

Unrealistic Underlying Assumptions; Unrealistic Budget

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One thing that stands out clearly in the proposed 2009 budget is the faulty premises upon which it was based. As important as it is, the robustness and reliability of any budget derives in the first place from the corresponding reliability of its underlying assumptions. Since in itself the budget comprises arrays of estimates of expected earnings and expenditures, the basis for those estimates must be seen to be reasonably reliable. The reliability of assumptions does not mean that the planners need to be pessimistic when they ought to be optimistic or vice versa, but that the fundamental drivers of each of the influences on each assumption/parameters are thought through and fairly reasonable conclusions on the future performance of those parameters reached. It is fair enough to appreciate the fact that no human can predict the future with reasonable certainty, but past trends, historical experiences, future expected developments and many other considerations all intermarry to shape consensus on the magnitudes and directions of various parameters under consideration. One would have expected much of such thinking in the presented budget estimates.

Key considerations on the revenue side for Nigeria have been the levels of crude oil production, the benchmark price for crude oil, the exchange rate of the naira, the inflation rate, the growth rate of gross domestic output, taxes, and joint venture cash calls. All these variables act independently or interact to define the revenue standing of the government. Taking a look at the assumptions underlying Nigeria's national budgets in the last five years much can be deciphered if one examines the levels of deviations between the parameter assumptions and their eventual performance. One would have expected increased efforts at minimizing the degrees of these variations in order to engender more reliability but that was not the case. For example, aside in 2004 when there was a positive variance between the budgeted and actual crude oil production, the rest of the years have shown widening negative deviations. In 2005, the budget was based on 2.7 mbpd but the actual production was lower by an absolute value of 0.2 mbpd. In 2006, this variation increased to 0.4mbpd. In 2008, the variation by July was 0.43 mbpd. Now in 2009 we are expecting to produce 2.3mbpd. My thinking is that this assumption is unduly optimistic for many reasons.

In August this year, oil production fell below 2.0 mbpd following OPEC cuts. Although it came back to 2.0 mbpd, there is no guarantee that the proposed 2.3 mpbd will be achieved. Following global financial crisis, the United States and many other developed countries cum major importers of oil have significantly reduced their demand levels partly in adjusting to lowered prosperity and in part in order to strategically depress the global oil price levels. This global oil market game can continue for a while because the United States' maintains huge crude oil reserves as well as have access to the Iraqi oil. Armed with these war tools, the option left for OPEC is to continue with quota slashes. The implication therefore is that the 2.3mbpd used for the budget may not be realistic in 2009. We are also not anticipating a major outbreak of war involving the United States or any other major oil supplier as was the case with Iraq in the recent times or the Yom Kipur experience that led to the 1973 oil boom. Perhaps too, the budget designers may have played down the Niger Delta factor in oil production. Although one may argue that with possibilities of oil production cuts, the full effects of the adverse impacts of Niger delta militancy on oil production may not be fully felt. That argument is neither here nor there. The important thing is that the forecast production level still ought to have been adjusted for the Niger Delta crisis. The fact that the budget did not satisfactorily address the Niger Delta situation is enough blunder that can justify further rebellion and vandalization of oil installations. The region may have been tired of talks and mediations and will obviously

appreciate concrete demonstrations of fiscal good faith.

Another related parameter underlying the budget proposal is the crude oil price. Even on the day of budget presentation, the price was about US\$46 per barrel: a level where it stood in an unbroken nosedive speed. If the recent past matters much in forecasting the future, the budget makers needed not to be told that basing the projections on a US\$45 per barrel may not sound reasonable. Unless something major that will stop the pricing strategy of major oil importers such as major war or catastrophe that hits key supply sources, oil prices will likely fall lower than US\$35 per barrel. The crude oil reserve accumulations of the United States were actually meant for situations like this which approximates a war condition. Thus given the financial crisis and the economic emergencies faced by the country it only makes more sense to cut down on its expenditure by reverting to its reserves of crude oil which can last for several years. The longer this lasts the less the possibility of early upward price adjustment. Secondly, the adjustments of individual economic agents in various countries as a consequence of this crisis will equally depress demand and prices. On the whole, again the US\$45 per barrel benchmark is unreliable. Perhaps, the budget makers relished on the illusion of the continuity of the performance of price benchmarks relative to actual performance. In 2004, actual price performance was 68% higher than the benchmark. It was 93% (2005); 47% (2006); 68% (2007); and 83% up till June 2008. Unfortunately, the realities on ground from the second half of the year 2008 clearly signalled a change of direction which the budget makers would have heeded.

Perhaps one of the thorny part of the underlying assumption has pertained to the exchange and inflation rates. The exchange rate assumption underlying the 2009 budget was clearly omitted. One can however guess that an exchange rate of US\$116.00 was used. It is equally debatable whether the naira exchange rate will on average be US\$116. At present, the naira value has started dropping. We believe that the foreign exchange reserve accumulation can do much in stabilizing the rate but that must be at a much lower naira value (relative to the dollar) than what currently obtains. With the drop in dollar earnings, the huge deficits and its inflationary impacts, expectations of low output etc. one can only expect that the value of the naira will fall but can be propped to some level through central banks interventions. Aside the exchange rate however is the highly optimistic inflation rate expectation. In 2007, the inflation rate upon which the budget was based was 9% and the actual (official statistics) was 6.6%. In 2008, the budget was based on an expected inflation rate of 8.5%. The published inflation rate as at end of November was 14.7%. How does it appear realistic to expect a year of combined austerity and expanded monetary growth to yield inflation rates lower than the currently going rate? Aside the CBN's proposed inflation targeting -aimed at freezing inflation rates at the official reporting levels - which in itself is full of pitfalls, expecting a single-digit inflation rate - lower than that of 2008 and 2007 - in a year with proposed fiscal deficits in excess of 4% of GDP shows unreasonable optimism.

