RECOMMENDATIONS ON THE 2023-2025 MEDIUM TERM EXPENDITURE FRAMEWORK AND FISCAL STRATEGY PAPER

TABLE OF CONTENTS

BACKGROUND

In every economic challenge, threat or weakness, lies an opportunity for a reset, a new beginning that learns from the experience, to build back better, to formulate and implement new policies and, to implement extant but neglected policies that effectively respond to the challenges. Nigeria's current economic situation is no exception to this hypothesis. The Nigerian economy is bound to improve if appropriate policy frameworks are introduced and a whole of society approach is brought to bear in policy formulation and implementation.

In the last seven and half years, Nigeria has experienced two recessions and its GDP growth has averaged less than 1.5% while population growth has averaged 2.5% per annum. Poverty has increased with the number of poor Nigerians totaling 95.1million. Virtually all the macroeconomic indicators are headed south. The headline inflation rate in August 2022 was 20.52% while the food index stood at 23.12%. There have been several factory closures and the unemployment rate at 33.3% is an all-time high while youth unemployment stands at 42.5%. The multiple naira exchange rates have further depreciated in the last couple of months. There is a wide gulf between the official exchange rate which hovers between N415 to N420 to the $USD and the street value in excess of N710 to the USD. This provides the opportunity for a rent arbitrage of N300 per USD.

Nigeria's total public debt portfolio as at June 30th 2022 stood at N42.845trillion ($103.312billion). This excludes the N20trillion in Ways and Means financing which (the Federal Government is converting into a long-term debt) when added to the portfolio brings the total to N62.845trillion ($151.538billion). For the very first time, FGN's debt service of N1.910trillion exceeded retained revenue of N1.6trillion as at April 2022. The FGN borrowed N310billion to augment retained revenue to service debts. The debt service scenario also implies that FGN borrowed to meet personnel, overhead and capital expenditure. The external reserves are depleting and FGN is unable to meet the foreign exchange demands of businesses as epitomized in ticket sales of foreign airlines stuck in the Naira.

Furthermore, Nigeria has been unable to take advantage of the high energy prices occasioned by the Russia-Ukraine War. This has increased revenue from oil sales from the projected $73 per barrel to the average of $103 per barrel recorded in the first four months of the year 2022. However, Nigeria was unable to meet its OPEC production quota of 1.8million bpd. It only produced 1.32mbpd between January to April while losing more than 400,000bpd to oil theft. As at August 2022, Nigeria produced less than 1mbpd of crude oil. At the same time, petroleum motor spirit subsidies have exceeded appropriation and have reached unsustainable levels that will exceed N4trillion by the end of the year 2022. The NNPC which hitherto contributed a large share of the Federation's revenue has stopped contributions in the last eight months. By its latest conversion to a commercialized firm, the contributions are bound to reduce in the medium term.

The foregoing scenario is compounded by a security crisis where terrorists, insurgents and bandits hold sway. This has created a negative climate that impairs the blossoming of economic and social activities. The depreciating food inflation index and the increasing number of out-of-school children, now stated at 18.5million by UNICEF estimates, bears this out. The COVID-19 pandemic and fallouts of the Russia-Ukraine War have also contributed to this poor state of the economy. A lot of leakages are still recorded in the fiscal system and this includes leakages in operating surpluses of Government Owned Enterprises (GOEs), mismanagement of special funds, and outright theft of public funds, etc.

KEY ISSUES REQUIRING URGENT ATTENTION

1. FUEL CONSUMPTION AND SUBSIDY

1.1 Fuel Consumption

The official position is that subsidy has ballooned from 35 million litres a day in the year 2015 to the present 65 million litres. The ballooning subsidy claim is not supportable by empirical evidence. Since 2015, Nigeria has passed through two recessions, unprecedented insecurity that has negatively impacted economic activities, massive factory closures, and the highest unemployment rate since independence. Energy consumption is inextricably linked to economic activities and growth.

