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BUDGET AND POLITICAL INSTITUTIONS AND BUDGETARY PERFORMANCE

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Abstract: *In this study, the role of budget and political institutions in promoting the efficiency of the budget process in Nigeria is examined. Efficiency of the budget process is described as budget activities that aid fiscal policy to respond asymmetrically to the business cycle by contracting during booms and expanding during recession. The direct institutions guiding the budget process as well as politically motivated institutional influences are considered in the study in order to show their varied impacts. Descriptive and correlation analyses are employed in describing the relationships using budget data obtained from annual budget reports in Nigeria. The empirical results from the study compare well with both regional and international positions; the budgetary process in Nigeria is fraught with largescale inefficiencies in terms of preparation and allocations. Moreover, budget institutions in Nigeria are shown to be weak in terms of maintaining accelerated processes or efficient resource use. The institutions do not provide the expected formidable guard against inefficiency of budget outcomes in Nigeria. This is largely due to strong influences of political factors in fiscal operation which, in turn, is due to inconsistent oil price development overtime. Thus, more external factors appear to bear in on the budgetary processes in Nigeria. To ensure improved countercyclical fiscal performance based on budgetary provisions therefore, the institutional framework of budget processes has to be strengthened.*

Keywords: Budgetary process; budgetary institutions; Nigeria.

JEL Classification: E62; H5; H77.

1. Introduction

The debate on fiscal policy as an essential agent of macroeconomic management in developing economies has focused on the output growth outcomes. The consensus in this regard is that in developing countries fiscal policy is highly procyclical, owing mainly to the effects of political economy factors. The proposition is that while developed countries are equipped with strong institutions and political systems, developing countries rarely have strong, healthy and stable institutions (Gavin and Perotti, 1997; Kaminsky, Reinhart and Vegh, 2004; and Talvi and Vegh, 2005). The predominance of resource dependence for fiscal activities has further compounded the efficiency tragedy of fiscal policy in these countries. Barnett and Ossowski (2002) identify this problem by highlighting the exhaustible nature of revenue streams and uncertainty posed by volatile income flows that are exogenous. This has led to implications that resource-rich developing economies have not performed well relative to their developed counterparts. While this may be true in the case of Nigeria, additional forces may be at work, persistently rendering fiscal stabilization efforts to be weak.

The difficulties posed by a volatile, unpredictable, and exhaustible source of fiscal revenue to fiscal management have been compounded in a number of cases by institutional weaknesses (IMF, 2007). Such institutional weaknesses hold powerful influences on the success and sustainability of fiscal management in Nigeria. For instance, dynamic factors

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surrounding Nigeria's fiscal setup have persistently derided the effectiveness of the Fiscal Responsibility Act which was introduced in 2007 to ensure that oil price shocks are not transmitted directly into the Nigerian economy.

Fiscal institutions surrounding the budget preparation in Nigeria seem to be weakened by persistent political institutional influences. Successful budget preparation within the medium term expenditure framework (MTEF) has often been intensely challenged due to pressures from political actors involved within the fiscal space. Benchmarks for budgetary applications are often manipulated to suit political interests with attendant delays in budget presentation and implementation. However, the introduction of the rules does not seem to have extensively stymied perennial political incursions in the budget processes. The data indicate that the oil price benchmark for the budget has grown by 260 percentage points from $20 pb in 2003 to $72 pb in 2012, even though neither the deficit ratio nor output forecast has changed considerably over the period. The National Assembly seldom adjusts output forecast, but are wont to amend either the oil price benchmark or total spending in each of the years.

Apparently the rationale for budgetary adjustment is based on current movements in oil prices and revenues. For instance, oil price benchmark was reduced from the initial presidential submission in 2009 in response to dramatic fall in oil prices in late 2008, but the benchmark was increased in 2010 with improvement in oil prices and expectation of fairly stable movement over the next periods. Indeed, Frankel (2011) noted that overly optimistic official forecasts tend to stem from the influence of politics which can exacerbate when 'the government is formally subject to budget rules.' As Olomola (2012) aptly observed, budget delays have occurred in terms of the preparation, screening, approval and implementation" in Nigeria. He maintained that the usually long delay in publishing the approved budget for both official and unofficial use has intensified in recent years, leading to weakening of the institutional foundations of transparency and accountability that are firm guards of the budgetary process. According to Olomola (2012), perpetual delays in release of approved budgets has led to ad hoc provisions have been made by both the legislative and executive arms of government to 'operationally extended from 12 to 15 months – a move which signaled the collapse of the budget process.'

