



NATIONAL OPEN UNIVERSITY OF NIGERIA

SCHOOL OF MANAGEMENT SCIENCE

**COURSE TITLE:
PUBLIC FINANCIAL MANAGEMENT**

COURSE CODE: PAD 401



NATIONAL OPEN UNIVERSITY OF NIGERIA

14/16 Ahmadu Bello Way, Victoria Island, Lagos

COURSE DEVELOPMENT

PUBLIC FINANCIAL MANAGEMENT

PAD401

COURSE GUIDE

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1.0 INTRODUCTION

This course, PAD401 Public Financial Management in Bachelor's in Public Administration has been designed to give you self instruction on the fundamentals of Public Financial Administration. It teaches you development in public financial management in the public sector.

2.0 COURSE AIMS

The aim of this course is to introduce you to the basics of public financial management methods and processes. It also aims at encouraging you to acquaint yourself with the nature and scope of public financial management.

3.0 COURSE OBJECTIVES

By the end of this course, you should be able to:

- (i) explain public(government) financial management;
- (ii) define and explain fiscal and monetary policy in Nigeria;
- (iii) identify the sources of government revenue and classify government expenditure;
- (iv) discuss budget and budgeting budgetary control in government sector;
- (v) discuss public(government) debt and its sources;
- (vi) Identify and discuss government enterprises and multilateral institutions.

4.0 WORKING THROUGH THIS COURSE

This course, PAD401, Public Financial Management, expects you to do a lot of reading in order to cover the materials in the course material. It implies that you should devote much time to this course by reading through this material and getting more information from numerous texts and journals. These abound in every library and from the internet. The course material has been made easy to read and user-friendly. However, you will need to attend the tutorial sessions where your Facilitator would direct and provide you with more information. You will need to work in groups with other students in order to discuss, compare notes and thoughts as well as to exchange and share ideas. Below are the lists of all the components of the course:

5.0 COURSE MATERIALS

The National Open University of Nigeria will provide you with the following items:

- Course Guide
- Study Units
- TMA Assignment File for continuous assignment.

In addition, at the end of every unit, is a list of texts for your references and for further reading. It is not compulsory for you to read all of them. They are only essential supplements to this course material.

6.0 STUDY UNITS

The study units in this course are as follows:

MODULE 1 ENVIRONMENTAL AND CHARACTERISTICS OF GOVERNMENT ACCOUNTING

UNIT 1 Environmental Characteristic of Government and Institutional Accounting

UNIT 2 Governments and Institutional Accounting

UNIT 3 Fiscal Policies

UNIT 4 Monetary Policies

UNIT 5 Sources of Government Revenue

UNIT 6 Introductions to National Fiscal Responsibility

MODULE 2 FISCAL FEDERALISM, TAXATION AND BUDGETING IN PUBLIC SECTOR

Unit 1 Fiscal Federalism and Resources Allocation

Unit 2 Taxation

Unit 3 Government (Public) expenditure

Unit 4 Auditing of Government Accounts

Unit 5 Cost-Benefit Analysis and Project Management in Public Financial Management

Unit 6 Forms of Budgeting

MODULE -3 NATIONAL DEBTS, ACCOUNTABILITY AND MULTILATERAL INSTITUTIONS

Unit 1 Government Budget and Budgetary Control in Public Sector

Unit 2 Government Expenditure Control

Unit 3 Politics of Budgeting: Appropriation, Authorization & Control

Unit 4 National Debts & Debt Management

Unit 5 Government Organizations/ Managers of Public Finance

Unit 6 Role of Multi-lateral Institutions- IMF, World Bank etc

7.0 ASSIGNMENT FILES

You will find the assignment questions for each tutor marked assignment (TMA) in the folder labeled “Assignment File.” You will find the details of the work.

8.0 ASSESSMENT

There are two aspects to the assessment of the course: first is the tutor-marked assignment; and secondly, the examination. Within each unit are self-assessment exercises, which are aimed at helping you to check your assimilation as you proceed. Try to attempt each of the exercises

before finding out the expected answers from lecture. In tackling the assignments, you are advised to be sincere in attempting the exercises; you are expected to apply information, knowledge and techniques gathered during the course.

9.0 TUTOR-MARKED ASSIGNMENT (TMAS)

This is your continuous assessment and accounts for 30% of your total score. You are expected to answer at least four TMA's, three of which must be answered and submitted. However, it is desirable in all degree level education to demonstrate that you have read and researched more widely than the required minimum. Using other references will give you a broader viewpoint and may provide a deeper understanding of the subject.

10.0 FINAL EXAMINATION AND GRADING

With this examination written successfully, you have completed your course in Basic research and one believes you would apply your knowledge (new or up-graded) in your project. The 'end of course examinations' would earn you 70% which would be added to your TMA score (30%). The time for this examination would be communicated to you.

11.0 HOW TO GET THE BEST FROM THIS COURSE

In distance learning, the study units are specially developed and designed to replace the conventional lectures. Hence, you can work through these materials at your own pace, and at a time and place that suits you best. Visualize it as reading the lecture.

This is one of the great advantages of distance learning. You can read and work through specially designed study materials at your own pace, and at a time and place that suits you best. Think of it as reading the lecture that a lecturer might set you some readings to do, the study unit will tell you when to read other materials. Just as a lecturer might give you an in-class exercise, your study units provide exercises for you to do at appropriate points.

Each of the study units follows a common format. The first item is an introduction to the subject matter of the unit, and how a particular unit is integrated with the other units and the course as a whole.

Next is a set of learning objectives. These objectives allow you to know what you should be able to do by the time you have completed the unit. You should use these objectives to guide your study. When you have finished the unit, you must go back and check whether you have achieved the objectives. If you make a habit of doing this, you will significantly improve your chances of passing the course.

The main body of the unit guides you through the required reading from other sources. This will usually be either from a **Reading Section** of some other sources.

Self-tests are interspersed throughout the end of units. Working through these tests will help you to achieve the objectives of the unit and prepare you for the assignments and the examination. You should do each self-test as you come to it in the study unit. There will also be numerous examples given in the study units, work through these when you come to them too.

The following is a practical strategy for working through the course. If you run into any trouble, telephone your tutor. Remember that your tutor's job is to help you. When you need help, don't hesitate to call and ask your tutor to provide it.

- (1) Read this course guide thoroughly.
- (2) Organise a study schedule. Refer to the course overview for more details. Note the time you are expected to spend on each unit and how the assignments relate to the units. Important information e.g. details of your tutorials, and the date of the first day of the semester will be made available. You need to gather all this information in one place, such as your diary or a wall calendar. Whatever method you choose to use, you should decide on and write in your own dates for working on each unit.
- (3) Once you have created your own study schedule, do everything you can to stick to it. The major reason that students fail is that they get behind with their coursework. If you get into difficulties with your schedule, please let your tutor know before it is too late for help.
- (4) Turn to unit 1 and read the introduction and the objectives for the unit.
- (5) Assemble the study materials. Information about what you need for a unit is given in the 'Overview' at the beginning of each unit. You will always need both the study unit you are working on and one of your references, on your desk at the same time.
- (6) Work through the unit. The content of the unit itself has been arranged to provide a sequence for you to follow. As you work through the units, you will be instructed to read sections from your set books or other articles. Use the unit to guide your reading.
- (7) Review of the objectives for each study unit and confirm that you have achieved them. When you are confident that you have achieved a unit's objectives, you can then start on the next unit. Proceed unit by unit through the course and try to face your study so that you keep yourself on schedule.
- (8) After completing the last unit, review the course and prepare yourself for the final examination. Check that you have achieved the unit objectives (listed at the beginning of each unit) and the course objectives (listed in the Course Guide).

12.0 SUMMARY

This course PAD401 is designed to give you some knowledge which would help you to understand financial management as applied to public sector. After going through this course

successfully, you would be in a good position to pass your examination at the end of the semester and use the knowledge gained to apply in the management of finance as public administrators and contribute to the development of scholarly thoughts in public sector management.

We wish you success in this interesting course and hope you will use what you have learnt in this course to the discipline of Public Administration which is very dynamic.

We also hope you would appreciate the unique role and opportunity you have to make a difference in using the knowledge derived from this course in solving problems. We, therefore, sincerely wish you the best as you enjoy the course. GOOD LUCK.

MAIN TEXT

PAD401

PUBLIC FINANCIAL MANAGEMENT

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MODULE-1 ENVIRONMENTAL AND CHARACTERISTICS OF GOVERNMENT ACCOUNTING

Unit 1 Environmental and Characteristics of Government and Institutional Accounting
Unit 2 Governments and Institutional Accounting
Unit 3 Fiscal Policies
Unit 4 Monetary Policies
Unit 5 Sources of Government revenue
Unit 6 Introductions to National Fiscal Responsibility

MODULE-2 FISCAL FEDERALISM AND BUDGETING IN PUBLIC SECTOR

Unit 1 Fiscal Federalism and Resources Allocation
Unit 2 Taxation
Unit 3 Government (Public) expenditure
Unit 4 Auditing of Government Accounts
Unit 5 Cost-Benefit Analysis and Project Management in Public Financial Management
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MODULE -3 NATIONAL DEBTS, ACCOUNTABILITY AND MULTILATERAL INSTITUTIONS

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MODULE 1 ENVIRONMENTAL AND CHARACTERISTICS OF GOVERNMENT ACCOUNTING

UNIT 1 Environmental Characteristic of Government and Institutional Accounting

UNIT 2 Governments and Institutional Accounting

UNIT 3 Fiscal Policies

UNIT 4 Monetary Policies

UNIT 5 Sources of Government Revenue

UNIT 6 Introductions to National Fiscal Responsibility

UNIT 1 Environmental Characteristic of Government and Institutional Accounting

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3.4 Government/Economy and Government Intervention in the Economy

4.0 Conclusion

5.0 Summary

6.0 Tutor-Marked Assignment

7.0 References/Further Readings

1.0 INTROCTION

The simplest definition of 'Public Sector' is "all organisations which are not privately owned and operated, but which are established, run and financed by Government on behalf of the public." This definition conveys the idea that the public sector consists of organisations where control lies in the hand of the public, as opposed to private owners, and whose objectives involve the provision of services, where profit making is not a primary objective. Accounting generally is a scientific study in which records of expenditure and income of a company, individuals or Government are kept coupled with other useful information for planning, decision making and control. Government accounting, on the other hand, is composite activities of analyzing, recording, summarizing, reporting and interpreting the financial transactions of Government Ministries, Departments and Agencies. It is also worthy of note that accounting procedure is universal, whether in Government, private or public limited liability companies. The essential requirement is to record all historical costs and income, which when processed further, become useful information necessary for current appraisal, future decision-

making and performance control. In this unit, you would learn the objectives and users of public sector accounting information as well as the regulatory framework governing it. The main goal of this unit is to give a view of what Public (Government) finance entails and this will lead us to knowing the meaning of finance and financial management. The trend will differentiate personal, business and public functions of financial management including their dispositions and peculiarities. They are all governed by different circumstances. Public finance and its management will be expounded to demonstrate their importance. In this unit, you will be introduced to the definition of finance and public finance. We will also identify the various types of financial management. Finally, we will discuss the public financial management.

2.0 OBJECTIVES

After studying this unit, you should be able to:

- State the objectives of Public Sector Accounting.
- Public Sector Accounting information.
- Define finance management and Identify various types of financial management
- Discuss public (Government) financial management and the economy

3.0 MAIN CONTENT

3.1 Environmental and Characteristics of Government and Institutional Accounting

It is also worthy of note that accounting procedure is universal, whether in Government, private or public limited liability companies. The essential requirement is to record all historical costs and income, which when processed further, become useful information necessary for current appraisal, future decision-making and performance control.

In this unit, you would learn the objectives and users of public sector accounting information as well as the regulatory framework governing it.

3.2 The Meaning, Nature and Scope of Public (Government) Financial Management

Meaning: Finance is the function in business (private/public) that acquires funds for the organization and manages those funds within the organization. These activities include preparing of budgets; doing cash flow analysis; and planning for the expenditure of funds assets (Nickel, et. al. 2005:582). Public (Government) finance on the other hand refers to all activities of government in generating and allocating (spending) revenue towards ensuring efficiency of the state and the general well-being of the people, that is, financial operation of public treasury and its implication. Professor Dalton affirmed too, that Public Finance is concerned with income and expenditure measures of the public budget authorities together with the adjustment of one to the other. The management of public finance would bring about control and coordination of the funds to achieve viability of projects in the public sector. This discussion would be as followings: Ola and Offiong (2008) defined public financial management as “the measures put in place to control the people’s money or funds. You will note that the word ‘public’ means the people while ‘finance’ connotes funds or money. The management of the public funds is known as public financial management.

Nature: In a modern money-using economy, finance may be defined as the provision of money at the time it is wanted. Every person responsible for finance, whether it be the finance of company (business), household (private) or government (public), is confronted with the prospect during the coming days, months or years of an inflow of receipts on the one hand and an outflow of payments on the other. It is the person's responsibility to try to ensure that the inflows and outflows are so arranged that money is always available to make necessary payments as they arise. Where both receipts and payments take place evenly and continuously little difficulty may occur. Where either the receipts or the payments or both occur discontinuously and especially if they occur in relatively large amounts at relatively long intervals, much care and forethought have to be taken to ensure that at any given moment there is money available to make the necessary payments.

Scope: Public financial management is a vast field of endeavour which encompasses the whole processes of formulating and implementing decisions made on government services, expenditures, taxes, public debt and other revenue. For the Federal, State or Local Government, public financial management is vital in the governance than other matters; since money (funds) is the hub of the wheel of every government activity. Behind the formulation and execution of financial decisions like many questions of public policy, and this question ranges from: what fiscal measures are to be put in place to ensure high standard of living; satisfactory income distribution, resource allocation and public accountability? More questions could be raised as to what changes are required to make the tax system more equitable and efficient in order to generate substantial funds to meet the needs of the people?

Self-Assessment Exercise 1.1

Identify the features of the different types of financial management.

3.3 Public (Government) Financial Management – Subject Matter

The aims of government in a modern economy have identified four conceptual functions. The first is the provision of essential public services. The second function is the control of certain sectors of the economy – banking, manufacturing, agricultural, industry, for intervention and regulatory role. The third is the application of social policy and the fourth is that government assumes responsibility for the overall state of the economy. This involves the maintenance of a level of employment, the encouragement of growth in the economy's productive capacity, the relative stable prices and the preservation of solvency in its external business relationships. The subject matter of public financial management could be pinned-down to the acquisition and disposal of resources by the government and its agencies through proper management and control. Public financial management is all about government's management and control of its income and expenditure. This presupposes that the management and control involves governments' budget usually prepared annually or through developmental plans for a specified period depending on the government's needs. Financial management is divided into private, public and business. Ekpung (2001) cites definition of Financial Management as the study of money management. It deals with how businessmen, governments, financial institutions and families handle money. How they budget, save, lend, spend, and invest it in a more useful manner without misappropriation by the authority or to those concerned. Financial Management is all

pervasive as it is to ensure that funds are efficiently acquired, safely held, properly committed, effectively and economically utilized to meet specific objectives. These objectives may include:

- a) Determining financial policies of organization
- b) Ensuring financial control
- c) Setting out the required organisational structures for effective discharge of financial duties and responsibilities.

This according to Ekpung (2001), Public (Government) Financial Management is defined as the management of the flows of money or financial resources through an organisation (public), whether it is a company, a school, bank, or government agency. The actual flow of money or financial resources as well as claims against money in a judicious way is its concern. Public Financial Management is a specialised functional area found under the general classification public administration and finance;

- The traditional concept of finance (providing funds needed by an organisation) has the merit of highlighting the central core of the financial function –the treasury function- which is simply keeping the organisation supplied with enough funds to accomplish its objectives. In the present modern economy, there is increase in complexity, size technology, inflation, recession and government control with a lot of implications to financial management in many organizations.
- As a result the focus of financial management has shifted from treasury function to the concept of managerial finance, which is concerned not only with the acquisition but also with the application, conservation, timing, volume and composition of funds in order to ensure an effective utilisation of funds. Thus financial management is seen as the provision of the needed funds from the most suitable and appropriate sources in the required amount at the right time and a cost that will make their employment beneficial
- In public financial management, every decision is based on equity and efficiency back-up by public policy (not on sentiment personal aggrandisement). This is so to ensure efficient employment of resources in production but also that both real and nominal benefits accruing to society in the form of income and wealth are equitably distributed.

Thus public financial management deals with judicious use of funds and also ensures accountability and financial control.

Self-Assessment Exercise 1.2

- 1) Summarize the role of public financial management.
- 2) Define and explain Public Financial Management

3.4 Government/Economy and Mechanisms for Government Intervention in the Economy

Modern governments try to assume responsibility for state of the economy;

- It intervenes in the market economy in order to fine tune it and provide the enabling environment first to minimize or eliminate distortions arising from natural or artificial monopoly from externalities and from lack of information about the safety of products or workplaces.
- This made possible through antitrust legislation, regulation of natural monopolies, pollution controls and standard legislation.
- The government intervenes through the provision of public goods and income distribution.

- It is worthy of note that government projects are social services with welfare of its citizenry on top consideration, hence, the projects are sited to solve socio-cultural challenges which cannot be quantified in terms of value and cost. That is why on investment, government invests on projects supposedly not attractive to private investors but beneficial to the citizens.
- These projects are: relatively low in profitability, with long break-even point, large initial capital outlay, long gestation period, multi-purpose projects and attributes of a natural monopolist.

The various instruments for government intervention in the economy include:

- **Fiscal Policies:** These are government policies through government revenue and expenditures are manipulated. They include nature of taxation, government expenditure, direct government investment, subsidy, budget and budgetary control etc.
- **Monetary Policies:** Government through the Central Bank targets the quantity of money in circulation within the economy, considering the cost (interest) and general credit direction. These are government policies administered through the Central Bank of Nigeria to regulate the circulation of money in the economy.
- **Direct Control:** Where the tools mentioned above failed the direct control is applied. This comes in the form of rules and regulations involving the passing of laws or executive directives.
- **Income Policy:** Some policies are aimed directly at regulating the disposable incomes accruing to earners to meet government macro-economic objectives and to ensure that income is in line with productivity level. These include wages squeeze, price control etc.
- **Debt Management:** Government normally incurs internal and external loans for some important reasons. Once these debts are raised the onus lies on government to fulfill the contractual obligation by paying the capital as well as the interest as and when due. A policy as an instrument of debt management will be in place to avail the team of managers to meet current fiscal obligations.
- **Exchange Rate Policy:** With international trade, the exchange rate (price of foreign currency) is of value in the economy as it affects and influences virtually all other prices for the purpose of controlling the economy. All these instruments will be discussed elaborately, in subsequent units.

Self Assessment Exercise 1.5

List the mechanisms for government intervention in the economy

4.0 CONCLUSION

The public sector (government) financial management is concerned with expenditure and accountability while the business sector is concerned with profit maximization. The differences in organisational policies and goals and orientation in the business and public sectors tend to dictate the type of financial management approach in both sectors.

5.0 SUMMARY

In this unit, we have defined and discussed financial management and public financial management. We highlighted nature of finance, the subject matter of public finance management.

- a) Investment decisions
- b) Assessing the volume of finance required
- c) Decisions of the types of finance to employ
- d) Controlling the use of finance

In the next unit, you will be introduced to the fundamentals of public financial management where you understand the basic functions of government in the management and control of funds in the economy.

6.0 TUTOR-MARKED ASSIGNMENT

- 1) Define Public Finance and state the main sector of government focus in a country
- 2) Discuss public (Government) financial management and the economy

7.0 REFERENCES/FURTHER READING

Ekpung Edame (2001): *The essentials of Public Finance and Public Financial Management in Nigeria*, University of Calabar Press

Nickel, W.G, McHugh, J. M, McHugh, S. M (2005) *Understanding Business* 7th Edition McGraw –Hill/Irwin New York NY, 10020

Ola, R.O.F. and Offiong, O.J. (2008). *Public Financial Management in Nigeria*. Lagos: AMFITOP Books.

Paish , F. W (1975) *Business Finance* 4th edition Pitman Publishing Corporation 6 East 43rd Street, New York N.Y 10017, USA

Ogunjimi, Samuel Olatunji (1997) *Public Finance: For Polytechnics ICAN Students* Lekem Productions Bida Nigeria

UNIT 2 GOVERNMENT AND INSTITUTIONAL ACCOUNTING

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1.0 INTRODUCTION

The flow and management of funds is the life blood of our system of public administration that is government. No policy, however farsighted, on system of administrative performance, however well crafted, can function unless it is associated with the flow of funds that will make it possible. In public administration (government), the system of public financial management rest on designs and reforms over the years. In this unit, we will consider the need for the Administrators of public institutions to understand the accounting fundamentals of how the public system is designed, what it is intended to do, what it is capable of doing and especially what is not capable of doing.

2.0 OBJECTIVES

After studying this unit, you should be able to:

- Enumerate the functions of government;
- Identify the dynamics of public financial management;
- List the basic principles of the design of public financial management;
- Identify normative principles and the characteristics of public sector accounting.

3.0 MAIN CONTENT

3.1 Government and Institutional Accounting

In Unit 1, we identified the functions of government to include among other things:

1. The up-keep of the president, legislature, the judiciary, maintenance of law and order, provision of facilities for defence and diplomatic representation including discharge of international responsibilities.

2. The direct or indirect involvement in enterprises example the postal services, energy, inland waterways, gas and oil etc. It could be through financial assistance or advisory services.
3. This involves revenue and expenditure. Revenue is taxation and its distribution among the community. Expenditure is on social services like education, health etc.
4. The maintenance of a high and stable level of employment, the encouragement of growth in the economy.

From the above enumerated function of government we can identify the subject of public finance to be the acquisition and disposal of resources by the government, be it Federal, State or Local Government. It is about government income and expenditure. It deals with budgets. Budgets are statements about how a government plans to obtain income (income) and the ways a government plans to spend such income during a particular financial year. A budget can be deficit, surplus or balanced.

Self-Assessment Exercise 2.1

List the functions of Government.

3.2 Dynamics of Public (Government) Financial Management

Public Financial Management is a dynamic, living, breathing system with which citizens interact every day. Let us think of an irrigation system, one that gathers rainfall behind large dams and distributes the flow of water through large and small pipes and channels this to many disparate communities, to commercial users, to schools and hospitals, parklands and charities, to businesses and individuals, to seaside areas and deserts. Such a system must be managed and regulated throughout its length, and its consumers must be built according to politically accepted framework. If adequate rain falls, if the dams and pipes do not leak or burst and if the supply of water is not diverted or stolen before delivery, the system will become a precondition for life growth and even abundance. That means public administrators as well as citizens are river wardens. They all are sustained by its flow.

3.3 Public (Government) Financial Management System based on Principles

At the heart of the design of an effective system of public financial management, are the following principles:

- Democratic consent: Taxation and spending should not be done without the explicit consent of the governed.
- Equity: Government should be equitable, i.e. people should be treated in similar circumstances similarly- in raising and spending taxes.
- Transparency: Government activities in raising and spending funds should be open to public knowledge and scrutiny.
- Probity: There must be scrupulous honesty in dealing with public funds, of which the legislators and administrators are the stewards, not the owners.
- Prudence: These stewards should not take undue risks with public funds.
- Accountability: Those who deal in public funds can and should be regularly called to account for their stewardship through legislative review and audit process.

Self Assessment Exercise 2.2

List the principles affecting effective public financial management.

3.4 Normative Principles and Public Sector Accounting/ government accounting

These normative principles are “should”; but they are often breached in real life. Public financial management can be abused. Democratic consent is lacking when government is conducted in secret. Concerns for equity often yield to favouritism toward areas, or groups (*favouritism by a government in the allocation of benefits or resources; legislation that favours the district of a particular legislator by providing for the funding of public works or other projects- such as post office or pipe borne water contract- that will bring economic advantage to the district and political favour for the legislator*). Without transparency, probity and prudence, the inherent caution so essential to the management of public funds is thrown to the winds. Governments then may incur substantial losses through risky investments or negligence (Shafriz and Russell, 2005). Public Sector Accounting/ government accounting: The need for greater attention in developing government accounting or public sector accounting and financial control is now globally awoken. The reason being that government is obviously the largest single business entity and broad sense; it is the pivot of the economy. The pattern of resource allocation determines the level of accountability for economy to be efficient and effective. These objectives can be realized by having a sound financial control system which depends on the status of the accounting system. Government accounting can be defined as the process of recording, analyzing, classifying, summarizing, communicating and interpreting financial information about government in aggregate and in details, reflecting all transactions involving the receipt, transfer and disposition of government funds, assets/property and stores

Objectives of Government Accounting: government accounting objectives as follows;

1. to determine the extent of probity and accountability in the management and disbursement of government resources
2. to determine propriety of transactions and their conformity with established rules
3. to provide financial information useful for control and co-ordination of activities; determining and forecasting the flows; balance and requirements of short term financial resources; monitoring performance in various facets of the economy, planning and budgeting for effective allocation of resources and assessment of socio-economic, political conditions of government establishments.

Basis for Government Accounting: You can deduce from the above objective that the basic feature of public or government accounting is established on accountability and probity.

- It deals with the control and stewardship of receipts, payments and related activities in the public sector.
- The peculiar nature of social or government accounting transactions make it desirable and indeed mandatory to treat them in accordance with specific but cohesive and standardized measurement theories and rules like budgeting system and applicable procedures, fiscal accounting procedures, nature of source of revenue etc.
- The need to get formal approval on estimates of revenue and expenditure before they are collected or incurred, makes budgeting to largely determine the structure of government accounting
- The governments-Federal, State and Local- sometimes find it necessary to demarcate and segregate its resources into specific or special purpose compartments – receipts and payments

- and the method of accounting adopted in recording and measuring each component is referred to as “fund accounting”
- Another peculiarity of government accounting is that it is maintained on cash basis. This ensures stewardship accountability and cash programming. Accordingly, the Balance Sheet (known as Monthly Reconciliation of Accounts, surplus and Deficit Statement of Assets and Liabilities in Government) does not contain information on fixed assets such as buildings.