Recommendations

- FGN should conduct an open and transparent public inquiry to determine the actual PMS consumption, on the basis of which a final subsidy decision will be made. There is prima facie evidence to indicate that the figures churned out by NNPC limited are inflated.

1.2 Fuel Subsidy

The current daily bill for subsidy is N18.4billion. Two fuel subsidy scenarios are presented in the fiscal framework of the MTEF 2023-2025:

> *Scenario 1 - the Business-as-Usual scenario: This assumes that the subsidy on PMS, estimated at N6.72 trillion for the full year 2023, will remain and be fully provided for.*
>
> *Scenario 2 – the Reform scenario: This assumes that petrol subsidy will remain up to mid-2023 based on the 18-month extension announced early 2021, in which case only N3.36 trillion will be provided for.*

The first scenario is not sustainable considering our level of indebtedness and the proposal for a deficit of N11.3 trillion. At the proposed exchange rate of N435.57 to 1USD, this is $15.428billion. This sum is sufficient to build a 500,000bpd refinery.

The second scenario is a refusal of the current administration to take responsibility for hard decisions needed to address fiscal challenges. It seeks to postpone decision-making on fuel subsidy to the next administration. Paying subsidy until mid-year 2023 means incurring 50% of the subsidy in scenario 1, which is the sum of $7.714billion or N3.360trillion.

Recommendations

- Start the process of gradual/phased subsidy removal over a period of two years. Remove 50% in the first year and the remaining 50% in the second year.

- Engage organized labour, private sector and the public in good faith disclosure and negotiations with relevant information and design a social intervention programme to cushion the hardship in critical sectors like transport, agriculture/food, etc.

- Take steps to conclude the revitalization of existing refineries and thereafter run them efficiently. In the alternative, concession or privatise them after the repairs and turn-around maintenance. The proposed private sector participation should be done under a process that is transparent, guarantees value for money and ensures that the firm has technical, financial and managerial capacity to run the refineries. On no account shall a firm taking over the management of the refineries be allowed to engage in asset stripping.

- Transparently support Dangote Refinery to start production at the earliest time.

2. OIL THEFT

About 400,000 barrels of crude oil are lost daily. At the current price of crude oil, this translates to $1.2billion per month and $14.4billion (N6.272trillion) per annum. This sum when brought into account in the books of NNPC Limited will increase its profit and the dividends to be paid to the government. However, from the reports of Nigeria's August 2022 oil production reported at less than 1mbpd, the theft may have escalated beyond 400,000bpd. The publicized Tompolo N4billion a month contract may not solve the challenge. Comparative experience and previous budgetary votes show that technology can be deployed to solve oil theft.

Recommendations

- Reduce oil theft and vandalization to a minimum by holding accountable officers under whose watch industrial-scale oil theft occurs.

- Demand value for money in the Tompolo Pipeline Protect Contract and similar contracts.

- Consider the removal of the leadership of NNPC under whose watch this stealing has escalated. In the alternative, FGN should set clear theft reduction targets for the leadership of NNPC and the security agencies.

- Consider a certification and authentication system – pipeline integrity programme that traces Nigerian crude from the wells to refineries as a means of eradicating oil theft. Lessons can be drawn from the experience of "blood diamonds".

- Activate the real-time online monitoring of pipelines and strategic oil and gas resources paid for in federal budgets between the years 2010 – 2014. If this facility is not available, hold to account individuals and institutions that drew down the appropriated votes without delivering any value.

3. OIL PRICE BENCHMARK

The fiscal projections still include oil price benchmark and oil production (mbpd) at a time NNPC has become a limited liability company and is no longer under obligation to simply sell crude oil and remit the proceeds to the Federation Account for sharing by the three tiers of government. The implication is that it can only remit profits at the end of a year or at agreed intervals. It is acknowledged that the quantum and price of crude oil are very important considerations in the profitability of NNPC Limited. However, the most important consideration is that the profit is not necessarily tied to the price of crude. The company will pay for investments and other business outgoings before it can return a profit. Furthermore, not all profit will be distributed as dividends as the company will be entitled to retain some part of it for future investments.