In Nigeria, fiscal institutions would be more successful in aiding budget performance when there is broad political support for pursuing fiscal objectives. The main question that this study focuses on is whether budget and political institutions have had any success in ensuring budgetary regularity and efficiency in fiscal manage in Nigeria since these institutions were put in place. This will constitute the background upon which fiscal institutions in Nigeria can be considered as either effective or weak. Apparently, procyclical fiscal policy and disproportionate increases in government spending during oil booms in the country can be a manifestation of weak budget institutions that lead to weak fiscal management.

2. Literature

North (1990, 1992) set the pace for analyzing institutional factor influences on economic performance. Most of the studies that followed North's work show the positive benefits of improved quality of institutions in general output and growth outcomes (for instance, Kaufmann, Kraay and Zoido-Lobaton, 2003; Acemoglu, Johnson, and Robinson, 2005; and Akpan and Effiong, 2012) usually through the channels of policy analysis and the decision making processes of governance. The specific roles of institutions in coordinating and aligning fiscal policy with macroeconomic objectives have also received some attention although most of the studies focus on cross-country analysis (e.g. Frankel, 2011; Debrun and Kapoor, 2010; and Lledo, Yackovlev and Grdenne, 2009). These studies confirm that fiscal institutions are essential in the determination of fiscal behaviour in developing

countries. They also investigate reasons why budget institutions play a role in shaping the fiscal response to the cycle. The general consensus is that budgetary spending tends to expand during booms, often resulting in increased spending commitments which are difficult to rescind. The overall implications of the studies give the direction that well-designed and efficiently managed budget institutions can enable policymakers to adopt a countercyclical policy stance by reducing the deficit bias, raising awareness about the medium term implications of policy actions, and by highlighting the need for sustainable policies.
The *common pool phenomenon* - which arises when the various decision makers involved in the budgetary process (legislators, the finance minister, line ministers, etc.) compete for public resources and fail to internalize the current and future costs of their choices (Velasco, 1999) – has a strong impact on the nature of the budget process and the quality of budget outcomes (Dabla-Norris et al, 2010). In the same vein, information asymmetry and incentive incompatibilities between the government and voters and within the government hierarchy (e.g., between the federal and state governments) can also influence the size, allocation, and use of budgeted resources (Dixit, 1998; and Lienert, 2005). Unless regulated by strong institutional arrangements, the common pool phenomenon can result in a “deficit bias” in the form of excessive expenditures, deficits and debt levels (see IMF, 2010). Strong core fiscal institutions can counteract this bias by ensuring that the budgetary consequences of policy decisions are appropriately taken into account.
Hallerberg and Wolff (2006) researched literature and noted that problems with fiscal discipline can arise from at least two sources: Differences between long-run and short-run benefits can induce deficit spending biases if policy makers discount the future more heavily than private consumers, second, differences between the marginal benefit and marginal cost to an individual group in the budget making process lead to a common pool resource problem Procedural rules of the budget process can be used as a commitment device to reduce this spending bias. The main feature characterizing fiscal institutions can thus be characterized by the degree to which they centralize the decision-making process (Hallerberg, Strauch, and von Hagen 2004). Good budget institutions centralize the process and reduce the spending bias associated with the common pool problem.
We seek to contribute empirical backing to the growing literature on budgetary and fiscal institutions in Nigeria. Moreover, institutional factors and their setups can be country-specific. For instance, apart from the apparent effects of poor governance and corruption on economic performance in Nigeria, other institutional factors like the federal system, resource allocations, budgetary institutions, and the arms of government exert strong effects on fiscal and economic behaviour (Olomola, 1999, 2012; Wantchekon and Asadurian, 2002; Eifert, Gelb and Tallroth, 2002; and Jimoh 2003).

