

POLICY OPTIONS
FOR
MANAGING
MACROECONOMIC VOLATILITY
IN
NIGERIA

Ukwu I. Ukwu
A.W. Obi
S. Ukeje



AFRICAN INSTITUTE FOR APPLIED ECONOMICS

128 Park Avenue, GRA, P.O. Box 2147 Enugu, NIGERIA

Phone: 234 (042) 256035, 300096; Fax: 234 (042) 256035

Email: aiae@infoweb.com.ng; Website: www.aiaeonline.org

AUGUST 2003

POLICY OPTIONS FOR MANAGING MACROECONOMIC VOLATILITY IN NIGERIA

OUTLINE

EXECUTIVE SUMMARY

0 INTRODUCTION

1 THE SIGNIFICANCE OF MACROECONOMIC VOLATILITY FOR GROWTH AND DEVELOPMENT

- (a) The Nature and Significance of Macroeconomic Volatility
- (b) Trends in Nigerian Development
- (c) Patterns of Volatility

2 INSTITUTIONAL ARRANGEMENTS AND POLICIES THAT AMPLIFY THE CONSEQUENCES OF VOLATILITY

- (a) Fiscal Federalism and Budgetary Practices
- (b) Real Exchange Rate Regimes
- (c) Capacity for Medium Term Planning

3 POLICY OPTIONS: SHORT- MEDIUM TERM PROSPECTS

- (a) Monetary Policy
- (b) Prices, Exchange Rate Management
- (c) Public Expenditure Rationalization and Stabilization
- (d) Revenue stabilization

4 POLICY OPTIONS: LONGER-TERM PROSPECTS

- (a) Revenue Diversification and Growth
- (b) Data and Capacity to Plan
- (c) Medium-Term Expenditure Planning Framework
- (d) Re-thinking Fiscal Federalism
- (e) Constitutional Issues

5 CONCLUSIONS AND RECOMMENDATIONS

BIBLIOGRAPHY

POLICY OPTIONS FOR MANAGING MACROECONOMIC VOLATILITY IN NIGERIA

EXECUTIVE SUMMARY

The paper examines the nature, dimensions, sources and consequences of macroeconomic volatility in Nigeria and evaluates policy options for managing volatility. Nigeria is recognised as one of the most volatile economies in the world. This volatility is a major constraint on development, making planning more problematic and investment more risky. A more stable macroeconomic environment would promote long-term planning for sustainable growth and development

The pattern of economic volatility in Nigeria is complex. At the macroeconomic level the very high volatility recorded in real growth rates, price inflation, and private investment per capita, government revenues per capita, terms of trade and real exchange rate closely reflect the movements of oil prices. But patterns of volatility vary among sectors. Patterns of volatility vary among sectors. In terms of GDP the most volatile sectors are Building and Construction, Communication, and Mining; while the least volatile are distribution, transport, and manufacturing. On government expenditure sectoral expenditures is highest for the economic sectors and lowest for the administrative sectors; while public expenditure as percentage share of GDP has been relatively stable

With oil funded public spending as the driving force of the Nigerian economy, fiscal policy and budget management constitute the pivot of macro-economic policy. Major problems include: excessive centralization of resources and powers, to the detriment of sub – national units of government; prevalence of fiscal imbalances both vertically horizontally; and frequent overlapping and non – coordination of expenditure responsibilities among different levels of government. There is need to evaluate the and restructure present fiscal set-up, to ensure fiscal discipline at all levels , as well as to secure greater understanding and cooperation across the different tiers of government.

Exchange rate policy is a key factor in economic management. In an elusive search for a real exchange rate to maintain both internal and external balance, Nigeria has experimented with a succession of exchange rate regimes. The latest experiment, the Dutch Auction System, has recorded significant success, but may soon be superseded with the adoption of a West African currency

Since its beginning in 1946 national development planning in Nigeria has suffered from lack of systematic, integrated and target oriented approach, each plan being essentially a laundry list of projects, some rolled over from the over from the previous ones. Lack of clear vision, transparency and functional cooperation at the political levels, marginalisation of civil society in the planning process, and lack of rigour at the bureaucratic level have severely compromised the quality of the planning. At all levels, of government technical expertise as well as technology and information management systems are very deficient.

The review of policy options considers short-middle term as well as long term prospects. It focuses on monetary policies, prices and exchange rate management, revenue stabilisation, diversification and growth, public expenditure management, and the constitutional and operational problems of fiscal federalism. The main determinant of the stock of money, in Nigeria, has been the consolidated fiscal balance of all levels of government, federal, state and local, which has been in deficit for 80% of the time since 1965..The money supply growth has

contributed to the relative growth of the service sector and the relative decline of the agricultural sector of the economy, contributing to considerable GDP volatility and the incidence of the Dutch Disease phenomenon.

The FGN and most state governments have embarked on programmes to improve public expenditure management by rightsizing and restructuring the public services and privatising public enterprises. The stabilisation of public expenditure is constrained by the lack of harmonisation and coordination of expenditure management by the various tiers of government.

Public revenue in Nigeria is inadequate and unstable. The major cause of revenue volatility is a combination of two factors: the large and unpredictable fluctuations in oil revenue and the large share of oil revenue in total revenue. In the short run efforts should be made to raise more revenue through more effective harvesting of existing sources and more imaginative investigation and development of new ones. In the long run steps should be taken to promote and support increased production and productivity in the various sectors of the economy. The low level of social development and social security is a major constraint to sustainable growth. There is need to enlarge the revenue base through social security taxation in order to provide adequately for the necessary investment in social service delivery.

The paper supports the introduction of a medium term planning and expenditure framework for Nigeria. This requires an appropriate policy and institutional framework which addresses the long-term goals of the nation as determined through a transparent process involving all the legitimate stakeholders, and should be based on a clear strategy and an integrated programme of action. The National Economic Council has a central role to play in this task.

The problem of inadequate, untimely and unreliable data has adversely affected development planning and management. Although there are several institutions at the federal level charged with the production of statistical and survey reports, their performance has been uneven and irregular. The system lacks the capacity to harvest and use the information available at the various agencies and centres of action.

There is need to re-think and restructure fiscal federalism in Nigeria. Under prolonged military rule the principles and practice of fiscal federalism were eroded. Efforts are now being made to re-build the system. Such efforts should include the establishment of mechanisms for coordination and cooperation between FGN and federating sub nationals in such a way as to make it possible to agree on economy - wide macroeconomic objectives and targets, and ways of achieving same. The Constitution itself should be drastically reviewed and refashioned in the light of the needs and expressed wishes of the people.

0 INTRODUCTION

This paper seeks to complement and follow up the very stimulating and useful paper titled, Nigeria: Policy Options for Growth and Stability in a Challenging Environment presented by Addison. It examines the nature, dimensions, sources and consequences of macroeconomic volatility in Nigeria and evaluates policy options for managing volatility. Nigeria is recognised as one of the most volatile economies in the world. This volatility is a major constraint on development, making planning more problematic and investment more risky. A more stable macroeconomic environment would, other things being equal, promote long-term planning for sustainable growth and development.

The paper is organized in five sections. The first section presents an overview of the nature, dimensions, sources and consequences of macroeconomic volatility for growth and development. The second focuses on the institutional arrangements and policy that affect volatility and its consequences. The third section third examines the short and medium term options, and the fourth considers the long-term prospects, in the light of Nigeria's federal structure, constitutional provisions, institutional capacity and other relevant factors. The fifth section presents the conclusions and recommendations.

1 MACROECONOMIC VOLATILITY AND ECONOMIC DEVELOPMENT

The Nature and Significance of Macroeconomic Volatility

1 Macroeconomic volatility refers to a situation of rapid fluctuations in the overall condition and in the critical macroeconomic variables in the economy. Such volatility can be measured on many dimensions. The World Addison paper by Addison¹ has focused on four key variables: real growth rates, price inflation, monetary growth and real GDP in a useful analysis of trends in a large sample of countries around the world. The analysis shows that Nigeria ranks among the top ten most volatile countries for the years 1961 to 2000 for the indicators chosen, except for monetary growth and consumer price inflation. It notes that Nigeria also recorded very high volatility in private investment per capita, government revenues per capita, terms of trade shocks and real exchange rate shocks.

Macroeconomic volatility is a major constraint on development, making planning more problematic and investment more risky. In Nigeria's weak and fragile economy the impact of volatility has been particularly disruptive. A more stable macroeconomic environment would reduce management problems and improve the prospects of realistic planning for sustainable growth and development.

2 But stability is not enough, nor is it always good. In a situation of mass poverty and low productivity, in a situation arising not from lack of resources from failure to recognise, mobilize and manage them effectively, stabilizing the system could bring stagnation or decline rather than growth and development. Stabilizing poverty cannot be an appropriate development objective. Any meaningful strategy for stabilization needs to be built on a platform of structural transformation and growth, or in Robstown's phrasing,² it requires the creation of a viable platform for "take-off into sustained growth." The options for stabilization must be evaluated against this strategic imperative.

3 The questions thus arise: what are the conditions for transformation and growth? How do we attain the platform for growth and stability? This paper will attempt some answers.

Trends in Nigerian Development

4 Comparative analysis of trends across countries reveals contrasting patterns of development and highlights some of the underlying factors in macroeconomic performance. Table 1 summarises the trends in per capita income and life expectancy in the world's largest countries. It shows that relative to other large countries, Nigerian development has been very slow and unsteady. Table 2 compares data on selected development indicators, income indicators and selected finance indicators for the year 2001. It shows that on many dimensions Nigeria remains among the world's least developed countries. It also gives some insight into some of the factors Nigeria's undevelopment. Aspects of these facts will be discussed in greater detail in appropriate chapters. Focusing on Nigeria, Table 3 summarises the trends in selected macroeconomic factors from 1970 to 2000, while Table 4 traces the changing structure of GDP from 1960 to 2002. These statistics highlight not only the high volatility in the major dimensions but also the linkages and interactions among them.

¹ Addison 2002

² Rostow

5 Nigeria's record of development has been very poor. In marked contrast to most developing countries, its GDP was not significantly higher in the year 2000 than it was 35 years before. An examination of the long-term pattern reveals the following secular swings:

1965-1968	Rapid Decline (civil war years)
1969-1971	Revival
1972-1980	Boom
1981-1984	Crash
1985-1991	Renewed Growth
1992-2000	Wobbling

6 Analysis of sectoral contributions to long-term growth indicates that the services sector has been the most consistent, with an average growth rate of 5% per annum. By contrast the performance of the agricultural sector has been highly cyclical: decline (1965-1969); sharp rise (1970-1974); decline (1975-1985); and steady rise (1985-2000). The most significant factor in macroeconomic volatility in Nigeria is of course the petroleum factor. Nigeria provides a classic illustration of the Dutch Disease phenomenon: export revenues fuelling domestic consumption of imports at the expense of domestic production of agriculture and local resource-based products constrained by severe domestic cost inflation. Manufacturing maintained a very low profile throughout the period. Starting from a very low base in 1965, it recorded slow but steady growth between 1965 and 1975, a spurt of growth under heavy public investment between 1977 and 1982, and steady decline since 1983. The services sector is a highly variegated group and the average conceals disparate trends, at one end the exploding financial services sub-sector and at the other the inept and stagnant distribution sub-sector. The level of social services has also declined in recent years. Indeed the neglect of human development remains the most critical constraint on Nigeria's development. Particular notice should be taken of the building and construction sector, which is a good indicator of physical investment. The steady erosion of this sector since the 1990s is a reflection of the neglect, dilapidation and collapse of the nation's physical infrastructure.

Patterns of Volatility

7 We may now examine some of the critical aspects of macroeconomic volatility in Nigeria. Table 5 summarises the correlation coefficients of sector shares of GDP from 1960 to 2000, highlighting the different trends of development across the major sectors. Expectedly, agriculture and mining have moved in diametrically opposite directions as have, rather perversely, mining and transportation. Trends in manufacturing are closely related to trends in utilities, transport and communications. The trends in transport and commerce are also closely similar.

8 Patterns of volatility vary among sectors. In terms of GDP the most volatile sectors are Building and Construction, Communication, and Mining; while the least volatile are distribution, transport, and manufacturing. As Table 7 indicates, volatility of sectoral expenditures is highest for the economic sectors and lowest for the administrative sectors; while public expenditure as percentage share of GDP has been relatively stable.