Self-Assessment Exercise 2.3

- 3) A) What are the objectives of government accounting? b) Identify normative principles and the characteristics of public sector accounting.

4.0 CONCLUSION

We have seen that public financial management is based on norms and value of good governance with corporate identity and focus. There is need for framework to guide the funding strategy based on equity and fair play among others. The fundamental issue is that the acquisition and utilization of resources by government should be handled on trust for the citizen, respecting their yearnings and aspirations.

5.0 SUMMARY

We have discussed the basic functions of government along with the fundamentals of public finance. The dynamics of public financial management and the principles guiding the system to work effectively were considered with a normative view in a contemporary circumstance.

In summary government accounting are based on the following;

1. Cash basis
2. Accrual basis
3. Group account into fund
4. Commitment/obligation basis

6.0 TUTOR-MARKED ASSIGNMENT

1. Explain the dynamics of public financial management in a developing economy.
2. What are the principles of public financial management system as tenable in Nigeria?

7.0 REFERENCES/FURTHER READING

Shafritz, J.M. & Russell, E.W.(2005) *Introducing Public Administration* Fourth Edition PEARSON Longman, New York

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UNIT 3 FISCAL POLICIES

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 - 3.4.3 Functions of Local Government
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- 5.0 Summary
- 6.0 Tutor-Marked Assignment
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0.0 INTRODUCTION

We continue this unit with fiscal policy, which is the use of government spending and taxation policies to influence the level of economic activity, inflation and economic growth. Fiscal means having to do with taxation, public revenue or public debt. The fiscal year is a 12-month accounting period without regard to a calendar year. The fiscal year for the federal government is from 1st January to 31st December. Fiscal year is also used as all-purpose adjective to refer to anything that has to do with government finances and its management(IMF1994).. Thus, at each level (tier) of government, fiscal integrity is a characteristic of that government budget that spends no more than anticipated revenues. You will be deemed to have fiscal integrity when the person so deeming agrees with your fiscal policies. If that same person disagrees with your policies, you may be deemed to so lacking in fiscal responsibility as to be considered fiscally irresponsible. In this unit, you will learn about definition of fiscal, fiscal year and fiscal policy. You will also learn about the major instruments of fiscal policy, the fiscal system in Nigeria, and finally, allocation of functions between the tiers of government.

2.0 OBJECTIVES

After studying this unit, you should be able to:

- Define fiscal, fiscal year and explain fiscal policy
- Identify major instruments of fiscal policy
- Explain fiscal system in Nigeria
- Identify allocation of functions of tiers of government

3.0 MAIN CONTENT

3.1 The Government Sector

The government sector is defined as comprising “all units that implement public policy by providing non-market services and transferring income. These units are financed mainly by compulsory levies on other sectors. The central government includes all units representing the territorial jurisdiction of the central authority throughout the country”. The government sector in Nigeria includes all the three tiers of government, comprising the federal, state and local governments as well as government agencies that provide public goods and services with funding from public treasuries. The government sector is also commonly known as the public sector largely as the result of the characteristic of the type of goods and services that are supplied by the sector. Due and Friedlander (1977) described public goods as “goods possessing the basic characteristics of non-appropriability, non-rivalry and non-excludability in consumption”. What we are saying here is that the goods are perishable and not tangible as physical consumable goods. They are mostly in the form of infrastructural facilities, social amenities and capital goods which could be used to generate further goods and services (utilities).

3.1.1 Public Goods

They are collectively and indivisibly consumed while consumption by an individual those reduce the amount available to others. The consumers of public goods do not reveal their preferences. These characteristics make it difficult or impossible to package public goods for sale under the conditions of market mechanism. Examples of public goods are roads and highways, defence and national security, environmental protection etc. These characteristics of public goods render price mechanism ineffective in allocating resources effectively in a market economy, providing the rationale for public sector intervention in order to ensure efficient allocation of resources, income redistribution and stabilization objectives.

3.1.2 Private Goods

This is in contrast to the situation in private sector that engages in the production and sale of private goods which are divisible and individually consumed while consumer's preferences can be readily ascertained through effective demand.

Consequently, private goods such as bread residential accommodation vehicles etc are produced in units and offered for sale in markets. People who cannot pay for private goods can be excluded from its consumption in the absence of effective demand.

Self-Assessment Exercise 3.1

Differentiate between public and private goods.

3.2 Fiscal Policy

Fiscal policy consists of the manipulation of government finances by raising or lowering taxes or levels of spending to promote economic stability and growth. This role of government sector in economic management is performed through the formulation and implementation of economic policy generally and fiscal policy in particular. It is designed to achieve the objective of price stability, growth, balance of payments equilibrium, full employment, mobilization of resources

and investment. These objectives have influenced government's economic policy design and development efforts in Nigeria since independence. Nigerian governments had designed and implemented four development plans between 1960 and 1985, adopted Structural Adjustment Programme (SAP) in 1986, three-year rolling plans thereafter, vision 2010 programme, National Economic Empowerment and Development Strategy (NEEDS) and currently the Seven Point Agenda of the present Administration, all with the objectives of achieving economic development and bringing about significant improvement in the living conditions of the people.

Self-Assessment Exercise 3.2

What is a fiscal policy?

3.3 Major Instruments of Fiscal Policy

The major instruments of fiscal policy have been taxation, government expenditure and borrowing from domestic and external sources to finance budget deficits when there is a fiscal gap in the operation of a budget. During the review years, the result of government role in economic activities and the achievements in economic performance in Nigeria have been mixed. The economy experienced growth in real output in some years and declines in others. But the overall picture is low scoring for the country's development efforts. The economic crisis from the 1980s and early 1990s brought out vividly the distinction between growth and development. A country may achieve growth of Gross Domestic Product (GDP) without corresponding economic development. The oil boom of the 1970s propelled Nigeria into the class of countries with higher per capita income. However, as the oil market weakened and foreign exchange earnings from the sector declined and Nigeria regressed into the group of countries with low capita income. The crisis is not only that of low capita income but also that of macroeconomic instability, characterized by high inflation rate, steep depreciation of national currency, high unemployment and balance of payments disequilibrium. These problems have resulted from the continued dependence on the export of crude oil for foreign exchange earnings and government revenue. The experience in Nigeria as in many other sub-Saharan African countries, have also proved the public sector intervention in an economy can result in failure just as the rationale for government intervention is based on the inherent failure of price mechanism to achieve a stable equilibrium in the market economy.

3.3.1 The Role of Fiscal Policy in the Economy

Having identified the major instruments of fiscal policy, there is need to now discuss the role of these policy instruments, namely:

- (i) **Taxation**
Fiscal policy through taxation means the reduction of taxes in certain areas of the economy in order to increase disposable income among businessmen, individuals and corporate bodies. Reduction of corporate taxes would be more available for the corporate bodies to expand their business thereby increase employment opportunities. On the other hand, individual consumers who may be affected by tax reduction would now be in a better position to make effective demand for more goods and services produced by the corporate business firms and industries.
- (ii) **Price Stabilisation**

- Government may use fiscal tool i.e. contractionary fiscal policy to combat inflation and expansionary fiscal policy to combat deflation and unemployment. This approach helps to stabilize prices of goods and services in the economy. In using contractionary fiscal policy, government could increase the taxes of corporate bodies and those of individuals in order to lower the level of disposable income in the hands of these entities. Government could equally reduce its expenditure on chosen special areas of the economy in order to curb aggregate demand in the economy.
- (iii) **Equity in Income Distribution**
Fiscal policy through appropriate tax system may be used to reduce the gap between the incomes of the rich and the poor. A tax system which is highly progressive in nature may likely reduce the consumption and accumulation of wealth of the rich.
 - (iv) **Increase in Investment**
Fiscal policy can assist in generating revenue to increase investment in viable sectors of the economy if managed effectively. In the process, it helps to accelerate economic growth.
 - (v) **Maintain a favourable Balance of Payment**
The government may impose taxes in order to reduce imports and encourage exports so as to minimize the balance of payment deficits. In so doing, it could engender a favourable balance of payment in its foreign trade.
 - (vi) **Exchange Rate Stabilisation**
Effective fiscal policy properly implemented could lead to exchange rate stability. A stable exchange rate is effective when there are no constant disequilibrium in the nation's balance of payment position.

Self-Assessment Exercise 3.3

State the process of economic development in the public sector of Nigeria.

3.4 Fiscal System in Nigeria

Nigeria is a federal system of political administration hence this has fundamental implications for the fiscal system and economic management of the country. The economic role of the public sector in a federal system is the joint responsibility of the multi-levels of government. This joint responsibility of local, state and federal governments in performing the fundamental functions of socio-political administration and economic management introduces complications in the fiscal system which must be technically and constitutionally resolved in the light of political factors and pressures that gave birth to the union. For instance, in a unitary system of government, the basic economic functions of government, such as the attainment of stabilization, efficient allocation of resources and income redistribution are performed by the central government with delegated power to sub-units, such as local councils or county authorities but in a federal system; but in a federal system the relationship between the local, state and the federal governments, is that of autonomy and inter dependence, an inter-governmental fiscal relationship that is adequately recognized in the constitution.

3.4.1 Allocation of functions among the tiers of government in a Federation

Theoretically, there is an optimum allocation of functions among the tiers of government in a federation such that the fiscal relations would facilitate the achievement of macroeconomic objectives of price stability, full employment, economic growth and balance of payments equilibrium. If the three tiers of government were to provide the functions of stabilization, income redistribution and resource allocation simultaneously, inefficiency would result (Musgrave & Musgrave; 1973; pp. 613-616). The citizens of a country incidentally belong to all the tiers of government in a federal system. There is, therefore, intersection of jurisdiction among the tiers of administration. Local government areas intersect the state constituencies while the states intersect the national boundary of the federal government. State and local governments engage in the performance of the resource allocation functions along with the federal government in accordance with the provisions of the constitution. However, the stabilization and income redistribution functions are better performed when localized in the central government to avoid unintended spillovers. In addition, the federal constitution always makes provision for the generation of financial resources to be used in providing public goods and services as well as ensuring a suitable arrangement for its distribution or revenue sharing among the tiers of government. This has been the experience in Nigeria.

Table 1: Tiers of Government in Nigeria (1967 – 1998)

Years	Federal Government	Regional / State Governments	Local Governments
1967	1	12	299
1970	1	12	299
1976	1	19	299
1979	1	19	301
1981	1	19	781
1984	1	19	301
1987	1	21	449
1991	1	30	500
1991	1	30	589
1996	1	36	774

Source: Compiled from Nigerian Constitutions and Official Gazettes (CBN Publications)

Self-Assessment Exercise 3.4

What is fiscal responsibility at each tier of government?

3.5 Allocation of Functions

The need for sharing the role of government in the public administration among the component tiers of government was recognized and accorded priority importance in the constitutional evolution of the Nigerian federation. The Federal Constitution that ushered in independence in 1960 explicitly recognized two tiers of government, the federal and the regional governments. The function to be performed by each tier was spelt out under the exclusive and concurrent legislative lists. The responsibilities of the federal Government were listed in the exclusive legislative list while those to be jointly performed by the regional and federal governments were listed in the concurrent list. Other functions left in the residual lists were to be performed by the regional government to the exclusion of the federal government. Although there were Local

Councils from independence, this tier of government was not explicitly recognized as an autonomous and interdependent entity until 1975 when a clear mission for the local government system was enunciated- to govern at the grass roots or local level.

3.5.1 Local Government Reform of 1975

This was clearly articulated in the guidelines for Local Government Reform of 1975. The guidelines acknowledged the local government in the federation as the third tier of government which implied that local government authorities were to be given definite powers, sources of revenue and functions for which they would be held accountable. In 1999 Federal constitution spelt out the function of the three tiers of government as follows:

3.5.2 Exclusive Legislative List

This list is reserved for federal government power to execute. Example is the keeping of accounts of the government of the federation involving issue of legal tender currency, external affairs, defence, construction and maintenance of federal trunk roads; collection of customs and excise duties, immigration and issuing of passports, exploitation of mines and mineral (including oil fields), oil mining, geological surveys, natural gas, public debt of the federation, regulation of political parties etc.

3.5.3 Concurrent Legislative List

This list is performed by the federal and state government. These include:

- Allocation of public revenue among the federal, state and local governments
- Collection of taxes
- Electric power
- Industrial, commercial and agricultural development
- University and post primary institutions
- Antiquities and monuments, archives etc.

Self-Assessment Exercise 3.5

List the items on the Concurrent legislature list in Nigeria.

Functions of Local Government

Local governments were empowered to provide the following:

Provision and maintenance of primary adults and vocational schools, development of agriculture and natural resources other than the exploitation of minerals, establishment and maintenance of slaughter houses, markets, motor parks public conveniences and health services, registration of birth, death and marriages etc.

In addition they were to perform other functions and provide other services that the state House of Assembly might assign to them.

Self-Assessment Exercise 3.6

When was Local Government recognized as a tier of government?

4.0 CONCLUSION

In this unit, we conclude that the fiscal policy and the responsibility at each tier of government is the determinant of the level of involvement and commitment of each level of administration. The constitution is the guide and provides the benchmark of performance.

5.0 SUMMARY

We have taken look at the public sector and have considered fiscal policy/system at the three tiers of government in Nigeria, major instruments of fiscal policy and allocation of functions defining fiscal responsibility to different levels of administration.

6.0 TUTOR-MARKED ASSIGNMENT

- 1) Explain fiscal year in Nigeria.
- 2) Identify major instruments of fiscal policy applied by the federal government of Nigeria.

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UNIT 4 MONETARY POLICIES

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1.0 INTRODUCTION

In this unit, we will consider monetary policy generally, which complements the fiscal policy as tool of economic balance in a nation. Monetary policy is concerned with discretionary control of money supply by the monetary authorities (Central Bank with Central Government) in order to achieve stated or desired economic goals. Governments try to control the money supply because most governments believe that its rate of growth has an effect on the rate of inflation. Hence monetary policy comprises those government actions designed to influence the behaviour of the monetary sector

1.0 OBJECTIVES

After studying this unit, you should be able to:

- Define Monetary Policy
- Identify the primary objectives of monetary policy in Nigeria
- List the Instruments of monetary policy
- Explain monetary policy Administration in Nigeria

3.0 MAIN CONTENT

3.1 Monetary Policy

Monetary policy is essentially a programme of action undertaken by the monetary authorities generally the central bank, to control and regulate the supply of money with the public and the flow of credit with a view to achieving predetermined macroeconomic goals. – Dwivedi D.N.

Monetary policy consists of a Government's formal efforts to manage the money in its economy in order to realize specific economic goals. Three basic kinds of monetary policy decisions can be made about:

- (1) The amount of money in circulation;
- (2) The level of interest rate
- (3) The functions of credit markets and the banking system.

The combination of these measures is designed to regulate the value, supply and cost of money in an economy, in line with the level of economic activity. Excess supply of money will result in an excess demand for goods and services, prices will rise and balance of payments will deteriorate. On the other hand, an inadequate supply of money could lead to stagnation in the economy, hence retard growth and development. Consequently, the central monetary authority normally attempted to keep the money supply growing at an appropriate rate to ensure sustainable economic growth and to maintain internal and external stability.

Self-Assessment Exercise 4.1

Name three basic kinds of monetary policy decisions.

3.1.1 Discretionary Control of the Money Stock

The discretionary control of the money stock by the central monetary authority involves the expansion or contraction of money, influencing interest to make money cheaper or more expensive depending on the prevailing economic conditions and channeling of fund to priority sectors. To sum it up the aims of monetary policy are basically to control inflation maintain balance of payments position for the country in order to safeguard the external value of the national currency and promote adequate and sustainable level of economic growth and development. Monetary policies are effective only when economies are characterized by well developed money and financial markets like developed economies of the world. This is where a deliberate change in monetary variable influences the movement of many other variables in the monetary sector

Self-Assessment Exercise 4.2

The discretionary control of the money stock by the central bank involves what?

3.2 Objectives of Monetary Policy in Nigeria

The primary objectives of monetary policy in Nigeria in recent years are to:

- a) Check the rate of inflation
- b) Sustain exchange rate stability
- c) Promote output and employment growth and
- d) Enhance overall efficiency of the economy

In pursuit of the above objectives, the stance of monetary policy will be non-accommodating and will ensure efficiency in resource allocation to support private sector. Monetary policy is used

to influence these ultimate objectives because there is a belief that there is a relationship between the real variables and the monetary variables.

However, this is valid only for a highly monetary economy. If the economy is not highly monetary, then the efficacy of monetary policy is restricted. In a developing economy like Nigeria, where a large proportion of output is subsistence, the level of output would be independent of supply of money. Therefore monetary policy would not be efficacious in determining the output level of the subsistence sector

Self-Assessment Exercise 4.3

Name the objectives of monetary policy in Nigeria.

3.3 Policy Instruments (Measures)

The primary instrument of monetary policy is Open Market Operation (OMO), Reserve requirements, Discount Window Operations and Moral Suasion. The techniques are used directly/portfolio control approach and indirect/market intervention. There is a basic difference between the mechanisms of direct and indirect monetary control. Under the system of direct monetary control, the monetary authority uses some criteria to determine monetary and credit targets and interest rates which are the intermediate targets to attempt to achieve the ultimate objectives of policy. During indirect monetary control only the operating variables related to the path of the intermediate variables in a predictable way are controlled (because the intermediate variables are not under the control of the Central Bank). The operating variables, particularly the monetary base are managed, while the market is left to determine interest rates and credit allocation (the primary instrument stated above).

3.3.1 The direct/portfolio control instruments

These instruments place restrictions on a particular group of institutions –especially deposit banks – by limiting their freedom to acquire assets and liabilities. This method is employed mainly in developing economies in which the financial infrastructure necessary for operating indirect monetary control is under-developed.

On the other hand, the indirect method is used mainly in developed financial systems. It relies on the power of the monetary authority as a dealer in the financial markets to influence the availability and the rate of return on financial assets, thus affecting both the desire of the public to hold money balances and the willingness of financial agents to accept deposits and lend them to users. These measures named above, are coordinated by Central Bank of Nigeria (CBN) and the Treasury to ensure consistency between monetary and fiscal policies as well as promote the stability of financial markets.

3.3.2 Open Market Operation (OMO)

This is an indirect monetary policy instrument introduced to influence the level of money supply in the economy. This involves the issuance of short-term instrument the issuance of short-term instruments such as treasury bills and other securities to the public subscription.

3.3.3 Reserve Requirements

These serve as prudential and liquidity management policy objectives and complement OMO. Cash reserve requirement is the least amount of reserve a bank must maintain with Central Bank of Nigeria expressed as a ratio each individual banks total liability. Liquidity ratio is the minimum percentage amount of reserve which shall be in form of liquid assets expressed as the banks total deposit liability, promissory notes and certificate of deposits which the banks must keep with the CBN.

3.4 Discount Window Operations

Transactions is in the form of short term, overnight loans, collateralized by the borrowing institution's holding of government debt instruments and other eligible first class securities approved by the CBN.

3.5 Moral Suasion

The CBN engages in this through regular dialogue with banks and other financial institutions, under the aegis of the Bankers Committee on monetary and financial issues and to encourage enhanced efficiency in the banking industry, especially with respect to interest rate and foreign exchange rate management. These institutions do oblige the CBN.

3.6 Monetary Policy Administration in Nigeria

The Central Bank of Nigeria proposes the monetary policy to be considered by the presidency through a memorandum with the caption monetary, credit, foreign trade and exchange policy proposals for a particular fiscal year. The memorandum is an input of all the policy departments of the CBN. It considers the prevailing economic conditions, prospects and the policy objectives that appear most appropriate to pursue in the immediate future. The memorandum is initially considered by the committee of governors, the highest management body for the daily administration of the CBN. It is deliberated upon and approved by the board of directors of the CBN and transmitted by the Governor of CBN to the presidency for consideration and approval. The Presidency after reasonable consultation with other tiers and agencies of government takes a decision on which proposals to accept and include them in the budget. The accepted proposals are subsequently outlined for banks and other financial institutions by the CBN as a monetary policy circular for compliance (along with penalties for non-compliance with specified guidelines are also indicated in the circular)

3.6.1 CBN Periodic and Special Examinations

The CBN conducts periodic and special examinations of the books of all licensed banks as a monitoring tool. The banks are also required to submit regular returns on their operations to the Central Bank. The examinations and returns from the financial institutions and current economic Developments enable the CBN to assess compliance with the monetary policy circular. Subsequent amendments to the circular are undertaken by the CBN and fundamental changes must be discussed with the Presidency (President).

Self-Assessment Exercise 4.4

Name the main channel of monetary policy administration in Nigeria.

4.0 CONCLUSION

In this unit, we have seen monetary policy as one of the tools of controlling money supply in an economy of a nation by the monetary authorities in order to achieve a desirable economic growth.

5.0 SUMMARY

In summary, we have discussed Monetary Policy and have identified the primary objectives of monetary policy in Nigeria. In this unit we have enumerated the Instruments (measures) of monetary policy and explained monetary policy administration in Nigeria. In the next unit, you learn about the sources of government revenue as they concern imposition of taxes in the oil and non-oil sector of the economy.

6.0 TUTOR-MARKED ASSIGNMENT

- 1) What are the primary objectives of monetary policy in Nigeria in recent years?
- 2) List the Instruments of monetary policy as applied in a developing economy.

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UNIT 5 SOURCES OF GOVERNMENT (PUBLIC) REVENUE

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1.0 INTRODUCTION

Government (Public) revenue can be defined as income generated by public sector from various services rendered. In other words, it could mean a portion of total funds required by government for the purpose of financing activities. The Constitution of the federal government of Nigeria provides for the generation of revenue through taxation and miscellaneous receipts as the main sources of revenue. In this unit, we will pin-down our discussions on two main sources of government revenue classified as: oil and non-oil although governments have other means of sourcing for fund for financing their spending requirements.

2.0 OBJECTIVES

After studying this unit, you should be able to:

- Identify the source of government revenue
- Differentiate Oil-revenue from Non-oil Revenue
- Identify the main types of taxes
- Explain Value Added Tax (VAT) as additional source of government revenue

3.0 MAIN CONTENT

3.1 Sources of Government Revenue

In this unit, we will find out that these days, governments apart from conventional sources of revenue namely: direct and indirect taxes, have expanded its arm to be able to access more revenue to stay afloat in corporate governance. Income generated by the public sector from various services rendered could mean a portion of total funds required by government for the purpose of financing its activities. We know that Government earns money to sustain itself and perform its duties of national building through fiscal measures. The money required by government to perform its duty must be from a source and utilized on recurrent and capital expenditure. In Nigeria there are two main sources of Government Revenue-Oil and Non-oil.

This became imperative since exploration of oil became major contributor to the national budgeting

Self-Assessment Exercise 5.1

Name two main source of government income in Nigeria.

3.2 Oil Revenue

This source consists of Royalties, Petroleum profit, Rent, Earnings from direct sales of crude oil to domestic market by Nigerian National Petroleum Corporation (NNPC), Gas flaring penalties, pipeline licenses etc.

- Since the 1970s oil revenue became the dominant source of government revenue, contributing over 70 per cent of federally- collected revenue.
- For most of the 1960s, federally-collected revenue from oil sources accounted for an average of 8 percent of total receipts.
- The oil boom of the 1970s propelled the sector to become dominant, accounting for most of the foreign exchange earnings as well as federally-collected revenue.
- The contribution of the oil sector to total receipts increased from average of about 46 percent between 1970 and 1973 to about 77 percent between 1974 and 1980. Through-out the 1980s and 1990s, the contribution of the oil sector to total revenue maintained its dominant position and contributed between 70 and 76 percent of the federally-collected revenue (CBN, 2000).
- With the constitutional powers vested on the federal government to control the exploration of mineral resources, proceeds from the sales of crude oil, petroleum profit tax, rents and royalties etc are collected by the federal government and paid into the Federated Account for distribution among the three tiers of government. The status quo is retained till today with legislations for adjustment.

3.3 Non-oil Revenue

These are Direct and In-direct taxes:

Direct taxes include:

- Personal income tax
- Company gains tax that is, taxes on profits.
- Capital gains tax – taxes on assets held for more than one year
- Death duties- taxes on the property of deceased
- Royalties and mining rents, stamp duties, motor vehicle duties
- Miscellaneous receipts of the government include loans profit from direct government investment, grants and fines.

Indirect taxes are:

Custom duties – imports and exports:

- Excise duties – domestic products
- Purchase tax – on certain goods at wholesale level
- Sales tax – levied and collected either at wholesale or retail level.
- Value-Added-Tax- VAT. (Replaced sales tax since 1994)

As discussed above, for most of the 1960s, federally-collected revenue was largely revenue from non-oil sources, accounting for an average of 92 percent of the total receipts while revenue from the oil sources accounted for the balance. As can be deduced from the narration of the oil disposition from the 1970s to this day, the non-oil sector revenue accounted for the balance of about 20 to 30 percent receipts annually, to complement the oil sector receipts which form the mainstay of the sources receipts of Federal Republic of Nigeria. The government also borrows from the public through issuance of bonds and using innovative finance techniques, public-private partnerships, franchise or licensing of private sector providers etc are also applied where the need arises.

3.4 Value Added Tax (VAT)

VAT is the acronym for valued added tax. This tax which is in other words called consumption tax can be defined as the amount charged by the government for every goods or services purchased from time to time. This means it can only be paid when there is consumption of goods or services (It forms part of the price paid for the good or service).

- Value Added Tax was introduced in 1994 to replace sales tax which hitherto generated revenue for the state governments.
- VAT was designed broadly to be levied on imported goods, locally-manufactured goods, hotel service, bank transaction etc. It was to be federally-collected.
- A uniform rate of 5 percent was fixed on all affected items while VAT proceeds are shared among the three tiers of government at an agreed proportion.

Characteristics of Value Added Tax

There are three main characteristic spelt out as follows:

1. It is a consumption Tax. This is that it can be paid when there is consumption of the good or service.
2. Its incidence is borne by the final consumer
3. It is multi-stage tax. That is as additional value is created at each stage of production the tax is paid by the consumer of the product at that stage. The total payments make up the consumer's price of the product.