3. Budgets and Budgetary Allocations in Nigeria

A major institutional issue that governs budgets and fiscal allocations in Nigeria is Fiscal Federalism that has been enshrined into the constitution. According to Kalu (2011), Fiscal Federalism in Nigeria is synonymous with revenue allocation and “resource control”. Indeed, the methods, procedures and formula for dividing resources among the various segments of the country in Nigeria has always been an issue of controversy. From the onset, various commissions have been set up to work out acceptable and equitable revenue allocation formula for the country. The commissions include:

- The Phillipson commission of 1946
- The Chicks -Phillipson commission of 1951
- The Chicks commission of 1953
- The Raisman Commission of 1958
- The Binns Commission of 1964

- The Dina Interim Revenue Allocation committee of 1968
- The Aboyade Technical Committee of 1977
- The Okigbo Presidential Commission of 1979
- The T.Y Danjuma Fiscal Commission of 1988

In perspective, there has been many insinuations about undue influences by political factors on the position of the various commissions with the tendencies to suit particular constituencies and that their analyses are not informed by logic but preconceived self or sectional interests rationalized and justified by theories (Kalu, 2011).
Essentially, state governments in Nigeria rely mainly on federal allocation, grants and proceeds from excess crude account as their major sources of funding. As shown in Table 1, this dependence also affects the structure of local government allocations. This could, in effect, influence the vested interest of state and local governments, either through representations at the National Assembly or direct fiscal relations with the centre, in distorting the budgetary system to favour their cause. The fiscal unitarism, in the Nigerian polity, brought about by the above, provided incentive to abandon internal revenue generation drive, macroeconomic mismanagement and instability in the states. It is also an open license for uneconomical competitiveness in the federal government’s provision of public services and public goods across the states, the so called ‘federal presence’ (Ojo, 2010).

Table 1: Vertical allocation of the federation account, 1981-Till Date

	Initial 1981 Act 1/	Revised 1981 Act	1990	January 1992	June 1992 to April 2002	May 2002 (1st Executive Order) *	July 2002 (2nd Executive Order) *	March 2004 (Modified)/ 2*
Federal Government	55	55	50	50	48.5	56	54.68	52.68
State Government	26.5	30.5	30	25	24	24	24.72	26.72
Local Government	10	10	15	20	20	20	20.6	20.6
Special Funds	8.5	4.5	5	5	7.5			
Derivation (Oil Producing States)*	2	2	1	1	1	0	0	0
Dev. Of Mineral Producing Areas	3	1.5	1.5	1.5	3	0	0	0
Initial development of FCT Abuja	2.5	0	1	1	1	0	0	0
General Ecological problems	1	1	1	1	2	0	0	0
Stabilisation	0	0	0.5	0.5	0.5	0	0	0
Savings	0	0	0	0	0	0	0	0
other Special Projects	0	0	0	0	0	0	0	0
TOTAL	100	100	100	100	100	100	100	100

Source: Adapted from Ojo, 2010
Note: 1. Nullified by Supreme Court in October 1981
* From the 1999 Constitution, the 13% Derivation provision is accounted for before the revenue is allocated into the federation account.
2. The current revenue formula is based on the modified grant from the Federal Ministry of Finance, which came to effect in March, 2004

Empirical Analysis

The main issue investigated in the empirical analysis is to show that fiscal outcomes respond effectively to the effects of poor budgetary and political institutional setups in Nigeria. Fiscal institutions are basically mechanisms that are intended to permanently shape fiscal policy design and implementation (IMF, 2010). The institutions are categorized into two sets for the purpose of this study: the first involves the special fiscal institutional set-up in managing fiscal policy over the last few years. The budgetary oil price benchmark and deficit ceiling are included for the analysis. The second primarily focuses on the roles of budget-making institutions measured as the outcomes of their influences with respect to time taken to pass the annual budget (as in Lienert, 2005).