Table 1 DEVELOPMENT TRENDS IN THE WORLD'S LARGEST COUNTRIES, 1960-2001								
		PER CAPITA GNP (US DOLLARS) AT CURRENT EXCHANGE RATE VALUES						
YEAR		1960	1976	1981	1986	1991	1994	2001
1	Ethiopia	49	100	140	120	120	100	100
2	Bangladesh	NA	110	140	160	220	220	370
3	India	73	150	260	290	330	320	460
4	Nigeria	78	380	870	640	340	280	290
5	China	NA	NA	300	300	370	530	890
6	Pakistan	81	170	350	350	400	430	420
7	Indonesia	NA	240	530	490	610	880	680
8	Egypt	129	280	650	760	610	720	1530
9	Philippines	164	410	790	560	730	950	1050
10	Thailand	NA	380	770	810	1570	2410	1970
11	Turkey	190	990	1540	1110	1780	2500	2540
12	Iran	204	1930	NA	NA	2170	2200	1750
13	Brazil	206	1140	2220	1810	2940	2970	3060
14	Mexico	331	1090	2250	1860	3030	4180	5540
15	Russia	NA	2760	NA	NA	3220	2650	1750
16	U. K.	1358	4040	9110	8870	16550	18340	24230
17	Italy	690	3050	6960	8550	18520	19300	24340
18	France	1336	6550	12190	10720	20380	23420	22690
19	U. S. A.	2804	7890	12820	17680	22240	25880	34870
20	Germany	1323	7380	13450	12080	23650	25580	23700
21	Japan	458	4910	10080	12840	26930	37930	35990
LIFE EXPECTANCY AT BIRTH								
1	Ethiopia	34	38	46	46	48	49	42
2	Bangladesh	39	42	48	50	51	57	61
3	India	42	50	52	57	60	62	63
4	Nigeria	34	41	49	51	52	52	47
5	China	NA	NA	67	69	69	69	70
6	Pakistan	42	51	50	52	59	60	63
7	Indonesia	40	48	54	57	60	63	66
8	Egypt	45	52	57	61	61	62	67
9	Philippines	49	58	63	63	65	65	69
10	Thailand	49	58	63	64	69	69	69
11	Turkey	49	57	62	65	67	67	70
12	Iran	44	51	58	59	65	68	69
13	Brazil	56	61	64	65	66	67	68
14	Mexico	56	63	66	68	70	71	73
15	Russia	68	70	72	70	69	64	65
16	U. K.	70	72	74	75	75	76	77
17	Italy	69	72	74	77	77	78	79
18	France	70	73	76	77	77	78	79
19	U. S. A.	70	71	75	75	76	77	77
20	Germany	69	71	73	75	76	76	77
21	Japan	67	73	77	78	79	79	81

Based on Data from UNDP Human Development Reports and WB World Development Reports

Table 2
NATIONAL INCOME, GOVERNMENT REVENUE, SOCIAL SERVICES INVESTMENT AND HUMAN DEVELOPMENT
IN THE WORLD'S LARGEST COUNTRIES

	DEV INDICATORS					FINANCE INDICATORS				INCOME DISTRIBUTION		
	Per Capita Income US\$ 2001 (nominal)	Per Capita Income US\$ 2001 (PPP)	Life Expectancy at Birth (years)	Under 5 Mortality Rate	Adult Illiteracy	Current Tax Revenue as % of GDP	Current Non-Tax Revenue as % of GDP	Social Services as % of Govt Expenditure	Subsidies and Current Transfers as % of Govt Expenditure	Gini Index of Income Inequality	Share of Lowest 20% of Population in National Income	Share of Highest 20% of Population in National Income
China	890	4260	70	39	16	5.7	0	2.5	na	40.3	5.9	46.6
India	460	2450	63	88	43	8.6	3	9.2	40	37.8	8.1	46.1
United States	34870	34780	77	9	0	20.4	1.4	53.8	60	40.8	5.2	46.4
Indonesia	680	2940	66	51	13	15.6	1.2	26.2	36	37.8	8.1	46.1
Brazil	3060	7450	68	39	15	19	3.7	33	39	60	2.5	63.8
Russia	1750	8660	65	19	0	na	na	na	49	48.7	4.4	53.7
Pakistan	420	1920	63	110	57	12.6	3.3	na	8	31.2	9.5	41.1
Bangladesh	370	1680	61	83	59	na	na	na	0	33.6	8.7	42.8
Nigeria	290	830	47	153	36	na	na	na	0	50.6	4.4	55.7
Japan	35990	27430	81	5	0	13.7	0.8	52	54	24.9	10.6	35.7
Mexico	2098	8770	73	36	9	13	1.7	48.1	51	53.7	3.6	58.2
Germany	23700	25530	77	6	0	26.6	5.1	69.8	58	30	8.2	38.5
Vietnam	410	2130	69	34	7	15.8	2.4	30.5	0	36.1	8	44.5
Philippines	1050	4360	69	39	5	17	2	26.5	18	46.2	5.4	52.3
Turkey	2540	6640	70	43	15	19.1	2.8	25.7	29	41.5	5.8	47.7
Ethiopia	100	710	42	179	61	12.2	5.1	21.6	9	40	7.1	47.7
Egypt	1530	3790	67	52	45	16.6	9.7	23.6	15	28.9	9.8	39
Iran	1750	6230	69	41	24	11.2	15	41.8	14	na	na	na
Thailand	1970	6550	69	33	5	14.4	1.8	38.3	7	41.4	6.4	48.4
United Kingdom	24230	24460	77	7	0	36.3	3.2	57.5	58	36.1	6.6	43
France	22690	25280	79	6	0	39.2	2.6	68.2	65	32.7	7.2	40.2
Italy	19470	24340	79	7	2	38.6	2.9	na	58	27.3	8.7	36.3
Congo R	na	580	46	163	39	6.6	22.8	na	5	na	na	na
Ukraine	720	4150	68	16	0	na	na	na	na	32.5	8.6	41.2
Myanmar	na	Na	56	126	15	4.5	3.3	15.5	na	na	na	na
Korea	9400	18110	73	10	2	17.3	2.7	27.8	49	44.5	7.5	39.3
South Africa	2900	9150	48	79	15	24.5	1.7	na	49	59.3	2.9	64.8
Colombia	1910	5980	72	23	8	10.1	1.4	45.2	40	57.1	2	60.9

Note: Social services refer to education, health, social security, welfare, housing and community amenities
World Development Report 2000/2001 and 2003

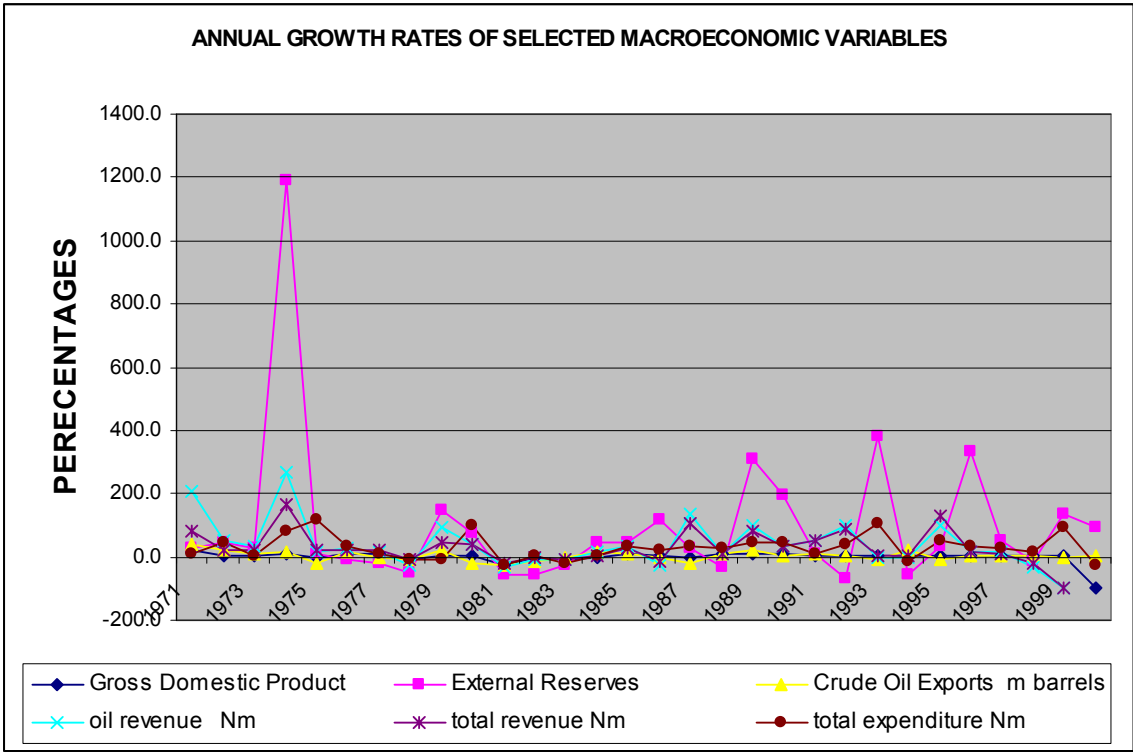


Figure 1

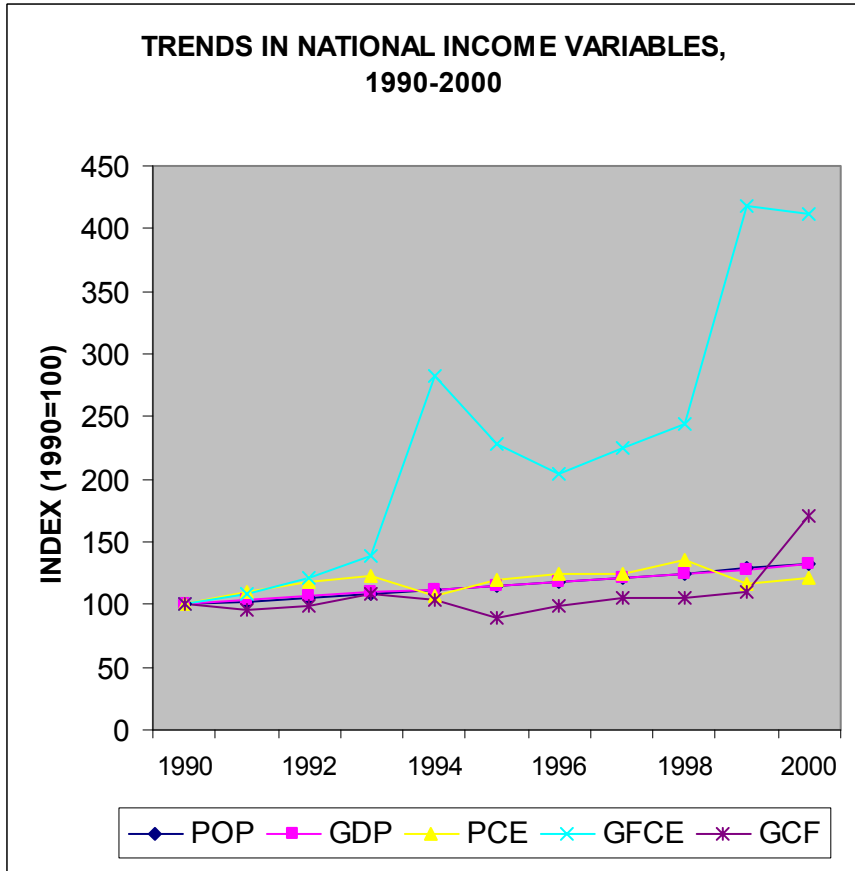


Figure 2

Table 4
 VARIABILITY RATIOS OF SECTORAL SHARES OF GDP,
 1960-2000

VARIABLE	VARIABILITY INDEX
total agric	34
Mining& Quarrying	65
Manufacturing	26
Utilities	55
Building & Construction	69
Transport	29
Communications	66
Distribution	23

Table 5
 VARIABILITY OF SECTORAL EXPENDITURE 1970-2000

	VARIABILITY INDEX
Administrative Sector	31
Economic Sector	55
Social Services Sector	51
Transfers	42
% Share of GDP	23

INSTITUTIONAL ARRANGEMENTS AND POLICIES THAT AMPLIFY THE CONSEQUENCES OF VOLATILITY

Fiscal Federalism and Budgetary Practices

9 Given the nature, structure and essential character of the Nigerian economy since the early 1970's (see Obi, 2003) – with oil funded public spending as the driving force – fiscal policy and budget management constitute the pivot of macro-economic policy in Nigeria. This is so because all other macro policies derive from or must adjust to the macroeconomic imbalances occasioned by government's fiscal policy stance at any given period of time. The purpose of this sub – section is to examine those aspects of the existing fiscal federalism arrangements in the country which amplify the consequences of volatility or constrain or impede the use of fiscal policy to achieve macro – economic stability in the economy.

10 . Fiscal federalism refers to inter – governmental fiscal relations in a federal political system as regards the division or assignment of taxing and expenditure powers and responsibilities. Numerous recent studies have highlighted various undesirable aspects of fiscal federalism in Nigeria as at now.³ There are two possible ways in which one can view the present short – comings of fiscal decentralization in the country. One approach is to do so from the standpoint of the orthodox theory of public goods and other normative principles of multi – unit public finance. Another, perhaps more fundamental way, especially where one is concerned with issues of feasibility and sustainability of possible reforms, is to proceed from recognition that there is a socio – political context inclusive of values in which the management of fiscal policy takes place, and consider the specific historical processes through which the existing constitutional arrangements emerged.