Recommendation

- The fiscal framework should be reworked based on a forecast of NNPC Limited's profitability over the medium term.

4. TAX EXPENDITURE

Table 1 shows the foregone revenue for the years 2020, 2021, 2022, and projections for 2023 and 2024.

FORGONE TAX REVENUE & ACTUAL REVENUE COLLECTED					
Tax Expenditures (₦ Billion)	**2020**	**2021**	**2022**	**2023**	**2024**
Companies Income Tax	457.00	548.40	658.08	789.70	947.64
Value Added Tax	4,300.00	3,870.00	3,483.00	3,134.70	2,821.20
Custom Duties	600.00	720.00	792.00	871.20	958.32
Petroleum Profits Tax (PPT)	307.00	337.70	371.47	408.62	449.48
Total Forgone Tax Revenue	**5,664.00**	**5,476.10**	**5,304.55**	**5,204.22**	**5,176.64**
Non-Oil Revenue	3,861.81				
Oil Revenue	3,804.96				
Total Actual Revenue	**7,666.77**				

Source: MTEF 2023-2025

Note: This excludes tax credits under the Road Infrastructure Tax Credit Scheme.

Between 2020 to 2022, a total of N16.4trillion was foregone as tax expenditure while FGN and the states continued to pile up debts.

The proposal in 2023 to give away N5.204trillion against a projected revenue of N8.46trillion, while incurring N11.3trillion deficit is difficult to reconcile under fiscal responsibility rules.

S.29 (1) of the Fiscal Responsibility Act (FRA) is titled restriction on the grant of tax relief. It states:

> *Any proposed tax expenditure shall be accompanied by an evaluation of its budgetary and financial implications in the year it becomes effective and in the three subsequent years, and shall only be approved by the Minister, if it does not adversely impair the revenue estimates in the annual budget or if it is accompanied by countervailing measures during the period mentioned in this subsection through revenue increasing measures such as tax rate raises and expansion of the tax base.*

There is no documentation showing evidence of compliance with the provisions of the FRA on these tax expenditures. There is no evidence of an evaluation of their budgetary and financial implications in the years they were granted and in the three subsequent years. These expenditures adversely impaired the revenue estimates and there were no countervailing measures through revenue increases, etc.

Recommendations

- Amend the FRA in the Finance Act 2022 to remove the power to grant tax expenditures from the Minister or the Executive and only place a duty on the Executive to document the recommendations, proposals and justification for tax expenditure subject to the approval of the legislature.

- Cap tax expenditures to not more than 10% of projected revenue every year or within the medium term.

6. INDEPENDENT REVENUE

In Scenario 2 of the fiscal framework referenced under fuel subsidy, it was stated:

> *Additionally, there will be tighter enforcement of the performance management framework for GOEs that will significantly increase operating surplus/dividend remittances in 2023*

Government's investments over the years in GOEs have not been compensated with adequate operating surpluses by the GOEs. Evidence emanating from Auditor-General's reports and legislative hearings by the Public Accounts Committee (PAC) and other committees indicate that revenues accruing from operating surplus of GOEs can be doubled.

Recommendations

- The mandatory use of a Treasury Single Account for all GOE financial transactions as stated in the MTEF and earlier civil society recommendations. Strengthen the administration and management of TSA to ensure that no expenditure and income is recorded outside its system.

- Monthly remittance of interim operating surplus and reconciliation of cumulative remittances after year end should be converted to a monthly deduction by the Accountant General. FGN need not wait for GOE to remit but the platform should be set up in such a manner that facilitates automatic deduction thereby ensuring that the sums due to FGN is not under any circumstance available for GOE expenditure.

- Prosecution and administrative sanctions for unauthorized use of funds due to FGN as operating surplus. This should start from an automatic suspension process for the accounting officer of the GOE.