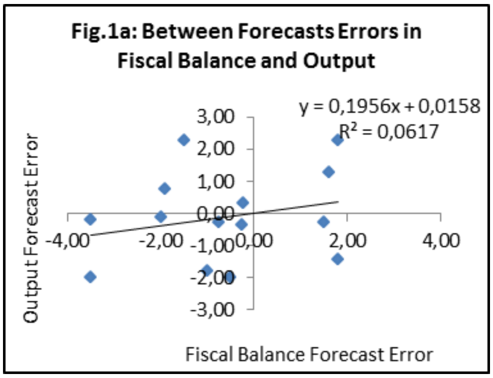
These measurements particularly follow Tornell and Lane (1998) voracity arguments to fiscal procyclicality in resource-rich countries. They argued that economic and fiscal performance could be reduced when there are powerful groups, especially in a system with weak institutional barriers to discretionary redistribution. This is because the 'non-cooperative powerful groups generate a redistribution struggle' which often ends up in wasteful and inefficient use of the resources. In the same analysis, the researchers showed that a reduction in power concentration through increasing the number of powerful groups would ensure better economic performance. We intend to provide empirical tests for these arguments for the Nigerian case. In Table 2, the descriptive statistics for out-turns and budgetary forecast errors in output and fiscal deficit between 2003 and 2012 are reported. The errors are computed as the difference between forecast values and actual out-turns. The standard deviations for forecast errors are higher than those of actual outcomes in both deficits and output; errors appear to be rife in budgetary forecasts. This suggests weakness in fiscal or budgetary applications in the country.

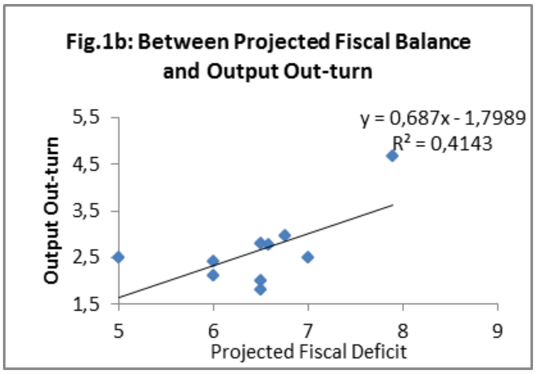
Table 2: Errors in Forecasting Budget Deficits expressed as % of GDP and Output Growth Rate for 2003 to 2012

	Actual Outcomes		**Budget Forecast Error**	
	Budget Deficit (% of GDP)	Output Growth (%)	Budget Deficit (% of GDP)	Output Growth (%)
Mean	1.86	6.47	-0.27	-0.76
Max	3.3	7.9	-2.0	-3.50
Min	0.5	5	2.30	1.80
Std.	1.19	0.75	1.28	1.61

Source: Federal Government of Nigeria, Annual Budget Reports

The place of budgetary institutions in affecting budgetary stance is initially presented in figure 1 below. In this place, we show how effective the annual forecasts about the fiscal balance and output needed for each budget year have been. We do this by examining the relationship between errors in forecasts and output for the budget years. In figure 1a, the relationship between budgetary forecast errors in fiscal deficits and output indicates a positive slope. If there are errors in fiscal balance benchmarking, there is a relatively high chance that errors will occur for output forecasts. The second chart shows that when fiscal balance is projected high, output tends to turn out high too. These results indicate that if budgetary rules are weak and ill-planned, the results in output will follow the same pattern.





Source: Underlying Data from Federal Government of Nigeria, Annual Budget Reports

4.1 Budget Institutions and Fiscal Cycles

The effects of the budgetary institutions in budget outcomes in Nigeria are particularly lucid from the perspective of actors in budgetary administration. Here, we consider the rules set-up by the system to monitor the federal budget for it to function within a medium term expenditure framework, and the influences exerted by key budget actors (the legislators cum executive arms of government). In table 3 below, a simple correlation matrix is reported showing the relationship that fiscal rules and budgetary preparation efficiency have on fiscal outcomes in the country since 2003. Error in fiscal balance forecast has a negative relationship with actual output level, suggesting that when the fiscal balance is unduly and inefficiently fixed, output growth tends to reduce. However, when projected balance is high, output growth may rise for the period (as shown by the positive correlation coefficient) since spending is expected to rise along with the projected balance. Oil price forecast error is negatively correlated with actual fiscal balance but positively correlated with balance error. This shows that weak oil benchmarking tends to reflect in balance error. Hence, it is shown that oil price movement reflects on the eventual fiscal balance in Nigeria. This is an indication that fiscal institutions are still not effectively isolated from oil price vagaries in the international market.