11 . In the context of the first approach, major problems commonly highlighted in the relevant studies include:

- Excessive centralization of resources and powers, to the detriment of sub – national units of government;
- Prevalence of fiscal imbalances both vertically (i.e. mismatch of revenue means and expenditure needs) between and horizontally (i.e. inconsistency between revenue raising ability and revenue needs) within the tiers of government, leading to misdirection, misallocation and wastage of resources;
- Frequent overlapping and non – coordination of expenditure responsibilities among different levels of government.

012 As a result the system is beset with widespread imbalances between expenditure and revenue assignments, with serious adverse implications for both the locative and stabilization functions respectively of fiscal policy in the country. With specific regard to the stabilization role, there are two major sources of problem, one quite serious, and the other only potentially so at this time. These are:

- Uncoordinated fiscal operations including borrowing activities within the consolidated government sector; and
- Potential destabilization from the activities of off – budget agencies, e.g. the defunct Petroleum Trust Fund (PTF) and the Education Tax Fund (ETF).

³ see e.g. Agiobenebo (1999); Alade (1999); Anyanwu (1999); Olomola (1999); and World Bank (2002)

12 The first stabilization problem arises from an interesting aspect of Nigeria's uniquely "dynamic" federal constitution that as at the last count (in 1996) recognizes 36 federating States, which between them account for a total of 774 local government councils (Lags), as against the four federating Regions that existed in 1966 when the First Republic was sacked by the military, and in which the nature and processes of local or community level administration were entirely the business of the respective Regions, having regard to the socio – cultural peculiarities of the latter. Under the existing constitutional provisions over 90% of public sector revenues are collected by the central government, which is then obliged to make revenue transfers to sub – national units of government. Even in respect of some supposedly independent revenue sources for the States, e.g. the personal income tax, the capital gains tax and stamp duties, etc, legislative jurisdiction resides with the central government⁴. For most these States, transfers from Federation revenues represent as much as 60% to 90% of their respective total current revenues. These large revenue transfers are unconditional, a situation which is often cited as having a strong disincentive effect on the development of internal capacities for revenue generation and collection efforts at the sub - national levels of government. Furthermore, the timing of their releases is not under the effective control of the Federal government (FGN), the only unit of government in a position to carry out economy – wide stabilization policy. FGN cannot also impose stabilization funds on States and Lags. There is at present no law under the constitution prohibiting any State from engaging in deficit budget financing through domestic or external borrowing, including borrowing from banks fully owned by the state in question⁵.

13 . As regards the second possible source of destabilization, the problem is only potential at present as already stated. ETF has the statutory responsibility for disbursing the proceeds of the 2% education tax on corporate profits, which are meant strictly for infrastructural development of public schools at all levels of education. ETF funds do not pass through any government but go directly to the benefiting institutions, and actual disbursements are based on strict performance criteria and accounting for previous releases. However, even though ETF transfers are project specific, they represent indirect transfers to the affected governments to the extent that they relieve them of some of their spending obligations. As such they constitute unbudgeted flows into the system, which if they become large enough can disrupt price stability. The point, however, is that the present scope of ETF activities is not at a level where the problem can be considered real.

14 Overall, however, the problem of macro instability arising from the fiscal operations of States and Lags is one of increasing severity, given that these two tiers of government currently account for an estimated 45% of consolidated government expenditure in the country, as against about 28% in 1997. The recent World Bank⁶ *Nigeria State Finances Study* found that total Federation revenues going to States as a group tripled between 1997 and 2001. Since the return to civil rule in 1999, and following rising grass roots pressure throughout the country to deliver "democracy dividends", States as a collective have been increasingly assertive of their autonomy

⁴ For details of the current revenue sources and assignments, as well as expenditure responsibilities at all levels of government, see Olomola, 1999).

⁵ As a matter of fact some guidelines in respect of states' external borrowing were introduced in 2001 under the auspices of Nigeria's SBA with IMF at that time. Among the salient features of the guidelines are provisions that for a state intending to borrow externally: debt service obligation should not exceed a stipulated ratio (40%) of the state's statutory federation allocations; the Federal Ministry of Finance should be authorized to deduct the debt service charge from the state's allocation; and the loan agreement should be supported by FGN's guarantee. However, given the current state of inadequate and unreliable data relating to states' financial activities and lack of bureaucratic transparency at both the state and federal levels, it is doubtful if the guidelines can be implemented in a way to prevent a determined state government from over borrowing. See e.g. World Bank (2002, p.56).

⁶ World Bank (2002)

within the existing constitutional provisions, such as it is. Thus, they were able to successfully thwart the attempt by FGN to save the excess crude oil windfall of about \$8bn accruing during 1999 and 2000; which sum was thereupon fully monetized and spent, resulting in considerable pressures on prices and the exchange rate. This trend of events is expected to intensify with the land-mark April 2002 Supreme Court ruling on the “Onshore – Offshore Dichotomy” case, which upheld the position of the States as regards various unilateral deductions made by FGN from federally collected revenues. The World Bank (*ibid*, p.6) was accordingly led to the conclusion that “success of any efforts to achieve overall macro stability in Nigeria must recognize States as key players and will depend to a good degree, on *ensuring that states are fiscally disciplined and set fiscal targets for themselves consistent with macroeconomic stability objectives*”.(Emphasis added).

15 . It is, however, necessary to avoid leaving any impression that fiscal indiscipline resides only in sub – national units of government or that it manifests only during civilian regimes. It is true that under the military, FGN could at its absolute discretion withhold any oil revenue windfall from the Federation Account pool before sharing with other governments. Yet there is little evidence that military regimes of the past had any better record of performance in terms of growth and stability. Thus, after a detailed examination of the relevant data for Nigeria during the period from 1965 to 2000, Addison (2002), was able to observe that “it must be acknowledged that the *old* rules and the *old* ways of conducting government business were far from successful in creating growth and stability”, [old rules and old ways referring to the era before the return to civil rule]. Accordingly, and having regard to the existing fiscal federalism arrangements in the country, the relevant question that needs to be asked at this point is: what are the prospects of securing the requisite degree of *fiscal discipline* at *all* levels of government, not just in the states and LGAs? The earlier stated second approach to evaluating the present fiscal set - up in the country would appear to offer a more suitable framework for answering the question.

16 *The Political Economy of Fiscal Federalism in Nigeria* :Since the return to civil rule in 1999, there has been, as already indicated, widespread and increasing agitation in the country for greater decentralization of fiscal powers so as to enable states and LGAs deliver on their mandates vis – a – vis the electorate. The World Bank⁷ correctly notes that such a change in fiscal federalism arrangements “would require *fundamental* changes to the Constitution”, which fundamental changes it, however, considers a daunting task, “given the *fractious* nature of Nigerian politics and society”. (Emphases added). It is possible that by the “fractious nature of Nigerian politics and society” reference is being made to the well known fact that the country is highly heterogeneous -- in terms of ethnic origin, religion, language, income class, etc, and that these differences produce social tensions and political conflicts. But these features are common to most pluralistic societies. One such country incidentally is Indonesia, which is often used in an adverse comparative framework to highlight the dysfunction and dismal performance of the Nigerian economy since the early 1970’s. Aside from similarities in social heterogeneity, both countries are also heavily populated and up to the 1970’s were mainly peasant agricultural societies with comparable income levels. Both also suffered the “Dutch disease” syndrome of the oil boom about the same time in the same 1970’s. However, Indonesia proceeded thereafter to become a substantially wealthier country decades later, with average per capita GDP quadrupling from approximately \$249 to \$962 between 1960 and 1999, while Nigeria has stagnated at about an average per capita GDP of \$250 during the same period.

⁷ The World Bank (*ibid*, p.15)

17 While the above comparison of the different economic outcomes in the two countries is usually meant to underscore the divergent policy paths taken in the two places from the 1970's, it also shows that the mere fact of socio – cultural heterogeneity cannot explain the evident inability of Nigeria to sustain any positive growth and development friendly policy direction during the period in question. The year 1970 marked the end of the Nigerian civil war, which itself was preceded by military incursion into politics. It is on record that upon coming into power and following the end of civil war, the military unilaterally embarked on a series of far reaching measures, the effect of which was to liquidate federalism and render Nigeria a “unitary state in federal disguise”⁸. The existing fiscal federalism arrangements in the country derive directly from and continue to reflect the essence of the brand of “military federalism” nurtured under the many years of military autocracy, the “civilian” pretensions of the 1979 and later the 1999 constitutions notwithstanding. Given all the known facts of Nigeria's post – civil war history, it is difficult to deny the contention that the foregoing reality lies at the root of the continuing dysfunction of the Nigerian economy. At any rate it is the case that the specific processes through which the existing fiscal set – up evolved has been such as to generate and entrench attitudes, perceptions and expectations which have pre – disposed the system to fiscal indiscipline, while rendering the underlying political structure prone to instability; and political instability is the ultimate constraint on effective macro stabilization policy. The key elements of the processes in question include: the unilateral creation and proliferation of states and LGAs; the monolithic source – crude oil - of the revenue sharing pool; and perceptions of inherent inequity in the existing political structure as well as self reinforcing expectations of continuing atomization of the polity.

18 *Unilateral Atomization of Federating Units:* Immediately prior to the advent of the military in 1966 Nigeria's fiscal system was fairly evenly decentralized among four federating regions (previously three, up to 1963 when the Mid – West Region was created by an act of Parliament to join the Eastern, Northern, and Western Regions) and the central government. The system had evolved from the early 1950's through periodic mutual negotiations among the regional governments and FGN. This evolution process was not without its moments of friction and serious disagreement⁹ But this is common in most other complex federal systems; what is important is that *binding* decisions eventually arrived at were always based on consensual agreements. By contrast, the military, on assumption of power unilaterally embarked upon re – centralizing the fiscal system while simultaneously creating more and more states, evidently in a bid to whittle down the powers of the latter, so as to obviate any opposition from them¹⁰. Resources were transferred from the states to the federal government and redistributed in a way that increasingly made states which would otherwise have been financially unviable to survive on the resources of the few rich ones. In 1976 the process was started whereby LGAs were centrally created and became officially recognized as the third tier of government, which was entitled to statutory allocations from both federation and state revenues.

19 Additional states and LGAs were always created on the justification that they would enhance development by bringing government nearer to the people. However, the undue proliferation in their numbers has produced the paradoxical and contradictory situation of states and LGAs being viewed as catalysts for development if a federal system that concentrates powers and resources at the federal level. Individual states are so weak that they lack any

⁸ See e.g. Ehwarieme (1999) and some of the literature cited therein.

⁹ See Adedeji (1969).

¹⁰ This is obviously the case, even if the first states creation exercise in 1967 could be said to have been partly in response to the long standing agitations for the Calabar – Ogoja – Rivers and Middle – Belt states respectively.

meaningful *federal* political autonomy. More importantly, most of them under the existing situation lack the capacity for independent development. Where is the rationale in creating more and more mini states, ostensibly to enhance localized development, but under circumstances which in practical terms vitiate the capacity of the same states to independently address developmental problems peculiar to the local environment; given the nature of the “distributive imperative” of Nigeria’s federalism whereby most things are shared mechanistically on the basis of “the equality of states (and LGAs)”, even when states and LGAs have not been created equally among the regions of the country? This situation is the springboard for the development and entrenchment of the existing culture of near total dependence of all governmental units on the centre, while contributing to feelings of inequity in the system.

20 *Monolithic Source of Revenue Sharing Pool:* During the decade and a half prior to the introduction of VAT in 1995 nearly 75% of federally collected revenues in Nigeria on the average came from corporate taxes, mining rents and royalties, NNPC joint venture profits, etc, relating to the extraction and sale of crude petroleum. Almost all of crude oil production in the country occurs in a relatively small geographical area around the River Niger delta. Even though this area has borne the brunt of the negative externalities of crude oil production, especially environmental pollution, while receiving little of any positive transformational effects, there developed a tendency in the country to perceive the huge economic rents from crude oil as a “free – for – all” belonging to nobody in particular. Of course such a perception was possible only because of the unilateral manner that the military were re – centralizing the fiscal system. The point, however, is that with such an attitude in place, it was hardly surprising that a mad scramble as it were soon ensued among those in a position to do so to appropriate as much as possible of this “free” booty -- -- through unconscionably over – priced government contracts with the attendant “kick – backs”; fraudulent over – capitalization and over – staffing of public enterprises and wildly irrational location of publicly owned industrial establishments; import license racketeering and foreign exchange trafficking, etc, etc. This development as could be expected had a devastating adverse effect on societal values at all levels.

