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Economic Newsletter

Buhari Version II (2019—2023): Economic Perspectives

The Reflexive Statist

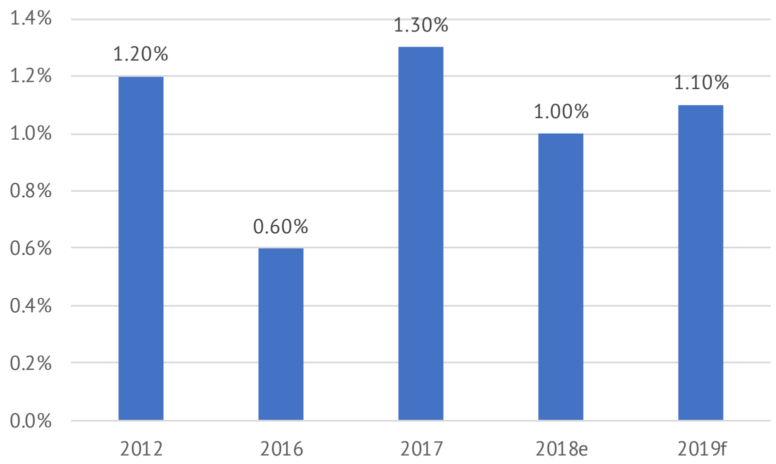
According to The Economist, leaders do not tend to switch from being reflexive statists in first terms to free-marketers in the second. This argument by The Economist should be the pertinent question around the economic game plan of the Buhari led administration in its second term which will commence on May 29th 2019 and terminate on the same day in 2023.

Mr. Buhari's victory of 2015 was largely greeted with euphoria by a business community expectant of badly needed macro reforms. However, long-term watchers of the president were quite dismissive of his inclinations towards macro-reforms. Middle of the ground analysts buoyed by some of the bold pro-market reforms in the Economic Recovery Growth Plan (ERGP), had hoped for some form of Damascene moment for the president that would get him to expend some of his political capital on tough and politically unpopular macro reforms.

The 68% rise in the pump price of petrol to ₦145 in May 2016 from ₦86.50 and the feeble response from the oft anti-reformist labour unions had given a bit of hope to these middle of the ground analysts that Mr. Buhari did intend to expend some of his political capital to pursue unpopular reforms. However, Mr. Buhari's rhetoric on exchange rate policies which may have driven the Central Bank into adopting a demand management stance on the currency, cleared doubts about the president's statist economic ideologies. Without a doubt, the effects of the currency crisis did send Nigeria into its first recession in 25 years.

While the demand management policy of the Central Bank remains the biggest symbol of Mr. Buhari's statist stance, there are quite a number of seemingly innocuous illustrations that support this assertion. Firstly, some of the germane bold market reforms in the ERGP document such as the review of the pricing mechanisms for the key prices (exchange rates, electricity tariffs and petrol prices) to reflect fundamentals have been largely ignored. This has left the country with a burgeoning fiscal deficit (currently only three basis points shy of the 3% guidance in the Fiscal Responsibility Act). The second argument to demonstrate the statist stance of this administration would be the abortion of its own reform programs. For instance, the planned concession of the major international airports in Lagos, Kano, Port Harcourt and Abuja by this administration and the cold trail of the process buttress this argument.

Figure 1: Capital Expenditure as a % of Nominal GDP



Source: Agusto Consulting

> *"Mr. Buhari's government will have to work to raise revenue while also restructuring government spending. This will require politically unpopular but inevitable choices."*

Fiscal Background

Nigeria is currently in a dire fiscal strait and the numbers are quite grim. For instance, despite the positive spin about Nigeria's benign debt to GDP currently around 20%, interest payments as a percentage of revenue are over 60%.

Other fiscal indicators also put Nigeria at the bottom of the rung even amongst sub-Sahara African peers. Nigeria's five-year average of capital expenditure as a percentage of nominal GDP is a meagre 2.1% which pales in comparison to Angola (7%) and Kenya (7.6%). However, with a projected budget deficit of N3.8 trillion in 2019, CAPEX as a percentage of nominal GDP could decline further to 1.1% this year. The implication of this burgeoning deficit is that in 2019, Nigeria will have to borrow to meet its obligatory spendings (interest payments, transfers and payroll) projected at about ₦5.4 trillion with a revenue of about ₦4 trillion. This implies a cash crunch for CAPEX.