Table 3: Fiscal Institutions and Budget Effects Correlation, 2003-2012

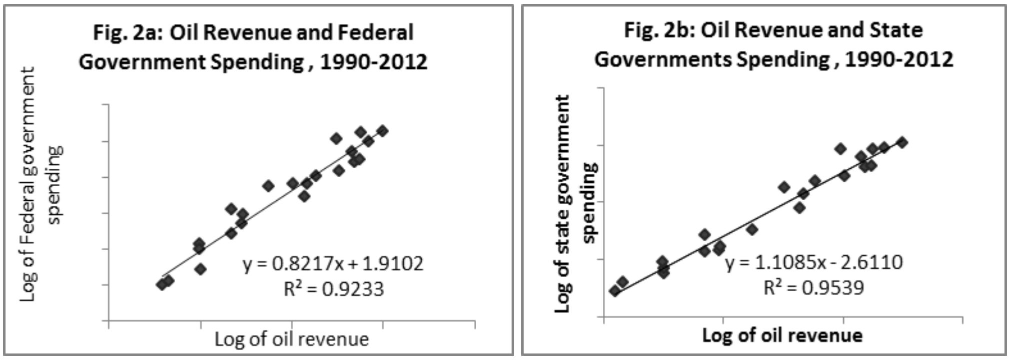
	Actual output	**Actual fiscal balance**	**Balance error**	**Budget making period**	**Early passage of budget**
Actual fiscal balance	0.439				
Balance error	-0.196	0.087			
Projected balance	0.644	-	-		
Budget making period	-0.088	0.317	0.317		
Early passage of budget	0.183	0.496	0.178	0.736	
Oil price forecast error	-	-0.065	0.284	0.158	-0.035

Source: Federal Government of Nigeria, Annual Budget Reports

In terms of the budget process, influence of budget institutions are viewed from the time taken to complete the budget processes. In table 3, a negative correlation is reported between length of time taken to complete the budget process and output growth for the period, but early budget passage is positively related with output growth. It can also be seen that a positive relationship exists between period of time taken to complete the budget process and the difference between actual fiscal balance and budget benchmark. The general indication of these results is that fiscal institutions in Nigeria are not as strong as should be and there influences tends to exacerbate fiscal procylicality in Nigeria. Perhaps, the reason for this weak performance may be linked with the political institutions effect as shown in the next analysis.

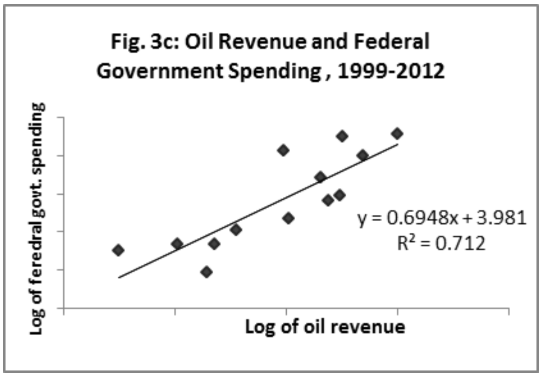
4.2 Political Institutions and Budget

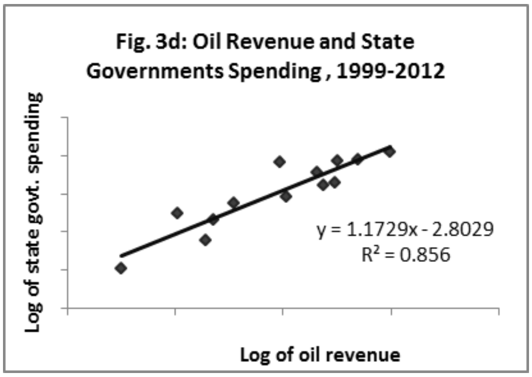
An analytical position on the voracity view may also be shown by examining the role of political influences on the budget outcomes. In this section, we show that spending patterns based on oil revenues is heavily influenced by state and federal government relationships. In Figure 2 the scatter plot for the relationship between oil revenue and both federal and state governments spending for the period 1990 – 2012 are plotted along with the regression line and equation. It can be seen that the slopes for each of the charts is rather steep and positive showing that as oil revenue rises, spending automatically rises too. It should be noted that oil boom episodes that witness less than proportionate increase in government spending reflects the success of fiscal policy management restraint or fiscal institution success. However, periods that witness more than proportionate increase in spending as a result of an oil boom is a sign of existence of voracity effect in which the government is under pressure to increase spending (Dabla-Norris et al, 2010).



