-cyclical subjecting the economy to boom-bust cycles
- During 2004-2008 , with oil price-based rule and ECA, economy stabilized and inflation fell.
- In 2009 and 2010 external shock and large spending expansion resulted in high budget deficits and depletion of ECA
- Since 2012, fiscal policy has been tightened.

Revenue and Expenditure



Current Fiscal Policy Framework

- Oil and gas revenue constitutes over 75% of total revenue. FG has little oversight over half of these receipts which are allocated to SLGs.
- Non-oil revenue consists of company income tax, customs and excise duties, and VAT; tax base is narrow.
- Oil revenue reached 47 % of non-oil GDP in 2010 (16% of total GDP) and about 46% in 2011.

Fiscal Anchor

- How is fiscal policy determined?
 - A budget oil price is negotiated between the Executive and Legislature; according to the 2007 FRA:
 - **“Reference Commodity Price” means such price as may be determined by the President subject to the approval of the National Assembly.”**
 - A 3% of GDP deficit ceiling and a debt ceiling of 25 % of GDP are applied, consistent with the FRA.

Fiscal anchor

- There are several difficulties with the current fiscal anchor:
 - The negotiated budget oil price is not rule based and can result in a highly expansionary fiscal policy--i.e., 2009 when the (estimated) consolidated fiscal balance moved from a surplus of 6 % to a deficit of 9% of GDP!
 - Since its inception in 2004 the reference oil price has risen from 22.5 to 75 dpb in 2013.

Fiscal anchor

- The 3% deficit-to-GDP ceiling in the FRA is “indicative” and not binding:
 - “Aggregate expenditure and the aggregate amount appropriated by the National Assembly for each financial year shall not be more than the estimated aggregate revenue plus a deficit, not exceeding three per cent of the estimated Gross Domestic Product **or any sustainable percentage as may be determined by the national Assembly for each financial year.**”

Fiscal anchor

- While the FG may exercise prudence it has limited say on the fiscal stance of SLG and hence on the overall fiscal position of the consolidated government.
- Data on the FG budget but no data on budgets of all SLGs, hence no easy way to analyze the fiscal stance of the consolidated budget.

SWF—Nigeria Sovereign Investment Authority (NSIA)

- FRA is being strengthened by SWF, or NSIA.
- NSIA is owned jointly by the three tiers of government.
- NSIA has three components with 20 % each:
 - Stabilization fund
 - Infrastructure fund
 - Inter-generation saving fund

SWF--NSIA

- NSIA's governing board has discretion to allocate remaining 40% among three funds.
- New system makes it more difficult to have ad hoc withdrawals.
- Act does not specify what mechanism will be used to determine how much revenue is allocated to NSIA nor does it specify how fund is consolidated with budget.

Fiscal Rules – country examples

- Oil price-based rule can help reduce revenue volatility
- Several resource rich countries have used price-based rules in which the price is determined by a formula:
 - Mexico uses a weighted-average of 10-year historical price (25%); short-term futures price (50% multiplied by 0.84 for prudence); and medium-term futures price (25%).

Fiscal rules-country examples

- Ghana uses a 7-year moving average that includes 3 years of price projections.
- Chile has set up a committee of independent experts who determine the reference price of copper.

Oil-price based rule

- The oil price-based rule can be supplemented by an expenditure growth rule—limit spending growth in nominal or real terms, or as a percent of non-oil GDP. This would set limits to expenditure growth and help contain pro-cyclicality.

Fiscal Rules: oil-price based rule

- Oil-price based rule is easy to explain to policy makers and the public.
- However, a price-based rule does not offer direct link to sustainability and might not address intergenerational equity issues directly.
- In oil-based economies deciding on tradeoff between consuming now and saving and investing for future generations is critical.

Fiscal policy framework

- Main focus in short to medium term should be on managing revenue volatility and avoiding fiscal pro-cyclicality.
- Exhaustibility of oil and gas raises issues of sustainability and intergenerational equity.
- This calls for smoothing government consumption over time and avoiding massive fiscal adjustment once resource wealth has been depleted.