Thus, with this fiscal backdrop, macro reforms that will improve the revenue position of the government and pare back the deficit by cutting spending are non-negotiable.

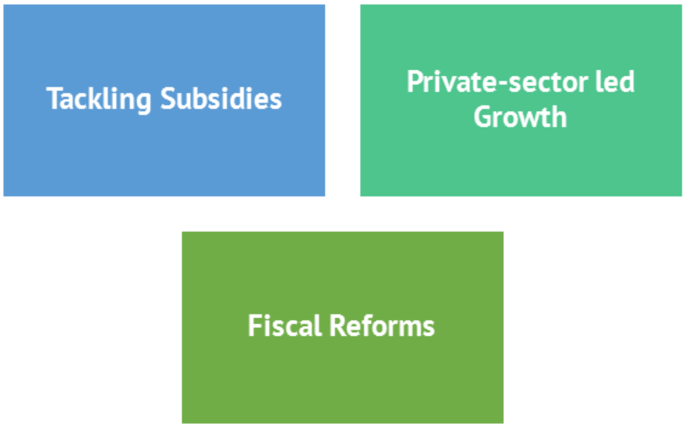
Buhari's Rock and a Hard Place Moment

All options on the table for Mr. Buhari in his last term are hard choices with no easy way out. Mr. Buhari's government will have to work to raise revenue while also restructuring government spending. This will require politically unpopular but inevitable choices.

For instance, Nigeria's current fuel subsidy regime indicates the country may have re-adopted opaque practises of the past that not only create a huge fiscal hole but a morass as well. With subsidy payments probably in the range of ₦1.2 – ₦1.3 trillion annually, the country is obviously haemorrhaging especially amidst the steep opportunity costs. Mr. Buhari will not only have to stop this fiscal haemorrhage but also muster the political will to deregulate the downstream petroleum industry once and for all times.

Despite the current inertia amongst exchange rate activists, risks abound in that space. Nigeria still operates a multiple exchange rate regime. Agusto & Co is even more baffled by the inertia of state governors to push for reforms in the exchange rate policy. By adopting the official rate of ₦306/$ as opposed to the NAFEX rate of about ₦360, states lost more than ₦500 billion in 2018 from the federation account.

Figure 2: Pillars of a Strong Reform Agenda



Source: Agusto & Co.

> *"The pertinent question going into this second term is: will Mr. Buhari continue with his pursuit of statist policies?"*

Mr. Buhari's To—Do List (2019—2023)

The Reform-Lite approach of the Buhari administration in the first term implies that it has an extensive To-Do list in the second and final term. Some of the big issues that will make or mar Mr. Buhari's economic records will be the management of subsidies and other cost unreflective tariffs being stifled by price controls. These reforms will require the removal of subsidies on the pump price of petrol, allow market forces to determine the domestic price of natural gas, allow electricity tariffs that enable operators earn margins on their costs and also ensure exchange rates reflect fundamentals. These reforms could help stimulate investments across board and unlock economic growth.

The Buhari administration will also need to adopt a private sector growth approach. Nigeria's poor non-oil tax takings (3% of nominal GDP) implies that the aggressive adoption of a Keynesian model – which prioritises government spending amidst poor tax credentials – could create a fiscal time bomb for the nation. Government will have to understand its limits in stimulating growth and creating jobs. The Buhari administration should seek to improve efficiencies in the economy by concessioning key infrastructure and eliminating monopolies of state-owned enterprises (SOEs) in key sectors such as aviation (airport ownership and management), railway and electricity transmission by opening up these sectors to private sector investments.

Mr. Buhari's reform agenda should also include germane fiscal reforms such as the reduction of interest payments as a percentage of revenues, reduction in the public sector payroll and other recurrent expenditure and boosting government revenues by improving non-oil tax compliance. These reforms will require Mr. Buhari to expend some of his political capital that has just been raised from the February 2019 presidential elections. The jury will be unforgiving on Mr. Buhari if he fritters his political capital akin to the first term approach.

The pertinent question going into this second term is: will Mr. Buhari continue with his pursuit of statist policies? Or will he require a Damascene moment to metamorphose from being a reflexive statist into a free-marketer? Long term watchers scoff that the status quo will persist. Overall, we believe that Nigeria cannot sidestep reforms without severe consequences that could last an entire generation.

History beckons on Mr. Buhari to prove the naysayers wrong.

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