Goods and Services exempted from VAT

All goods and services are VAT-able except those exempted by the Act.

Goods exempted are:

1. Medical and pharmaceutical
2. Basic food items
3. Books and educational materials
4. Agricultural equipments, product and veterinary medicine
5. Fertilizer
6. Agricultural Chemicals
7. Baby product
8. Exported goods

Services exempted are:

1. Medical services
2. Services by Development Finance Institutions – like Agricultural, Cooperative and rural Development, Mortgage Banking institutions.
3. Plays and entertainments conducted by educational institutions (part of learning)
4. Religious services
5. Exported services

VAT Administration: The tax authority for VAT is the Federal Inland Revenue Service (FIRS) with Head Office centrally located at Abuja and has Zonal offices and local offices throughout the Federation, Nigeria. They VAT Directorate works in close cooperation with the Nigerian Custom's Services and the State Internal Revenue Service.

VAT-able person: It is one who trade in VAT-able goods and services for a consideration- (ref; information circular No. 9901 of 1999). Every VAT-able person has an obligation to register for VAT-operation covering all the business activities of the VAT-able person.

The person can be a sole proprietor, a partnership, a limited liability company, a professional body, a club, an association or a charity organization.

A resident of Nigeria who performs services outside Nigeria needs to register with the Local VAT office. A non-resident needs to register using the address of the person with whom it has subsisting contract as its local address.

VAT Registration Procedure:

- First step- identification of VAT-able person and its address
- Prepare a comprehensive list of all suppliers of goods and services
- Form VAT 001 is completed by each VAT-able person
- VAT identification number given
- VAT certificate issued to the VAT payer
- VAT-able person must register for VAT within six months of commencement of the business
- A penalty of N10,000 is given in the first month of failure and
- N5000 for each subsequent month if failure continues.
- Government ministries, Statutory Agencies have to register for VAT as FIRS Agents.
- For the purpose of collecting the VAT and paying to the appropriate VAT office.

Non-resident companies doing business in Nigeria shall register for VAT with FIRS, but the person with whom it has a subsisting contract shall act as agent of FIRS in collecting the VAT and paying over to the VAT office

3.5 Representation of Public Revenue

- **OIL REVENUE**

1. NNPC Earning
2. Petroleum Profit
3. Tax
4. Royalty

- **NON OIL REVENUE**

1. Import Duties
2. Export Duties
3. Excise Duties
4. Stamp Duties
5. Value-Added Tax
6. Personal Income Tax
7. Corporate Tax
8. Capital Gain Tax
9. Capital Transfer Tax

- **INDEPENDENT REVENUE SOURCES**

1. Fines
2. Fees
3. Rates
4. License
5. Income from Government Investment

Self-Assessment Exercise 5.2

List examples of in-direct tax in Nigeria

4.0 CONCLUSION

In conclusion, this unit identified sources of Government Revenue as Oil Revenue and Non-oil Revenue. During the oil 'boom' period in the 1970s oil receipts contributed over 70 per cent of federal revenue to date.

5.0 SUMMARY

In this unit, we have identified the sources of government revenue as Oil and Non-oil Revenue and other means by which government generate receipts. Value Added Tax (VAT) was explained as a sales tax replacement and it's contributions to the growth in revenue since inception. In the next unit, you will be introduced to National Fiscal Responsibility.

6.0 TUTOR-MARKED ASSIGNMENT

1. Identify the sources of government revenue in Nigeria
2. Explain Value Added Tax (VAT) and list its impacted on Nigeria's revenue base.

7.0 REFERENCES/FURTHER READINGS

Central Bank of Nigeria (CBN) (2000) *The changing structure of the Nigerian Economy and Implications for development* Realm Communications ltd. Lagos

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UNIT 6 INTRODUCTION TO NATIONAL FISCAL RESPONSIBILITY

CONTENTS

- 1.0 Introduction
- 2.0 Objectives
- 3.0 Main Content
 - 3.1 Introduction to National Fiscal Responsibility
 - 3.1.1 Composition of the Fiscal Responsibility Commission
 - 3.1.2 Functions of the Fiscal Responsibility Commission
 - 3.2 Expenditure Framework- Medium Term
 - 3.2.1 Preparation of the Medium-term Expenditure Framework
 - 3.2.2 Content of the Medium-term Expenditure Framework
 - 3.3 Aggregate Expenditure Ceiling
 - 3.4 Annual Budget
- 4.0 Conclusion
- 5.0 Summary
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1.0 INTRODUCTION

In this unit, you will be introduced to National Fiscal Responsibility in Nigeria established to strengthen the Nigerian economy, fast track the tempo of socioeconomic development and ensure value for all resources deployed into physical and intrinsic development; the Nigerian Government has enacted various laws by setting up various legally backed commissions. Fiscal Responsibility Act, 2007 was enacted as a means of providing for prudent management of the Nation's resources, ensuring long-term macro-economic stability of the national economy and securing greater accountability and transparency.

2.0 OBJECTIVES

After studying this unit, you will be able to:

- Explain the purpose of the Fiscal Responsibility Act.
- List the functions of the Fiscal Responsibility Commission.
- Preparation and explain the Medium-Term Expenditure Framework.
- Explain annual budget accompaniments.

3.0 MAIN CONTENT

3.1 Fiscal Responsibility Commission

This Commission was established by the Fiscal Responsibility Act, 2007 to carry out the following functions, among others:

- (a) Monitoring and enforcing the provisions of the Act, thereby promoting the economic objectives of the Nation.
- (b) Disseminating standard national and international practices that will ensure greater efficiency in the allocation and management of public expenditure, revenue collection, debt control and transparency in fiscal matters.
- (c) Undertaking fiscal and financial studies, analysis and diagnosis and disseminating the result to the general public.

3.1.1 Composition of the Commission

The commission is to consist of:

- (a) A chairman who will be the Chief Executive Officer and Accounting Officer of the Commission.
- (b) One member representing;
 - (i) organized private sector;
 - (ii) civil society engaged in causes relating to probity, transparency and good governance;
 - (iii) organized labour;
- (c) A representative of the Federal Ministry of Finance not below the rank of a Director;
- (d) One member to represent each of the six geo-political zones;

All the members of the Commission shall be persons of proven integrity.

3.1.2 Functions of the Fiscal Responsibility Commission

The Act empowers the Commission to, among other matters, to

- (a) formulate and provide general policy guidelines for the discharge of the Commission's functions;
- (b) superintend the implementation of such policy guidelines;
- (c) appoint employees to ensure proper and efficient performance of its functions; and
- (d) Determine the conditions of service of employees and fix their remuneration allowances and benefits.

Self-assessment exercise

List the functions of the Fiscal Responsibility Commission.

3.2 Expenditure Framework- Medium-Term

The Federal Government in consultation with the States would:

- (a) Prepare and submit to the National Assembly a medium-term expenditure framework for the next three financial years on which the National Assembly will deliberate. This would have to be done not later than six months from the commencement of the Act.
- (b) Subsequently, not later than four months before the next financial year, commences a Medium-Term Expenditure Framework for the next three financial years will be prepared for the National Assembly's consideration.

3.2.1 Preparation of the Medium-Term Expenditure Framework

The Minister will be responsible for preparing the Medium-Term Expenditure Framework. In doing this he may hold public consultations on:

- (i) The macro-economic framework.
- (ii) Fiscal Strategy Document.
- (iii) The strategic, economic, social and developmental priorities of Government.
- (iv) Such other matters as he may deem necessary.

The consultation should be open to the public, the press, the citizens, organizations, group of citizens, etc.

The Minister shall seek inputs from the following organizations:

- (i) National Planning Commission.
- (ii) Joint Planning Commission.
- (iii) National Commission on Development Planning.
- (iv) National Economic Commission.
- (v) National Assembly.
- (vi) Central Bank of Nigeria.
- (vii) National Bureau of Statistics.
- (viii) Revenue Mobilization Allocation and Fiscal Commission.

3.2.2 Content of the Medium-Term Expenditure Framework

- (a) A macro-economic framework setting out the three financial years, the underlying assumptions and an evaluation and analysis of the macro-economic projection for the preceding three financial years.
- (b) Fiscal strategy document setting out:
 - (i) Federal Government's medium-term financial objectives;
 - (ii) the policies of the Federal Government for the Medium Term relating to taxation, recurrent expenditure borrowings, lending and investment and other liabilities;
 - (iii) the strategies, economic, social and developmental priorities of government for the next three financial years;
 - (iv) an explanation of the financed objectives, strategic, economic, social and developmental priorities and fiscal measures;
- (c) An expenditure and revenue framework which will set out:
 - (i) estimates of aggregate revenue for the Federation for each financial year, based on the pre-determined commodity Reference Price adopted and tax revenue projections;

- (ii) aggregate expenditure for each of the next three financial years;
- (iii) minimum capital expenditure projection for the Federation for each of the next three financial years;
- (iv) aggregate tax expenditure projection for the Federation for each of the next three financial years.
- (d) A consolidated Debt Statement indicating and describing the fiscal significance of the debt liability and measures to reduce the liability;
- (e) A statement on the nature and fiscal significance of contingent liabilities and quasi-fiscal activities and measures to offset the crystallization of such liabilities;

The estimates and expenditure in (c) (i — iv) above should be:

- (i) based on reliable and consistent data;
- (ii) targeted at achieving the macro-economic projection;
- (iii) Consistent with and derive from the underlying assumptions contained in the fiscal strategy document.

3.3 Aggregate Expenditure Ceiling

The estimates of aggregate expenditure and the aggregate amount appropriated by the National Assembly for each financial year shall not be more than the estimated aggregate revenue plus a deficit which must not be more than 3% (three percent) of the Estimated Gross Domestic Product or any sustainable percentage as may be determined by the National Assembly for each financial year. Aggregate expenditure for a financial year may exceed the ceiling indicated above if in the opinion of the President there is clear and present threat to national security or sovereignty of the Federal Republic of Nigeria.

3.2 The annual budget

This must be accompanied by:

- (a) A copy of the underlying revenue and expenditure profile for the next two years;
- (b) a report setting out actual and budgeted revenue and expenditure with a detailed analysis of the performance of the budget for the 18 months up to June of the preceding financial year;
- (c) A fiscal target broken down into monthly collection targets;
- (d) Measures of cost, cost control and evaluation of result of programmes financed with budgetary resources;
- (e) A fiscal target document derived from the underlying Medium - Term Expenditure Framework setting out the following targets for the relevant financial year:
 - (i) Target inflation rate
 - (ii) target fiscal account balances
 - (iii) Any other development target deemed appropriate.
- (f) A Fiscal Risk document evaluating the fiscal and other related risks to the annual budget and specifying measures to be taken to offset the occurrence of such risks.

4.0 CONCLUSION

This unit introduces fiscal responsibility at all levels of public administration and in Nigeria. It discussed such fiscal issues like duties of the Fiscal Responsibility Commission, Medium Term Expenditure Framework of government.

5.0 SUMMARY

In this unit, you were introduced to National Fiscal Responsibility, its composition and functions of the Fiscal Responsibility Commission; Medium Term Expenditure Framework and its preparation and Annual Budget.

6.0 TUTOR-MARKED ASSIGNMENT

- a) Explain the purpose of the Fiscal Responsibility Act.
- b) List the functions of the Fiscal Responsibility Commission.

7.0 REFERENCES/FURTHER READING

ICAN Study Pack

MODULE 2 FISCAL FEDERALISM, TAXATION AND BUDGETING IN PUBLIC SECTOR

Unit 1 Fiscal Federalism and Resources Allocation

Unit 2 Taxation

Unit 3 Government (Public) expenditure

Unit 4 Auditing of Government Accounts

Unit 5 Cost-Benefit Analysis and Project Management in Public Financial Management

Unit 6 Forms of Budgeting

UNIT 1 FISCAL FEDERALISM AND RESOURCES ALLOCATION

Table of Contents

1.0 Introduction

2.0 Objectives

3.0 Main Content

 3.1 Fiscal Operations of the Federal Government

 3.1.1 Principles, Criteria and problems

 3.2 Distribution of Revenue and Revenue allocation

 3.3 Value-Added-Tax

4.0 Conclusion

5.0 Summary

6.0 Tutor-Marked Assignment

7.0 References/Further Readings

1.0 INTRODUCTION

In this unit, we will see the adoption of a federal system of political administration with fundamental implications for the fiscal system and economic management of a country through revenue allocation formula.

2.0 OBJECTIVES

After studying this unit, you should be able to:

- Describe the distribution of revenue via revenue allocation;
- Identify the priority accorded each tier of government;
- Explain Value-Added Tax.

3.0 MAIN CONTENT

3.1 Fiscal Federalism

As could be cited in Module 1, Unit 3: Fiscal Policy; section 3 sub-section 4:

- Nigeria is a federal system of political administration with fundamental implications for the fiscal system and economic management of the country.
- The economic role of the public sector in a federal system is the joint responsibility of the multi-levels of government with joint responsibility of local, state and federal governments in performing the fundamental functions of socio-political administration and economic management.
- Complications in the fiscal system are technically and constitutionally handled and resolved in the light of political factors and pressures that gave birth to the union.
- The process of economic transformation and development calls for the collaboration and participation of many interest groups in an economy such as household, firms, public and private sectors etc.
- The role played by government or public sector in achieving desired changes in the structure of the economy is unique.
- This uniqueness of the government sector is formed from the fact that apart from being the element of the economy, the government sector plays a decisive role in achieving macroeconomic objectives of stability growth and development through a package of economic policy measures and legal provisions.

Self-Assessment Exercise 1.1

State the focus of Nigeria federal system.

3.2 Distribution of Revenue

The distribution of revenue from the Federation Accounts is done at two levels:

1. between federal, state and local governments;
2. intra-states and local governments.

The formula and principles of revenue distribution have always been subjects of intense debate with the formation of ad-hoc fiscal review commission without satisfaction.

3.3 Revenue Allocation

The use of Revenue Allocation Formula for sharing Federation Account revenue among the tiers of government in Nigeria originated from the colonial administration and the revenue allocation was based on the prevailing political structure then.

As the country became independent, the structure changed and the review of revenue formula became necessary. Revenue Allocation Commissions were appointed at ad hoc level thus: Binns (1964), Dina (1968), Aboyade (1977) Okigbo (1980).

3.3.1 National Revenue Mobilization Allocation and Fiscal Commission (NRMAFC)

- These ad hoc Commissions could not come out with a lasting solution; there became need for a permanent body that would regularly review the major sources for revenue and advice on the necessary changes in the revenue allocation formula.
- In 1989, the Federal Government established it under the Presidency, to find enduring solutions to problems of revenue mobilization and adequate allocation to the three tiers of government.

3.3.2 Structure for Revenue Allocation from the Federation Account

The allocation principles of revenue sharing formula that are in use at the inception of the present democratic dispensation are: Population, Equality of States, Internal Revenue Generation, Land mass, Terrain, Population density and Derivation. These principles are expressed in the Nigeria's 1999 Constitution under Section 162 (2), which provides that "in any approved formula, derivation accruing to the area which is home to natural resources being exploited for foreign exchange earnings, takes a magnitude of not less than thirteen percent of the revenue accruing to the Federation Account. So far, a revenue allocation formula was proposed by the Revenue Mobilisation, Allocation and Fiscal Commission in 2003 and submitted to the National Assembly through the Presidency, as prescribed by the 1999 Constitution. There emerged a structure of sharing of revenue from the Federation Account as typified below:

A. Vertical Formula

This shows the structure of allocation to the three tiers of government.

S/N	Beneficial	Percentage
1.	Federal Government	46.00%
2.	State Government (including FCT)	33.33%
3.	Local Governments (including Area Councils)	21.00%
	Total	100.00%

B. Horizontal Formula

This shows the structure of allocation among State Governments (including FCT) and among Local Governments (including Area Councils) to the three tiers of government.

S/N	Principles of Allocation	Percentage
i.	Equality	45.00
ii.	Population	25.60
iii.	Population Density	1.45
iv.	Internal Revenue Generation Effort	8.31
v.	Land Mass	5.35
vi.	Terrain	5.35
vii.	Rural Roads/Inland Waterways	1.21
viii.	Portable Water	1.50
ix.	Education	3.00
x.	Health	3.00
	Total	100.00

Revenue Sharing Formula in use in Nigeria

The revenue sharing formula in Nigeria has always tilted in favour of the Federal Government as evident from the recent formula used and presented in the figure below.

Practiced Revenue Sharing Formula (1999 – 2007)

Year	Beneficiaries	Formula (in percent)
1999 – 2000	Federal Government	54.68
	States	24.72
	Local Councils	<u>20.60</u>
		<u>100.00</u>
2001	Federal Government	41.30
	States	31.00
	Local Councils	16.00
	Special Funds	<u>11.70</u>
		<u>100.00</u>
2002	Federal Government	56.00
	States	24.00
	Local Councils	<u>20.00</u>
		<u>100.00</u>
2003 – 2006	Federal Government	54.68
	States	24.72
	Local Councils	<u>20.60</u>
		<u>100.00</u>
2007	Federal Government	52.68
	States	26.72
	Local Councils	<u>20.60</u>
		<u>100.00</u>

Proposed Revenue Sharing Formula by RMAFC

Year	Beneficiaries	Formula (in percent)
2001	Federal Government	41.30
	States	31.00
	Local Councils	16.00
	Special Funds	<u>11.70</u>
		<u>100.00</u>
2003	Federal Government	46.63
	States	33.00
	Local Councils	<u>20.37</u>
		<u>100.00</u>
2004	Federal Government	41.30
	States	20.50
	Federal Capital Territory	6.50
	Local Councils	20.00
	Special Funds	<u>11.70</u>
		<u>100.00</u>
2007	Federal Government	47.19
	States	31.10
	Local Councils	15.21
	Special Funds:	
	(i) General Ecology Fund	1.50
	(ii) Solid Mineral Fund	1.70
	(iii) National Reserve Fund	1.50
	(iv) Agricultural Dev. Fund	<u>1.75</u>
		<u>100.00</u>

Source: Abdullahi, S.A. (2008). Public Financial Management in Nigeria: Principles, Practice and Issues, pp. 136 – 137.

Self-Assessment Exercise 1.2

Explain Fiscal Federalism.

3.3.2 The Federal Government independent revenue comprises the following:

- Personal income tax of personnel in armed forces
- Staff of the Ministry of Foreign Affairs
- residents of the Federal Capital Territory, Abuja
- operating surplus of federal agencies
- dividends from Federal Government's investment in public quoted companies
- rents on government properties
- interest on and capital repayments of loans on-lent to state government and their agencies.

Table 1.1: Summary of Federal Government Finances (₦ Million)

Sources	1994	1995	1996	1997	1998
Oil Revenue	160,192.4	324,547.6	369,190.0	416,811.1	289,532.3
Non-Oil Revenue	41,418.4	135,439.7	151,000.0	166,000.0	174,076.5
Total Federally-collected Revenue	201,910.8	459,987.3	520,190.0	582,811.1	463,608.8

Table 1.2: Summary of Federal Government Expenditure (₦ Million)

Sources	1994	1995	1996	1997	1998
Recurrent Expenditure	89,974.9	127,629.8	129,416.3	146,421.0	206,477.5
Capital Expenditure	112,538.1	121,138.3	158,678.3	289,841.3	237,085.8
Total Federally-collected Revenue	202,513.0	248,768.1	288,094.6	356,262.3	443,563.3

Source: Federal Ministry of Finance and Economic Development / CBN Publication (2000).

The State Governments' sources of internally generated revenue are:

- Personal income tax of citizen resident in the states.
- Fees for registration and licencing of vehicles, permits, fees charges and levies with respect to land development etc.

For the Local Governments, the sources of internally generated revenue are:

- property tax within their boundaries
- Licenses on bicycles, tricycles, motorcycles trucks, canoes, wheelbarrows and crafts, collection of rates, radio and television licences etc.

3.3.3 Fiscal Operation of Government

You should note that under the fiscal system of Nigeria, the multi-levels of government engage in:

- Fiscal management
- Preparing and implementing annual budgets for the provision of services in the respective area of jurisdiction
- The main objective of fiscal management over the years is that of promoting accelerated economic growth as a base for achieving higher per capita income and social welfare

3.3.4 Federally-Collected Revenue

Nigeria's fiscal management experience in the 1960s was characterized by narrow revenue base, largely the relative under-development of the economy.

- However, total federally-collected revenue rose steadily with non-oil revenue dominant, averaging N301 million annually between 1961 to N634 million in 1969 and rose to N467.4 million in 1970, constituting 73.7 per cent of total federally-collected revenue.
- Federally-collected revenue recorded substantial increase oil revenue during the period, 1970-1980 and contributed to 64.3 percent, while the non-oil revenue accounted for 35.7 percent.
- You should note that each regime or administration adopted one measure or the other to improve the mono-economic base of the country- example: Structural Adjustment Programme (SAP) in 1986.
- The Federally-collected revenue retains the trend of oil based revenue being 70 percent and above till today.

3.5 Value-Added-Tax (VAT)

This was introduced by the federal government in 1994 to replace sales tax. Initially, the federal government received only 20 percent of the VAT proceeds to cover administrative cost of collection while state and local governments received 50 and 30 percent respectively.

- In 1995 the Federal Government decided to take 50 percent while state and local government receive 30 and 20 percent respectively.
- This formula varied in 1996, 1998, and 1999 **as shown on the table below**. You should note that revenue from VAT recorded a substantial growth since its inception in 1994, increasing from N726.8 million in 1994, which represented 3.6 percent of totally-collected revenue in that year, to N36,867.7 million or 8.0 per cent of the total revenue in 1998.

Table 2: VAT revenue allocation formula (%)

S/N	Governments	1994	1995	1996	1997	1998	1999
1.	Federal	20.0	50.0	35.0	35.0	25.0	15.0
2.	State and FCT	50.0	30.0	40.0	40.0	45.0	50.0
3.	Local	30.0	20.0	25.0	25.0	30.0	35.0
	Total	100.00	100.00	100.00	100.00	100.00	100.00

Sources: CBN Publication (2000). Approved Budgets of the Government of the Federal Republic of Nigeria

Self-Assessment Exercise 1.3

When was VAT introduced into Nigeria fiscal system? Which tax did VAT substitute?

3.0 CONCLUSION

We have described the distribution of revenue via revenue allocation formula based on the structure/tier of government and demonstrated the Fiscal Operations of the Federal Government

4.0 SUMMARY

In this unit, attempts were made to identify the Fiscal Federalism and Resources Allocation narrating from fiscal operation of government base on National Revenue Mobilization Allocation and Fiscal Commission. Also, we attempted to identify the federal, state and local government independent revenue base and internally generated revenue and VAT.

5.0 TUTOR-MARKED ASSIGNMENT

- 1) Identify the priority accorded each tier of government in Nigeria
- 2) Explain Value-Added Tax system in Nigeria

6.0 REFERENCES/FURTHER READINGS

Central Bank of Nigeria (2000) *“The changing structure of the Nigerian Economy and Implications for development”* Realm Communications ltd Lagos

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UNIT 2 TAXATION

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- 1.0 Introduction
- 2.0 Objectives
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 - 3.1 Definition and Historical Perspective
 - 3.2 Types of Tax
 - 3.3 Canons of Tax
 - 3.4 Incidence of Tax
 - 3.5 Effect of Tax on economic amenities
 - 3.6 Tax evasion and avoidance
 - 3.7 Tax as Revenue to the Government
- 4.0 Conclusion
- 5.0 Summary
- 6.0 Tutor-Marked Assignment
- 7.0 References/Further Readings

1.0 INTRODUCTION

This unit will take you through a brief historical perspective of the general principles of taxation in Nigeria, types and the purpose, incidence and canons of taxation with current development to support.

2.0 OBJECTIVES

After studying this unit, you should be able to:

- Explain Taxation background in Nigeria
- Define Taxation
- Identify types of tax in Nigeria
- State the purpose of Taxation
- List the canon/principles of Taxation

3.0 MAIN CONTENT

3.1 Taxation Definition and Historical Perspective in Nigeria

Definition

Taxation is defined as a compulsory payment or levy imposed via legislation by the government of a country on the income of the residents.

- The Joint Tax Board defined taxation as “the legal demand made by the Federal Government or the State Government for its citizens to pay money on income, goods and services”.

Historical Perspective

In Nigeria, taxation had existed before the name was given.

- Before the advent of the Colonial rule, a system in kind by rendering free services such as clearing of bush, digging pit toilets, wells etc, for the benefit of the community as a whole. Failure to render such services usually resulted in seizure of property, which might be reclaimed on payment of money.
- In 1904, the then Britain Governor-General to Nigeria introduced direct Personal Income Tax in Nigeria. This originally was introduced in the Northern Nigeria through the Native Revenue Ordinance of 1917, which was amended in 1918 to make it possible to apply its provisions in the Southern Nigeria.
- In 1940, a direct taxation ordinance was passed to repeal the Native Revenue Ordinance. In 1954, the Nigerian (Constitution) Order in Council empowered the regions in Nigeria to tax all Africans resident in each region.
- In 1958, a Fiscal Commission was set up to recommend the basic principles for uniform taxation throughout the country embodied in the Nigerian (Constitution) Order in Council, 1960.
- It is pertinent to note that this recommendation gave birth to the Income Tax Management Act of 1961 which ensured that uniform principles are adopted by various tax authorities in Nigeria.

Self-Assessment Exercise 2.1

Define Tax and name the Act that gave birth to uniform Taxation in Nigeria.

3.2 Types of Taxes

In Unit 5 Source of Government (Public) Revenue of this module, Tax was classified into two broad types: Direct and indirect Taxes-refer for examples;

- **Direct Tax:** If the payer bears the burden of the tax and cannot shift the burden to any other person.
- These taxes are based on income or receipts and their incidences fall directly on the payer.
- It can be used as a fiscal instrument to adjust disposable income of the citizens and redistribute income through different forms of direct taxes.
- Different forms of direct taxes are: Progressive, Regressive and Neutral (Proportional).

Progressive Tax:

The higher the tax base, the higher the rate will be. The rate of taxation is graduated progressively as income increases.

