

# Financial Programming and Policies in Nigeria



BY

OHUCHE F. K  
ASSOCIATE FELLOW  
AIAE  
ENUGU

# Presentation Outline



- Introduction
- What is Financial Programming
- Uses of Financial FP
- Steps in Preparing FP
- Accounting Framework
- The interface between the macroeconomic accounts
- Concluding Remarks

# Introduction



- Countries often face threats of disequilibrium in their economic objectives arising from domestic and external environment and wrong policy choices
- Such threats are propelled by the structure of the economy and the type of shocks it is exposed to. For instance, Nigerian economy is exposed to fiscal dominance, oil price shocks, drought, exchange rates volatility and policy uncertainty
- Financial Programming (FP) is prepared to anticipate such shocks to the economy and provide policy responses designed to mitigate its impact and refocus development objectives both in the short, medium and long term

# What is Financial Programming?



- A Financial Programme (FP) is a comprehensive and consistent set of policy measures aimed at achieving certain desired economic objectives in a given time horizon
- Economic targets and policy measures are set for a period of one to three years ahead. They are specified in concrete, mostly quantitative terms but remain subject to periodic review
- FP is essentially a set of dynamic flow-of –funds framework . This ensures consistency between sectoral forecasts and a comprehensive approach. It highlights the trade-offs from macro-accounting identities, stressing financial constraints, explicitly considers the banking sector
- FP is developed (1) considering key economic relationships and (11) relying on judgments and econometric projection techniques. However it is not developed with a formal fully-specified Model

# What do we mean by” Comprehensive”?



- This means that it involves the four macroeconomic Accounts :
- Every thing that happens in the macroeconomic economy is captured by these accounts
  - National Accounts ( Real Sector )
  - Balance of Payments ( External Sector )
  - Government Accounts ( Fiscal sector )
  - Monetary Accounts ( Monetary Sector )

# Policies



- Initiatives that guide actions of both government and private institutions in influencing behaviors of agents and achieving stated objectives
  - Fiscal policies
  - Monetary Policies
  - Exchange Rate policies

All meant to impact on the real sector and grow the Economy .

# Medium Term Objectives



- **Growth:** To achieve and maintain high rate of economic growth
- **Inflation:** to achieve and maintain low and stable inflation
- **Balance of Payments:** to improve, maintain and achieve a sustainable balance of payments

# Short Term Objectives



- To create conditions that foster higher economic growth
- To Reduce inflation as much as possible
- To improve the Balance of Payment Position of the country

# Policy Choice



- Two Sets of policies are identified
  - Demand Management Policies ( Expenditure reducing policies)
  - Expenditure Switching Policies

# Demand Management ( Expenditure Reducing Policies)

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- Policies aimed at reducing peoples' spending power  
eg
  - Increase in taxes
  - Reduction of Subsidies
  - Removal of incentives

# Expenditure Switching Policies



- These are policies that alter the relative prices of imports in domestic currencies
- It is meant to encourage spending on either domestic goods and services or on imported goods
- For instance, if government wants to encourage exports vis avis imports , it may depreciate its currency and this induces people to switch from spending for imports to exports

## Expenditure Switching Policies contd.



- Use of Exchange Rate policies
- Reduction in current account deficit
- Increase in external reserves
- Reduction in Imports
- Encourage increase in exports through export led growth

# Forward – Looking Framework



- **Analysis** : Here we attempt to analyze the economy and identify its characteristics, underlying structural relationships and past performance
- **Forecasting**: Based on our analyses we forecast what the aggregates would be in the future .
- **Policy Advice**: Based on the outcome of our forecasts we provide policy advice to government and institutions

# Consistency



- Accounting Framework: We need to understand the accounting relationships between the variables we use
- Policy Objectives: This is like the driving force, we need to clearly and strategically specify the objectives we want to pursue
- Behavioral Equations: From the accounting framework and the policy objectives we develop behavioral equations to guide our programming

## Uses of FP



- To aid efficient macro economic management
- Helps in deciding the choice of policy to adopt
- Assist in deciding the level of mix between expenditure reducing and expenditure switching policies
- It helps to set targets on the level of various macroeconomic indicators namely : inflation & GDP
- Money supply and reserve money
- Allowable level of CBN lending to government

# Steps in Preparing FP



- Collection of historical data , present and analyze them in the form of financial programming accounting frame work
- Prepare Baseline projections that assumes “ unchanged economic policies”
- Analyze the economic outcomes under the baseline for macroeconomic stability, sustainability and desirability, identify the main problems and their causes
- If there is room for improvement, prepare a programme scenario. Set ambitions targets for key economic outcomes
- Develop set of specific policy measures to achieve the targets