21 Given the ease with which many people could be seen to have acquired vast amounts of unearned income and wealth in the wake of this development, there occurred a progressive misalignment at the level of individual perception between skills and work productivity on the one hand, and the structure of rewards on the other. With this therefore, it was not long before Nigeria became, as even as a high government official recently admitted, a country where “it does not pay to work hard and be honest”. At the level of government itself, there developed a “rentier” mind – set which celebrates big spending with little regard for the source of funding or the productive impact of the expenditure. This is evidenced at the federal level in among other things the well documented mismanagement of the vast financial windfalls accruing from the 1973 / 74, 1979 / 80, and 1990 / 91 (Gulf War) oil booms. At the state level, some available figures show for instance that state governments as a group took external loans amounting to the sum of over \$7bn outstanding at the end of 1994, with little evidence that the loans had been used to improve productive capacity in a way to enhance their ability to service and repay the loans or raise internally generated revenue. As for LGAs, President Obasanjo recently set up a “technical committee” to review the structure of LGAs in the country, justified this by drawing attention to the “non – performance or gross underperformance” of LGAs [in relation, that is, to the huge amounts of money released to them over the years]. The President incidentally referred also to the persistent trend towards “fragmentisation and continual fragmentisation of LGAs, including impractical divisions of towns and cities into unworkable mini LGAs”. . The main irony here is in the President singling out LGAs alone for indictment for gross fiscal indiscipline,

a phenomenon which pervades all tiers of government, and which, as has been shown above is the direct outcome of a process initiated during the first period of military rule (i.e. 1966 – 1979), during which General Obasanjo himself was a major player throughout.

22 *Perceptions of Inherent Inequity and Destabilizing Expectations:* . It would have been one thing of course if the exceptional degree of centralization of powers and national resources in the existing fiscal set up were generally perceived as having been designed and actually being used in an honest and purposeful attempt to evenly develop the whole country. But that is far from being the case. It is common knowledge that many sections of the country, on the contrary, see the existing arrangements as the deliberate design of a largely corrupt, inept and sectionally controlled military establishment to not only enrich themselves but also divert national resources to preferred groups. This is the root cause of the increasingly strident agitations in especially the southern states of the country, and in particular the Niger Delta states, for “resource control”, “true federalism” and “restructuring”; agitations which are increasingly heating up the polity and rendering it unstable. Yet another source of problem is a factor which imparts a destabilizing internal “dynamism” to the system. This is the “boomerang effect” whereby the progressive creation of additional states and LGAs over the years – ostensibly to bring government nearer to the people, only succeeded in raising the expectations of and whetting the demands for further subdivisions of the polity (recall the aforementioned presidential complaint about ‘...continual fragmentation’ of LGAs’); because such political subdivisions have in fact proved to be avenues for easy access to the “national cake” falling like manna from the “heaven” of the crude oil and natural gas wells of the River Niger delta.

23 The upshot of all the foregoing is that the specific historical processes through which the existing fiscal federalism arrangements in Nigeria have emerged have resulted in serious constraints on macro stabilization policy in the country, by creating an in – built predisposition to fiscal indiscipline at all levels of government, while rendering the underlying federal structure increasingly unstable politically. More generally, it has created strong disincentives against good governance in the country, by encouraging large scale corruption, in particular diversion and embezzlement of public funds at all levels of government; while discouraging independent non – oil revenue generation and collection efforts at all levels of government.

Real Exchange Rate Regimes

24 For an open economy, exchange rate policy is a key factor in economic management. This is especially so for an economy, whose currency is not internationally traded. Nigeria's currency, the naira, is not internationally traded. Also the country has abandoned the fixed exchange rate regime since the end of the Bretton Woods system in 1973. Although not fixed, the exchange rate has not been truly flexible, because it is subject to the administrative management of the central Bank of Nigeria, CBN.

25 The factors which affect the (nominal) exchange rate include market forces of demand for and supply of foreign currencies. Nigeria historically was a foreign currency deficient country because the goods we exported had weak international demand. They were unprocessed natural products that have weak local demand and for which there are severely limited local alternative uses, such as Cocoa, Beniseed, coal, palm oil, hides and skin, tin, columbite, timber, crude petroleum and other Nigerian exports.. Nigeria traded almost exclusively with the United Kingdom (UK) and had its trade controlled by UK firms. When the UK devalued her currency during Nigeria's civil war, the Nigerian pound was not devalued because it was expedient not to do so. But when she joined the European Economic Community (EEC), now European Union (EU), preferential trade between her and Nigeria declined and adversely affected Nigeria's exports. Appreciation of the Nigerian pound and decline in exports of produce and minerals (except crude oil) did two things to Nigeria's exchange rate, the exchange rate appreciated and supply of foreign currencies earned from produce declined. Without the quantum leap in the international price of crude petroleum as a result of the market actions of the Organisation of Petroleum Exporting Countries (OPEC), beginning from 1973, the impact of these two-fold developments would have become more manifest from the mid 1970s.

26 Mankiw,¹¹ discussing the macroeconomic debate, grouped economists into two: those who view economies as inherently unstable (William McChesney Martin) because of frequent shocks to aggregate demand and supply which necessitate the use of monetary and fiscal policies to stabilise it and avert fluctuations in output, employment, inflation and exchange rate; and those who view economies as naturally stable (Milton Friedman) and who blame ambitious economic policies as the trigger for economic instability and the symptoms it manifests. In any case, it is difficult to convince any government and citizens that government should do nothing about any observable macroeconomic problems.

27 Optimal exchange rate policy is designed to obtain real exchange rate (RER) that maintains both internal and external balance¹² The concept of real exchange rate comes from a realisation that the observable nominal exchange rate movements, result from both price changes and inflation rate changes in trading economies¹³ When the real exchange rate is optimal, domestic producers of tradables can compete internationally, imports are not artificially cheaper than comparable domestic alternatives. Exporters also are not disadvantaged by the exchange rate, when the real exchange rate is right.

¹¹ Mankiw (1997:361)

¹² Agu (2002:142).

¹³ Maciejewski (1983:497).

28 The optimal real exchange rate will represent the equilibrium real exchange rate. Equilibrium real exchange rate of a country depend on several factors such as:

- ◆ the composition of government expenditure;
- ◆ import intensity of all sectors of the economy;
- ◆ external capital flows;
- ◆ international terms of trade;
- ◆ international real interest rates;
- ◆ trade and commercial policies; and
- ◆ technological progress¹⁴ There are many models for setting the equilibrium real exchange rate, each with its associated difficulties. For an open economy, like Nigeria, regardless of the approach used in setting equilibrium exchange rate, economic management requires that a nominal effective exchange rate (NEER) be determined. Four approaches to equilibrium real exchange rate setting¹⁵ are:

- (a) The Purchasing Power Parity (PPP) exchange rate which equates the national price level of the focus country to the national price levels of her trading partners¹⁶ The PPP approach has been termed the law of one price, (LOOP);
- (b) The fundamental equilibrium real exchange rate (FEER) approaches¹⁷. This is a behavioural approach based on the path of some fundamentals of exchange rate determination¹⁸
- (c) Equilibrium real exchange rate (REER) approach. This approach like FEER, assumes some fundamental determinants of real exchange rate. It differs however in that it calculates the present and estimates the future value of the determinants of RER and from these set equilibrium RER.
- (d) The Desired Equilibrium real exchange rate (DEER). When Nigeria decided to peg the naira to an import-weighted basket of the currencies of seven trading partner countries in 1978¹⁹ the intention was to achieve a desired exchange rate, consistent with our fiscal policy objectives.

29 DEER and PPP are intuitively and politically appealing approaches and are easy to use. Given the problems facing Nigeria's economy today,²⁰ it is vital that an appropriate nominal effective exchange rate (NEER) framework be developed for the country. The Desired Equilibrium Real Exchange Rate (DEER) of today must reckon with the fact that our foreign exchange earning has not been growing (unlike in 1974–1978) that oil and gas alone cannot be relied upon to earn the foreign exchange requirement of the country, and that the continuous monetisation of U.S dollar earnings in the domestic economy is both price inflationary and destabilising to the real sector of the economy. The managed Dutch Auction System of foreign

¹⁴ Obadan (1994:19)

¹⁵ Agu (2002)

¹⁶ Rogoff (1996:650).

¹⁷ Williamson (1994)

¹⁸ such as in Obadan (1994:19)

¹⁹ Enuenwosu (1982),

²⁰ Soludo has noted that Nigeria has accumulated US \$ 31bn in foreign debt; incurring US \$4.9bn annual debt service requirement which the country have been unable to meet (and has been defaulting). Nigera has only U.S \$8bn foreign reserve; with grave balance of payments, and poverty implications. see C.C. Soludo in *This Day* 1 August 2003, pp 1 & 6)

exchange allocation cannot address the problem of exchange rate determination. Addison²¹ has determined that the standard deviation in real exchange rate growth, in Nigeria, for the years 1961 – 1970 was 4% while for the period 1991 to 2000, it was 35%. Between 1970 and 1991, the standard deviation was always in the range of 4 – 35%.

30 The question is naturally, what RER regime should Nigeria adopt? I think that we should calculate one RER index based on the IMF Multilateral Exchange Rate Model (MERM) and another based on absolute PPP. The idea is that deviations of the two rates from our nominal rate will give a comparative picture of what it should be to solve our debt and BOP problems (given the existing domestic real sector), while the other will give a picture of what it should be to get us out of poverty and into sustainable growth. With the two calculations, a policy maker's choice will be less complex, and what is acceptable distortion (if any) and programme of eliminating any identifiable distortions can be agreed.

DATA

²¹ Addison (2002: C65)

Capacity for Medium Term Planning

31 The Nigerian planning experience began in 1946 when the British colonial administration launched a “Ten Year Plan of Development and Welfare for Nigeria, 1946-1955”. The “plan” was, however, merely a bureaucratic response to a request from the colonial office to guide the allocation of imperial funds earmarked for Nigeria as part of a general British Colonial and Welfare Programme. It consisted of “a series of projects which had not been considered or related to any economic target”, most of which were expansion of existing departmental activities. It was not intended to be comprehensive. The value of development projects outside the plan exceeded that of the plan programme. Halfway through the plan period the plan was revised so as to provide for inflation, take some account of Nigerian opinion and incorporate new ideas. A new plan was launched in 1955 to tie in with the new federal constitution. In the political climate of rigid regionalism four different plans emerged, one for the federal government and one for each of the three regions.

32 The “First National Plan 1962-1968)” was launched two years after Independence, and truncated by the civil war in 1967. Two national plans were launched by the military regime after the civil war: the Second National Plan (1970-74), and the Third National Plan (1975-80). The Fourth National Plan (1981-85) was launched in 1981 by the civilian Second Republic elected in 1979, but by the end of 1983 both the regime and the plan had been discarded. Efforts under the new military regime to prepare the Fourth National Plan were terminated with the adoption of a Structural Adjustment Programme in 1986. The nation managed without a Plan in place until 1990 when the first of the National Rolling Plans was launched in nominal compliance with a trumpeted new approach of “Perspective Planning”. However, no perspective plan was put in place, or has subsequently emerged to guide the rolling.

Thus there have been three phases of development planning in Nigeria:

- 1) Medium Term Plan Phase (1946-1985)
- 2) No Formal Plan Phase (1986-1989) and
- 3) Rolling Plan Phase (1990 to the present)

33 The dominant mode has been medium term planning but the history speaks for itself. In none of the plans was there any serious attempt at systematic, integrated, targets-oriented planning. Each “plan” was essentially a laundry list of projects, some rolled over from the one before. Only one (The Second National Plan (1970-74) was allowed to run its course without truncation, change of direction or control. Ironically, the SAP period, in which there was no formal plan was the only period in which a deliberate attempt was made at articulating a strategic approach and instituting a systematic and integrated policy framework and programme of economic development. But the strategy was flawed and the programme inconsistently and ineffectively implemented. The current regime of Rolling Plans, without any Perspective Plan to guide it, has proved irrelevant to the budgeting and financial management process and has become an empty ritual.

34 In all, the national planning record has been weak. As various Public Expenditure Reviews have established, the entire financial management system is weak and needs to be restructured and strengthened. The challenges of Medium Term Planning are as complex as they are demanding. The present institutional, operational and procedural arrangements are manifestly incapable of meeting them. Lack of rigour at the bureaucratic levels and lack of clear vision and functional cooperation at the political levels have severely compromised the quality of the plans. To make matters worse, there is very little involvement of the civil society – except for formalistic consultations with the Organised Private Sector – in the entire planning process.