- Reduces inequality of income
- Increases aggregate demand
- Is non-inflationary
- Yield more revenue to government
- May induce disincentive as it is exorbitant to addition income of tax payers.
- Adopted in real life situation

Regressive Tax: The tax rate diminishes as income level/tax base increases. This is the opposite of progressive tax.

- Low rate of tax is paid at high levels of income
- Creates incentives to efforts
- Widens inequality of income in the economy
- Decreases aggregate demand
- Only rich saves extra income
- The rest discouraged in investment in the economy
- Not applied in real life

Neutral (Progressive) Tax:

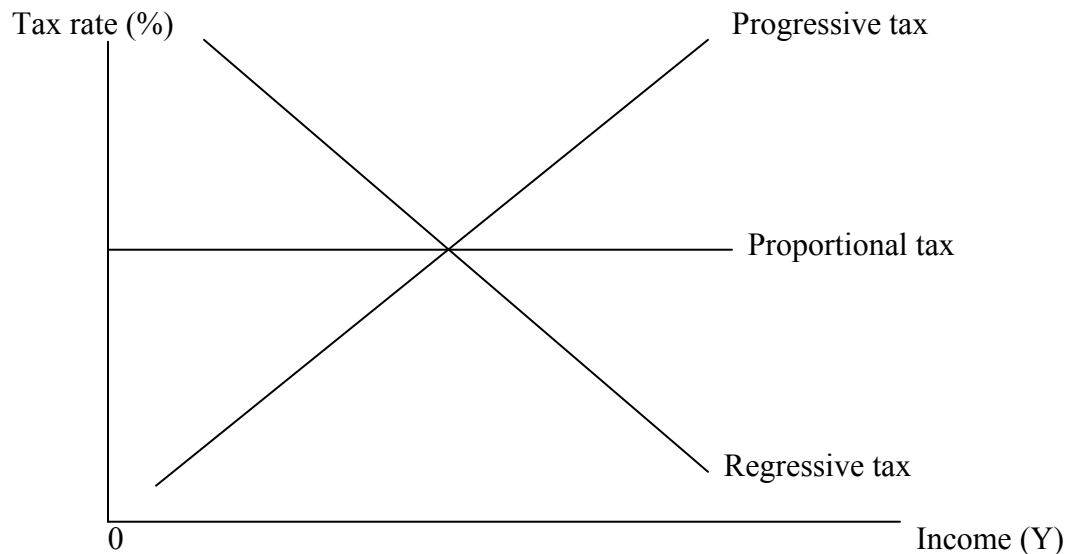
Takes no cognizance of the economic situation of the tax payer and the tax is proportional to the tax base/income at a constant rate.

- Is impartial
- Is not disincentive to efforts
- It does not provide incentives
- It is insensitive to economic situation
- It is against social equity

GRAPHICAL EXPRESSION OF THE BEHAVIOUR OF THE FORMS OF DIRECT TAXES

The graphical expression of the behaviour of the forms of direct taxes is as shown below for direct taxes:

Figure 1.1: Graphical expression of the Behaviour of the forms of Direct Taxes



Indirect Tax:

The payer shifts the burden to someone else. This depends on the elasticity or otherwise of the demand for the goods and services and the object of the tax.

- Tax on expenditure
- It is possible to shift tax incidence (partly or wholly) to someone else.

Tax Base:

Taxes are based on something. In Nigeria tax system it is based on three main bases namely; Income, Capital Gains and Consumption.

1. Income Tax

This is the regime of tax levied on the financial income of individuals, companies and corporate entities. Diverse income tax regime exists in different degrees of tax incidence – progressive, regressive or proportional which had earlier been discussed above. The income tax is levied on the income or profit of the companies as corporate tax, corporate income tax or income tax. It is based on net income – the difference between gross earnings and expenses and/or any other write offs. When it involves an individual, the income tax is often assessed on the total income less deductions or exemptions statutorily permitted by the law and regulations of tax in a given country. Types of payments that are taxable include: personal earnings, capital gains and business income.

2. **Capital Gains Tax**

This is tax levied on the gains or profits realized from sales of assets. The most common capital gains tax around the world are charged on the sale of stocks (shares), bonds, precious metal, real estate, mutual trust shares, interest on bank deposits, etc. The capital gains take into account the cost of investment and the proceeds realized from the sales of such assets. There are exemptions like agricultural land, primary residential buildings, etc.

3. **Consumption Tax**

Sales taxes are also known as consumption tax charged at the point of purchase for certain types of goods and services. The percentage of this tax is set by the government (authorized tax authority – Federal Inland Revenue Service and backed up by their States counterpart). There are exemptions in terms of goods and services which are not subject to sales tax. This sales tax can be included in the sales price of the good or service. By its nature and application, sales tax is considered to be fair and has a high compliance rate which makes it difficult to avoid. The retail sales tax (a version of sales tax) is usually affected by charging the tax only on the ultimate consumer as compared to the gross receipt tax levied on the intermediate businesses in production or distribution line.

Value Added Tax

The value added tax (VAT) is also known as goods and services tax, and is a tax on exchanges. It is levied on the added value that results from each exchange through the whole gamut of the production of goods to the final consumer. It is an indirect tax because the tax is collected from someone other than the person who actually bears the cost of the tax; the seller of the product or service pays the tax rather than the consumer who benefit the utility of the commodity. Please refer to the detail of VAT on Module 1, Unit 5 of this course for further explanation.

Self-Assessment Exercise 2.2

Mention different types of taxes in Nigeria.

3.3 Cannon or Principles of Taxation

1. **Equity:** equality of sacrifice. This principle states that the subjects of every state should contribute towards the support of the government in proportion to the revenue which the respectively enjoy under the protection of the government.
2. **Certainty:** By this principle tax paid by individuals must be certain with respect to amount paid, time of payment and manner of payment.
3. **Convenience:** The principle of convenience states that the time of payment and the manner of payment should be suitable to the contributor
4. **Economy:** The administrative cost of collecting the tax should not be higher than revenue realized, but should be less enough to leave surplus revenue.
5. **Simplicity:** The tax system should be coherent, straight forward and clear to the tax payers and accepted by the public.
6. **Flexibility:** The tax system should be such that it should respond to charges

7. **Impartiality:** All similar income earners should pay the same amount of tax.
8. **Productivity/fiscal Adequacy:** The origin of taxation is to raise revenue for the expenditure of government, hence should be able to cover government's expenditure.

Self-Assessment Exercise 2.3

List the canons of Taxation

3.4 Incidence of Tax

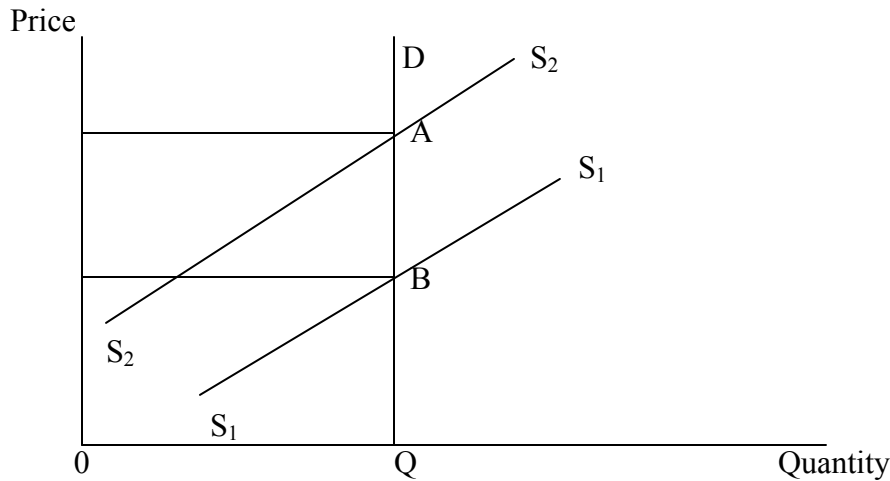
The incidence of a tax is upon the person who pays it.

- In the case of income tax- the incidence is always on the person receiving the income because income tax cannot be shifted to someone else. A person's income is always being reduced by the full amount of the tax.
- In the case of an indirect tax- one cannot be sure in advance whether the incidence of the tax will be on the buyer or on the seller of the commodity or whether it will be on them. The effect will depend on the elasticity of demand.

Illustration

Suppose a specific tax of N2 is imposed on a commodity previously priced N10. If the price is immediately raised to N12, the incidence of the tax is clearly on the purchaser. For now he has to pay N2 more than previously for it. That is, the old price plus the full amount of the tax. If the demand for the commodity is perfectly inelastic the price will rise to N12 and the full incidence of the tax will then be on the buyer as shown graphically below: figure 1.2.

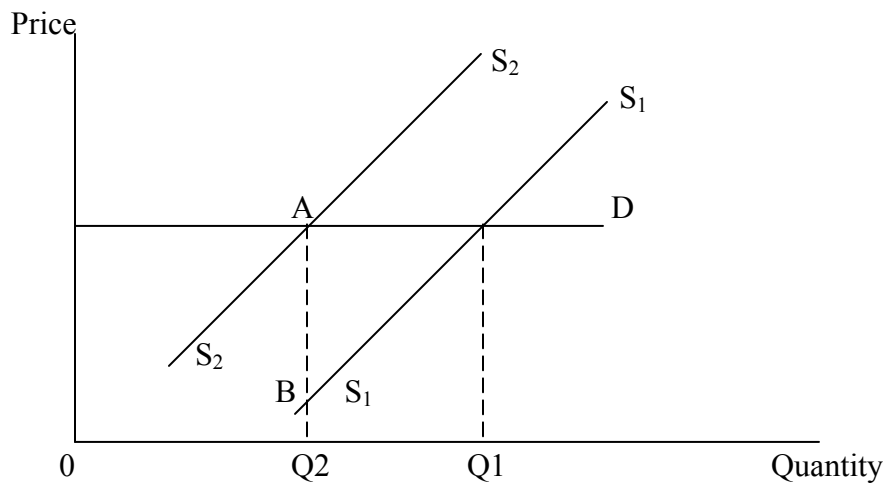
Figure 1.2: Incidence of Tax – inelastic demand



The tax AB increases the cost of production by that amount and so the condition of supply moved from S_1 to S_2 . The demand curve being perfectly inelastic, the price rises from Op_1 to Op_2 , this increase being exactly equal to the amount of the tax AB .

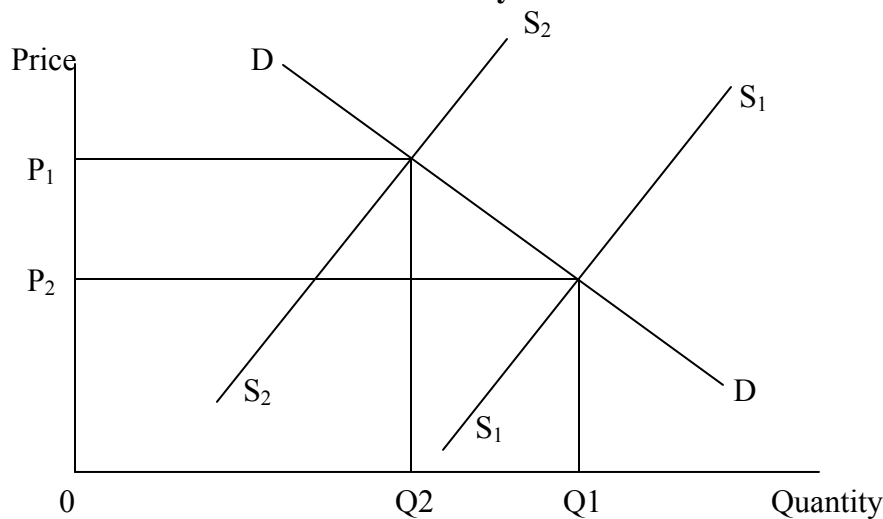
If the demand for the commodity is perfectly elastic, the incidence of the tax will be entirely on the seller, since at any price above $N10$ sales drops to zero as shown in figure 1.3 below. Again the tax AB increases the cost of production by the same amount, but because demand is perfectly elastic, the price OP remains the same.

Figure 1.3: Incidence of Tax – elastic demand



The above two are extreme cases of incidence. If demand is moderately elastic, the quantity demanded will fall off due to increase in price. To keep sales up, the price may be reduced to may be $N11$. In this case, buyer and seller pay part of the tax each so that the incidence of the tax is partly on the buyer and the seller as shown in the figure 1.4 below:

Figure 1.3: Incidence of Tax – moderately elastic demand



From the foregoing discussions and graphical presentation it stands to reason that the commodities most suitable for taxation (when thinking of maximizing revenue) will be those for which demand is inelastic. Unfortunately, many of the commodities for which there is a fairly inelastic demand are common necessities of life, whereas for some luxury goods demand moves towards more elastic. Semi-luxuries like alcoholic drink have to bear an increasing burden of taxation because experience has indicated the demand for them to be fairly inelastic.

3.5 Effect of Tax on Economic amenities

3.5.1 Purpose of Taxation

The general tax administration and practicing guide for professionals (2002) provides the following reasons for imposition of taxes inter-alias:

1. To maintain general administration, defence, law & order, and social services provided by government.
2. To reduce income and wealth in order check inequality.
3. To control consumption of goods and services considered non-essential and harmful.
4. To check inflation by reduce the volume of purchasing power.
5. To service national debt and to provide retirement benefit etc.
6. To provide subsidies in favour of preferred sectors of the economy example Agro-allied industries.
7. To implement government policies since budget is now an adjunct to monetary policy.
8. To serve as a dependable fiscal tool to plan and direct the economy, by shaping the growth and development of the country.

Annotation: Apart from the points stated in the guide mention above, Government needs money to meet its social, economic and political obligations e.g. construction of roads and building of schools etc and other exigency needs, like export promotion for balance of payment equilibrium, to stimulate growth and development in the economy and to preserve and augment foreign exchange reserve.

Self-Assessment Exercise

List the purposes of Taxation.

3.6 Tax Evasion and Avoidance

Tax evasion is the manipulation of forms when rendering returns and claims as regard the taxpayer's income status and the accompanying responsibilities. This is a direct violation of the law and it involves a fraudulent or deceitful effort by the tax payer to escape legally stated obligation. It is a criminal offence as it involves illegal means of reducing the tax payable by making false returns or by deliberate omission from the return of some source of income like declaring lower income or refusing to pay altogether.

Tax avoidance is where the individual takes advantage of the loopholes in tax regulation and manipulate his/her economic situation accordingly to pay low tax. It occurs when a tax payer takes a perfectly legal course to lower the amount he has to pay in taxes like the taking a life assurance policy, deductible from the total amount subjected to tax or claiming the existence of an aged mother or father- where there not which statutorily attract some deductions from the taxed sum and declaring that he has children whereas he/she has none

Self-Assessment Exercise 2.5

Differentiate between tax avoidance and evasion.

3.7 Tax as Revenue to the Government

Public financial management involves how funds are generated, allocated and managed by the government (Ola and Offiong, 2008). Nigerian income depends so much on the incidence of tax and different types of taxes are imposed on individuals, businesses and corporate bodies. Government also borrows funds from different available sources in order to meet its general responsibilities. The oil and gas sector, for some time now, has contributed greatly to the revenue base of the country as it has helped in the long run to solve social and political problems. It has also helped the government in addressing a lot of issues concerning the populace (despite Nigerian increasing population) hence psychologically; the attitude of people towards payment of tax has been in the low level as discussed above under tax evasion and avoidance. The character of the people has negatively affected the incidence of tax and those who find themselves in the 'corridor' of power have not helped issues because they do not pay their taxes. In view of these, the reliance of government on taxes for public expenditure has been relatively low hence the dependence on revenue from oil and gas sector. This has negatively affected the numerous public projects being embarked upon by different tiers of government. Sense of responsibility by citizens as tax payers has been neglected and even corporate bodies have also joined this 'wagon'. Invariably, the standard of living of the people has been affected because of shortage of revenue through taxation.

4.0 CONCLUSION

Tax is compulsory levy on the residents of an economy by the government of that economy. In this unit, we will see tax as a compulsory payment which is enforced by law for adults within the

work-force age to pay and the non-payment leads to penalties. The other fact is the only government can levy tax as a means of revenue.

5.0 SUMMARY

In summary, we have discussed the definition and historical perspective in Nigeria, highlighting types of tax, canons/incidence of tax, effect of tax on economic amenities, tax evasion and avoidance as well as their contribution to government revenue.

In the next unit, you will be introduced to another interesting unit known as public expenditure.

6.0 TUTOR-MARKED ASSIGNMENT

1. State the purpose of Taxation
2. List the canon/principles of Taxation

7.0 REFERENCES/FURTHER READINGS

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UNIT 3 GOVERNMENT (PUBLIC) EXPENDITURE

Table of Contents

1.0	Introduction
2.0	Objectives
3.0	Main Content
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5.0	Summary
6.0	Tutor-Marked Assignment
7.0	References/Further Readings

1.0 INTRODUCTION

In this unit, we will consider the expenditure of government in Nigeria and the classification and types of revenue as they affect different levels of government. You have to study this unit closely in order to identify the broad parts of public expenditure. As with the machinery of government and the system of inter-governmental relations, many aspects of the design of the Nigerian system of public financial management depend so much on political considerations and compact – basically constitutional on relative term.

2.0 OBJECTIVES

After studying this unit, you should be able to:

- Identify the broad parts of government expenditure
- Classify government expenditure
- Differentiate different types of revenue of each government level
- Relate government expenditure with Gross Domestic Product

3.0 MAIN CONTENT

3.1 Government Expenditure

Wagner's Law predicted that the development of an industrial economy would be accompanied by an increased share of public expenditure in gross national product (GDP). This is not an exception in Nigeria, as a developing nation, trying to expand its industrial base – manufacturing, agriculture, mining, extractive industry etc. The scope of government expenditure has obeyed this law since the economic base and government expenditure has been expanding over the years. Furthermore, Wagner's law suggests that a welfare state evolves from free market capitalism due to the population voting themselves ever increasing social services. Neo-Keynesians and socialists often urge governments to emulate modern welfare states like Sweden, which Nigeria is taking a cue from. As progressive nations industrialise, the share of the

public sector in the national economy grows continually. The increase in state expenditure is indeed due to three reasons as identified by Adolf Wagner (German economist, 1835 – 1917), namely:

- (i) Social activities of the State;
- (ii) Administrative and Protective Actions; and
- (iii) Welfare functions.

The material below is an apparently much more generous interpretation of Wagner's original premise.

- Socio-political, i.e., the state social functions expand over time; retirement insurance, natural disaster aid (either internal or external), environmental protection programmes.
- Economic: advance in science and technology, given room to an increase of state assignment into the sciences, technology and various investment projects.
- Historical: the state resorts to government loans for covering contingencies and thus the sum of government debts and interests amounts grow. What this is means is that it is an increase in debt service expenditure.

This principle applies to Nigeria as it increases her economic and capital bases socially and politically. As explained, there are two broad parts of government expenditures, namely: the recurrent and capital expenditures.

- Recurrent expenditure-the financial outlay daily running of government business
- Final consumption of government expenditure.
- For that of Federal Government is divided into three main parts: personnel emoluments, other charges and special
- Personnel emoluments are wages and salaries of government workers the allowances accruing to them
- Other charges are maintenance expenditure, travel, stationery, and consolidated charges Consolidated charges include emolument for judges and settlements government debts
- Special expenditure-to acquire durable equipment, machines, motor vehicles, furniture etc At times they are more of capital than running costs
- Capital expenditure-investment outlays that increase the asset of government.
- It depends not only on the size of revenue but on the amount used annually by government.

Self-Assessment Exercise 3.1

1. Name two broad parts of government expenditures.
2. What do you understand by Wagner's law of public expenditure?

3.2 Classification of Government Expenditure

In developing countries like Nigeria, government spending can be classified as follows:

1. Administration of law and order
 - Police, Law courts, Prisons, Civil service, Government Agencies, Foreign Affairs
2. Defence
 - Army, Navy, Air-force

3. Social Amenities
 - Education, Health, Housing, Social Welfare, Environment, Recreation
4. Economic Development
 - Agriculture, Mining, Power and Electricity, Oil and Gas, Commerce and Industry, Transport, Communication
5. Miscellaneous
 - National Debt interest payment, Grant to local Governments, Social Security, Pension payment, Aids to other countries

3.3 Types of Revenue for each government level

The major sources of revenue collected **by the Federal Government are:**

- Import, export, excise duties and fees
- Direct tax mainly company income tax and petroleum profit tax
- Licence fees and stamp duties
- Mining rents and royalties
- Earnings and sales
- Rents on government property
- Reimbursements
- Revenue from Armed Forces
- Interest and repayments
- Miscellaneous

Reference: Module 2 Unit 1 Fiscal Federalism and Resources Allocation Section 3

Sources of Revenue for **States are:**

- Independent Revenue (Refer Mod 2 Unit 1)
- Statutory appropriations from the federation account
- Non-statutory grants
- Total recurrent revenue
- Less recurrent expenditure
- Budget surplus or deficit
- Capital grant from Federal Government
- Internal loans
- External loans
- Total capital receipts

Sources of **Local government revenues are:**

- Independent revenue (Refer Mod 2 Unit 1)
- Statutory allocation from the Federal Government
- Statutory allocation from the State Government
- Budget surplus
- Internal loans
- Capital grants

- Total capital receipts

Self-Assessment Exercise 3.2

Enumerate the revenue base of states in Nigeria.

3.4 Government Expenditure and Gross Domestic Product

Generally, government expenditure has been on the increase with increase in the Gross Domestic Product (GDP). That is the marginal propensity to spend in the public sector is high (the increase in current expenditure as a percentage of the increase in the GDP). This is as the need of the society increases.

- As government revenue increased, government decided on the provision of a number of social services as a means of spreading oil wealth such as free education etc.
- As a matter of necessity, government can embark on the provision of public capital goods. Hence overhead capital like roads etc with heavy operating and maintenance expenditure
- Relatively, cost of public services is higher than private owing bureaucracy in government administration resulting in red-tape in the system.

4.0 CONCLUSION

In this unit, we have attempted to identify government expenditure and revenue from the different strata of governance in Nigeria recognizing their different base as well as responsibilities which gyrate around the laws of the country. This in effect affects the gross domestic product in the long run.

5.0 SUMMARY

In summary of this unit, we have discussed the classification of government expenditure; the types of Revenue for each government level government expenditure and as they affect the Gross Domestic Product of Nigeria. In the next unit, you will learn another interesting topic known as capital investment management and project management in the public sector.

6.0 TUTOR-MARKED ASSIGNMENT

1. Classify government expenditure in Nigeria.
2. Differentiate different types of revenue base of each government level in Nigeria.

7.0 REFERENCES/FURTHER READINGS

Ogunjimi, Samuel Olatunji (1997) *Public Finance: For Polytechnics ICAN Students* Lekem Productions Bida Nigeria

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UNIT 4 AUDITING OF GOVERNMENT ACCOUNTS

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- 3.0 Main Content
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 - 3.2 Types of Audit
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 - 3.4 The Objectives of Internal Auditing
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 - 3.4.2 The Role of a Government Internal Auditor in the Presidential System
- 4.0 Conclusions
- 5.0 Summary
- 6.0 Tutor Marked Assignment
- 7.0 References/Further Reading

1.0 INTRODUCTION

In this unit, you will learn of auditing of government accounts and audit alarm committee, introducing the nature, types, factors contributing to an Effective Audit, Audit Alarm Committee, the Federal Audit, and reliance of the External Auditor on the Internal Auditor's Work, Assurance Engagement and The Objectives of Internal Auditing.

2.0 OBJECTIVES

After studying this unit you should be able to:

- Explain Auditing, Objectives and Types of Audit
- Explain Investigation and steps in investigation.
- State the objectives internal auditing

3.0 MAIN CONTENT

3.1 Nature of Auditing

Auditing is an independent appraisal process often governed by statute, for examining, investigating and verifying the financial statements of an organisation, by a person competently appointed. The Auditor seeks to establish an opinion concerning the truth, accuracy, validity, reliability and fairness or otherwise of the statements and the underlying records on which the statements have been built and whether or not they comply with any statutory or other requirements. He also makes a report to the users of the financial statements, giving his opinion concerning the accuracy and integrity of the accounting records and information.

3.2 Types of Audit

These may be briefly discussed, as follows:

3.2.1 External Audit

In an external audit, a report is made to a person external to the audited entity and its management. External Audit is carried out by a professional who has the authority of the law to vouch the financial statements and records of the entity. Under paragraph 85 of the 1999 Constitution, the Auditor-General for the Federation vouches the financial statements and records of Public Offices. He has indirect control over the accounts and audit of the Federal Parastatals/Agencies. Conversely, the State Auditor-General, under section 125 of the 1999 Constitution, exercises the same powers and influence as his Federal counterpart. Nonetheless, by the laws creating the Parastatals/Agencies, they have the authority to appoint independent auditors. These are external auditors.

3.2.2 Internal Audit

An internal audit is an independent appraisal activity within an organisation for the review of accounting, financial and other operations as basis for services to management. It is carried out by an individual designated as internal auditor as a control process. In Government, audit certificates are issued before contractors and suppliers are paid.

3.2.3 Annual/Statutory Audit

Annual audit is a regular responsibility covered by the statute. It is a requirement of the law. It is carried out on a yearly basis by an independent person to establish proper, adequate and accurate stewardship on the part of management.

3.2.4 Ad-Hoc or Special Audit

Ad-hoc or special audit is a "one-off" assignment arising from a special request for investigation to be made. It could be in respect of an arm or a unit of the organisation; for example, a case of fraud involving an officer could be the ground for investigation.

3.2.5 Pre-payment Audit

Pre-payment audit is carried out before payment is affected. It is common in Government Services. An example is the audit carried out before contractors are paid. 'Prepayment audit' is carried out by the internal auditor to evaluate the extent to which management has achieved economy, efficiency and effectiveness and adhered to laid down rules and regulations. The Objectives of Pre-payment Audit are:

- (a) To guard against unreasonable or extravagant expenditure;
- (b) To ensure that sufficient funds are available to enable payment to be effected.
- (c) To ensure compliance with budgetary, civil service rules, financial memorandum, legislation and other legal requirements on payment; and
- (d) To ensure that goods/services conform to the prescribed standards before payments.