Macro stability and fiscal sustainability

- To help underpin fiscal policy the non-oil primary balance (NOPB) could ideally serve as the fiscal anchor.
- NOPB is defined as non-oil revenue less total non-oil spending, excluding interest payments on public debt.
- NOPB identifies the impact of government operations on domestic demand, since oil revenue originates from abroad.

Nigeria – Fiscal indicators

	2009	2010	2011	2012
FG overall balance (% of GDP)	-4.2	-5.9	-4.0	-3.3
CG overall balance (% of GDP)	-9.4	-7.7	-0.2	0.3
NOPB (% of non-oil GDP)	-27.2	-34.6	-32.9	-27.9

Sources: IMF estimates

How to set the non-oil primary balance

- The Permanent Income Hypothesis (PIH) approach suggests that net financial wealth is preserved when the present value of oil revenue is equal to the present value of future NOPBs.

NOPB

- PIH can be used to derive the sustainable NOPB in one of two ways:
 - Derived at a level that is equal to the real rate of return on the accumulated financial assets—“bird at hand approach”.
 - Derived at a level consistent with the sum of the present value of the oil wealth under ground—the “virtual financial wealth” and the accumulated financial assets.

Norway's Non-oil balance

- Budget Balance Rule (since 2001): Non-oil structural deficit of the central government should equal the long-run real return of the Government Pension Fund - Global (GPF) assumed to be 4 percent.
- The fiscal guidelines, which also govern the GPF, allow temporary deviations from the rule over the business cycle and in the event of extraordinary changes in the value of GPF.

Non-oil Revenue

- Should oil-based economies impose non-oil taxes?
- Most taxes create distortions and disincentives to saving and investment
- Government spending is inefficient: what do taxpayers get in return by way of service delivery

Non-oil revenue

- A means of diversifying the revenue base and enhancing macro stability and fiscal sustainability.
- Could enhance government accountability-- the need to establish better links between the pain of paying taxes and the enjoyment of public services
- Lead to improving the management and quality of spending which can further bolster compliance with the tax system.

Scaling up

- The PIH approach can be modified to allow for scaling up of public investment.
- Instead of preserving financial wealth over time, financial assets can be drawn down for a few years to allow for investment with a high rate of return.
- This assumes that the scaling up of investment will result in higher physical capital stock and higher GDP growth which will increase non-oil revenue, which will in turn strengthen the NOPB.

Capital spending

- It is important that the NSIA be integrated into the budget and in particular the Infrastructure Fund.
- Such integration is critical for the stabilization function of the NSIA—cannot save and sterilize and then come around and spend.
- Scaling up of public investment has potential growth benefits but rapid expansion risks resource misuse, higher costs and Dutch disease.
- Physical capital stock needs to be maintained and appropriate budgeting for maintenance is essential.

A recent World Bank study on Nigeria's infrastructure

- Power sector's operational efficiency and cost recovery are among the weakest in Africa;
- Water and sanitation sector suffers from low and declining levels of piped water coverage;
- Road networks are in poor condition from lack of maintenance.

Nigeria's infrastructure

- Raising Nigeria's infrastructure endowment to that of the region's middle-income countries could **boost annual growth by around 4 percentage points!**
- Addressing the country's infrastructure challenge will require sustained spending of some \$14 billion (\$10.5 billion by the FG) per annum over the next decade.
- Nigeria currently spends (FG) about \$6 billion.

Nigeria's infrastructure

- Additional finding could be obtained from PPPs, FDI, and tapping the domestic market.
- WB simulations show that if additional funding cannot be obtained, the 10-year time horizon will have to be extended to 16 years.
- There is a pressing need to improve the efficiency of infrastructure projects: Current execution remains weak due to capacity constraints but also abuse.

Issues for discussion

- How should Nigeria strengthen effectiveness of fiscal policy and its growth orientation:
 - maintain the price-based rule or target NOPB?
 - Should an effort be made to compile CG data?
 - How should intergenerational equity and fiscal sustainability issues be dealt with?
 - How should the NSIA be linked to the budget?
 - What should be the role of non-oil revenue?
 - How should infrastructure projects be managed?

Thank You