35 *The Planning Machinery:* Over the years an elaborate planning bureaucracy has been built up but it is structurally flawed, technologically ill-equipped and ineffectively managed. The main institutions constituting the planning system are as follows:

NATIONAL LEVEL

Federal Executive Branch

- The President
- The National Economic Council
- The Federal Executive Council
- The National Planning Commission
- The Executive Ministries and Parastatals

The National Assembly

STATE LEVEL

The State Executive Branch

- The Governor
- The State Executive Council
- The State Planning Ministry/Commission
- The State Executive Ministries and Parastatals

LOCAL GOVERNMENT LEVEL

The Local Government Council

The Local Government Planning Department

36 Since the return to civil democratic rule the basic institutional framework still has to settle down. In the Executive Branch, at the federal level the planning and budgeting processes are fragmented among the National Planning Commission, the Ministry of Finance, the Budget Office and the offices of the various Presidential Advisers and Assistants. Conditions are worse at state level. The legislature lacks the basic institutional capacity in terms of staffing, skills, equipment and procedures to handle effectively its statutory roles of critical areas of legislation, oversight and review of plans and budgets. The rules and procedures for Executive-Legislative harmonisation and cooperation in planning and budgeting are yet to be established. At all levels of government technical expertise as well as technology and information management systems are very deficient and need to be significantly upgraded for efficient and effective operation.

MONETARY POLICIES: SHORT – MEDIUM TERM PROSPECTS

- 37 Three approaches to monetary policy rules have been suggested in recent debates²²
- (i) a slow and steady increase in money supply by the CBN in order to maintain a stable output, employment and prices regime; this assumes a steady velocity of money.
 - (ii) A nominal GDP target growth rate, set by the monetary authorities, constitutes a bench mark that guides money supply. When the GDP growth rate exceeds the bench mark, money supply growth rate is reduced. While when the converse is the case, the money supply growth rate is increased. These alterations will help achieve stable output and prices and eliminate shocks;
 - (iii) Target inflationary rate as bench mark which guides money supply. Money supply adjusts to the inflationary rate.

38 These three rules of monetary policy target nominal variables – money supply, Gross Domestic Product, GDP, and inflation rate (or general price level). It is possible to consider targeting them and other variables in real terms. One real variable that can be used as policy target is unemployment rate. The draw back is that we hardly know the rate of unemployment rate which is consistent with economic equilibrium (full employment) or the natural rate of unemployment. Thus when the policy instrument, in this case, monetary policy achieves an unemployment rate which falls short or exceeds the natural unemployment rate, inflation or deflation, respectively will follow. Naturally, real GDP and real rate of inflation can also be addressed as policy targets.

39 The question that needs to be answered in the beginning is: is there evidence that money supply and its rate of growth as policy instruments are determinants of nominal GDP growth rate and stability and general price level and stability? According to Feldstein and Stock²³ “it is widely agreed that the goals of monetary policy are a low rate of inflation (“price stability”) and a small gap between actual real GDP and potential real GDP. There is general agreement that a low long-term rate of inflation can be achieved by sufficiently limiting the rate of growth of broad monetary aggregate over a long enough period of time”. The answer for Nigeria is to establish that the relationship between M2 and nominal GDP is sufficiently strong and stable to warrant using M2 to influence nominal GDP in a predictable way. It is accepted that changes in M2 in an economy where the Central Bank uses Open Market Operations (OMO), automatically incorporates, interest rate and exchange rate both directly and indirectly (through the money market and lending rates).

DATA

F-tests (P-values) on lags of:

Equation	Repressors	R ²	R ² (2)	R ² (4)	M2	R-90	R-FF	GN-91	CP6–G6
1	NGDP								
2	NGDP M2								
3	NGDP M2			R-90					

²² See Mankiw (1997:336)

²³ Feldstein and Stock (1994:8)

4		NGDP	M2	R-FF			
5	NGDP	M2	R-90	R-FF			
6	NGDP	M2	R-90	ZMD			
7	NGDP	PGDP					
8	NGDP	PGDP		M2			
9	NGDP	PGDP		R-FF			
10	NGDP	PGDP		R-90			
11	NGDP	PGDP		M2	R-90		
12	NGDP	PGDP		M2	R-FF		
13	NGDP	PGDP		M2	R-90	ZMD	
14	NGDP	PGDP		R-90	POIL	ZMD	
15	NGDP	PGDP		R-90	CP6 – G6		
16	NGDP	PGDP		M2	R-90	CP6 – G6	ZMD
17	NGDP	PGDP		R-90	910-GI		
18	NGDP	PGDP		M2	R-90	G10 – GI	ZMD

↑
Quarterly data
Conclusion

40 A further question that need be asked is: what are the sources of Nigerian M2 growth and how effective is the open market operation in affecting the general level of interest and exchange rate? The main determinant of the stock of money, in Nigeria, has been the consolidated fiscal balance of all levels of government, federal, state and local, which has been in deficit 80% of the time from 1965 to 2003.

DATA

41 The money supply growth has contributed to the relative growth of the service sector and the relative decline of the agricultural sector of the economy. In addition, it has contributed to considerable GDP volatility, and the incidence of the Dutch Disease phenomenon as a feature of the country’s economy.

Data from Addition
B + , 10, 12

Given that Nigeria production of tradables are negligible [evidence] tradables prices in the domestic economy depend on the real exchange rate and trade partner inflation rate. But non-tradable prices are subject to money supply growth rate. If it is true that our trade partners are more efficient producers of tradables and their economies are experiencing comparative price stability, then the conclusion is that money supply is implicated in Nigeria’s price instability.

42 Data on cross country inflation rate (including trading partners – E U North America, south East Asia Japan. Korea and South Africa.

The implications of the evidence above are that the deficit incurred by all levels of government in Nigeria has been wasteful. And the correct response for the Central Bank is to restrict money supply (credit) to the government increasingly in the short to medium term.

Prices and Exchange Rate Management

43 Unlike in industrialised countries, Nigeria does not suffer from insufficient demand for existing and affordable goods and services, arising from investor expectations. Price inflation of imported goods is demand pull. The crowding out effect of government expenditure generates cost push inflation of some domestic tradables, except where subsidies exist. Also the pattern of government expenditure and real exchange rate appreciation has caused decline in domestic agricultural output and consequent nominal rise in agricultural prices.

44 One of the objectives of the Central Bank of Nigeria's monetary policy since inception has been the achievement of domestic price and exchange rate stability. With modernization defined as introducing new activities from Europe rather than reforming the ways of doing existing things, economic policy in the 1960s was geared towards cheap money (to encourage new investors into the modern sector of the economy). This resulted in rapid monetary expansion.

1960	M1	M2	Data]	Credit to the	Inflation rate	Late of Growth
				domestic economy		of Govt. Exp.

45 In the five years from 1960 to 1964, the average annual rate of growth of total money stock (M1 + M2) was 36.8%. Whilst narrow money, M1 grew by 29.7% per annum, broad money, M2, grew by 44% per annum, during the period. Unlike now, the expansion was due to accelerated growth of bank credit, to private sector of the domestic economy. Naturally, the inflation rate increased during the same period. Although the problem was realised, the intense political crises in the country did not allow the monetary authorities to address it. Matters got worse as the crises progressed. The statutory limit on the ratio of federal government borrowing, using treasury bills, to its estimated revenue was increased in 1970 from 85% to 150%. This has remained the case to date²⁴

46 After 1973, government revenue massively increased, and further fuelled government expenditure. But because the earning came mostly in foreign exchange, it financed extensive increase in imports, as the foreign exchange earnings were monetised in the domestic currency. The rate of growth of government expenditure was so high at this time that by 1976, deficits were evident. The deficits were financed by the Central Bank; and the government did not show any willingness to reduce her expenditure levels significantly. Thus cheap money policy, rapid monetisation of foreign earnings, growing deficit and high inflation rate combined to produce real exchange rate appreciation of not less than 4% from 1973 to 1986 (World Bank 2002:C 65). To make matters worse, inflation was tackled by means of (1) credit rationing to preferred sectors, to stimulate output growth (2) fixing the exchange rate to stabilise the domestic price of imported consummables and (3) the acquisition of apparently cheap foreign loans to finance social infrastructure and projects which should assist domestic production and services.

47 Two coups d'etat in 1983 and 1985 were blamed on patriotic intentions to restore external and internal balance. The introduction of structural adjustment programme (SAP) in 1986 signalled the unsustainability and failure of these instruments to achieve the intended goals. The devaluation of the Naira which accompanied SAP had a knock-on effect on the financial system,

²⁴ Sanusi (2001:14).

investments such as the refineries, steel mills, River Basins and import commerce. Even now the economy has not recovered from the shock. Worse, the debt accumulated in the 1970s have become a burden on the economy as Paris and London Clubs and multilateral creditor alliances have emerged to demand repayment with the assistance of the IMF. Foreign credits are no longer available now that we actually need them; imports on open account, with government guarantee, and on (real) letters of credit are no longer possible. Because of these strains and stresses, Nigeria cannot keep faith with structural adjustment programmes and reforms. This is evident in the data for the period 1990 – 1994.

48 Price inflation has been sustained by the twin evils of excessive fiscal programmes of the government and the waste (corruption) involved in government consumption and investment expenditure. If waste and corruption are substantially reduced, it will be evident that Nigeria does not have the executive capacity for all the fiscal programmes she undertakes at any one time, regardless of the urgency of the need for some or all of the projects contained in the annual budgets. Also the introduction of absorptive capacity measures in fiscal planning, especially federal fiscal allocations, will lead to an acceptance of financial stabilisation and sterilisation activities. Finally a well structured programme of eliminating uneconomic and inequitable subsidies enjoyed by some sectors, example import trade, urban consumers, and persons engaged by government in the services sector, will combine with the previous two programmes to reduce pressure on general price level.

49 The exchange rate management has improved in terms of demand management, through the Dutch Auction system (DAS). The demand management need further improvement to eliminate avoidable transactions costs. Every authorised bank branch should be a bidding point for foreign exchange auction, using electronic transfer/communication. The current procedure give bidders operating in Lagos an unwarranted advantage and all banks are induced to have a Lagos office for foreign exchange transactions reasons only. This has an element of rent and is not cost effective. A forward market in foreign exchange well help business planning and reduce the level of anxiety in the bidding process. It is possible that forward operations will bring in new suppliers of foreign currency to the market. After reforming the foreign exchange demand management framework, it is then necessary to devise an exchange rate management system that will prevent over valuation of the domestic currency, guided by the principles of purchasing power parity.

Public Expenditure Rationalization and Stabilization

50 *Public Expenditure Rationalization:* Rationalization of public expenditure to reduce the size and efficiency of the public sector consists mainly of privatization of loss making public enterprises, and civil service reforms to downsize the government bureaucracy. Privatization is already being pursued by FGN as a matter of priority. From available evidence only a few state governments seem to be giving serious attention to this reform, and even for those that have actually commenced the programme there seems to be lack of political will to go through with it, and perhaps the capacity or wherewithal for effective implementation. An effective privatization programme is necessarily a fair and transparent one, which would require that adequate measures should be put in place to accommodate as much as is feasible and reasonable any resulting short – term costs, e.g. job losses or firm closures.

51 FGN and most state governments have at one time or the other stated their intention to carry out civil service reforms. To the extent that this would entail significant contraction of staff size, a major constraint for state governments would be the ability to raise the relatively large lump sums to settle the terminal benefits of affected staff, to ensure that the said benefits are promptly paid, as would be required for equitable staff separation under the 1979 Pensions Act. This is not an easy task, given that many state governments are already in substantial arrears in respect of current wages, not to talk of pensions and gratuities. Under the existing set up, a significant portion of this burden on states is the result of either Federal legislation, e.g. the uniform civil service wage and pensions structure across all the tiers of government, or federally driven initiatives to which states in the circumstances must adjust wily – nilly, e.g. the public sector wage increases of 2000. A feasible option on the problem in the circumstances would be for the states to negotiate with FGN for special grants or at least soft loans with which to settle the obligations.

52 *Stabilization of Public Expenditure:* The main objective of public expenditure stabilization should be to achieve a sustainable low rate of inflation, which should in turn facilitate the realization of a stable RER regime. In the face of volatile oil based revenues, and the absence of a Medium Term Expenditure Framework (MTEF) in place for budget and planning in the country as well as uncoordinated fiscal operations within the consolidated government sector, the only conceivable short – term option for stabilizing expenditure *in principle* is for each unit of government to commit itself to a spending pattern based on revenue saving during booms, with the possibility of spending out of existing reserves or the proceeds from borrowing. It goes without saying that the prospects for this are very low in the country at this time. FGN can certainly carry out such a programme based on its own share of federation revenues. But this would not be enough to have the required impact on economy wide macro stability, given the large and growing importance of states and LGAs in the overall fiscal picture of the country, as already discussed in II (a).

53 As for sub national governments, this proposal is hardly worth any serious consideration *in practice*. Observed behaviour at this level is a persistent tendency to see revenue booms as permanent and downturns as temporary, resulting often in disproportionately higher increases in expenditure, for given increases in revenue. The resulting fiscal deficits are invariably covered either through high interest loans and overdrafts secured against future federation revenue transfers, or / and accumulation of unpaid arrears on staff wages, pensions and gratuities, contractors' fees, etc; all of which render the entire system increasingly precarious and unsustainable.