3.2.6 Post-Payment Audit

Post-payment audit is carried out after payment for the goods and services has been effected. 'Post payment audit' is executed by both Internal and External Auditors. The exercise is to complement the prepayment audit and ensure that disbursements take place in consideration of organisational interests and policies.

3.2.7 Value-for-Money Audit

Value-for-money audit is the review of the financial transactions to confirm that an organisation has received adequate benefit for the money expended. In other words, we can describe it as a review to confirm whether or not a company has committed its resources economically, efficiently and effectively.

The steps to be taken in carrying out Value-For-Money audit are:

- (a) Do initial analysis of the financial statements.
- (b) Review the management system.
- (c) Plan and control.
- (d) Carry-out compliance test. Check for approval by authorized office and limits of

authority.

(e) Carry out substantive tests which is subdivided into three, as follows:

(i) Economy Test. The objective of Economy Test is to ensure that resources (inputs) are obtained at the cheapest prices.

The tests to be carried out are: Oral interview, and Circularization.

(ii) Efficiency Assessment. The objective of Efficiency

Assessment is to ensure that wastages are reduced to the barest minimum.

The tests to be carried out are: Physical asset verification, Check to 'third party' evidence, Review computation, Review extension, Circularization, Conduct oral interview, Review internal audit report.

(iii) Carry out 'Effectiveness Review'. The objective of 'Effectiveness Review' is to confirm the popularity of the policy adopted by the organisation.

The tests to be carried out are: Circularization, and Oral interview.

Write the report. To evaluate efficiency and effectiveness, it is necessary to carry out physical verification of assets, check to evidences of third parties, review computations for occupancy, consider internal audit reports, circular for debtors and conduct oral interview.

3.2.8 Interim Audit

This is an audit carried out by the external auditor for the earlier months of the year. It is designed to reduce the workload at the end of the year. It has the advantage of early detection of frauds and mistakes, and evaluation of the adequacy of the existing internal control.

3.2.9 Final Audit

This is the audit carried out after the end of the year to finalise the audit since the interim audit was carried out.

3.2.10 Management Audit

Management Audit is a review of the performance of management during a period. It is synonymous with the investigation or performance review of the management, otherwise called 'operational audit.'

3.2.11 Operational or Systems Audit

The review concentrates on the operational aspect of management performance. The review evaluates the efficiency and effectiveness of management practices in rendering services to the members of the public.

3.2.12 Vouching Audit

Vouching audit checks the relevance and adequacy of the supporting documents of a transaction. Receipts are checked to third parties while evidence and all other financial papers are traced to the ledgers.

3.2.13 Verification Audit

This is a review to confirm the existence and ownership of the assets. It is undertaken by physical asset verification and review of evidence of ownership.

Self-assessment exercise

In your own words explain internal audit.

3.3 Factors Contributing to an Effective Audit

The following factors make for an effective audit:

- (a) **The independence of the auditor:** He should be given free hand to do a good job. The auditor should not be under the control of management of the Organisation.
- (b) The adequacy and scope of **the auditor's power:** The authority of the auditor should be guaranteed. The Auditor must be given adequate authority to discharge his responsibilities.
- (c) **The expertise and professionalism of the Auditor and his staff:** The Auditor should be adequately trained, versatile and skilful at his job.
- (d) The resources at **the Auditor's** disposal: There should be enough funds at the disposal of the Auditor to carry out his assignment.
- (e) **Freedom of reporting and the qualitative nature of reports** the reports which the auditor transmits should be promptly looked into and timely and effective decisions taken.

3.4 The Objectives of Internal Auditing

The objectives of Internal Auditing may be outlined, thus:

- (a) Determining the adequacy of the system of internal control which is in existence.
- (b) Investigating compliance with the existing financial memorandum, laws and financial regulations.
- (c) Checking the adequacy of monthly returns of activities.
- (d) Verification of the physical existence of assets and liabilities.

3.4.1 The Scope of Internal Audit Functions

The duties and responsibilities of internal auditors are at the discretion of management. However, from empirical studies, the following are the areas of interest to an internal auditor, viz:

- (a) Pre-audit.
- (b) Vouching of payroll and third party claims.
- (c) Auditing of store movements and records.
- (d) Conducting internal investigations and evaluation for management.
- (e) Constant review and appraisal of the existing internal control measures.

3.4.2 The Role of a Government Internal Auditor in the Presidential

System

The main idea of introducing the presidential system of Government is to further ensure accountability and probity. In this perspective, there are various laws, rules and procedures that must be complied with, to ensure sanity in the polity and Governance. The Internal Auditor is expected to render 'exception reports' on continuous basis on the financial activities of Government. He writes his reports to the Accounting Officer and copies the Auditor General. The presidential system of Government empowers the Legislative House to interview the Auditor-General on his position on actions already taken by the Executive arm which he had endorsed as correct. The system of Government expects him to ensure budget discipline through continued monitoring of receipts and payments. He is expected to be objective, fair and articulate in reacting to the views of opposing parties on financial matters. The Auditor-General for the Federation can audit any State or Local Government Council on how the Federal's special allocations as Ecology Fund are being utilized.

Self-assessment exercise

Outline the objectives of Internal Auditing in government

4.0 CONCLUSION

In this unit, you have learnt that Control of expenditure is necessary to ensure that the resources obtained are used for the purposes for which they are meant. Audit is an independent appraisal of financial statements of an organisation, with a view to expressing opinion on the fairness and truth or otherwise of those statements.

5.0 SUMMARY

In summary, the following were discussed Auditing of Government Accounts and Audit alarm committee. In unit 5, you will learn of government advances. This unit is end of module 1, in the next module; the first study shall be preparation of vouchers.

6.0 TUTOR MARKED ASSIGNMENT

- a) Explain Auditing and name Types of Audit.
- b) State the objectives of Internal Auditing in the public sector

7.0 REFERENCES/FURTHER READING

ICAN Study Pack

UNIT 5 CAPITAL INVESTMENT ANALYSIS AND PROJECT MANAGEMENT IN PUBLIC SECTOR

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- 2.0 Objectives
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 - 3.1 Concept of Capital Budgeting
 - 3.2 Capital Budgeting Factors
 - 3.2.1 Capital Budgeting Decision Steps
 - 3.2.2 Capital Budgeting Tool in Public Sector
 - 3.3 Cost –Benefit Analysis (CBA)
 - 3.3.1 Cost-Benefit Analysis- process
 - 3.4 Evaluation of Costs-Benefits and Project Selection
 - 3.4.1 Risk Evaluation in Cost-Benefit Analysis
 - 3.5 The Cost of Capital in Cost Benefit Analysis
 - 3.6 Project Management-Planning and Nature of Project
 - 3.6.1 The Network-Diagram and Convention
 - 3.6.2 Total Project Time: Critical Path Method (CPM)
- 4.0 Conclusion
- 5.0 Summary
- 6.0 Tutor-Marked Assignment
- 7.0 References/Further Readings

1.0 INTRODUCTION

In this unit, we shall attempt to discuss capital budgeting via cost-benefit analysis as applied to the public sector. The private sector objective is always expressed in financial terms while the principal objective of a public sector enterprise is not necessarily financial. Political and social consideration over-ride financial objective in the public sector.

You would be led through project management using network analysis in executing government project.

2.0 OBJECTIVES

After studying this unit, you should be able to:

- Explain the concept of Capital Budgeting
- Apply capital budget tool in Public Sector
- Describe the process in Government Projects
- Identify its impact on Government Decisions
- Evaluate cost-Benefit Analysis and Project Selection
- Discuss Project Planning-Management

- Explain Network in Project Development

3.0 MAIN CONTENT

3.1 Concept of Capital Budgeting

According to Hampton (1992), capital budgeting is the decision making process by firms evaluate the purchase of major fixed assets including buildings, equipment, stocks etc.

Capital Budgeting is also the act of long term planning decision for investment and financing of fixed assets, evaluating capital expenditure. The primary objective in capital budgeting decision is to add value to an going concern (private or public) by selecting investments/projects that meet the goals of the organization and provide best possible rates of return. There are many techniques of capital budgeting: Investment appraisal techniques like;

- Traditional Methods (Non-discounted)-Pay-back, Accounting Rate Return,
- Modern Methods (Discounted)-Net Present Value, Internal Rate of Return Profitability Index, Discounted Payback Period
- Capital Rationing and Risk Analysis
- Cost-Benefit Analysis

Self-Assessment Exercise 4.1

List the various techniques of capital budgeting.

3.2 Capital Budgeting Factors

The following factors may influence capital budgeting decision

- Economic Change- is very dynamic
- Technological Change- is very rapid
- Political Change- is ever presence
- Social Change- societal values, norms and orientation change
- Financing Capacity- capability and policy thrust is considered
- Future Prospects- provision for future growth is considered

3.2.1 Capital Budgeting Decision Steps

1. Identify possible investment projects
2. Acquire from the data on the projects under consideration
3. Evaluate the projects from the data assembled
4. Identify possible alternative to the projects being evaluated
5. Select project
6. Implement project
7. Monitor and control project

3.2.2 Capital Budgeting Tool in Public Sector

Government at whatever level might want to provide certain standard or service to the citizens at a charge below cost;

- It may be through subsidizing the industry and accepting loss from the industry example postal services etc.

- This makes the capital investment analysis most at time the public sector different from that of the private sector.
- Cost Benefit Analysis (CBA) proffers a better approach to analysis of projects in the public sector (Federal, State and Local Government).
- Cost Benefit Analysis is the most widely used technique.

Self-Assessment Exercise 4.2

State the steps taken in capital budgeting decision.

3.3 Cost –Benefit Analysis (CBA)

Public sector project might be done through the use of Cost-Benefit Analysis. This technique of CBA is drawn on the concept of Capital Budgeting as discussed above.

CBA is sophisticated technique that incorporates;

- A number of issues such as environmental problems, opportunity costs and transfer prices.
- Is more subjective than the normal capital budgeting technique especially forecasting of future outcomes of proposed project.
- Attempts to consider all the consequences of embarking on a project
- Can be used to determine the viability of a project
- Can be used to determine the time cycle that would be beneficial to the project
- Can be assessed in terms of cash flow or profit (cash flow is preferable)

3.3.1 Cost-Benefits Analysis Process

- Establish the objectives and possible advantages of a proposed project
- Ascertain alternative solutions to the problem
- Estimate and analyze the cost and benefits (this is a wide spectrum)
- Considers the costs and benefits that may accrue to anyone outside the project
- Example:

if government builds an airport, in addition to the costs and benefits of building the airport, the ripple effect that will occur might include reduction in road accident, increase in commercial activities, tourist attraction etc
- Opportunity Costs: Opportunities forgone because of the project.
- Shadow prices the cost of obtaining an extra unit of a scarce resource
- Transfer payments include subsidies and grants from a federal government fund to a state or local government funds.

3.4 Evaluation of Costs-Benefits and Project Selection

The government considers evaluating cost and benefit through various criteria namely;

- Benefits/costs Comparison-comparing the costs with the benefits
- Benefits/cost Ratio-ratio estimated benefits to estimated costs
- Discounted Cash flow techniques-this includes the net present value and internal rate of return criteria- Both consider time value of money.

3.4.1 Risk Evaluation in Cost Benefit Analysis

CBA is a forward planning technique which involves forecasting.

- The acceptance or rejection of project depends on accuracy of the forecast of costs and benefits.
- The forecast might be guesses and not the accurate figure.
- There is risk in accurately forecasting in CBA

Self-Assessment Exercise 4.3

Name the various criteria government considers evaluating Cost Benefit.

3.5 The Cost of Capital in Cost Benefit Analysis

The following considerations are used as cost of capital in the public sector as it is difficult to calculate using private sector approach of market value, no interest, business or financial risk in government activities;

1. **The Social Time Preference rate:** expresses the value which one places on consuming or owning an asset now as an alternative to consuming or owning it in future.
2. **Government Borrowing and lending Rate:** roughly the risk free rate of interest. The interest rate on Treasury bills can be used
3. **The Opportunity Cost Rate of Interests:** If a project has been under taken at the expense of to another project, the rate of interest that compensates for the capital being freed for the alternative project is called the opportunity cost rate of interest
4. **Real Cost of Capital:** used where the government set a target real rate of return for projects.

3.6 Project Management-Planning

Management of a project involves planning expediently through coordinating efficiently the factors there in. Planning has not been given priority as projects were less complex; the rule of thumb method would work well. However, today, as projects have become more complex project managers and public administrators have associated themselves increasingly to systematic planning and management. This section of the unit will lead you through the complexity services and you will affirm the need for systemic outlay of projects. Projects are in stages- a life cycle which include: planning, execution and phase- out At each stage of this life cycle, a variety of skillful requirements are involved. In effect;

- Project unit human resources and with diverse knowledge and skills,
- Some go from project to project as they are needed –consultants

In project management and planning, the size and scope of projects varies widely according to the nature and purpose of the project. It is worthy of note, that all projects have something in common. The go through a life cycle which can be arraigned into five phases;

1. Concept-the need for the project
2. Feasibility-expected costs-benefits analysis
3. Planning-details of work-human, time and cost
4. Execution-ensure project
5. Termination-target achieved

Self-Assessment Exercise 4.4

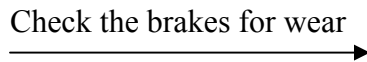
List the processes involved in management of a project.

3.6.1 The Network: Symbols, Diagram and Convention

The first stage of analysis is to divide the project into a number of different activities. An activity is merely a particular piece of work identifiable as an entity within the project. If for

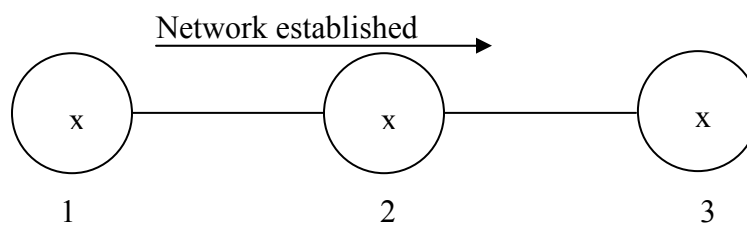
example, the project under consideration is the servicing of a motor car, then one of the activities would be to check the brakes for wear.

Now an activity within a network is represented by an arrow, with the description of the activity written on it, as:



Note: In addition to activities, events are identified too.

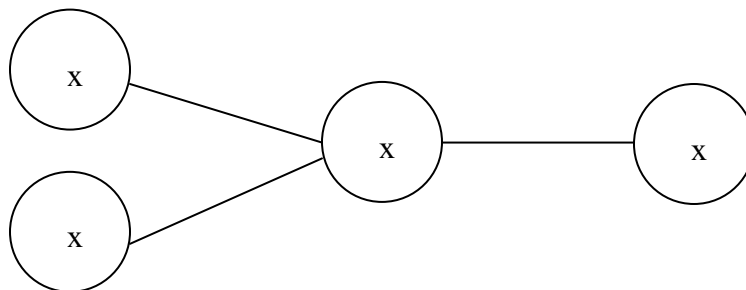
Events mark the point in time when activity is completed and the next activity can be started. Events are normally represented by circles:



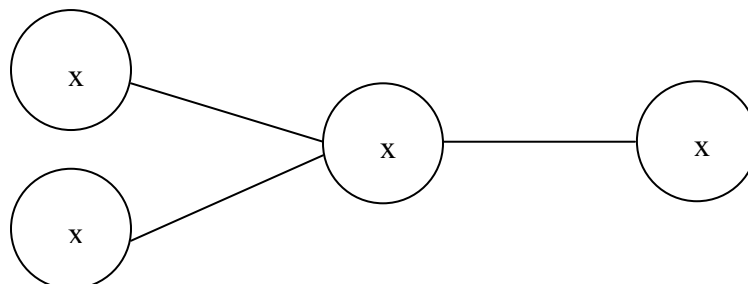
Network

A network is a convenient method of showing the logical sequence of activities in a project.

The event (x) represents the point in time when activity is completed, but also represents the point in time when activity can begin.



The activities depend upon more than one activity or vice versa. The point of networking can be from one individual or source and terminates in dual results or contact points.

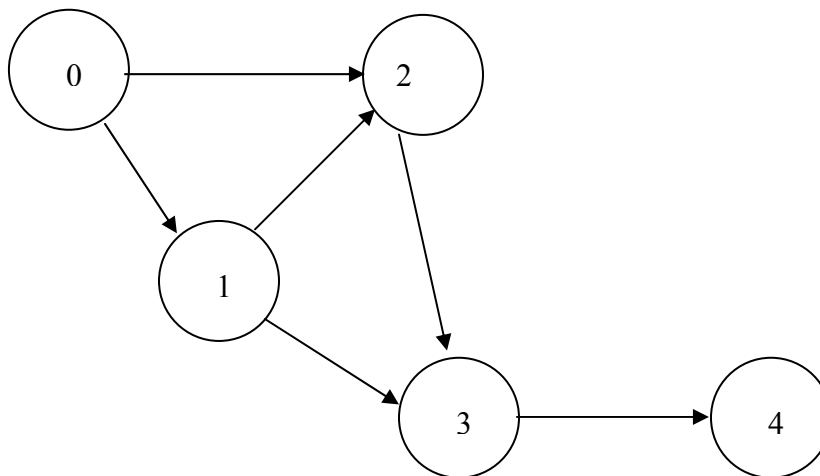


Dependence Tables

The first task of network analysis is to sort out the logical sequence of activity. This is done by constructing a dependency table by listing all activities according to priority. For example, a financial manager can affect the volume of credit sales and collection period and consequently investment in accounts receivable. This is called a dependable change in credit policy. Credit policy hence is used to refer to combination of decision variables like, initially, to start with credit standard, credit terms, and credit collection. The financial manager proceeding activity influences the activities thereof. Constructing a dependence table (trend) is often the most difficult part of project analysis, hence, in public sector project management; experts are engaged as consultants in their different phases of the project.

Network Diagram

The network diagram below is composed of a number of arrows and nodes. These arrows represent the flow of project activities. A network diagram is generally preferred to portray the project's activities as follows:



The network diagram shows relationship among major activities of a project. For example, 0 to 1 has been completed, 1 to 2 is completed, 2 to 3 is also completed, and the circle has to be full by 1 to 3 which is the final spot and 3 to 4 is remote in to check if the project can start the test of time. A path is a sequence of activities that leads from the starting node to the finishing node. The project life cycle is equals to the expected time of the longest path. The longest path is the critical path because of the depth and value of activities involved for the completion of the project. There is always an allowable slippage for any path which is called **slack**, and it reflects the difference between the length of a given path and the length of the critical path. The slack brings about flexibility in terms of implementation requirement.

3.6.2 Total Project Time: Critical Path Method (CPM)

The main determinant of Performance Evaluation Review Technique (PERT) and Critical Path Method (CPM) networks are analyzed and interpreted as whether activity time or estimated is probabilistic or deterministic. If the time estimates can be made with the high degree of

confidence, the actual time would not differ significantly. We say the estimates are deterministic. If estimated times are subject to variation, we say the estimates are probabilistic. Probabilistic time estimates include an indication of the extent of probable variation.

4.0 CONCLUSION

You were led through the application of capital budgeting via cost-benefit analysis in public sector financial management and the use of modern strategic planning in project management against the rule of thumb which was the order of the day in the years past.

5.0 SUMMARY

In summary of this unit, we have discussed the following; Concept of Capital Budgeting. Capital Budgeting Factors, Capital Budgeting Decision Steps, Capital Budgeting Tool in Public Sector, Cost –Benefit Analysis, Cost-Benefit Analysis- process, Evaluation of Costs-Benefits and Project Selection, Risk Evaluation in Cost-Benefit Analysis, The Cost of Capital in Cost Benefit Analysis, Project Management-Planning and Nature of Project, The Network-Diagram and Convention, Total Project Time: Critical Path Method and have shown how they are useful in the public sector despite associated limitations. In the next unit, we shall discuss the definition of budget, its theory and practice, the objects of budgeting, the influence of Keynes, types of budgets and the processes involved in budget making.

6.0 TUTOR-MARKED ASSIGNMENT

1. Identify capital budget tool in Public Sector.
2. Discuss Project Planning and Management approach in public sector.

7.0 REFERENCES/FURTHER READING

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UNIT 6 FORMS OF BUDGETING

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3.0	Main Content
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3.2	Budgeting Theory and Practice
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1.0 INTRODUCTION

In this unit, we will attempt to explain budget and emphasises on its application in the public sector administration especially as it affects developing economy like Nigeria. Budget is presented as a major financial management tool. The execution of a government's budget is carried out within an established legal framework for management of public finances as enshrined in the constitution and further elaborated in other statutes

2.0 OBJECTIVES

After studying this unit, you should be able to:

- Define Budget
- Explain the theory and practice of Budgeting
- Identify object and types of Budgeting
- Narrate the making procedure of a Budget in public sector

3.0 MAIN CONTENT

3.1 Budget Definition

According to Chartered Institute of Management Accountants, a budget could be defined as a plan stated in quantitative monetary terms which is prepared and approved prior to a defined period of time usually showing planned income to be generated and or expenditure to be incurred during that period and capital to be employed to attain a given objective. Budget is applied by users differently. In the individual / personal, business and public sector the scenario differs. For personal budget instinct and personal idiosyncrasies come to bay; while in the business sector liquidity and profitability are the guiding barometer. The public sector budget considers the

availability of funds and socio-political consideration uppermost along side regulations cum policies.

3.2 Budgeting Theory and Practice

Budgeting is the most important decision making process in public institutions. It is also a jurisdictions most important reference document. A public budget has four basic dimensions.

1. It is a political instrument that allocates scarce public resources among the social and economic needs of the jurisdiction
2. It is a managerial and administrative instrument: it specifies the **ways** and **means** of providing public programs and services; it establishes the cost of programme and criteria by which these programme are evaluated for efficiency and effectiveness; it ensures that the programme will be reviewed or evaluated at least once during the budget year.
3. It is an economic tool that can direct a jurisdiction's economic growth and development
4. It is an accounting instrument that holds government officials responsible for for the expenditure of funds with which they have been entrusted

3.2.1 Planning, Budgeting and Public Expenditure

In the introduction of this unit, we stated that execution of government budget is based on established framework. In this sub section, we reiterate that the legislative frame contained in the statutes of the country has been arraigned to ensure that government has access at all times to financial resources to defray approved public expenditure. The legislative framework also ensures that the government's access to financial resources other than tax revenues is not utilized before and certain set limits, which, if exceeded, would compromise the government's ability to finance its operations in the years ahead and could be inflationary, thereby causing fiscal imbalances in the economy

Self-Assessment Exercise 5.1

List the basic dimensions of public budget.

3.3 Object of Budgeting

Budget is a Management tool. I. M. Pandey ascribes the following to be the purpose of budgeting for both business and public sector;

- Planning – compels planning to take place
- Coordination – helps to coordinate, integrate all efforts to achieve objectives
- Control – facilitates control by providing definite expectations in planning phase
- Evaluation – ensures evaluation of past with present and future
- Communication – improves the quality of communication
- Utilization – optimum use of resources
- Improvement – leads to productivity
- Efficiency – it leads to self assessment of the organization

A good budget should be able to fulfill these objectives.

3.4 The Influence of Keynes

Before the intervention policy put forward by a British economist John M. Keynes, in the wake of the Great Depression of the 1930's, that government spending could be critical in managing an economy by stimulating demand when resources were underutilized and unemployment was high. The annually balanced budget was a common feature of most governments' budgetary practices. His thought created the notion of budgetary policy as an instrument by which a country can execute macroeconomic policy.

Self-Assessment Exercise 5.2

State the purposes of budgeting.

3.5 Types of Budgets

In public sector the classifications accorded budget are balanced, surplus or deficit, annually balanced, cyclically balanced and functional finance, incremental, priority resource, rolling, fixed and flexible budgets.

- Balanced-when revenue projections and expected expenditures in a budget are presumed equal
- Surplus-the presumed excess of revenue projections over estimated expenditure
- Deficit-if the expenditure estimates in a budget outweigh the revenue projections

You should note that in Nigeria (Federal, State or Local government), all budgets are either surplus or balanced with major source of balancing either internal or external debt contraction.

- Annually- balanced- budget- common feature of most government budgetary practice. With time most economists observed that an annually balanced budget rules out government fiscal activity as a counter cyclical stabilizing force. It is a tool to curtail undesirable and uneconomic expansion of the public sector.
 - Cyclically-balanced-budget-is the one balanced over the course of business cycle rather than being annually balanced. Therefore, government could initiate its counter cyclical influence while at the same time balancing the budget.
 - Functional finance-is based on the assurance of a non-inflationary full-employment which is balancing the economy and not the budget.

Other Budgets are:

3.5.1 Line-Item Budgeting

1. The line-item budget was the original budget format-each item of expense had a literal line in a ledger book. This is the Traditional or Incremental system
2. It classified budgetary accounts according to narrow, detailed objects of expenditure (such as motor vehicles, clerical workers or reams of paper) used within each particular agency of government, generally without reference to the ultimate purpose or objective served by the expenditure.
3. It is useful as a record of expenditures and the criteria against which audits could measure compliance.
4. It is widely used mostly in the local governments as their basic budget format or as a supplement to more sophisticated formats. This is so because it offers such comprehensive details on proposed expenditures.

A major weakness of this budget is that it might allow the test to be made as to whether funds had been spent on the purposes for which they had been appropriated. Despite several budgetary innovations and experimentations, the **line-item** or **incremental budget** is the most commonly used method of budgeting. In this method, each category of activity is afforded its separate appearance. It facilitates very less detail for both planning and cost control purposes. The amounts proposed are generally based on a predetermined increase from previous year's amount. This is extrapolated for the following year by adding a growth factor- owing to inflationary trend.

Sample of Table for Line-Item Budget

<i>Expenditure Items</i>	<i>Last Year ('07)</i>	<i>Current Year ('08)</i>	<i>Next Year ('09)</i>
Salaries			
Materials			
Other expenses			
Total			

The main advantage of line-item budget is the ease of its preparation and it makes a simple comparison of performance from one fiscal period to another.