The monotonous argument will again be about government's disposition to fiscal prudence, the quality of spending on infrastructure which is supposed to raise output, the mode of deficit financing etc. One important fact is that no matter how fiscal deficit is financed, it must be inflationary and must have fairly long term deleterious consequences unless an unprecedented boom occurs midway. Though this may not be very widely felt immediately but because of the austere conditions that will prevail and consequently affect output, expansions in money supply will result in inflation much faster than otherwise would have been expected. Inflation is always a consequence of monetary expansion. It will even be worse in a situation where we are anticipating poor output performance. Thus with lower economic activity and increasing supplies of money, your guess is as good as mine. The argument about prudence is out of the question. We are not yet there. If this government is harassing and intimidating the media; has dead-cold feet concerning the passage of the freedom of information bill which underlie openness in governance; indirectly supporting the persecution of anti-corruption champions, we may never be able to tell exactly how our monies have been stolen. The difference is that this time around, the stealing may be done more 'prudently' as opposed to the past when it was

carried out with abandon regardless of what the people might say. The quality of investment in infrastructure is good but we also know that the effects of these may not be felt in any significant way in 2009. Infrastructure development is usually of a medium to long-term span. We can equally testify to the amount of infrastructure development in spite of the monetary releases. Budget performance or implementation did not exceed 35%. The reason is not too far from the incentive system and a leadership that lacks the desired commitment to achieving targets that will authentically lead to Nigeria's growth and development. For now, the important thing is that allocation has been made for infrastructure. Be that as it may too, aside few local jobs that may be created in the process, the bulk of the infrastructure spending will be repatriated to their home countries as incomes to largely foreign firms who will be handling the projects.

This therefore brings us to the assumption of the GDP growth rate which was used in the budget. It really appears as if those who designed the year 2009 budget live in the outer space. One finds it difficult to fathom the premise upon which the expectation of a growth rate of 8.9% of real GDP for this economy in 2009 was made. Let me concentrate only on two areas upon which the proposed budget deliberately attempts to further weaken the economy. The first area is tax. With evaporating hope in the capacity of crude oil earnings to meet its fiscal obligations, the government has announced that following the performance of nonoil revenue performance last year that government will pay significant attention to taxes. No one condemns the use of taxes for development even though it is itself evil in Nigeria: a coercive transfer of ones property to a cabal who does what they want to do with it. In economies where taxes are predominantly relied upon to drive government spending and economic activities, the full impact of these taxes are seen. As a matter of fact Nigerians have long been suffering varieties of shades of taxes long before now and yet nothing could be shown for it.

For many years government failed consistently to support the development of the non-oil revenue sources. The cocoa and groundnut pyramids once existed but are now fabled. The cotton and textile industries are dead. Small and medium scale enterprises are all operating on the fringe. More than 30% of businesses die prematurely because of the scorchingly inclement environment of business which has been created by the government. Now what this budget is saying is that in spite of this death row to which many of these enterprises are already committed, it will strike them more strongly with taxes. We simply hope that the government does not fall for the schemes of the federal inland revenue service for increased value added taxes in order to achieve its aim. It is regrettable that government is beginning to realize that non-oil sources can strongly support its revenue expectations but has consistently failed to meet its environment of business needs for increased economic activity. What Nigerian businesses need now is the ease of taxes, well-functioning infrastructure and non-inflation inducing policies. The implications that the increased tax drive will have particularly on medium scale businesses will be devastating. With low demand consequent upon government's curtailed spending on what it terms non priorities, many businesses which are tied to government patronage up to the 8th chain may die. More taxes can equally fastrack their crisis. Many have already exited from the competitive space before this impending crisis. Dunlop is a well-quoted example. What will happen when the iron rod is finally applied? The inflationary consequences of the huge fiscal deficits will also act like taxes on these businesses and will further weaken their capacity to generate positive value added. The cumulative effect of an obvious future shrinkage of economic activities based on the proposed budget is that the real growth of national output in 2009 can never be as high as 8.5%. Those who conceived and arrived at these underlying parameter magnitudes should go back to the drawing board.

In sum, it is my considered opinion that the legislature should ask the executive arm to review these assumptions and of course the consequent estimates. We should not trivialize what is as important as the national budget. Basing a twelve-month plan that will ensure that the economy of over 140 million people either runs well or strutters on parameter assumptions that are obviously unrealistic is to say the least a demonstration of how unserious as a people we

are. The starting point in debating this budget is the assumptions which will determine in actuality what resources are truly available or can possibly be available for the various proposals. It is only after the assumptions have been tamed with realistic bounds that considerations of impact of the various proposals should follow. This places huge burden on the national assembly.