Revenue Stabilization

54 The critical facts about public revenue in Nigeria are that it is inadequate and unstable. The inadequacy reflects the low productivity of the economy as a whole, while the instability reflects the over-reliance on one particularly volatile source of revenue – oil. Volatility of revenue is a major constraint in the management of the economy because it increases the difficulty of realistic and effective financial management, most critically in planning, budgeting and budget implementation. In the Nigerian experience there has been the tendency to embark on new programmes and projects and to increase the level of expenditure in times of increased revenue inflow without due regard to whether or not such “windfalls” will last long enough to sustain the new commitments. The result is that when the revenue flows slow down government often resorts to deficit financing. In theory, international borrowing is a possible resort, but the level of Nigeria’s foreign debt is already overbearing. Foreign direct investment has never been a major source of funds in Nigeria, except in the oil sector.

55 The major cause of revenue volatility is a combination of two factors: the large and unpredictable fluctuations in oil revenue and the large share of oil revenue in total revenue. The second factor is a direct function of the small size and low growth of non-oil revenue. In the long term the strategic approach must be to significantly raise the level of non-oil revenue and establish a viable growth trajectory. Diversifying the tax base away from oil will contribute positively to this process. In the short term the challenge is to moderate the impact of revenue volatility by managing the deployment and utilisation of volatile revenue inflows in such a way as to promote steady growth and sustainable development. Useful efforts at revenue stabilisation must address these two factors. Technically, the options for revenue stabilisation are many. It must be emphasised, however, that the strategic goals of national development must take precedence over the technical goals of stabilisation.. The litmus test of any stabilisation option is its contribution to sustainable growth and development

56 One short-term solution which has been suggested is to transfer the volatility risk abroad through the use of hedging devices such as futures contracts, option contracts, forward contracts, and swaps. These are all technically feasible, but from the larger perspective of Nigeria’s socio-economic development, could be counter-productive in the long run. The critical fact about the Nigerian economy is that Nigeria is a very poor country, with a per capita income (PPP\$, 2001) of 11 percent of the world average, 41 percent of the average for low income countries and 3 percent of the average for high income countries.²⁵ and percent that of the United States. Stabilising the economy at that level means stabilising poverty, and that cannot be a proper national development objective. The proper use of government revenue must be as a stimulant of investment, productivity and growth. Instead of “sanitising” “excess” oil revenue abroad it would be more functional to create a Capital Investment Fund with an acceptable proportion of Federation Account Revenue. This should fund national investment projects including equity participation in critical sectors of the economy and joint ventures with foreign investors. Such investment should create an income stream into future Federation Account revenue. It would also resolve some of the contradictions in government’s involvement in the oil industry.

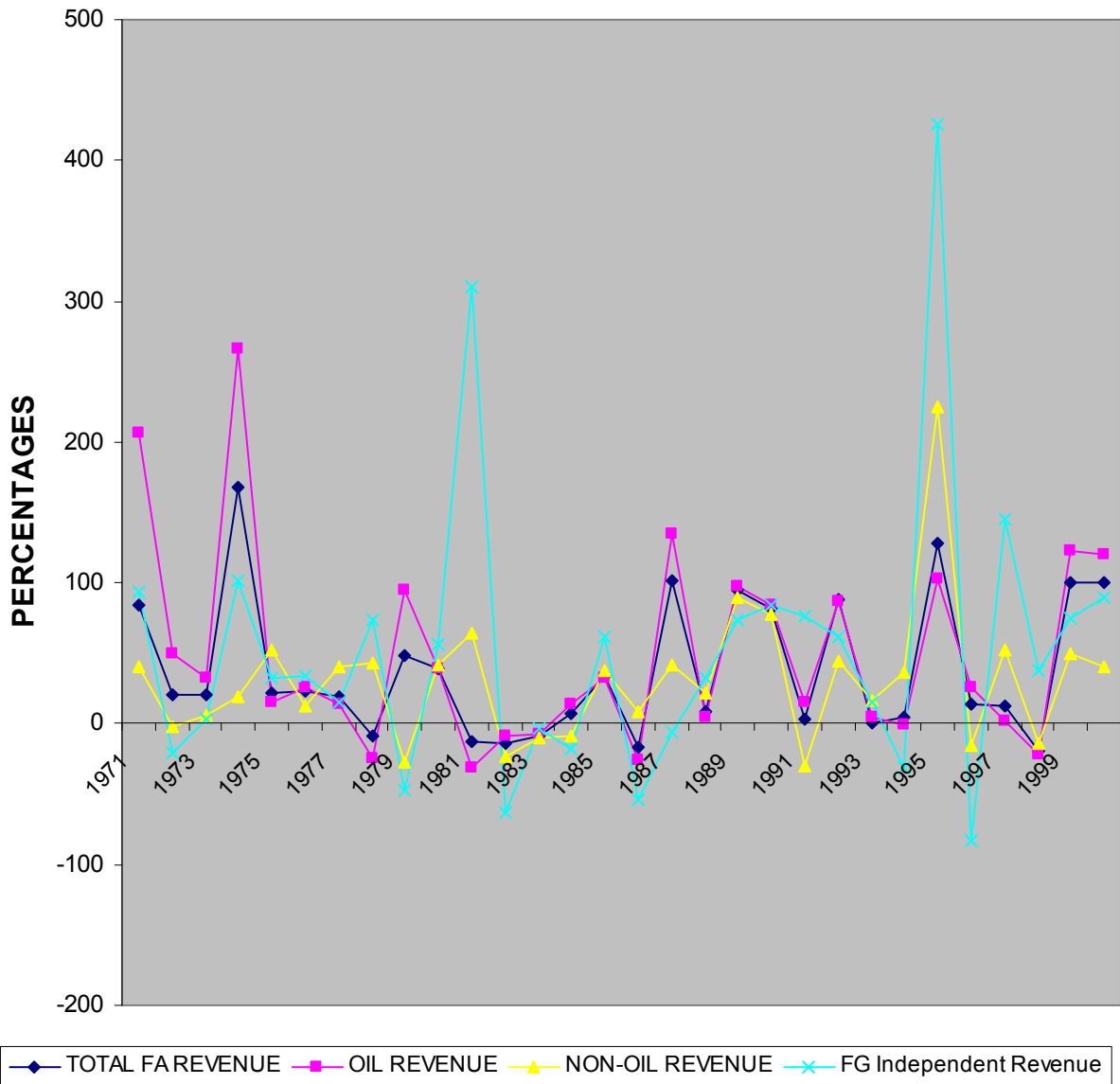
²⁵ World Bank *World Development Report 2003*

57 It has also been suggested that for revenue stabilisation it would be useful to find a way to make non-tax collections fall when oil prices rise and *vice versa*. Given the very small size of the tradable portion of the non-oil economy, such a procedure would yield only minimal impact without significantly changing the fundamental situation. However, there is considerable scope for enlarging the non-oil revenue base by rationalising the existing system and improving the assessment and collection machinery.

58 Scarcity of capital continues to be a major constraint and the case for making grants and loans to overseas recipients has to be examined very thoroughly. Repaying external debts has been one of the major destabilisers of the Nigerian economy. The newly established Debt Management Office in the Presidency is charged with handling this problem. The challenge is not how fast we can pay off the debt but how to ensure, first, that we pay only what is properly due and, secondly, that we pay in such a manner as does not incapacitate our economy.

59 The negative impact of revenue volatility is due not so much to the volatility of the inflow as to *how* the inflow is managed. Improved planning and budgeting systems and transparency and accountability in public expenditure management would reduce the leakages and feed increased output and productivity.

REVENUE ANNUAL GROWTH RATES 1971-2001



POLICY OPTIONS: LONGER-TERM PROSPECTS

Revenue Diversification and Growth

60 For the long term there is need to fundamentally review the existing revenue system which has evolved over the years through *ad hoc* changes to meet specific situations and current interests without rather than in pursuit of any over-arching vision or strategy of development. The sources of revenue utilised by a country are intimately related to the development goals targeted by the government and by the choice of options for financing them. Globally, governments differ significantly both in the size of the economy and the size of government and in the range of responsibilities exercised by government.

61 Statistics on some critical indicators for the world's largest countries (see Table 2) show that in most of the large and rich European countries total government revenue accounts for about 40% of GDP: France, 41.8%; Italy, 41.5% the United Kingdom, 39.4%. The United States recorded 21.8% and Japan 14.5%. By contrast the governments of most developing countries have very low revenue bases. The corresponding figures were for India, 11.6%; Indonesia, 16.8%, Brazil, 22.7% and Ethiopia 17.3. There are no figures for Nigeria in the World Bank source but the CBD report for 2001 indicated that, thanks to oil and gas revenues, Federation Account revenue amounted to 48.6% of GDP.²⁶ The structure of Government Revenue in Nigeria emphasises the extreme dependence on Federation Account revenue, dominated by oil revenue, at all levels of Government.

62 The high revenue base of developed countries supports a high level of social services, accounting for 68.2% of government expenditure in Germany, 65.2% in France, 57.5% in the United Kingdom, and 53.9% in the United States. Again by contrast the developing countries devoted rather low proportions of their low government revenues to social services. And in Nigeria, the high profile of government revenue in GDP notwithstanding, Government expenditure on social services was an abysmal 15.3%. Detailed examination shows that the main source of government expenditure on social services in most countries is social security taxation. In Nigeria there is no social security tax. The pension schemes for the small minority of public sector employees are meagre and currently non-functional. There is a clear need for Nigerian governments at all levels to expand and diversify their revenue base. This should also contribute towards improving the structure of public expenditure to provide some social security and attack the roots of mass poverty.

63 Lack of basic social security is a major factor in the persistence of poverty in developing countries. Some countries, like South Africa, are now giving serious consideration to the provision of a Basic Income Grant to every adult citizen. In Nigeria, the fact that most of the government revenue comes from oil and gas provides a window of opportunity for reducing poverty and stimulating production and growth at the grassroots level, that is, in every local community. The redistribution of some of the oil and gas revenue as Basic Income Grant to every adult citizen will immediately enhance levels of welfare in every community and stimulate production. A small proportion of the public funds currently wasted on unnecessary projects, inflated contracts, or through plain theft would be enough to alleviate the present situation and facilitate the more fundamental reforms of revenue generation and diversification.²⁷

²⁶ CBN Annual Report and Statement of Accounts 2001

²⁷ While this paper was under preparation, the IMF, of all institutions, came out with a recommendation for some form of basic income grants, to make sure that at least some of the oil and gas money gets to the people, who can

Table 10		
SOURCES OF NIGERIAN GOVERNMENT REVENUE 1997		
	Percentage	Percentage
Federally Collected Revenue		89.5
Oil	76.1	
VAT	5.5	
Other	7.9	
Federal Government Independent Revenue		3.1
State Governments Independent Revenue		6.9
Local Governments Independent Revenue		0.5
Data Source: <i>National Rolling Plan 1997-1999</i>		

use it much more relevantly and sensibly that the governments and their hangers-on! This is clearly an idea whose time has come.

DATA AND CAPACITY TO PLAN

64 The first major book on development planning in Nigeria was titled *Planning without Facts*²⁸ the problem of inadequate and unreliable data continues to bedevil development planning in Nigeria to this day. This situation cannot be blamed on lack of awareness of need. Indeed by 1928 a post of Government Statistician was already in place. In 1947 the Office of Statistics was established and in 1957 it was statutorily charged with the responsibility of coordinating the nation's statistical activities. Unfortunately this responsibility has never been taken seriously enough.²⁹ The Federal Office of Statistics, is an agency of the National Planning Commission, and remains the country's principal statistical agency. It publishes a number of statistical reports and surveys. However, publication of these has been irregular and many of the series have not appeared in recent times.

65 Another potentially useful central statistical institution is the National Data Bank, established in 1986 with the mandate to standardise statistical survey methods as well collate and analyse key national development data. It is yet to make its presence felt. The profile of the Central Bank of Nigeria as a source of macroeconomic data has been rising. But the potential of another major institution, the National Population Commission, is largely unexplored. Other major sources of development data and statistics include the NDIC. In addition the various federal government ministries and agencies are expected to produce and disseminate data and records based on their own operations and information sources.

66 At the state and local levels, on which an effective data procurement and management system must rely for basic information, the infrastructure for data collection remains vestigial and fragmentary. Much of the required basic data simply cannot be collected. At state level the Rural Economic Surveys which were routine activities up to the 1970s seem to have been abandoned. So low is the capacity of the statistical agencies in many of the new states that some are obliged to rely on the Federal Office of Statistics or hire outside consultants to produce their *Digests*, and some have given up trying.. At the local level – at community and local government levels – there are no regular structures and procedures for collecting basic information such as vital statistics, employment and income, productivity, output and prices.