The main problem is the difficulty of relating the line budget to the goals of the parent organization. Without much reviews, past inefficient activities are carried forward, making some resources wasteful. This could be deduced from the sample table above.

3.5.2 Performance Budgeting

The concept of performance budgeting requires a performance measure to be stated alongside each line item, so that elementary calculations of unit cost and efficiency could be made. Line items were grouped or categorized in functional items. For example, refuse collection department's workload could be determined on the basis of the number of houses and businesses served, which made it relatively easy to calculate how much trash is generated each week, month or year. Using this measure, the efficiency of collection could be compared to a base period and a base cost. This system is recommended by World Bank and International Monetary Fund to countries seeking to reform their budgetary system. Performance Budgeting (PB) is a system wherein managers are provided with the flexibility to utilize organization's resources as required, in return for their commitment to achieve certain performance results. It is a system of planning, budgeting and evaluation that emphasizes the relationship between money budgeted and result expected

Characteristics of a Performance Budget:

- It helps in identification of mission, goals and objectives of organization
- It links strategic planning information with the budget
- Development and integration of performance measures into budget
- Expenditures classified into very broad areas like, personnel, operating expenses and capital outlays, rather than specific line-items

Advantages

- It has more of a policy-making orientation since it links plans, measures and budgets.
- It forces departments and policy-makers to think about the big picture.
- It provides better information about the impact of budget decisions on people.
- It gives department's increased budgetary flexibility and incentives for generating budget savings.
- It allows for ongoing monitoring to see if agencies are moving in the right direction.
- It helps in developing unit costs for the activities. Activity-based costing may be applied under this approach.
- It strengthens legislative decision-making and oversight.
- It enhances financial accountability to citizens, decision makers and governmental monitoring agencies, and
- It supports better management and evaluation.

Performance information can increase public accountability and public services. Furthermore, performance information provides decision makers information they need for evidence-based policy-making.

The primary disadvantage associated with it is the emphasis on quantity, not quality, of the activity being monitored. Besides, the link between performance measures and resource allocations are subject to political choices.

There may also be lack of credible and useful performance information. In addition, difficulties may arise in achieving consensus on goals and measures. There could also be dissimilarities in programme and fund reporting structure as well as the limitations of information and accounting system.

Table 5.1: Performance Budget

<i>Expenditure Items</i>	<i>Function N1</i>	<i>Function N2</i>	<i>Function 3</i>	<i>Total</i>
Salaries				x
Materials				x
Other expenses				x
Total				x
Percent				100%

Figure

5.2

Detailed head (Financial targets or expenditure)		Total Budget
		₦
Salary		xxxxxx
Wages		xxxxxx
Office expenses		xxxxxx
Rent		xxxxxx
Stationery		xxxxxx
Supplies		xxxxxx
Diet		xxxxxx
Medicines		xxxxxx
Grants		xxxxxx
Vehicles		xxxxxx
Others		xxxxxx
Categories of manpower:	Gazetted	xxxxxx
	Non-gazetted	xxxxxx

3.5.3 Programme Budgeting

Programme budgeting system focuses on the output services that the programme provides to its users. It also readily relates to overall organizational goals and objectives. Under this system, budget request of public agencies or departments include funding and outputs and outcomes the expect to produce as a result of that funding

The legislature establishes performance targets for outcomes and outputs in the implementing act to appropriations act. Public organ then report their actual performance in their long range programme plans and budget requests for the following fiscal year. Incentives are given when performance exceeds standard or disincentives when it falls below standards. These incentives and disincentives can be monetary or non-monetary.

Examples:

- Monetary incentive- bonuses employees and
- Non-monetary- increase in budget flexibility

3.5.4 Zero-Based Budgeting (ZBB)

Zero based budgeting is a cost benefit approach to budgeting which ensures value for money activities which involves the use of decision packages. It is a budget for public sector organization in which all expenditures must be justified afresh each year and not just amounts in excess of the previous year. Under zero based budgeting, nothing is considered as sacrosanct. Every time, the managers or directors are supposed to start from scratch or writing on a 'clean slate'. ZBB is claimed to be a new technique of planning and decision-making. It reverses the working process of traditional budgeting. In traditional budgeting, departmental managers or directors need to justify only increases over the previous year budget. This means what has been already spent is automatically sanctioned. While in ZBB, no reference is made to the previous level of expenditure, every department function is reviewed comprehensively and all expenditures rather than only increases, are approved. ZBB is a technique, by which the budget request has to be justified in complete detail by each divisional manager or director starting from the zero-base. The zero-base is indifferent to whether the total budget is increasing or decreasing.

Self-Assessment Exercise 5.3

Classify budget in the public sector.

4.0 CONCLUSION

The public sector budget considers the availability of funds and socio-political consideration uppermost along side regulations cum policies of the country

5.0 SUMMARY

In this unit, we defined Budget and analyzed budgeting theory and practice, object of Budgeting, types of budgets and budget making process in Nigeria as a developing country.

8.0 TUTOR-MARKED ASSIGNMENT

- 1) Identify object and types of Budgeting in government sector.
- 2) Narrate the making procedure of a Budget in public sector in Nigeria democracy.

9.0 REFERENCES/FURTHER READING

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MODULE 3 NATIONAL DEBT AND ROLE OF MULTILATERAL INSTITUTIONS

Unit 1 Government Budget and Budgetary Control in Public Sector

Unit 2 Government Expenditure Control

Unit 3 Politics of Budgeting: Appropriation, Authorization & Control

Unit 4 National Debts & Debt Management

Unit 5 Government Organizations/ Managers of Public Finance

Unit 6 Role of Multi-lateral Institutions- IMF, World Bank etc

UNIT 1 GOVERNMENT BUDGET AND BUDGETARY CONTROL IN PUBLIC SECTOR

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- 2.0 Objectives
- 3.0 Main Content
 - 3.1 Government Budget
 - 3.2 Budgetary Control in Public Sector
 - 3.2.1 Importance of Budgetary Control:
 - 3.2.2 Essential features of Budgetary Control
 - 3.4 Master Budget
- 4.0 Conclusion
- 5.0 Summary
- 6.0 Tutor-Marked Assignment
- 7.0 References/Further Readings

1.0 INTRODUCTION

In the last unit, we discussed about the definition of budget, its theory and practice, the objects of budgeting, the influence of Keynes, types of budgets and the processes involved in budget making. In this unit, we shall explain budget in government sector and budgetary control as a primary device for ensuring compliance in public sector funding. The decisions are based on available policy thrust of the government on such funding.

2.0 OBJECTIVES

After studying this unit, you should be able to:

1. Explain Government Budget;
2. Define Budgetary Control concept;
3. Discuss Budgetary Control functions in Government Sector;
4. Itemize the features of Budgetary Control.

3.0 MAIN CONTENT

3.1 Government Budget

The description of government intentions and policies presented by a financial plan with details of estimates stating the receipts and proposed expenditures under various classifications is known as Government Budget.

- It is a projection of the flow of funds and how the funds will be expended to achieve stated objectives of individuals, households, business firms, institutions and governments.
- Budget is a financial plan which typically is made up of detailed estimate of expenditures, revenues- surplus or deficit for the present and successive fiscal years.
- Government Budget is not mere accounting statement of proposed expenditures and anticipated revenues; it bears the fruits of conscious policy decisions about the amount involved.
- Government Budgetary policy is fiscal policy directed to specific activity within the framework of the budget. Essentially, government budget is the instrument employed in the actualization of development plans hence, has legal backing. The Nigerian system of budgeting is usually for a year- from January to December.

There are two essential aspects of budget framework:

Capital and Recurrent estimates:

1. The recurrent budget includes recurrent revenue and recurrent expenditure. This category consists of items for the smooth running of government and of consumption nature like salaries, purchase of stationery as well as maintenance of infrastructures.
2. The capital budget includes capital receipts and capital expenditure. The annual capital budget is the instrument through which planned targets are translated to a programme of action. It is worthy of note that recurrent expenditure surplus and development loan stocks usually come under capital receipts with the defined development plan known as Rolling plan in Nigeria.

The economic policy objectives of a nation namely; stabilization of the economy, indigenization, income distribution, balanced development, socio-cultural growth etc are focused through the budget.

3.2 The concept of budgetary control

Budgetary control is a system of controlling costs which include the preparation of budgets. Budgeting is thus only a part of the budgetary control. Budgetary Control is defined by Chartered Institute of Management Accountants as “the establishment of the budgets relating to the responsibilities of the executive to meet the objective of an organization and the continuous comparison of actual with budgeted estimates so that if remedial is necessary it may be taken at an early stage”.

- It can also be defined as “a continuous process which reviews and adjusts budgetary targets during the financial year and produces a control mechanism to hold budget holder to account”
- This means that budgetary control is a technique encompassing the entire process starting from the preparation of the budget or the action plan, covering monitoring and review culminating in corrective action.

The characteristics of budgetary control are to;

- Establish target of performance/budget
- Record the actual performance
- Compare the actual performance with the budgeted
- Establish the differences and analyze the reason
- Act immediately for corrective actions

Annotation:

The principle behind budgeting is synonymous with the captain of a ship who planned his route by considering hazards, tides and possible adverse weather forecast. During the journey, details of the progress and frequent checks are recorded. He may deviate from the plan, though may still be on course owing to prevailing circumstances. On completion of the journey, he will compare what he encountered with expectation. The experience gained will be an equipment to plan similar trip in future.

Self-Assessment Exercise 1.1

State the characteristics of budgetary control.

3.2.1 Objective of Budgetary Control

The following are the objectives of budgetary control; refer to Module 2 Unit 5, Section 3.3 above (object of budgeting).

- To plan – A budget provides a detailed plan of action for activities over a definite period of time. By planning, many problems are anticipated long before they arrive and solutions sought through careful study. Example government planning for infrastructural development in a particular year for an area that is in need.
- To coordinate – Budgeting aids managers in coordinating their efforts so that objectives of the organization are harmonized with the objectives of its constituents. This will help in achieving result. Like the different sector need to be achieved and prioritizes in the light of the scarce resources.

- To communicate – A budget is a communication device. The approved budget indicating the details of planned activities assist in communicating the plans. The copies are distributed to the different ministries, extra ministerial departments and agencies.
- To control – The budget ensures that plans and objectives are being achieved. Control in budgeting may be synthesized effort aimed at keeping management informed of what pre-determined plans will achieved. Control comes through variance analysis and reporting
- To motive – Careful budgeting control motivates the human resource of the organization.

Advantages of budgetary control: The following are the advantages;

- Planning- It provides a well-organized plan based on facts. It provides definite objectives with regard to future operation.
- Control- It enables management to control each function, sector, ministry or department in order to achieve the best possible result.
- Coordination- It promotes and encourages coordination between departments of activities for the attainment of the overall good of the organization/institution
- Cost consciousness- It makes management to become more cost conscious and eliminate waste and inefficiency in its operations
- Management by exception- It is a time saving mechanism as attention is directed to areas of more pressing needs.
- Management Responsibility- It enables each manager to assume responsibility which is clearly established
- Measurement of performance- It provides a means of measuring the performance of individual managers and the various cost centres or departments by comparing targets against the performance of the manager can be assessed.
- Communication and motivation- It involves communication between top management and lower levels on how to attain the objectives. This motivates managers to achieve the target set.
- Prevention of waste- It prevents waste of physical resources such as labour, equipment, machinery etc Duplication of efforts is avoided as the most efficient and effective use of these resources is expressed in the budget
- Authorization and Delegation- It explicitly and expressly authorizes budget's policy thrust at approval of the master budget of the organ be it private or public. By the acceptance of the budget by the sectors concerned, responsibility for executing the policy can be delegated to the desk officers.

Limitations of budgetary control

- The budget plan is based on estimates: Budgets are based on forecasts and forecast estimates. Absolute accuracy is not possible in forecasting and budgeting. The strength or weakness of the budgetary control system depends to a large extent on the accuracy with which estimates are made.
- Danger of rigidity: Budget will not stand the test of time if not flexible because of the dynamic and continuous change in business condition
- Management tool: Budget is only a tool of management and cannot replace it. Its execution will depend on the will and nature of management concerned. The tool is as good as its applier.

- Expensive technique- Budget operation is costly, requiring specialized staff as well as incidental expenditure; however the cost used should not exceed the benefits to be derived there from.
- Inappropriate condition- Budgets are developed round existing organizational framework which may be inappropriate for current conditions
- Endangers morale and productivity- Budgets state clear objectives, realistic fulfillment of the desired established goal will be difficult.

Self-Assessment Exercise 1.2

Discuss the limitations in the installation of a budgetary control system.

3.2.1 Importance of Budgetary Control:

1. It increases efficiency
2. It reveals inefficiency
3. It reduces greater losses since it is a continuous measuring of actual and budgeted positions
4. The causes of variances between the budgeted and actual are identified to chart the remedial process to forestall such
5. It checks over-expenditure on the part of spending officer.

3.2.2 Budgetary Control in Public Sector

Budget and Budgetary Control is the backbone of any financial control system. The emphasis of financial control was in the private sector. Recently, the general attitude in the public sector has geared toward financial control because of the reality of scarce public resources which need proper management even at the macro-level. Nowadays, Public accounts Committees have been formed at the ministerial level and other agencies of government. Government prepare master budget which is supported by budget classification as; revenue, capital expenditure and cash budget. The budget targets are conventionally evolved not by consensus but from top to bottom. The incremental approach to budgeting overshadows the zero-base and programme-cum-performance approaches.

Costing and Cost Control in most of the public sector enterprises is not given appropriate attention. They pay lip service to cost and maintain no standards. Cost reduction drives are seldom undertaken. The concept of just-time-inventory is not practiced in public sector undertakings. Variance analysis is not a regular feature and the resultant effect of such analysis is not effectively utilized. Raw material consumption norms and optimum inventory limits have been developed by some of them. To be effective in this, extensive costing systems and appropriate procedure need be in place for their operation.

Internal audit is an important component of financial controls. It has been given adequate attention in public enterprise's management in terms of its location, organization, empowerment, resource allocation, staffing and performance. It is usually headed by an executive at the middle or senior level.

Self-Assessment Exercise 1.3

Name the importance of budgetary control in the public sector.

3.4 Master Budget

Public Sector Undertakings prepare master budget which is supported by budget classification under three sub-heads, namely, revenue capital expenditure and cash budgets. The budget targets are evolved not by consensus but from top down to bottom. The incremental approach to budgeting overshadows the zero-base and programme-cum-performance approaches. The Budgeting is not supported by a proper back-up of the management information system. This is a functional budget and it a summary of all the related functions of government.

4.0 CONCLUSION

Budgetary Control is explained as the establishment of the budgets relating to the responsibilities of the executive to meet the objective if an organization and the continuous comparison of actual with budgeted estimates so that if remedial is necessary it may be taken at an early stage”.

5.0 SUMMARY

In this unit, attempts have been made to describe government budget, essential features and the importance of budgetary control in public sector. The functional budget is known as the master budget summarizing all the main functions of government

6.0 TUTOR-MARKED ASSIGNMENT

- 1) Classify Government Budget
- 2) Itemize the essential features of Budgetary Control

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UNIT 2 GOVERNMENT EXPENDITURE CONTROL

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- 6.0 Tutor Marked Assignment
- 7.0 References/Further Reading

1.0 INTRODUCTION

In this unit, you will learn of how to control expenditure in Government showing the procedure through the arm of, institutions and departments. Public Accounts Committee and the various types of control exercised over government expenditure will be introduced to you.

2.0 OBJECTIVE

After studying this unit, you should be able to:

- ☐ Identify the various types of controls exercised over Government expenditure.
- ☐ List the arms, institutions and departments involved.

4.0 MAIN CONTENT

3.1 Expenditure Control

Expenditure control could be defined as the strings of coordinated actions which have

to be taken to ensure that all expenditures are 'wholly', 'necessarily', 'reasonably' and 'exclusively' incurred for the purposes for which they are meant. The following are the basic controls exercised over Government expenditure:

- (a) The Executive Control.
- (b) The Legislative Control.
- (c) The Ministry of Finance Control.
- (d) The Treasury Control (Office of Accountant - General of the Federation)
- (e) The Departmental Control.
- (f) Office of the Auditor - General for the Federation.

3.1.1 The Executive Control

The Executive comprises the President and his cabinet members who have the responsibility for the efficient and effective control of the administration of the country - politically and economically. The Constitution created two other arms of government, called the Legislative and the Judiciary for purposes of checks and balances. All measures and policies taken by the President are subject to the approval of the Legislature within the ambit of the Constitution. Consequently, in accordance with Section 75(1) of the Constitution, "The President shall cause to be prepared and laid before each House of the National Assembly at anytime in each financial year, estimates of revenue and expenditure of the Federation for the following financial year."

The President, in order to satisfy the provisions of the Constitution also appoints a Cabinet Committee on Estimates, to advise him on the contemplated policy measures. The policy measures contemplated are then transmitted to the Budget Department in the Presidency. This development in turn leads to the issuance of guidelines on the preparation of the Budget. As a result, effective supervision is exercised on all the Agencies involved in budget operation. Any Unit of the Government whose requirements are higher than the 'control figures' already issued, is invited to defend the excess request.

3.1.2 The Legislative Control

The National Assembly is the Supreme Authority on matters of the Nation's finance. The control exercised by the Legislature is both 'antenatal' and 'post-natal'. The 'ante-natal' control is in the sense in which the Legislature considers and approves the Estimates submitted to it by the President. 'Post-natal' control is the review of transactions after payment. No amount of public fund may be spent without the approval of the National Assembly. However, Section 82 of the 1999 Constitution empowers the President to spend from the Consolidated Revenue Fund to carry on the administration of Government of the Federation for not more than six (6) months or until the coming into operation of the Appropriation Act, whichever is earlier.

3.1.3 Auditor-General for the Federation

The Auditor General for the Federation scrutinizes all accounts and records of the money collected and spent and reports to the National Assembly appropriately on the instances of waste, extravagance, inefficiency or fraud. It is observed that the Auditor-General's duty is post-payment audit, except in the matters relating to pension and gratuity payments on which he performs pre-payment audit. This is in addition to the regularity and compliance audit that he carries out as a duty.

Self-assessment exercise

Differentiate between executive control and legislative control

3.1.4 Ministry of Finance Control

When Ministries/Departments require money to pay for services, they normally apply to the Minister of Finance, for such funds. The tradition is that once a year the Ministries and Parastatals present Estimates to cover their needs and requirements which are expected to be prudent, necessary and reasonable, in accordance with the Financial Regulations and Appropriation Act. The Minister passes the Consolidated Revenue and Expenditure Estimates to the President who will present them to the Federal Executive Council for approval before they are forwarded to the National Assembly as Appropriation Bill.

3.1.5 Controls by Warrants

Although the Estimates and Appropriation Acts guide the disbursement of public funds, the release of money is subject to issuance of relevant Warrants by the Finance Minister, for the expenditure. The Warrant authorizes the Accountant-General to release fund from the Consolidated Revenue Fund or Development Fund. The system of Warrant gives the Executive greater control over the issuance of funds than would be offered by a system which relies solely on the provisions of the Appropriation Acts.

3.1.6 The Treasury Control - Office of the Accountant-General of the Federation (OAGF)

The Accountant-General has overall responsibility for the total expenditure of Government. His office would keep necessary books of accounts to record all the receipts and expenditure of the various Ministries and Departments. The Treasury Department exercises some measure of supervision and checks over the accounting records of the Non-Self Accounting Units.

3.1.7 Inspectorate Division

Inspectorate Officers from the Office of the Accountant - General of the Federation visit the various Ministries and Departments to evaluate the system of internal control. They do this to ensure that the accounting system and maintenance of various books of accounts conform to the approved regulations and procedures.

3.1.8 Internal Audit

This is another aspect of control exercised in any organisation. The Treasury dispatches Internal Auditors to the Ministries and Self-Accounting Departments to appraise the effectiveness of the existing internal checks and report upon any inadequacy discovered.

3.1.9 Departmental Control over the Budgeted Expenditure

A Departmental Vote Expenditure Allocation Book (D.V.E.A. Book) is a record of payments made and liabilities incurred under the Votes or Funds approved for each Ministry or Extra-Ministerial Department. A Vote Book is maintained for each Head or Sub-Head of expenditure. It is an integral part of the Budgetary Control System. The Book is designed to facilitate vote watching to ensure that expenditure incurred are not in excess of appropriation. Over-expenditure of departmental vote amounts to reckless use of public funds and is seriously frowned at by Government. It is the duty of the Officer who is controlling the Vote to thoroughly investigate, without delay, payments or charges which appear in the schedules drawn up by the Accountant-General, which do not appear in the Vote Books particularly with a view to the prevention and detection of fraudulent payments.

Self-assessment exercise

Why is there need for expenditure control?

3.2 Public Accounts Committee

The 1979 and 1989 Constitutions brought into existence the Public Accounts Committee. The purpose of the Committee is to expose waste, corruption or inefficiency in the handling of public funds or projects. It is empowered to examine the audited accounts of the Federation and those of public offices as well as the Auditor-General's report thereon.

4.0 CONCLUSION

In this unit, you learnt of how to control expenditure in Government showing the procedure, the arm of, institutions and departments.

5.0 SUMMARY

This unit dealt with Expenditure Control, with emphasis on the various forms of control over Government expenditure. These include the Executive, Legislative, Ministry of Finance, the Treasury and Departmental Controls. In the next study unit, you will be taken through discussions on auditing of Government Accounts.

7.0 TUTOR-MARKED ASSIGNMENT

- a) What are the various types of controls exercised over Government expenditure?
- b) List the arms, institutions and departments involved.

7.0 REFERENCES/FURTHER READING

ICAN Study Pack

National Open University Nigeria (2009) MBA728: *Public Financial Management* Lagos

UNIT 3 POLITICS OF BUDGETING: APPROPRIATION, AUTHORIZATION AND CONTROL

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1.0 INTRODUCTION

In this unit, we shall discuss the politics of budgeting, process of budgeting in a democratic Nigeria, and identify the stages of budget making in Nigeria.

2.0 OBJECTIVES

After studying this unit, you should be able to:

- Explain the politics of budgeting
- Narrate the process of budgeting in a democratic Nigeria
- Identify the stages of budget making in Nigeria

3.0 MAIN CONTENT

3.1 Politics of Budgeting

The politics of budgeting cuts across all political settings whether it is developed or developing nation; the budget game is a major preoccupation in politics, occupying the time and energies of lobbyist politicians and officials at the federal, state and local strata of governance. The intensity depends on which level though it is fiercer at the national level in Nigeria where the centre controls the most of the most of the resources. Budget is the tool of decision and literally the biggest

game. In every game, there are winners and losers and the stakes are incredibly high. For these reasons Nigerian politicians has been pre-occupied with what Aaron Wildavsky termed the “politics of the budgetary process”.

3.1.1 The budget game (politics)

This of course consists of two fields of play for politicians:

1. Defending clientele (members of constituency) against revenue hikes such as tax increases and
2. Seeking to attract government spending programme that will benefit clientele

Often the game is so skillfully displayed that even the categorization of an initiative as revenue or expenditure may serve to conceal its nature. For example, government housing assistance to low-p workers is categorized as expenditure. Government housing assistance to high-paid workers (tax deductibility of mortgage interest payment) is presented as an exemption on the revenue side. One is a direct expense and one is a tax expense. How do they differ? Spending on the highway is characterized as the provision of necessary infrastructure. Spending from general taxation on public transportation is assigned the category “losses”. Again how do they differ? In many respect, the inter-play between the President and the National assembly represent the ultimate show-down. After all the convolutions of dealing, trading and bluffing the final play/politicking is between National Assembly and the Presidency. You should note that the play will be heightened in its drama National Assembly and President are from opposing parties.

- Both have budget offices to support them in analysis and in repackaging deals into budget options
- Both have enormous standing and access to the public through the media

But at the end the game remains. The president must send his budget to the National Assembly. The National Assembly, the more so if hostile will extremely amend it and return it; the president must decide whether and to what extent to use the veto. Behind the scene, horse traders, lobbyists continue to parley. Owing to its importance and the way in which it is conducted, the budget game should never under-estimated or ignored by public administrators. At the same time, its centrality should not divert attention far from the substantive merits new and existing policies as embedded in the constitution, rather than the gamesmanship with which funds for them may be sought or denied.

Self-Assessment Exercise 2.1

Briefly explain in your own what you understand by politics of budgetary control.

According to Kiragu, Kithinji, effective financial management is critical feature of a public administration system. He noted that the key objectives of an effective public financial management system are;

- Proper planning and budgeting for public expenditures
- Effective and efficient administration of government revenues
- Proper use of budget resources

- Effective control of public expenditure
- Accounting and reporting on public finance
- Full accountability for all public spending

3.2 Legal and Institutional Framework

The importance and sensitivity of the finance management function in the conduct of public affairs underpinned by the comprehensive legislative and other statutory provisions on what, how, where and by whom public resources are obtained and utilized. Usually, this key aspect of public financial management are enshrined in the constitution, elaborated in specific acts of parliament (National Assembly) and reinforced and enforced through supplementary legislation (financial regulations) usually issued by the Minister of Finance with the authority of National Assembly. For example, in the constitution of most Anglo-phone countries in Africa, including Nigeria, stipulates that:

- All government revenue will be collected under the authority of parliament (National Assembly) and paid into one Consolidated Fund, from which all funds for public expenditure purposes shall be paid
- No public moneys shall be spent without the authority of the parliament
- Government expenses shall be made only for the purposes authorized by the parliament
- All moneys spent out of the Consolidate Fund must be accounted for before the parliament
- The office of the Auditor General will operate independently of the executive arm of the government

3.3 Budgetary Process in Nigeria Democratic Development since 1999

1. The preparation of the Annual budgets is essentially the duty of the Executive and the approval that of the Legislature.
2. Statutorily, the section 81 of 1999 constitution of the Federal Republic of Nigeria empowers the president of the nation to prepare and present an annual estimate of revenue and expenditure of each fiscal year in a specific format to the National Assembly for approval.
3. Presidency through the Budget Department initiates budget policy which is sent to the Ministry of Budget and Planning for consolidation.
4. Guidelines are given to various ministries in form of Call Circulars for action in the various ministries.
5. These are collated and sent back to the Ministry of Budget and Planning for further review, revision and modification by the Draft Estimate Committee before transmission to the President who would present same to the National Assembly for approval.
6. In summary, there are three phases of approval namely; the Ministerial, the Executive and Legislature.