7. EXCHANGE RATE

The Naira has been depreciating due to low oil sales and revenue, capital flight, restrictive policies, etc. Nigeria's multiple exchange rates demand action for harmonization and convergence or at least steps towards harmonization. The Parallel Market hovers around N710; Investors and Exporters window is about N434 while the 2023 budget proposal is N435.57. This creates room for rent-seeking and arbitrage.

Recommendations

- An exchange rate adjustment to close the gap between the official and other exchange rates is imperative.

- Ultimately, increasing productivity and local value addition leading to economic growth and increased exports will shore up the value of the Naira.

8. WASTE AND IMPROPER EXDPENDITURE

Recent reports by the Independent Corrupt Practices and Other Related Offences Commission and a number of Civil Society Organisations show the preponderance of budget padding, frivolous, inappropriate and improper expenditures inserted into the budget. This runs into hundreds of billions of naira every year. Furthermore, there are reports of high level corruption involving huge sums of money.

Recommendations

- National Assembly should open up the budget implementation process and create opportunities for anti-corruption agencies, civil society and all critical stakeholders to contribute to weeding out these padded expenditure proposals before they are passed.

- At the level of implementation, FGN should ensure full implementation of the Public Procurement Act, open contracting and guarantee value for money in all public expenditure.

9. SECTORAL FUNDS

9.1 Health

The poor public funding of the health sector, population increase that outpaces economic growth, and the fiscal crisis have all combined to guarantee poor health indicators and out-of-pocket health expenditure of 70.52%, the highest in Sub Saharan Africa. Full implementation of the National Health Insurance Authority Act to reduce the high-level out-of-pocket health expenditure in Nigeria while moving towards Universal Health Coverage (UHC) is imperative. The high out-of-pocket expenditure has hindered the attainment of the goals of UHC - to ensure that all people have access to quality health services, to safeguard all people from public health risks, and to protect all people from impoverishment due to illness, whether from out-of-pocket payments for health care or loss of income when a household member falls sick.

The National Health Insurance Authority Act 2022 has made health insurance mandatory for every Nigerian and resident of Nigeria and seeks to pool funds for the realization of UHC. Implementing the NHIA Act will create a large pool of funds for the realization of the highest attainable standard of physical and mental health.

Recommendations

- The President should constitute the Governing Council of the Board of National Health Insurance Authority.

- The Governing Council should take policy steps to ensure that the mandatory health insurance scheme is activated viz, policy frameworks, implementation strategies, sensitization, education and awareness creation and enforcement mechanisms at the next stage of the campaign.

- FGN should immediately activate the Vulnerable Group Fund

- Considering that the increased taxes on Cigarettes, Tobacco and Alcoholic beverages are justified by reference to the health dangers of (over) consumption, it is pertinent that the accruing revenue be targeted to the health sector especially, the Vulnerable Group Fund to be used in paying the premiums of the poorest of the poor and vulnerable.

9.2 Housing

The National Housing Fund is established inter alia to facilitate the mobilization of the funds for the provision of houses for Nigerians at affordable prices; ensure the constant supply of loans to Nigerians for the purpose of building, purchasing and improvement of residential houses; encourage the development of specific programmes that would ensure effective financing of housing development, in particular, low-cost housing for low-income workers; and provide long-term loans to mortgage institutions for on-lending to contributors to the Fund.

Despite the deductions from workers' salaries, the Fund has been treated as a slush fund by FGN. Less than 2% of contributors have accessed facilities under the Fund.

Recommendations

- Reorganize the management of the Fund to guarantee that contributors benefit from the Fund.

- Increase the financial resources of the Fund.

10. RESTORE SECURITY

Insecurity has negatively impacted on economic growth, value addition, business and investment climate, job creation and the overall welfare of Nigerians. Banditry, insurgency, herder's disruption of farming, etc., has not only led to economic losses but also loss of lives. Restoring security will facilitate an increase in food production and agriculture's contribution to GDP thereby reducing the contribution of the food index to the overall inflationary pressure.