67 Overall, the quality of the data available leaves much to be desired. Take the most regular and abundant series – those on agricultural output. Research has shown that the different series published by the Federal Office of Statistics, the Federal Ministry of Agriculture and the Central Bank are often conflicting.³⁰ Some are internally inconsistent or simply do not add up. Indeed international agencies, from the World Bank to the UNDP, UNICEF, UNESCO, ILO and others, often find Nigerian official data so unreliable that they prefer to enter “not available” for the relevant items. In these circumstances Nigeria is still stuck in the groove of “planning without facts”.

²⁸ Stolper 19

²⁹ Adamu 1983

³⁰ See Odi (2002), Phillips (1999)

68 It is true that every government and organised private agency routinely collects data and information relevant to planning. But the ability to harvest such information at the appropriate levels is sadly lacking. Most of these institutions do not, even when they are required to, produce regular returns, reports and statistics on their operations and performance. Nor do the major data collation and analysis agencies make sufficient effort to encourage the production of, and to harvest and use such information. We must conclude that at present the capacity for data-based comprehensive planning is simply not there. There is need, first, to develop a strategy and system for harvesting, validating and using relevant data collected by various agencies, and then to develop a more comprehensive – necessarily decentralised – system of data collection, collation and analysis

MEDIUM-TERM EXPENDITURE PLANNING FRAMEWORK

69 The Medium Term Expenditure Framework (MTEF) is one of the latest reforms to public expenditure management in developing countries being promoted by the World Bank, and associated international agencies. With regard to the Nigerian situation, the advocacy of MTEF has elements of *de ja vu*. It recalls the hopes we had of our fixed term plans, as well as the euphoria with which we embarked on a short-lived experiment with PPBS and Zero-Based Budgeting. In a situation where every financial management reform has so far failed it is necessary to examine MTEF carefully in the harsh floodlight of our planning experience and to ensure that the environmental factors which ruined previous reforms do not re-surface to wreck it. A necessary condition for any system of financial management, indeed any system of governance, to work is the establishment and adherence to due process, transparency and accountability. Nigeria is still trying to achieve this.

70 The MTEF process is rigorous and demanding. It involves three main levels of action:

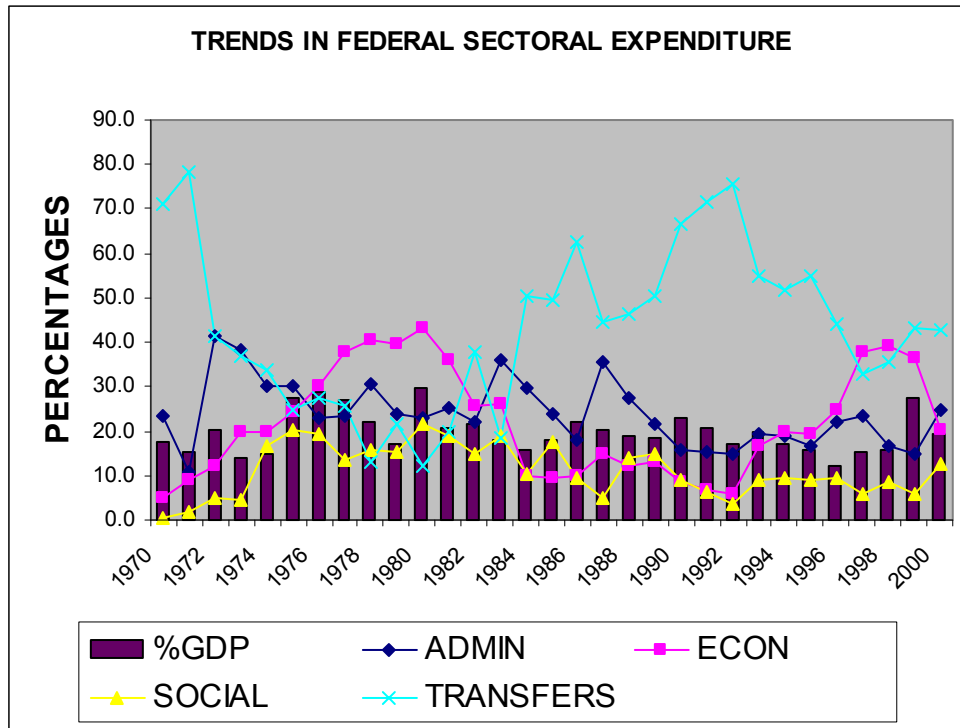
- A Budget based on a hard constraint, determined by realistic projections of resources
- A Medium Term Financial Framework (MTFF) with clear articulation of priorities on which the allocation of resources between sectors and ministries/departments is based as well as the costs of policy/services in each sector (Medium Term Budget Framework)
- Extending the MTBF by including the preparation of a three year, integrated performance based budget, the Medium Term Expenditure Framework (MTEF)..

An effective Medium Term Expenditure Framework (MTEF) can be established only in the context of an appropriate policy and institutional framework. A basic requirement for a relevant, viable and sustainable MTEF is that it should address the long-term system goals of the nation as determined through a process involving all the legitimate stakeholders – government, business and people. The framework itself should be based on a clear strategy and an integrated programme of action with specific assignment of roles and modalities for harmonisation and coordination.

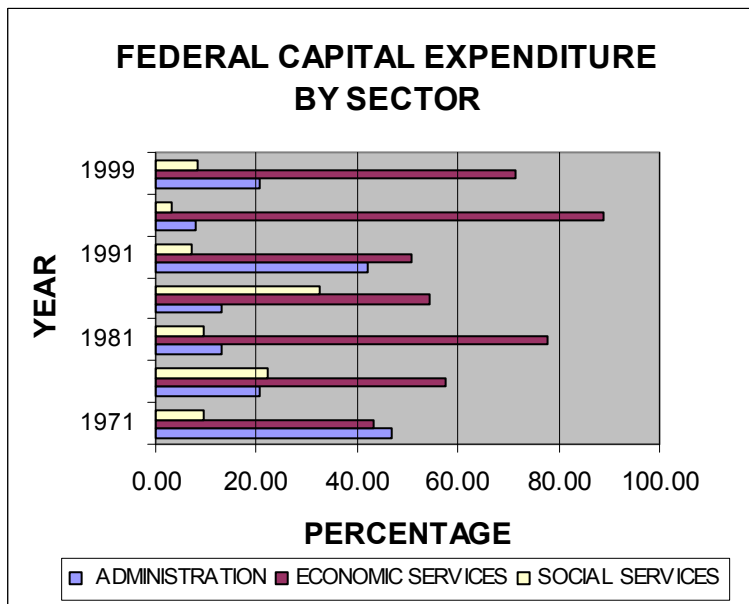
71 Since the 1980s the organised private sector, through the Nigerian Economic Summit, has presented a series of Vision Statements and associated action programmes. Useful as these are as inputs into a national vision and programme, they remain parochial, partial and fragmentary. There is need for a comprehensive national process of consultation and dialogue involving not only all the tiers of government, but all shades of political opinion, the organised business sector, the hitherto ignored “informal” sector, the various segments of civil society, and community interests. On the technical dimension there is need for a comprehensive situational analysis based on hard data on the condition and performance of the national society and economy. The resultant framework must have the consent and commitment of all the legitimate stakeholders.

72 Under our federal system there is a danger that a national framework could be rendered otiose by the exercise of constitutional autonomy by the various levels of government, as happened during the Second Republic. It is therefore necessary that the framework be developed under the umbrella of the National Economic Council, and confirmed by the

appropriate legislative chambers, thus securing the “national mandate” required by the tenets of cooperative federalism.



Figur



e 6

Re-thinking Fiscal Federalism

73 Identified short – comings in the existing fiscal federalism arrangements in Nigeria were reviewed in sub – section II (a), though with particular emphasis on the macro stabilization role of multi – unit public finance. It is of course the case that even in principle there cannot be an absolutely perfect fiscal federalism structure anywhere, given that it is not possible to achieve complete consistency among the allocative, stabilization and redistributive objectives of federal fiscal policy. There is, however, near complete consensus among informed observers that the existing system – the result of series of unilateral and *ad hoc* measures by military dictators – is so dysfunctional as to require major overhaul, in order to improve performance on all fronts. Needed and often proposed reforms usually centre around two major themes, both ultimately aimed at restoring fiscal discipline to the system: better alignment of revenue and expenditure assignments among the various units of government, and improved coordination of fiscal operations within the consolidated government sector.

74 *Re-assignment of Revenue and Expenditure Responsibilities:* There is wide consensus on the need to re – assign revenue and expenditure responsibilities, and adjust revenue sharing mechanisms in such a way as to ensure that:

- Each unit of government has adequate revenues to cover its assigned expenditure responsibilities;
- Each recognized tier of government has expenditure responsibilities exclusive to it, without prejudice of course to the existence of residual responsibilities where deemed appropriate;
- The existing prevalence of concurrent expenditure responsibilities between FGN and sub nationals is eliminated. Where such concurrent responsibility must exist the role of FGN should be limited to participation in policy legislation or purely regulatory functions, not actual expenditure or transfer of funds.
- Federating units of government have sufficient revenue and expenditure autonomy and control to enable them respond and adjust to fiscal shocks e.g. oil induced revenue volatility.

75 *Improved Coordination of Fiscal Operations:* There is need to devise effective mechanisms for coordination and cooperation between FGN and federating sub nationals in such a way as to make it possible to agree on economy - wide macroeconomic objectives and targets, and ways of achieving same. This could entail legally enforceable fiscal rules that ensure that individual governments pursue goals and targets that are consistent with overall national objectives, say, in the context of an MTEF approach to budget and planning.

76 There is wide consensus that the above reforms of the present structure of fiscal federalism in Nigeria would entail far reaching changes to the existing federal constitution in the country. A crucial question, however, is whether the changes would merely involve amendments to certain specific provisions of the constitution, while leaving the existing federal political set up intact, or whether they would entail a more fundamental restructuring.

Constitutional Amendments

77 The political economy analysis of sub – section II (a) showed that the present structure of fiscal federalism in Nigeria derives directly from brand of “military federalism” nurtured under military autocracy in the country. The specific historical processes that brought it about were such as to pre – dispose the system to fiscal indiscipline, while rendering the underlying political structure prone to instability. It is inconceivable, therefore, that the fiscal system could be meaningfully restructured, while leaving intact the existing federal set up, which is the ultimate source of the fiscal dysfunction. For instance, a key aspect of the dysfunction is that Nigeria, a country with in effect one exportable resource – crude oil – is not able, as a corporate entity, to save any significant portion of its national resources in a pooled fund; a disability which thereby leaves the country open to regular and severe external shocks. (The latest demonstration of this being the thwarted effort of FGN to save the oil windfalls of 1999 and 2000, following the concerted action of the 36 state governments, who in the circumstances were acting perfectly rationally in response to the situation in which they found themselves).

78 It is clear, therefore, that the type of fiscal coordination and cooperation discussed in sub – section III (b) (ii) above is likely to be feasible and sustainable only when all the relevant stakeholders operate from a well founded sense that they “own” both the policy reforms and the resources involved. This in turn is likely to happen only when the reform of fiscal federalism is done as part of a wider political restructuring to achieve a more *equitable* and *stable* federal structure in the country. It seems obvious that the minimum condition for this is to create the kind of federating units capable *in practice* of sustaining or enforcing the “federal principle”, that is to say, a system in which individual state governments on the one hand and the federal government on the other are *in fact* coordinate and interdependent authorities, neither of which is subordinate to the other in the discharge of its legitimately assigned taxing and expenditure responsibilities; which responsibility assignments are arrived at through mutually negotiated agreements. Such a federating unit would be capable of undertaking independent development primarily through its own internal resources. Aside from common services like federal highways, railway networks and inland waterways, etc, each state or regional government would be seen by all concerned as having primary responsibility for the economic well-being of its citizens, through the provision of services like education, health, rural and urban infrastructure, agricultural extension, etc; perhaps in healthy competition with other state / regional governments. This would be in contrast to the present situation whereby newly created states and LGAs, as well as the old ones, see themselves principally as instruments for obtaining one’s share of the “national cake” of oil revenues.

79 The adoption in 1995 of the six geo – political zones of the country during the Abacha constitutional conference seems a solid basis for the desired restructuring. Each of these zones – North Central, North East, North West, South East, South South, South West – as a federating Regional government would evidently be financially viable independently. These are the kind of stakeholders that, in a constitutional conference, would have the requisite political clout and self – confidence to agree on the type of *binding* and legally enforceable fiscal reforms discussed. It is unlikely, however, that the present states and the strong local interests they represent would

agree to dissolve into such regions. There is however a clear need for a comprehensive national conference to work out an appropriate new constitutional structure to take care of national, state and local concerns in a practical cooperative federal system.