3.4 Budget Making Process—Appropriation, Authorization and Control

You would deduce that the structure and government budget is the subject of successive waves of innovation. This is so because the ultimate statement of what a government stands for and

spends is found in the texture of its budget. The budget is the key focal point of public administration. It places authority and huge power in the hands of those who shape it.

The waves of innovation gave birth to different types of budget in the public sector owing to its timeless potency as follows. Budgeting in government comprises of two main arms, namely: the budgetary procedure and the budgeting system.

Budgetary Procedure:

The budgetary procedure consists of practices, processes, institutional arrangements, documentations, norms and conventions governing budgets preparation, approval, implementation, appraisal and review.

Budget System:

This means the management process that provides framework for acquisition, allocation and utilization of resources by pre-setting decision rules and other operational mechanism which governs the entire allocation process.

The budget cycle is a complete set of events which occurs in the same sequence yearly and cumulating into the approved budget. It has four phases, namely:

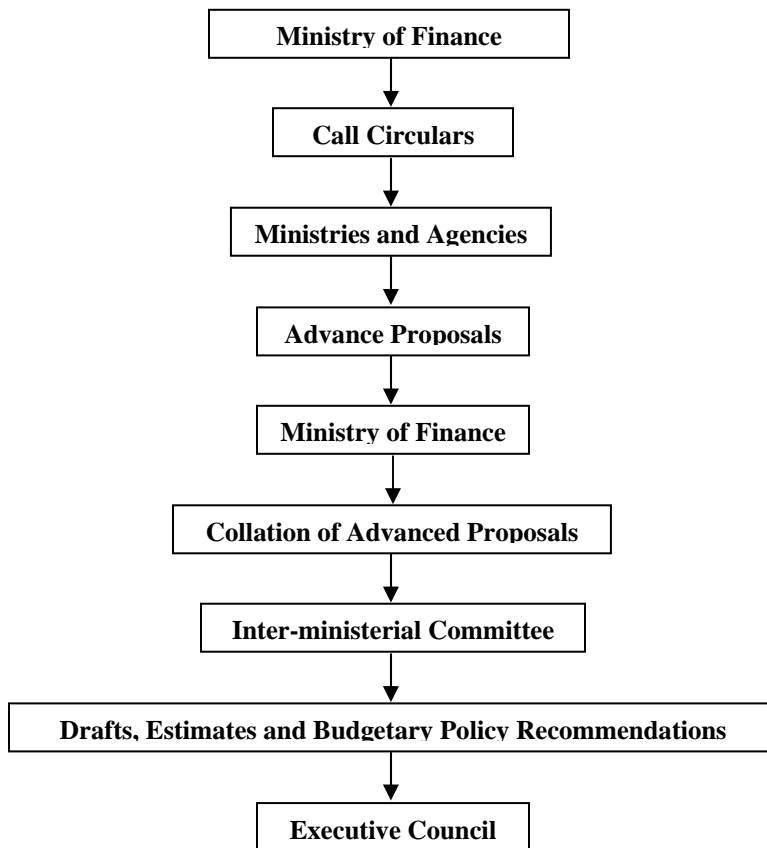
- (i) Executive preparation and submission;
- (ii) Legislative consideration and enactment;
- (iii) Execution; and
- (iv) Audit and review.

Phase One

Government objectives are articulated in terms of economic, social and welfare parameters. The priorities and expected levels of achievement act as indicators. These are made known both to the Ministry of Budget and the Council of Economic Advisers. Based on this, the Ministry of Finance (Federal and State level) issues call circulars inviting ministries, departments, and their agencies to submit advance proposals of revenues and expenditures for the next financial year (budget). In response to this call, these units of government send their advance proposals (revenues and expenditures) to the Budget Ministry to collate them for consideration by the inter-ministerial body of officials selected from the Treasury, Establishment, National Planning and the Federal Ministry of Works. The officials of each ministry and their agencies led by their Accounting Officers (Permanent Secretaries) would appear before the inter-ministerial committee of officials to defend their respective proposals. After this, the inter-ministerial committee completes its review exercise, transmits its decision in form of advice and recommendations through the Budget Ministry to the Federal Executive Council (Cabinet).

The Federal Executive Council made up of political heads of the ministries i.e. Federal Ministers and State Commissioners who then deliberate on the budget. At this point of political consideration, the programmes of the party in power and the particular preference of the chief executive (President or Governor) tend to gain attention than all other economic rationality and budgetary models and frameworks that the budgetary process had gone through. Under the presidential system of government, the draft of the estimate is sent to the State House of Assembly and the National Assembly, as the case may be. You should note that Section 81 (1) of 1999 Constitution place the responsibility for budget preparation on the President or the Governor at state level. The flow chart of budgetary process in Nigeria is shown below:

Flow Chart



Source: Philip Adeotun (1980) quoted in Ola and Offiong (2008). Government Budgetary Process in Nigeria, Mimeograph, University of Nigeria

Phase Two

This phase involves legislative consideration and enactment. More political factors are brought to bear on the draft budget. Ideally, it is expected to be concluded before the beginning of the budget year. In this phase, the budget is sent to the National Assembly at the national level and to the House of Assembly at the state level, where debates are held to accept more amendments if suggested before it is passed into law. The national and state assemblies reserve the rights to call on both the political and technical heads of the ministries and agencies to defend their proposals.

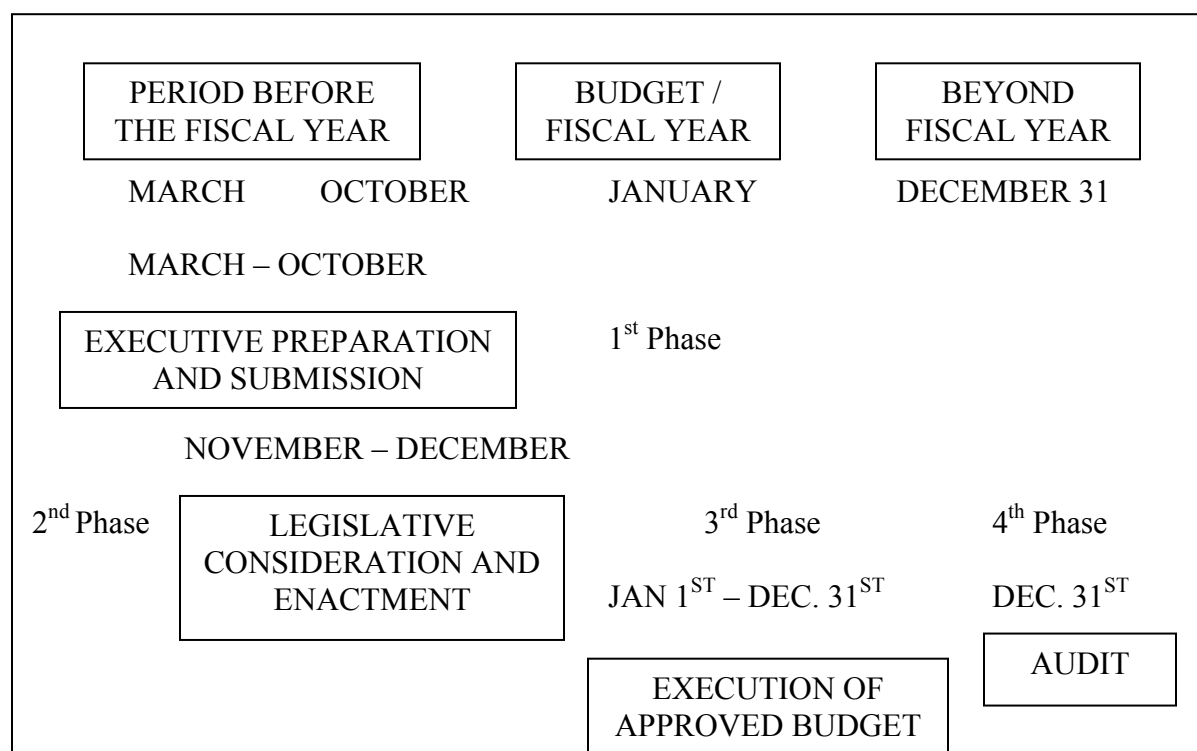
Eventually, the bill is returned to the President/Governor for assent, which is an approval authority. However, in a situation where there is a delay in approval of appropriation bill in respect of any financial year, the chief executive (President at the federal level or Governor at the state level or Chairman at the local government council) may authorize expenditure in default of appropriation for a period not exceeding three months. Such authorized amounts should not exceed the amount so authorized by the legislature during the immediate preceding financial year (refer to Sections 82 and 122 of the 1999 Constitution).

Phase Three

This is the implementation stage of the budget and schedules of financial disbursement are contemplated by the Budget Department. The implementation is fraught with problem of timely release of funds which could be caused by administrative bureaucracy. This has a tendency of delaying the execution of programmes and projects of various ministries and their agencies.

Phase Four

This is the audit stage and the review stage, which constitutionally, requires a post-mortem evaluation of government accounts by the Auditor-General of the Federation or the State, as the case may be – Federal, State and Local Governments. The Auditor-Generals then submit their reports to the various assemblies (National and State). The Auditor-General's basic function in the Nigerian budgetary process is the prevention of fraud, ensuring that there is a legislative authority for all payments being made or expenditure being incurred.



Source: Koleade Oshisami (1992) quoted in Ola and Offiong (2008). Government Accounting and Financial Control. Ibadan, Nigeria: Spectrum Books Limited, p. 55.

Rolling Plan in Nigeria's Planning and Budgeting System

Owing to poor achievement of past economic plans and poor budgetary implementation in Nigeria, the military administration in 1990, introduced the idea of a rolling plan based on three year perspective in order to address the planning and budgetary predicaments experienced in the past. The aim of this planning was to make provision for a long term vision of the economy taking into consideration the goals of socio-economic development for the distant future of 5, 10, 15, 20, 25 or 30 years. This aimed at setting long term targets and objectives of economic development. The strategic plan is also aimed at addressing three basic issues of capital growth, technological progress and population growth. This will serve as a background when preparing a

medium or short term plan. The medium chosen for Nigeria was three years plan while the short term is the annual budget hence, the framework of the rolling plan are three folds: the annual budgets representing the annual plan, the medium term plan representing the three years plan while the perspective plan ranges from 25 to 30 years.

Self-Assessment Exercise 2.3

What is the concept of government budget all about?

3.4 Government Agencies Managing and Controlling the Finances of the Federation

The following though not exhaustive can be listed as Public Financial Control Authorities in Nigeria:

(i) The Constitution

- The Constitution serves as the foremost control authority on financial matters just like and other matter of national interest. In it, is embedded all rules through which the country is governed. For example, it provides for the custody of all revenues or other moneys raised or received by the federation and the conditions and manners for their disbursement or utilization. The provisions of the Constitution are control measures and serves as an authority on which public fund is operated. The Constitution lays down the procedures for public fund control and compliance which protect it from abuse.

(ii) The President, Governors or Local Government Chairmen

(iii)

The Constitution vests executive powers (see Sections 5 (1-5) of the 1999 Constitution) on the President and his counterparts in other tiers of government. As a result, they have powers over public financial matters and indeed, their consent and assent must be obtained for any public financial transaction.

In their wisdoms, they can refuse consent or assent if any foul play is suspected or an abuse is sensed. Public accountability lies on their heads and they are respectively accountable for any financial mismanagement of their states and localities.

(iv) The Legislature

The legislature is the formal law-making body of a country. In any democratic setting, all annual expenditures are controlled by the legislatures. For example, the budget or the annual estimates must be approved by the legislature before it can become legal and disbursable. The Executive Annual estimates are subject to reduction or addition by the legislature. They also have powers over supplementary estimates.

The power of the legislature to control public funds is absolute and even the courts cannot challenge its decisions. The legislature also has powers over the custody and withdrawal of public funds. The legislature also has powers to enact money bills and laws. The Audit Act of 1956 and the Finance (Management and Control) Act of 1958 are cases in point. They all buttress the financial control authority of the Legislature.

(v) The Minister of Finance or Commissioners for Finance in the States

Though all Ministers are appointees of the President and only carry out tasks on his behalf, there is need to single out the Minister of Finance. This is because it is his ministry that disburses and provides control over funds in other ministries. Usually, before budgets are formalized, the Ministry of Finance which in most cases embodies or has supervising power over the department of the budget, peruses and seeks clarifications where necessary on the financial estimates of other ministries. It has powers to advise the President on public financial matters. It will be recalled as stated earlier that after other relevant bodies including the President or Head of State, the Legislature or the Supreme Military Ruling Council as the case may be have given their approvals, the Minister of Finance then issues warrants for money to be released. As part of his control powers, he could withhold issuance or the release of such warrant if there are grounds or issues to be cleared.

A typical example of this was the case of Anthony Ani (Minister of Finance) vs. Dan Etete (Minister of Petroleum Resources) former ministers during Abacha's regime, when the former publicly indicted the latter for lack of transparency and accountability. Ani buttressed his stand when he refused issuing warrant for the release of money meant for the Ministry of Petroleum Resources, even when it was claimed to have been consented to by the Presidency. This situation became a public issue as it then brought to a standstill the supply of petroleum products for domestic use in the country with the claim that money meant for maintenance of the oil industry (refineries) had been withheld. Ani insisted on his action by demanding for the account of money earlier disbursed to the Ministry.

The Ministry of Finance's broad objectives in financial administration includes:

- (a) the development of initiatives for the formulation of policies on fiscal and monetary matters;
- (b) the harnessing and mobilization of internal and external financial resources for development;
- (c) the supervision of the insurance industry;
- (d) the supervision and supervisory control of ministries, departments and agencies of government in financial matters;
- (e) management of foreign exchange;
- (f) external and internal borrowing, government-owned enterprises, public debt, trustee securities, etc;
- (g) the National Insurance Corporation of Nigeria, and
- (h) the Nigerian Re-Insurance Corporation and the Federal Savings Bank.

(vi) The Accountant-General of the Federation

This is another control authority. The Accountant-General is vested with the responsibility of keeping the accounts of the Federation. Indeed, the Financial Regulations describes him as the "Chief Accounting Officer of the receipts and payments of the Government of the Federation funds". He was conferred with this status by virtue of Ordinance 27 of 1937. He is responsible for the general supervision of the accounts of all ministries and departments within the Federation and for compilation of the annual

financial statements of government. The Federal treasury is under his control. Indeed, he operates the main government funds accounts annually for the receipt and disbursement of federal money, and ensures that there are adequate machineries in public offices for the control of public funds. Though, the Finance Ministry has overall responsibility for financial administration, it is the Accountant-General who finally releases money from the government funds after the warrants for same must have been issued by the Minister of Finance. His importance in public financial control cannot be undermined. Though he acts mainly on ministerial directives, he could raise alarm where public funds are to be abused or misused.

The Revised Financial Regulations of 1976 vests enormous powers on him. Some of these powers include: the powers to conduct surprise inspections of government accounts (FR 112) and of the cashbooks of revenue collections (FR 311) and to disallow expenditure which has been incorrectly charged to a vote (FR 516).

(vii) The Auditor-General of the Federation

Auditing is a crucial factor in ensuring proper control of public funds or any fund for that matter. The duties and responsibilities of the Auditor-General formally came to light through the Audit Act of 1956. Section 7 (3) of this Act provides the authority for the existence of his office. Due to the importance attached to the Office of the Auditor-General, relevant sections of subsequent Nigeria's Constitutions stipulate procedures for appointment, tenure of office and duties (powers to audit public accounts and conduct investigations).

The responsibilities of his office constitute perhaps, the most important financial control function within the overall financial control system. He ensures that public funds are not misappropriated, lost or abused. He is regarded as the watchdog of the people over the spending of public funds. He works in league with the Accountant-General of the Federation who must submit the financial statements of the Federation to him and he in turn after auditing submits his report to the National Assembly to be considered by a Committee of the House responsible for Public Accounts. One significant aspect in the exercise of his function is that he cannot be subjected to the direction or control of any other authority or person (see Section 85 (6) of the 1999 Constitution). However, what is important is that the Auditor-General is a crucial factor in public financial control. A sound financial base strives in the effectiveness and efficiency of an Auditor-General.

(viii) The Role of the Treasury

At the heart of any organized government is the treasury function. The treasury is the financial organisation of the Federal Government which receives keeps and disburses its funds, on the directives of the Accountant-General. As the final port of disbursement, the Treasurer or any Treasury officials can raise alarm if there are suspected misappropriations. The Treasurer, if sufficiently satisfied that a disbursement is wrong, can stay action on such disbursement. There are cases where Treasurers have stopped payments on misappropriation grounds and by this, they contribute in controlling public funds.

(ix) The Budget

This is another significant control authority which had been exhaustively discussed above. Budget simply means estimates for expected revenues and expected expenditures in a given period though mostly annually. It is just a quantified plan and direction put in place by management or public officials, to achieve set objectives. The Budget of a country therefore provides the quantification course of action of the ruling government. It serves as a guide to actions of government. In a democratic setting, the legislature must approve the budget before it becomes binding.

(x) The Directors General of Ministries (now Permanent Secretaries)

Before the 1988 Civil Service Reforms, the Directors-General (DGs) were fully responsible for their ministry's vote and expenditures. Thus public fund control was placed at their desks. The 1988 Civil Service Reform reverted this and placed the Ministers/Commissioners as Accounting Officers of their respective ministries. Many questions have been raised about this on the grounds that Ministers or Commissioners are political appointees while DG's are career officers and by the nature of their permanence, they can be held accountable for any misdeed at any time. This trend has however been reverted to the pre-1988 reforms and the DG's are now the Accounting Officers of their ministries. The DG's therefore serve as control authorities as money utilized in the ministries are all public fund.

(xi) The Central Bank of Nigeria (CBN)

The CBN serves as the sole monetary authority through its control of the monetary policy of government. As part of its functions, it serves as the Bank of the Government and Bankers to other Banks. Foreign exchange transaction is its responsibility. Indeed, it has enormous control over public funds and could raise alarm where foul play or abuse is suspected. It is also saddled with the responsibility to print currency, thus having control over physical government funds. Again, since most Government businesses are transacted through the CBN, it can refuse suspected transactions.

4.0 CONCLUSION

In conclusion, we have realized from this unit that the politics of budgeting is not peculiar to Nigeria as a developing country; it cuts across all political settings whether it is developed or developing nation. The budget game is a major preoccupation in politics, occupying the time and energies of lobbyist politicians and officials at the federal, state and local of government.

5.0 SUMMARY

In this unit, we endeavoured to discuss politics of budgeting, budgetary process in Nigeria Democratic Development since 1999, in terms of appropriation, authorization and control.

6.0 TUTOR-MARKED ASSIGNMENT

- 1) Explain the politics of budgeting
- 2) Identify the stages of budget making in Nigeria

7.0 REFERENCES/FURTHER READING

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UNIT 3 NATIONAL DEBT AND PUBLIC DEBT MANAGEMENT

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1.0 INTRODUCTION

In this unit, we will discuss national debt and the management strategy of the public debt. You will be led into the gaps that led to the national indebtedness and the agencies thereof.

2.0 OBJECTIVES

After studying this unit, you should be able to:

- Define Public Debt
- Define Deficit Financing
- Identify sources of Public debt
- Discuss Debt Management Strategies

3.0 MAIN CONTENT

3.1 Deficit Financing

It is worthy of note that filling of gaps between public revenue and public expenditure is responsible for borrowings and deficit financing. You should also be aware that precisely deficit financing is that part of expenditure which is met by:

1. ways and means advances
2. drawing down of cash balances and
3. borrowings through the issue of treasury bills (Bhatia, 1987)

Hence, Deficit financing:

- Means the creation of extra purchasing power by government which then utilizes it for purchasing away resources from the market.

- Could also be defined as the net increase in the amount of money in circulation where such an increase result from a conscious government policy designed to encourage economic activities which ordinarily would not have taken place.
- From another angle amounts to domestic credit creation which is not off-set by increased taxation, more restrictive bank credit policy and similar deflationary measures.
- Involves running down the government accumulated cash balances, net borrowing from the banking system, issuing of new currency by the central bank, net borrowing from abroad and drawing down of foreign assets
- Has a constructive role to play in the economy though excess of it is harmful

There is no single approach to economic development; multi-frontal attack on social, economic, political, cultural and attitudinal obstacles to it, which deficit financing is one tool. On the whole, you should note that there can be no deficit financing without deficit budgeting but not vice versa.

3.2 Public Debt

The short-fall between domestic savings and the desired level of investments in most economies (especially developing economies) has led to both internal and external borrowings to fill the gaps. These led to financial liabilities (public debt) by government to individuals and institutions within and outside the country.

- In a developing country like Nigeria, the Central Bank on behalf of the government borrows money from both internal and external sources. Public debt therefore is the amount of money owed by the government to institutions, governments and individuals' resident in or outside Nigeria.
- You should not that there is a difference between National debt and Public debt. The former is the debt owed by the Federal Government, while the later comprises the national debt, state local governments and public corporation debt

3.2.1 Sources of Public Debt

In both developing and developed countries, sources of internal debt are diverse. They are commonly incurred through monetary instruments like treasury bills/certificates and Government Development Stocks. They can be contracted through:

1. Banks-as part of their investment portfolio banks invest in these debt instruments. This is for their benefit from accruing interest at maturity.
2. Non-Bank Public-like state/local governments, savings institutions, insurance companies, statutory boards/corporations and individuals
3. Central Bank-as the bank of last resort, absorbs the unsubscribed portion of government securities floated in the primary market.

Instrument of domestic debt carry different maturities terms- short, medium and long.

3.2.2 Classification of Public Debt

Public debts are classified along the purpose for which the debt was incurred as follows;

- **Internal debt**-Domestic debt-money owed citizens, raised within the economy. Repayment is by local currency by tax revenue transfer to the creditors.
- **External debt**-Creditors are foreigners-money borrowed by government of one country from the government or non-governmental institutions of other countries. The repayment is by currency other than that of the debtor country
- **Trade Debt**-When Nigeria trades with other countries and is unable to pay for the goods and services supplied
- **Balance of Payment support Loan**-overall economic transactions between one country and other countries classified as current and capital accounts and the official settlement balance, constituting the balance of payment which may be favourable when it is deficit. With persistent unfavourable balance of payment, governments' decision to seek for support loan may arise.
- **Project Tied Loans**-Viable projects to accelerate economic growth and development may lead to government contracting project-tied loan-a self liquidating investment.
- **Socio-Economic needs Loans**-government borrow to finance provision of socio-economic amenities like infrastructure, health, education, recreation facilities etc.
- **Funded and Non funded debts**-Funded are debts of which sinking funds have been provided-loan with lesser risk of default as redemption at maturity has been provided. While the unfunded debts are without any specific provision for redemption-debts with high risk of default.
- **Marketable and Non-marketable Debts**-securitized loans which can be resold by the existing debt holder to willing buyer is marketable; while loans to debt-holder which cannot be resold in the secondary market are non-marketable
- **Loan Pooling and Consolidation**-the acquisition of loans from various sources in order to execute a particular project is loan pooling; while the gathering or consolidation of loans before utilization is loan consolidation.

3.2.3 Rationale for Public Debt

The classical principles of loan finance rationalize loans to provide intergeneration equity, pay-as-you-use, capital formation, old-age insurance, self-liquidating projects, adjusting distribution and reduction of tax friction.

Borrowing can be considered as a second best alternative to money creation during the period unemployment. Foreign loan is seen as a means of filling domestic savings gap, especially in the face of dwindling government revenues from domestic sources. It is particularly so, during fluctuating prices of primary commodities/exports and hence dwindling foreign exchange earnings.

Public external borrowing also enables a developing country increases its rate of real investment just as it is seen as an engine of growth. In this sense, it increases per capita gross national product (GNP) (Cairncross, 1961) hence debt acts as a source of capital formation. Public internal borrowing acts as an anti-inflationary measure by mobilizing surplus money in the people's hands. Such resources can be diverted from unproductive channels e.g. jewelry, real estates to productive ventures.

3.2.4 Consequences of Nigeria's Mounting Public Debt

Public debt once incurred, must be serviced through the payment of interest and amortization charges as and when due. When government incurred larger debt, the interest rate increases. If the entire amount of the interest charges were to be paid with tax revenue then the actual amount of tax collection must also rise continually. As a result, this imposes a burden on the public.

3.3 Public Debt Management

Every country has its own way of managing its public debt and for this purpose, a number of policy instruments with different objectives have over time evolved. Debt management policies are, for the most part, designed to go in tandem with the broader macroeconomic objectives of stabilization and growth. It is important to note that debt management strategies relate largely to the question of repayment and reduction of domestic as well as foreign debts. In Nigeria the Central Bank of Nigeria is statutorily with the responsibility of debt management in conjunction with the Federal Ministry of Finance and other agencies. Recent development has witnessed the establishment of Debt Management Office in the Vice President's Office to oversee the work of all the above named agencies on Public Debt Management. Debt Management is the technical, operational, and institutional arrangements engaged in managing a country's liabilities so that the debt stock and the debt service burden are contained a tolerable and sustainable level.

- The technical aspect focuses on the need to determine the level of external debt required and to ensure that terms and condition of those borrowings are in consonance with the future debt service capacity of the country.
- Institutional arrangements include the administrative, organizational and monitoring aspect of managing both new borrowings and the total stock of debt. Nigeria has made efforts by successive government administration to restructure the county's debt over the years.
- Measures adopted include, refinancing, rescheduling restructuring of debt arrears and out right payment/settlement of the debt.