# The Accounting Framework



- Four Sectors ( External, fiscal, real and monetary)
- For the economy as a whole, any gap between absorption and income must be covered by external savings
- Each sector needs to finance its gap between absorption and income by increasing/decreasing its net financial asset position
- The market for financial assets needs to be in a flow equilibrium
- These conditions should be satisfied for historical data( except for imperfections in statistical recording)
- Consistent projections need to satisfy the conditions in each of the projection years

# Accounting Framework: Monetary Analysis -CBN

- **Assets**

- Foreign Assets
- Claims on central Govt
- Claims on DMBs
- Other Assets

- **Liabilities**

- Base Money
- Currency outside banks
- Bank Reserves
- Central Government deposits
- Other liabilities

# Accounting Framework: Monetary Analysis: DMBs

- Assets
- Vault Cash
- Balances with Central Bank
- Claims on Central Government
- Claims of private sector
- Other assets

- Liabilities
- Demand deposits
- Saving deposits
- Time deposits
- Foreign currency deposits
- Central Government deposits
- Credit from Central Bank
- Other liabilities

# Monetary Survey

- **Assets**

- Foreign Assets(Net) NFA
- Domestic Credit ( Net) NDC
  - ✦ Claims on govt(net)
  - ✦ Claims of private sector(net)
  
- Other Assets (Net)

- **Liabilities**

- **Money ( M1)**

- ✦ Currency outside bank
- ✦ Demand deposits

- **Quasi Money**

- ✦ Savings Deposits
- ✦ Time Deposits

- **Foreign Currency Deposits**

- ✦  $(M1) + (QM) = M2.$



# Government Operations



- Economic Roles of govt. include:
- Provision of public goods
- Regulation of trade and economic activities
- Creation of enabling environment for business and economic activities to take place
- All these are done through fiscal operations- Budget and Revenue generation

# Fiscal Account



- Revenue
- Grants
- Expenditure
  - Recurrent
  - Capital
- Overall Balance
- Financing
  - Domestic Financing (Net)
    - ✦ Banking System ( central bank and dmbs)
    - ✦ Non-banking sector
- External financing
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# Real Sector



- National Accounts ( local currency flow)
  - Private consumption
  - General Govt consumption
    - ✦ Wages + purchases of goods and services
    - ✦ Private investment
    - ✦ Government investments
  
  - ✦ Exports of goods and services
  - ✦ Imports of Goods and services

# External Sector

- Balance of payments ( US dollar flows)
- Current Account
  - Exports of goods and services
  - Imports of goods and services
  - Factor services (net)
  - Transfers ( Net)
  - Official
  - Private
- Capital Account
  - Direct investment
  - Medium / long term capital
  - Private sector
  - Government
  - Short term capital (net)
    - ✦ Private sector
    - ✦ Government
- Overall Balance
- Reserve ( Change in Net Assets)

# Monetary Sector

- Monetary Authorities (local Currency Stock)

- Net foreign Assets
- Net Domestic Assets
- Net Credit to Government
- Credit to banks
- Other items (net)
- Reserve Money
- Currency
- Banks Reserves

- DMBs Local (currency Stock)

- Net foreign Assets
- Banks Reserves
- Net domestic assets
- Net credit to government
- Credit to private sector
- Other items (net)
  
- Liabilities to monetary authorities
- Private sector deposits

# Monetary and Fiscal Policy: The interface in Monetary Programming

- The relationship between monetary and Fiscal Policy

- $$\Delta M_2 = \Delta NDC(\Delta C_g + \Delta C_p) + \Delta OIN + \Delta NFA + \Delta QM \text{ or } \Delta RM \dots (4)$$

(Monetary Policy)      (Fiscal Policy)                                      (External Policy) (Reserve Money)

# Monetary and Fiscal Interface: Funding the Fiscal Deficits



- In broad sense, each form of financing can have serious implications on macroeconomic imbalances and therefore may require some policy intervention
- Excessive foreign borrowing leads to external debt
- Domestic bank borrowing often results in inflation requiring monetary policy action
- Financing through non-bank borrowing may result in high interest rates and government crowding out the private sector investment

# Monetary and fiscal Interface



- Monetary policy action involves changes in monetary policy rate to influence credit creation in the economy
- Credit creation here involves both private sector credit and credit to the government sector
- Poor fiscal policy could lead to deficit spending by government and funding these deficits has implications for monetary policy
- If net foreign inflow is not sufficient to fund the deficits, government could resort to borrowing from the Central Bank which has implications for inflation objectives of the central Bank

## Interface contd



- Therefore, fiscal policy should ensure that government revenue and expenditure are in line with stated economic objectives
- Financial Programming attempts to capture these relationships in a framework that ensures consistency in different sectors of the economy

# Concluding Remarks



- Financial Programming Targets the achievement of macroeconomic objectives of the country
- Monetary and fiscal policy play important roles in the development of financial programmes
- Real and external sectors are also integrated into the programme to account for domestic and external balance
- Objectives of FP will be better achieved if all policies are made more transparent, effective and efficient

And on this note.....



- Thank You for Listening