Source: Underlying Data from Central Bank of Nigeria, Statistical Bulletin

In comparison, the R squared for the 1999-2012 period is lower than that of the entire period suggesting that more factors, other than federal allocations, now explain government spending at both tiers. However, the slope coefficient for the states relationship is greater than one, indicating that the states tend to increase spending more than proportionately to the rise in oil revenue inflow. Also, even though the R squared has reduced after 1999 the slope coefficient has actually increased, indicating that state governments have mounted higher pressure on the pool resources of government since democracy was restored. This phenomenon can actually prevail when a nation transits into democracy but the institutions are not strengthened (Tornell and Lane, 1998).





Source: Underlying Data from Central Bank of Nigeria, Statistical Bulletin

Conclusions

In this study, the role of budget and political institutions in promoting the efficiency of the budget process in Nigeria was examined. Efficient budget process, it is argued, should aid fiscal policy that responds asymmetrically to the business cycle by contracting during booms and expanding during recession. In a natural resource dependent economy like Nigeria, this fiscal policy stance can be difficult to pursue or attain because of the peculiar nature of the supply side elements – revenue is highly unpredictable, and the political structure paves way for extensive influences. Because of this, budget processes have been found to be inefficient and fiscal policy is often procyclical (fiscal balance tends to rise during booms and fall in recession). We sought to investigate the role of the main players in fiscal institutions in either fostering or ameliorating this pattern of fiscal policy in Nigeria. The results showed that fiscal institutions were rather weak (they do not provide the expected formidable guard against procyclical fiscal management) and still react based on oil price development in directing fiscal policy in Nigeria. The influence of political factors in fiscal operation may be blamed for these inefficient budget institutions.

The results in our study are compare well with those for more advanced economies. Hallerberg et al. (2006) used econometric analysis to demonstrate the budgetary impact of both budgetary and political institutions for the European Union and showed that the 'effectiveness of centralising budgetary decision-making varies with the form of fiscal governance' in place. They noted that budgetary institutions would contribute less to fiscal sustainability when the political system is loose (such as a federal state) in which the stringency of multi-annual targets seems to be more important. However, the budget institutions would be more effective in attaining effective budget process 'more stringent budgetary targets seem to operate as disciplining devices' Hallerberg et al. (2006).

The results from our study therefore implies that the federal system in Nigeria would provide stronger impetus for weakening the budget institutions and maintaining fiscal discipline over time.

Within the context of other studies, this paper confirms the findings by Gollwitzer (2010) who conducted an Africa-specific composite indicator for the quality of budgetary institutions which represents an indicator of inter-temporal fiscal discipline for each of the African countries. The results also showed that Nigeria did not perform well in terms quality of budgetary institutions, especially in comprehensiveness and transparency. In addition, Gollwitzer (2010) results (also using correlation analysis) showed that for the entire African region, good budgetary institutions lead to less deficits in government, especially when budgetary transapency is used as the measure of quality.

In order to ensure improved countercyclical fiscal performance of the budgetary process therefore, the institutional framework of budget processes has to be strengthened. For instance, the enactment Sovereign Wealth Fund Act is a good starting point to ensuring this purpose. Also, elements of budgetary management should be improved by granting strong powers to the Ministry of Finance and other professional contributors to the budget on legal initiatives with budgetary impact and in budget decisions, especially regarding the process of budget passage. Also, budgetary planning should command a high technical capacity in order to limit benchmarking and forecasting errors.

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