CONCLUSIONS AND RECOMMENDATIONS

80 The paper has examined the nature, dimensions, sources and consequences of macroeconomic volatility in Nigeria and evaluates policy options for managing volatility. Volatility is a major constraint on development, making planning more problematic and investment more risky. Other things being equal, a more stable macroeconomic environment would promote long-term planning for sustainable growth and development. But in a situation of mass poverty and low productivity stability is not enough. Indeed a development approach narrowly focused on stabilisation would stabilise *poverty*, not *growth*. From this point of view, the strategic objective must be to transform the economy by stimulating domestic investment, productivity and output; thereby attaining a viable platform for growth with stability. The critical policy challenge has to do not merely with how to attain macroeconomic stability but how to generate and sustain investment and the roles of government and the private sector in that process. This raises the question not so much on the relative share of government and the private sector in investment as on the appropriate and optimal patterns of investment and partnership.

81 The high profile of government in the Nigerian economy derives from the Constitution which gives it, through the attribution of rights to proceeds from mineral resources. Since the 1970s oil revenues have dominated the government resource profile and constituted a significant share of the national income. The domination of the Nigerian formal private sector by transnational corporations affected its strategic focus, hence the extent and character of its involvement in the domestic economy. The limited move into local resource utilisation in the early 1980s was largely a result of legal and moral pressures from government. With the retreat of government activism in the era of SAP many firms reverted to their old habits. Today Government is once more trying consciously to induce and encourage nationally beneficial corporate behaviour by the Nigerian private sector. It is correct to argue that “nations seeking to increase their growth rates need to create conditions that encourage the private sector” But it is necessary to add that such nations need also to create and support conditions that encourage the private sector to make choices promoting the fuller utilisation of local resources, physical and human.

82 One major constraint to the development of a self-reliant economy is the underdevelopment - indeed the mal-development – of the financial sector itself. The modern economy is not only knowledge-driven but also credit-driven. The expansion of the Nigerian financial system has been rapid but uneven. The trading short-term end has grown at the expense of the investment long-term end (dramatised by the retreat of merchant banks into universal into “universal banking”) There is need for more capital market instruments, for venture capital, public bond, mortgage banking to energise the economy

83 A root cause of poor performance and lack of stability in the Nigerian economy is mismanagement. This factor requires detailed attention, as does the related factor of transparency and accountability. Unless due process and discipline are fully restored in governance, all other reform measures are doomed to failure.

84 In this paper we have examined the dimensions of macroeconomic stability in Nigeria. We have also addressed some key options for managing it, focusing on monetary policy, revenue management, expenditure management, the planning framework and the capacity to plan, and the

critical issues of constitutional structure and political culture. The very high volatility recorded in real growth rates, price inflation, and private investment per capita, government revenues per capita, terms of trade and real exchange rate closely reflect the movements of oil prices. But patterns of volatility vary among sectors. In terms of GDP the most volatile sectors are Building and Construction, Communication, and Mining; while the least volatile are distribution, transport, and manufacturing. On government expenditure sectoral expenditures volatility is highest for the economic sectors and lowest for the administrative sectors; while public expenditure as percentage share of GDP has been relatively stable. With oil funded public spending as the driving force of the Nigerian economy, fiscal policy and budget management constitute the pivot of macro-economic policy.

85 On revenue volatility, it is recommended that efforts should be made to raise more revenue through more effective harvesting of existing sources and more imaginative investigation and development of new ones. In the long run steps should be taken to promote and support increased production and productivity in the various sectors of the economy. Considering that the low level of social development and social security is a major constraint to sustainable growth, there is need to enlarge the revenue base through social security taxation in order to provide adequately for the necessary investment in social service delivery.

86 The introduction of a medium term planning and expenditure framework for Nigeria is welcome. But it requires an appropriate policy and institutional framework which addresses the long-term goals of the nation. Such goals should be determined through a transparent process involving all the legitimate stakeholders, and should be based on a clear strategy and an integrated programme of action. There is need for properly structured and modulated interaction between the Executive and the Legislature at all levels and among the three tiers of government. The National Economic Council has a central role to play in ensuring inter-branch and inter-governmental harmony and coordination.

87 The problem of inadequate, untimely and unreliable data has adversely affected development planning and management. There is need to strengthen the various institutions charged with the production and analysis of development data and to enhance their capacity to harvest and use the information available at the various agencies and centres of action.

There is need to re-think and restructure fiscal federalism in Nigeria. Under prolonged military rule the principles and practice of fiscal federalism were eroded. The welcome efforts now being made to re-build the system should include the establishment of mechanisms for coordination and cooperation between FGN and federating sub nationals in such a way as to make it possible to agree on economy - wide macroeconomic objectives and targets, and ways of achieving same. The Constitution itself should be drastically reviewed and refashioned in the light of the needs and expressed wishes of the people.

88 The policy options for Nigeria's growth and stability go far beyond a few macroeconomic reforms, into the transformation of the very basis of production and exchange in the Nigerian economy. Accordingly, there is need to pay specific and systematic attention to the context of action and the production relations in the various sectors of the economy.

89 The sectoral policies in agriculture are routinised, unimaginative and over generalized. The specific problems of individual production systems, ecological areas and products markets have not been particularised and targeted. There is need to address these issues so as to develop an effective productive agricultural system worth stabilising.

Critical areas for attention include:

- Land Use System,
- Research into and Development of Viable Agronomic Systems and Production Models,
- Review of Subsidy Systems. ,
- Agricultural Finance, and
- Agricultural Marketing

90 In the mining sector the challenge is to transform oil from an enclave economy into a catalyst of domestic development. There is need to promote indigenous participation in the provision of supplies and services to the oil and gas exploration and production companies bring hope of future transformation. But systematic development will depend on deliberate partnership and cooperation among the oil and gas companies, government and the Nigerian supplies and services providers

91 Manufacturing holds the key to technological development. It must be promoted not only for its contribution to the GDP but, even more importantly, for its capacity to energize and back-stop the other productive sectors of the economy Growth in the construction sector is directly related to growth in investment in both infrastructural and local resource development and should be actively promoted..

92 The generally low level of services - social, economic and infrastructural - is a manifestation of the condition of mass poverty in Nigeria. It reflects an approach to development that marginalises local communities, resources and interests. A new approach based on total mobilisation and participation at local levels has the potential of raising the level of performance to a higher, more sustainable and more stable level

BIBLIOGRAPHY

- Adamu, S.O(1983) “Data Collection in Nigeria: Some Institutional Problems” in Muhammed (1982)
- Adubi, A.A. and Fajingbesi, A.A. (2002) “Research and Capacity Building for Effective Planning and Budgeting” in Obadan, Oshionebo and Uga (2002)
- Agu, C.(2002) “Real Exchange Rate Distortions and External Balance Position of Nigeria: Issues and Policy Options. *Journal of African Finance and Economic Development* 2002, V 5 2, pp 143-174.
- Ajayi O.O. and Oladoye, J.O. (1996) “The Role of Statistics in National and Revitalization” in FOS 1996
- Akeredolu-Ale, E.O. (1999) “Statistical and Information Systems for Social Analysis” in NSA 1999: 8-22
- Akeredolu-Ale, E.O.(1996) *Integrated Rural Development in Nigeria: Policy Issues and Options*, Ibadan, Spectrum Books 1996, pp 57-71
- Barnett, S. and Ossowski, R. “What Goes Up ... Why Oil Producing States must Husband Their Resources” *Finance and Development* March 2003, 20-39
- CBNARSA *Central Bank of Nigeria Annual Report and Statement of Accounts* various issues
- CBNSB *Central Bank of Nigeria Statistical Bulletin* various issues
- DFID (2002) “Understanding and Reforming Public Expenditure Management: Guidelines for DFID” Paper presented at the Joint Government of Nigeria – World Bank Workshop on *Improving Public Expenditure and Financial Accountability in Nigeria*. Kaduna April 24-26, 2002
- E. B. Maciejewski, E.B. “Real Effective Exchange Rate Indices” *IMF Staff Papers* 30(3): September 491-525.
- Enuenwosu, C.E. “Exchange Rate Policy and Nigerian Balance of payments – A review of the Evidence”.
- Fayingbesi, A.A. (2003) *Data Management for Macroeconomic and Policy Analysis*
- Feldstein, M and Stock, J.H. “The Use of A Monetary Aggregate to Target Nominal GDP” *Studies in Business Cycles* Volume 29 1994 pp 7 – 69.
- FGN/WB/DPC (1999) Federal Government of Nigeria in Collaboration with the World Bank Group and the Policy Development Centre, *National Conference on Economic and Development Issues in Nigeria* Abuja 7-8 October 1999
- FOS (1988) *Producer/User Seminar on Household Statistics and Indicators fore Women in Development – Seminar Proceedings* Lagos FOS
- FOS (1996) *First National Seminar on Total Quality Management, 22nd and 23rd August 1996 – Proceedings* Lagos, FOS
- Gali, C.D. (2002) “Overview of the Planning and Budgeting Experience in Nigeria” in Obadan, Oshionebo and Uga (2002)
- Gregory Mankind Macroeconomics
Iwayemi, A (ed.) *Macroeconomic Policy Issues in an Open Developing Economy: A Case Study of Nigeria* Ibadan, NCEMA 1995
- Mankind,N.G. Macroeconomics
- Muggeridge, Liz (2003) “Reflections on the Medium Term Expenditure Framework” Consulting Africa Ltd.
- Muhammed B.A. (1983) *Production and Uses of Statistics in Nigeria* NISER/FOS 1983
- NESG (2001) *Nigerian Economic Summit Group Report on the Seventh Nigeria Economic Summit* Abuja, NESG
- NISER (2001) *NISER Review of Nigerian Development, 2000: The State in Nigerian Development* Ibadan NISER
- NSA (1999) *National Statistical Association 1999 Conference Proceedings* Lagos, FOS
- Obadan, M (1994) “Real Exchange Rates in Nigeria – A Preliminary Study” *NCEMA MONOGRAPH Series No. 6*
- Obadan, M.I., Oshionebo, B.O. and Uga, E.U. (ed)(2002) *Effective Planning and Budgeting in a Democratic Setting* Ibadan, NCEMA
- Odi, M.A.C.A. (2002) “Data Management for Effective Research, Planning and Budgeting in Nigeria” in Obadan, Oshionebo and Uga (2002)
- Olofin, S. (1995) “Policy Modelling and the Nigerian Economy” in Iwayemi (1995)
- Oxford Policy Management (2000) “Medium Term Expenditure Frameworks – Panacea or Dangerous Distraction?” *OPM REVIEW* May 2000
- Oyegun, D (2002) “Planning and Budgeting in Nigeria: Problems and Solutions” in Obadan et al 2002
- Phillips, Dotun (1999) “People-Friendly Statistics for Statistics-Friendly People” in NSA 1999: 153-166
- Rogoff, R. “The Purchasing Power Parity Puzzle” *Journal of Economic Literature*, 34, pp 647 – 668.
- Sachs, J (2001) “Nigeria’s Economic Condition: The Challenge of Socio-Economic Development” in NESG (2001)
- Sanusi J.O. (2001) “The Nigerian Economy Growth, Productivity and the Role of Monetary Policy” *Development Policy Centre Annual Lecture Services* Abuja 2001.
- Tamuno T. N. and Atanda J. A. (ed.) *Nigeria Since Independence - The First 25 Years: Volume IV - Government and Public Policy* Ibadan, Heinemann 1989 pp. 163 – 190

Bibliography

- Ukwu, U.I. "Governance And the Nigerian Economy, 1960-1999" Paper presented at the World Peace Initiative Workshop on *Stabilizing the Civil Polity after the Military* Enugu, 19 May, 1999
- Ukwu, U.I. (1985) *Managing National Development*. Enugu, IDS
- Ukwu, U.I. (1994) "Industrialization and Economic Development in Nigeria: The Significance of the Structural Adjustment Programme" *Nigerian Journal of Economic and Social Studies* (NJESS) Vol. 36 Nos. 1,2,3 (Special SAP Edition) 1994: pp. 434-448.
- Ukwu, U.I. (1995) "Adjustment, Income Distribution and Poverty" in Iwayemi 1995
- Ukwu, U.I. (1996) "A Critical Review of Rural Development Strategy, Policies and Programmes in Nigeria" in Akeredolu-Ale (1996)
- Ukwu, U.I. (1999) Facilitator's Report: "Report of Committee on Budgeting Formulation, Reporting and Accounting Process" in FGN/WB/DPC 1999
- Ukwu, U.I. (2002) "Public Expenditure and Financial Accountability in Nigeria" Paper presented at the Joint Government of Nigeria – World Bank Workshop on *Improving Public Expenditure and Financial Accountability in Nigeria*. Kaduna April 24-26, 2002
- Ukwu, U.I. (1989)"Management in Nigeria: Public and private" in Tamuno and Atanda (1989)
- Williamson, J. (1994) *Estimating Equilibrium Real Exchange Rates* Washington, Institute for International Economics 1994.
- World Bank (2002). *Nigeria Options for Growth and Stability in a Challenging Environment* (Unpublished Study).
World Bank World Development Report various years