Recommendations

- Deploy kinetic and hardcore military power to engage terrorists and insurgents.

- Deploy soft power- de-radicalization, negotiations, job creation, etc., to get participants out of criminal dispositions.

- Implement law reforms for state and local policing. Ensure that states vote in favour of the constitutional amendment to create state police.

11. DIASPORA RESOURCES

Nigeria's large Diaspora community is an asset waiting to be tapped as a source of investments that will grow the economy, create jobs and shore up the value of the naira. Diaspora remittances in 2020 were $17.21billion and rose by 11.2% to $19.2billion in 2021. The bulk of the remittance is for welfare and to support families back home which is distinct from capital investments.

Nigeria is in dire need of investments (foreign or local) for its critical sectors in energy, infrastructure, etc. Whilst pursuing foreign investors, Nigeria needs to target its highly skilled and top-earning migrants as sources of investment funding. This may reduce the quantum of resources that FGN and states need to borrow.

Recommendations

- Design a coherent policy framework for the harnessing of Diaspora remittances for investment.
- Create transparent platforms and special purpose vehicles to harness the resources of the Diaspora community for investments at home.
- Create Special Purpose Vehicles for pooling funds where funds to be contributed by interested members of the Diaspora may be a bit lower than the minimum acceptable to international investing firms.
- Facilitate investments in medium and small-scale enterprises from Diaspora funds.

12. DEBT

Nigeria's outstanding debts as at the end of June 2022 as reported on the website of the Debt Management Office is N42.845trillion ($103.312billion). This excludes the N20trillion in Ways and Means financing which when added brings the total to N62.845trillion ($151.538billion). With debt service requirements exceeding FGN retained revenue in the first four months of 2022 and a 2023 proposal of N6.663trillion (debt service and sinking funds) against projected revenue of N8.46trillion, it is imperative to review the debt accumulation procedure and rules.

Recommendations

- A moratorium on new debts except there are exceptional circumstances justifying the new debt and this should be in accordance with the provisions of the FRA.
- Set a debt ceiling in accordance with S.42 of the Fiscal Responsibility Act. This ceiling should be defined in the relationship of debt to revenue.

- It is imperative to redefine the purpose of incurring debts in clear terms of debts being for projects that will promote value chain development, improve the macroeconomic framework, develop infrastructure and build strategic human capital. This will imply a deletion of the amendment in the 2021 Finance Act which introduced an omnibus new term called “national interest” as a justification for borrowing.

- To continue borrowing for recurrent expenditure (personnel and overheads) and dilatory capital expenditure that adds no value to economic growth, wealth creation and development is not an option.

- Establish a public review mechanism through which the cost benefit analysis of loans and their implications are ascertained before the Federal or State Governments enters into loan agreements.

13. CONCLUSION AND SUMMARY OF KEY RECOMMENDATIONS

Nigeria can begin to record improved fiscal and economic performance. It is possible if and only if the right policy framework is adopted. The summary of the key recommendations are as follows.

- Stop oil theft. 400,000 barrels of crude oil lost daily - $1.2billion per month and $14.4billion (N6.272trillion) per annum. This sum when brought into account in the books of NNPC Limited will increase its profit and the dividends to be paid to the government.

- Ensure that the reported quantity of PMS consumed every day is not inflated by conducting a transparent consumption audit.

- Cut extant fuel subsidy by 50% and save not less than N3.36 trillion in 2023.

- Reducing the tax expenditure proposal by 90% will free up not less N4trillion revenue.

- Mandatory use of TSA by all GOEs will increase FGN’s independent revenue by not less than N1trillion.

- Set a debt ceiling in accordance with S.42 of the Fiscal Responsibility Act. This ceiling should be defined in the relationship of debt to revenue.

- Redefine the purpose of incurring debts in clear terms of debts being for projects that will promote value chain development, improve the macroeconomic framework, development infrastructure and build strategic human capital.