3.3.1 Internal (Domestic) Debt Management

The Federal Ministry of Finance (Treasury) manages government domestic debt; while Federal Government loans publicly issued in Nigeria is issued and managed by the Central Bank by:

- a. Advising the government on timing of floating debt instruments and terms of issue
- b. Advertising for public subscription to the issues
- c. Collecting the proceeds of issues on government behalf
- d. Supervising the issue of certificates and warrants
- e. Paying principal and interest on matured debts and in addition manages the sinking fund that facilitates redemption

The authority controlling the above responsibilities could underwrite the unsubscribed portion and provide a secondary market where the divestment of public holdings could be carried out at a discount as it is done in Nigeria. Thus, adequate guarantee is provided for debt instruments.

The Federal Ministry of Finance (a controlling agency) manages other domestic debts such as contractual debts and organizes the mode of payment through appropriate consultation with the Federal Government and the Central Bank.

1. *Acquisition of Domestic Debts*

The Central Bank of Nigeria advises government as to the timing of floatation of debt instruments and terms of issue. Advertisements are usually put up and subscription made through the banks and acceptance houses. The duty lies on the CBN to maintain appropriate books and accounts of such transaction.

2. *Restructuring of Domestic Debts*

The Central Bank of Nigeria accommodates government short term financial shortfalls through the provision of overdraft facility by Ways and Means Advances.

3. *Servicing of Domestic Debts*

The CBN makes the interests and principal payments of domestic debts which fall due. It provides discount as well as rediscount facilities in respect of debt instruments held by its customers. This later function is however being transferred to the Discount Houses. In the case of development stocks, the CBN publishes due dates for redemption of maturing stocks through redemption schedule statements and payment forms. This is further facilitated by the creation of a sinking fund. Sinking fund is a fund into which government pays in amount from time to time for the purpose of redeeming its liabilities on the development stocks under various balances. The balance of the sinking fund of each development stock is at times reinvested in another development stock with a higher rate of interest and of nearer maturity.

3.3.2 External (Foreign) Debt Management

External Debt Management is a conscious and carefully planned schedule of loans acquired either for development purposes or to support the balance of payment. It incorporates estimates of foreign exchange earnings, sources of finance, the projected returns from the investment and the repayment schedule. It also includes the assessment of the countries capacity to service existing debts and whether further loans could be contracted. Nigeria's external debt management strategies have varied from time to time since the early 1980s, when the debt crisis was pronounced. However, in 1988, comprehensive measures were set out with the following policy objectives:

- To evolve strategies increasing foreign exchange earnings thereby reducing the need for external borrowing
- To set out the criteria for borrowing from external sources and determine the type of projects for which external loans may be obtained
- To outline the mechanism for servicing external debts of the public and private sectors
- To outline the role and responsibilities of various organs of the federal and state governments as well as the private sector in the management of external debt.

The action on the above named policy objectives motivated the Nigerian government desire to reduce the burden of external debt and the following steps were developed over the years;

1. ***Embargo on New Loans***-to check un-manageable hike in debt stock leading to preventing more debt burden. This is used to prevent a situation where the public debt becomes unmanageable as a result of unnecessary increases. The federal government directed in 2001 that no applicant for external loans, whether a state or federal government agencies, was allowed to borrow more than US\$500m for any projects unrelated to poverty alleviation endeavours.

2. **Limit on Debt Service Payments**-encourages the use of a particular proportion of our external earnings to service the external debt.
3. **Debt Restructuring**-outstanding debts are converted into another type of debt. Refinancing, re-scheduling, buy-back, issuance of collateralised bond and provision of new money are different categories of debt financing.
4. **Re-financing of Trade Arrears** is a new loan is procured by a debtor to pay-off an existing debt if it involved short-term trade debt. This relates to procurement of a new loan by a debtor country in order to pay off an existing debt especially when it involves short term trade debt. The new loan may be contracted from the same creditor countries or a different set of creditor. However, what is important is that the repayment schedule is always contained in the loan agreement. In July and September, 1983, Nigeria had her first and second refinancing agreements. In both agreements, the sum of US\$2.1 billion worth of trade arrears, unconfirmed letters of credit were refinanced. There are two processes involved in re-financing of trade arrears. They are: debt rescheduling and debt buy back.
 - **Debt re-scheduling** is the postponement of the effective maturity date of debt owed to a future date. This relates to deferment of debts. It is the postponement to the future effective maturity date of the debts. This measure serves to give more temporary relief to the debtor nation or country. In December, 2001, Nigeria signed rescheduling agreement with Germany, Austria and Switzerland. The amount involved totaled US\$3.267 billion (Onuorah, 2001 quoted in Edosa and Osaze, 2003).
 - **Debt Buy-Back**-When a substantial discount is offered by the creditor to the debtor for the payment of outstanding debt. This is when the debtor is offered a substantial discount by the creditor nation for the payment of outstanding debts. Nigeria got involved in February, 1992, when USA 3.395 billion USD commercial debts owed to the London Club was bought back by Nigeria at 60 percent discount. The implication is that Nigeria paid USD1.352 billion to liquidate or buy back the commercial debts (Oriakhi, 1992 quoted in Edosa and Osaze, 2003).
5. **Debt Conversion**-the exchange of monetary instruments like promissory notes for tangible assets or other financial instruments. In simple terms, it means exchange of monetary instrument e.g. promissory notes for tangible assets or other financial instruments. It is designed for the reduction of a country's external debt burden by changing the character of the debts. Debt conversion could be of various types including debt for equity, and debt for cash. The debt conversion exercise involves the sale of an external debt instrument for a domestic debt of equity participation in domestic enterprises. It is practiced in Nigeria. This programme could assist in encouraging capital inflow and also help in recapitalizing of enterprises in the private sector. Between 1988 and 1991, the total amount of debt redeemed under the debt conversion programme was put at USD 622.8 million by the Central Bank of Nigeria (CBN, 1992).
6. **Collateralisation** – under this arrangement, the yield of a bond collateralised within a specified period is expected to offset or pay off a collateralised amount referred to as the zero coupon option.

7. **Debt Swap** – this is a loan that could be paid for by other means like crude oil as was carried out between 1984 and 1985 (Buhari/Idiagbon Regime).
8. **Debt Servicing** – this is paying interest on loan.
9. **Debt Settlement** – this implies paying up the debt which Nigeria did in 2005.

Nigeria's external debt outstanding at the end of 1998 was \$28.8 billion, made up of debts owed to Paris and London Clubs of creditors, multi-lateral institutions, promissory notes and other multi-nationals. These agencies will be discussed later in Unit 5 of this Module.

- The Federal Government through the Ministry of Finance and Economic Development during President Obasanjo administration passionately negotiated Nigeria debt burden and effectively settled the debts with the international agencies in 2003
- Hence the name of Nigeria was de-listed from international debtors list.
- The debt which has been accumulating over the years and the growth of the debt was attributable largely to the need to finance budgetary gaps.
- Since 1986 the strategies muted by successive Federal administration could not solve this monstrous effect on the economy.

4.0 CONCLUSION

Public Debt Management is shown as the technical, operational and institutional arrangements engaged in managing a country's liabilities so that the debt stock and the debt service burden are contained a tolerable and sustainable level. This will be performed by the agencies of government be it internal or external debts.

5.0 SUMMARY

In this unit, attempts ere made to define public debt, deficit financing, identify sources of public debt and discuss debt management strategies. The Central Bank of Nigeria, Federal Ministry of Finance and other agencies have been identify with debt management in Nigeria. Recent development establishes a Debt Management Office in the office of the Vice President of the Federation.

6.0 TUTOR-MARKED ASSIGNMENT

1. Identify sources of Pubic debt in a developing country
2. Discuss Debt Management Strategies in Nigeria

7.0 REFERENCES/FURTHER READING

Nwulu, A. O (2008) *Budgeting and Public Finance*, (MPA 752), Lagos: National Open University of Nigeria

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UNIT 4 GOVERNMENT ORGANISATIONS/ENTERPRISES

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1.0 INTRODUCTION

In this unit, we'll consider government organizations as product of growth of services needed and expected to satisfy the community. In the type of government tilted towards welfare economics, the main thrust for state involvement is usually public interest.

2.0 OBJECTIVES

After studying this unit, you should be able to:

- Identify Government Enterprises
- Enumerate the need for and weaknesses of the Public Enterprises
- Differentiate between Commercialization and Privatization
- State Public Finance Investment stride in Nigeria

3.0 MAIN CONTENT

3.1 Government Organizations/State Enterprises

You have to note as a student of public administration that as there are different types of government, so is the approach to addressing people's aspiration and public interest. If the arm of governance can not provide for certain need for urgent services to the community which can not be provided for by entrepreneurs, the government being responsive to its duties, as a stop gap strategize to entice private investor to venture into these areas.

3.1.1 State Enterprises in Nigeria

The British Colonial government administration introduced state enterprise system in Nigeria in 1898 by establishing;

- The railway transport project from Iddo in Lagos to the hinterland in Nigeria
- Coal mining in Enugu,
- Electricity (Electricity Corporation)
- Marine

All these were administrative ancillary of trade and commercial activities in the the developing country; which were government departments.

In the 1950s public corporation growth became remarkable. Owing to the adoption of a federal system of government the number of government owned enterprises increased so much as the regional government established their own and the subsequent state creation multiplied the enterprises.

Despite the advantages of government establishing enterprises disadvantages emerged in the areas of:

- Management incompetence
- Misconception of board members roles
- Political instability
- Inconsistent government policies
- Inadequate machinery for their coordination
- Power sharing and representation between Ministers and Boards
- Among others

All these militated against their ability to perform.

Self-Assessment Exercise 4.1

Mention the disadvantages of public enterprise.

3.1.2 Public versus Private Enterprises

The Nigeria economy has graduated over the years to a mixed economy ideology where the private and public sector compete in contributing to the mainstay of the economy. The general impression is that the public enterprises perform poorly because of the above mentioned limitations while the private enterprises perform better though they pursue private goals. The responsibility and accountability in the public sector is to the people.

We highlight the following: the public sector as;

- The government sector made of mainly government and its enterprises; federal, state or local.
- An economic agent, acting on behalf of citizen
- A major engineer of economic progress (Keynesian refer)
- Taken in the public interest

On the hand, the private sector

- Consists of individual and organizations who are economic agents.
- Responsible to themselves or their promoters.

- Strives for individual gain.

Economic System

The economic system of a particular country determines the importance of each of these sectors. In capitalist economies, the private sector is in the fore-front of development with government in providing only rules and regulations.

The reverse is the case in socialist/communist economies the public sector takes the central seat as the dominant sector. The private sector is played down as no individual owns means of production as government see to most economic question regarding production.

As we noted above that the Nigeria economy is tilted towards a mixed economy. It will be interesting for you to note that it took time and assessments to arrive at this position. Over the years, there has been a controversy on the relevance of the public sector in the Nigerian economy. Despite the abysmal performance of the public enterprises they are still needed because of development stride; moreover

- There are certain products and services better delivered by private sector with no government assistance/intervention
- If there is no public sector activities/intervention different interest groups would hijack and would have clashed against each other.
- Its activities are not efficient in the allocation of scarce resources.
- The negative consequence widens the gap between the have and the have not
- It leads to the enhancement of the few privileged minority to the detriment of the poor majority

The negative effect of public sector enterprises is ascribed to the attitude of economic planners which is charted toward promoting economic development and this phenomenon involves much more than economic growth. The inequality in income distribution is the bane of economic growth in Nigeria and has contributed to the ineffectiveness of the government owned enterprises.

3.2 Commercialization/Privatization Government Organizations

The move to enable the engine of economic growth and development be propelled by private sector is traceable to Adam Smith (1776) book- 'The Wealth of the Nations' which de-emphasized the role of government in the management of the economy and business. John Keynes (1936) book 'Government Theory of Employment, Income and Productivity which recommended a deliberate attempt on the part of government to stimulate aggregate demand (Ref: Module 2 Unit 5).

Privatization involves the introduction of private capital/management expertise into a public sector activity (2000: 14) while commercialization involves the redirection of government owned companies from non-profit making to that of profit making.

3.2.1 Types of privatization

There are different types and these include;

1. **Offer of shares to the public-** listing of the enterprise concerned on the stock exchange and offering for public purchase of shares by the public at stipulated price
2. **Trade Sales-** Where public enterprise is small or inadequately specialized for open offer of shares or where the capital markets are not well developed, the veritable option is trade sale.
3. **Sales of Assets-** With persistent losses the public enterprise are subject to sales of the assets.
4. **New Equity Investment by the Private Sector-** government benefit from the sale of newly issued stock of the public enterprise to private sector purchasers.
5. **Re-organization or Break-up-** Public enterprises could be re-organized or broken into different parts for the purchase of competition or dismantling of monopolies before they are privatized.
6. **Employee or Management Buy-outs-** Employee/Management or both could acquire stocks (all /some) in the public enterprise
7. **Management Contract and Leases-** Assets are leased to management group for a specified period of time
8. **Deferred Public Offer-** if they are sold out through shares the likely receipts could be grossly lower than the real value of underlying assets.

3.3 Management of Public Finance through Investments

Module 2, Unit 4 refers. Investment Management is an important segment of the finance function in public sector undertakings. In the management of public enterprises, investment proposals are examined by various agencies of Government in order to authenticate the projects. The working capital position is a vital element. The Financing and Capitalization decisions occupy a key place in the financial management of government enterprise. Financial controls include internal audit, budgeting (see Module 3 Unit 1) and financial reporting system.

Self-Assessment Exercise 4.2

Name different types of privatization carried out by the Nigeria public sector.

4.0 CONCLUSION

In this unit, we have seen that the arms of government can not provide for certain need of the community which can not be provided for by entrepreneurs. The government being responsive to its duties will act as a stop gap by strategizing into owning business in order to entice private investor to venture into these areas. It will also use this medium to address some imbalance in distribution of wealth and facilities.

5.0 SUMMARY

In this you we have attempted discuss government organizations/state enterprises in Nigeria and identifying the advantages and disadvantages. We also identified how the government commercialized and privatized these state investment because of inherent lapses to enable them remain as going concerns.

6.0 TUTOR-MARKED ASSIGNMENT

- 1) Enumerate the need for and weaknesses of the Public Enterprises
- 2) Differentiate between Commercialization and Privatization

7.0 REFERENCES/FURTHER READING

Nwulu, A. O (2008) *Budgeting and Public Finance*, (MPA 752), Lagos: National Open University of Nigeria

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UNIT 5 ROLE OF MULTI-LATERAL INSTITUTIONS-IMF & WORLD BANK

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4.0 Conclusion
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1.0 INTRODUCTION

In this unit, you would be introduced to the role of multi-lateral institutions that help in underwriting external debt of nations in international trade and enhancing the expansion and development of the respective economies thereof. Their functions and funding strategies as well as lending/borrowing activities of these institutions are briefly explained

2.0 OBJECTIVES

After studying this unit, you should be able to:

- Identify different multilateral institutions and their functions
- Explain their role to different economies especially developing nations
- State their funding strategies

3.0 MAIN CONTENT

3.1 World Bank (International Bank for Reconstruction and Development)

The World Bank is a multi-lateral institution which provides loans to needy countries. It was established as International Bank Reconstruction and Development (IBRD) in 1945 under the Bretton Wood Agreement of 1944 after the World War II to mid-wife reconstruction and development from Wartime to peace time. Functions are as follows:

1. To in the development of territories of it members by facilitating the investment of capital for productive purpose and to that of less developed countries.
2. To promote private foreign investment by means of guarantees on participation in loans and other investment made by private investors

3. To promote long-range balance growth of international trade and maintenance of equilibrium in the balance of payments of member countries by encouraging international investment for the development of their productive resources.
4. To arrange the loans made or guaranteed by it in relation to international loans through other channels so that more useful and urgent small and large projects are prioritized.

The memberships consist of financial members of International Monetary Fund (IMF). If a country resigns it shares the assets and liabilities of the bank as at that time.

Funding Strategy -Basic objectives are:

1. Availability of funds to the bank is ensured. This is to maintain un-utilized access to funds in the markets in which it borrows.
2. Minimizing the effective cost of funds to the borrowers
3. Control volatility in net income and overall loans charges
4. Provides appropriate degree of maturity transformation between is borrowing and lending.

Borrowing and Lending Activities

The World Bank capital is subscribed by members. It finances its lending operations from its medium and long-term borrowings in the international capital markets and Currency Swap Agreements (CSA). In these agreements, the proceeds of a borrowing country are converted into a different currency and simultaneously a forward exchange agreement is executed providing for schedule of future exchange of two currencies in order to recover the currency converted.

Subsequently, the bank evolved two new borrowing instruments; namely,

- Central Bank Facility (CBF) – A one-year, US dollar dominated facility for borrowing from official sources particularly central bank.
- Floating Rates Notes (FRN) – Borrowings in FRN are to help the bank meet some objectives of its funding strategy. This market enables the Bank to access a set of investors (financial intermediaries) which have not traditionally bought the Word Bank notes. The FRN have a medium/long-term maturity.

The Bank's mode of lending to member countries takes any of these ways; by

1. Marketing or participating loans out of its own funds;
2. Making or participating in direct loans out of funds raised in the market of a member or otherwise borrowed from the bank;

3. Guaranteeing in whole or in part loans made by private investors through the usual investment channels.

The Bank guarantees, participates in or makes loans to its members on different conditions as follows;

1. If it is satisfied that in the prevailing market conditions the borrowers would be unable to obtain the loan under conditions which the Bank presumes is reasonable to the borrowers.
2. Loans are for specific developmental projects or deemed to be so implied
3. If the member in whose territory the project is located is not itself the borrower, the member or its central bank fully guaranteed the repayment of the principal, the payment of interest and other charges on the loan
4. The project in question has been duly recommended by a competent committee in the form of a written report after a careful appraisal of the proposal
5. The borrower or the guarantor is in a position to meet its obligation under the loan

The World Bank Facilities to member countries varies according to needs and circumstances;

- Structural Action Programme (SAP)- Started in 1983 to strengthen World Bank's ability to assist member countries in adjusting to current economic environmental realities with the following elements;
 - 1) an expansion of lending for high-priority operations that support structural adjustment, policy changes, production for export, optimal use of existing capacity and maintenance of crucial infrastructure
 - 2) Accelerated disbursements under existing and new investment commitments to ensure timely implementation of high priority projects
 - 3) Expanded advisory services on the design and implementation of appropriate policies
 - 4) Enlisting familiar efforts by other donors for fast disbursing assistance in support of programme of the Bank and International Monetary Fund (IMF).
- Structural Adjustment Facility (SAF) – Introduced in 1985 to borrowing countries in order to reduce their balance of payments deficits while maintaining their economic growth potency. The funds are used to finance general imports with a few exceptions of luxury military imports. They are released based on stiff conditions of the Bank and it spans between 5 to 7 years.

- Enhanced Structural Adjustment Facility (ESAF) –It was set up to increase the availability of concession resources to low-income member countries totaling Special Drawing Right (SDR) 6 billion financed by special loans and contribution from developed and Oil Producing and Exporting Countries. Like others it helps in addressing positively the borrowing nation balance of payments problems and enhance growth and development.

The question of proper utilization of these facilities created and provided by the Bank is dependent on the type of government, policy and corporate governance will as well as the leadership trend as at the time the loan is granted. This is at the back drop that as developing nations financial assistance are needed for development of the yawning gap to be filled and still the repayment of these loans plus the interest to be settled as at when due.

Self-Assessment Exercise 5.1

Name the facilities provided by the World Bank to member countries.

3.2 International Monetary Fund (IMF)

The IMF is one of the multi-lateral institutions; an affiliate of the World Bank, involved in the act of providing loans for needy nations. It is established by different countries after the World War II with the objective of providing exchange stability throughout the world and increasing liquidity to enhance balanced multilateral trade through the cooperation of the member nations.

Objectives of IMF

The main purposes of the IMF summarized in the Article of Agreement are as follows:

1. To promote international monetary cooperation through a permanent institution that provides the machinery for consultation and collaboration on international monetary problems
2. To facilitate the expansion and balanced growth of international trade and to contribute to the promotion and maintenance of high levels of employment and real income and to the development of productive resources of all members economy
3. To promote exchange stability, to maintain orderly exchange arrangements among member and to avoid competitive exchange depreciations
4. To assist in the establishment of a multilateral system of payments in respect of current transactions between members and in the elimination of foreign exchange restrictions which hamper the growth of world trade
5. To give confidence to members by the Fund's resources available to them under adequate safeguards, thus providing them with opportunity to correct maladjustments in their balance of payments without resorting to measures inimical to national or international prosperity

6. In accordance with the above, to shorten the duration and lessen, the degree of disequilibria in the international balance of payments of members.

Resources of IMF

- The resources of the IMF are subscribed by the members.
- Each member subscription quota is based on its national income and its international trade position
- Every member nation must contribute 25% of its quota in international reserve assets and the rest 75% in its own currency
- The payment of 25% part of the quota was originally in gold [now in Special Drawing Right (SDRs)] – SDRs are international reserve assets created by IMF in 1969.
- The Fund can also increase its resources by borrowing and selling gold to the public and by receiving fee from the borrowing members.

3.3 International Development Association (IDA)

The International Development Association (IDA) was established in 1960 as an affiliate to the World Bank. The World Bank's finance usually is conditional and inadequately meets the credit needs of under-developed countries.

- Its loans are for specific development purposes
- Bear relatively high rate of interest and are for relatively short period
- There are many projects such as irrigation, railway construction, education, public health, housing etc. in under-developing countries which are vital to general economic development, with long gestation period and insufficient yield returns to meet the amortization charges.

Regarding World Bank rule, loan cannot be given for such general development projects. The IDA was established to supplement the World Bank's development assistance and to make available loans to the developing countries on soft terms and for long period. That is, IDA is 'Soft Loan Window of the World Bank'

Objectives of IDA

1. To provide development finance to the less developed countries on easy and flexible terms
2. To promote economic development, increase productivity and improve the standard of living in the developing countries
3. To supplement the objectives and activities of the World Bank

Financing Policy of IDA

IDA loans are not treated as conventional loans. The following are the distinctive features;

1. Loans are granted whether they are directly productive or not
2. Loans are interest free; with only a nominal annual rate of 3.4% on the amount
3. withdrawn and outstanding is charged to meet the administrative expenses
4. Loans are for long periods; for 50 years
5. Loans have ten years of grace; then 1% of principal is repaid annually for 10 annually for ten years; 3% annually for the remaining 30 years.
6. Loans are repayable in foreign exchange
7. Loans are granted by the government of the country concerned.

Self-Assessment Exercise 5.2

List the objectives of International Development Association.

3.4 International Financial Corporation (IFC)

International Financial Corporation (IFC) was established in July 1956 as an affiliate of the World Bank to provide finance to the private sector. It is worthy of note that conventionally World Bank loans are to governments of the member countries or provides loan capital to the private enterprises out of the guarantee of the member governments. Moreover the World Bank does not offer risk capital.

The IFC was with specific purpose of providing risk capital to the private sector/enterprises in the developing countries without government guarantee.

IFC Investment Policy

The main features of the IFC investment policy are;

1. It considers predominantly industrial enterprises which contribute to economic development of the country
2. The project to be financed must be in the productive private sector in nature
3. The IFC affirm that the enterprise has experience and competent management

4. The loan must not be more than half of the capital needed for the enterprise
5. The minimum investment to be made by the IFC to a single enterprise is fixed at \$100,000:00 with no upper limit
6. The rate of interest for the loan is determined by mutual negotiation, depending on the degree of risk involved and other terms of investment
7. The loans are disbursed in lump-sum or in installments and are repayable in a period of 5 to 15 years

3.3 Parish Club and London Club

These are some of the sources of external debt contraction.

- **Paris Club of Creditor**

This consists of mainly credit guaranteed by government. It is made up of United Kingdom, Federal Republic Government, The United States, Canada and France, who guarantee the export activities of their nationals through their official export credit agencies. If the recipient nation's government is unable to pay the foreign exchange equivalent of the domestic currency cover paid by the importer, it becomes public debt owned to the creditor nations. The Club commenced meeting in Paris in 1956.

- **London Club of Creditors**

This consists of mainly commercial banks in industrial countries where credit are extended by commercial banks to citizens of debtor countries, largely un-insured and un-guaranteed. It was in 1976 the first meeting was held in London.

3.6 African Development Bank (ADB)

The African Development Bank was established under the auspices of Economic Commission for Africa (ECA) in 1966

Functions as express in the statute establishing ADB are to;

1. Use the resources at its disposal for financing of investment projects relating to the economic and social development of its members
2. Undertake and participate in the selection, study and preparation of projects enterprises and activities contributing to such development
3. Mobilize both within Africa and outside Africa, resources for the financing of such investment programme
4. Promote investment in Africa of public and private capital in projects or programme
5. Provide such technical assistance as may be needed in Africa for the study, preparation, financing and execution of development project or programme
6. undertake such other activities and provide such other activities as may advance its purpose

Sources of Finances

The bank's ordinary share capital comes from the following:

1. Subscription Capital by members
2. Fund raised through borrowing by the bank
3. Fund received in repayment of past loans
4. Income derived from the bank's loans and guarantees
5. Any other funds received that do not constitute special sources

Self-Assessment Exercise 5.3

List African Development Bank sources of fund

4.0 CONCLUSION

We have explained the role of multi-lateral institutions as the underwriter of external debt of countries in international trade. This step helps the countries concern the expansion and development of the respective economies. Their functions and funding strategies as well as lending/borrowing activities we exposed as being distinct and depending on need and the level of the said economy.

5.0 SUMMARY

In this unit, we have attempted to identify the different multilateral institutions mentioning their objectives, policy thrust regarding lending and their considerations. These institutions include; World Bank, International Monetary Fund, International Development Association, International Financial Corporation, African Development Bank, Paris Club and London Clubs.

6.0 TUTOR-MARKED ASSIGNMENT

- 1) What are the functions of the World Bank?
- 2) The main features of the IFC investment policy are:

7.0 REFERENCES/FURTHER READING

Awua, Hemen & Lawal, Bello (2008) *International Banking* (MBF 745) Lagos, National Open University of Nigeria

Oriakhi, D.E (2004) *Introduction to Public Finance* Second edition Mindex Publishing, Benin-City, Nigeria