

BUDGET TRANSPARENCY AND FISCAL PERFORMANCE: LESSONS FOR NIGERIA AND SRI LANKA

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Abstract

A transparent budget process is expected to promote better fiscal performance in terms of sound primary balance and debt profile. However, there is no consensus on the relationship between budget transparency and fiscal performance. This paper contributes to the literature by examining the relationship between budget transparency as well as primary balance, and debt and provision of key infrastructure. Data were collected for countries in South Asia and West Africa. The analysis shows relatively strong positive relationship between budget transparency and primary balance. A weak positive relationship between transparency with debt and moderately positive relationship with infrastructure is observed. It is also observed that budget transparency is limited across the countries in South Asia and West Africa, particularly in Nigeria and Sri Lanka. The paper therefore recommended that Nigeria and Sri Lanka should practice a more transparent budget process by: (i) making information in budget documents more comprehensive; (ii) publishing all budget documents at the right time; and (iii) allowing public participation at all stages of the budget process.

Keywords: Budget Transparency, Primary Balance, Debt, Infrastructure

1. Introduction

Fiscal deficits and public debts have grown rapidly and persistently across most countries of the world since the late 1960s. In many of these countries, debts have grown to an unsustainable level such that these countries were labelled as Highly Indebted Countries (HIC). For example, according to International Monetary Fund (IMF), World Economic Outlook (WEO) (2017), the debt to GDP ratio as at 2002, was as high as 345.98 in Afghanistan and 180.66 in Sri Lanka. The debt to GDP ratio in some selected countries across South Asia and West Africa as at 2017 was 106.31, 125.84, 88.04, 71.84, 63.94, 79.10 and 63.91 in Bhutan, Cabo Verde, Gambia, Ghana, Sierra Leone, Sri Lanka, and Maldives, respectively. Similarly, primary balance to GDP ratio was negative (deficit) for most countries over a long period. In WEO (2017), primary balance was negative in Sri Lanka from 1990 to 2016, except in 1992 when it was 0.04. It was also negative in Ghana since 1980 to 2016 with the only exception in 2003 when it was 0.78. This picture is similar for most countries in West Africa and South Asia. Though, Nigeria had a positive primary balance for many years, it also recorded a negative balance in some years. Nigeria had a negative primary balance from 2007 to 2017 with the exception of only 2011 and 2012 when it was 1.22 and 1.21, respectively.

The fiscal crisis raised concern on the procedure for the budget process. Hence, reforms are carried out continually by different countries so as to improve the fiscal balance and debt profile as well as other fiscal outcomes including fiscal indiscipline. The reforms usually involved strengthening the budgetary institutions. Budgetary institutions are defined as the policies, rules and procedures of the public revenue and expenditure process (Gollwitzer, 2011). According to Alesina and Perotti (1999), budgetary institutions are all the rules and regulations according to which budgets are drafted, approved and implemented. The rules would clearly define the role of each participant in the budget process and regulate the flow of information among participants as well as non-participants.

Therefore, budget institutions are important at different levels of the budget process, including understanding the fiscal needs and challenges in the society, developing a consolidated plan, efficient and transparent approval process, and prompt execution as well as effective control of budget. Thus, fiscal outcomes such as levels of fiscal deficits, public debt and generally fiscal discipline largely depend on the strength and effectiveness of budget institutions. Provision of public goods is equally affected by budget institutions.

This paper focuses on fiscal transparency which reflects the quality of budget institutions. Although, measures of budget transparency do not in themselves measure budget institutions in the actual sense of what budget institutions mean. Poor transparent budget process epitomizes weak and inefficient budget institutions. An open budget process on the other hand, reflects the existence of strong and efficient institutions. Therefore, this paper examines the relationship between budget transparency and primary balance, debt as well as provision of public infrastructure. Comparison of budget transparency in Nigeria and Sri Lanka is carried out and lessons are drawn for further reforms of the budget process in the two countries.

The rest of the paper is arranged in 7 sections. Following this introduction is section 2 which presents a brief literature review. Section 3 presents the theoretical argument, the link between budget transparency and fiscal performance is presented in section 4. The link between budget transparency and provision of key infrastructure is presented in section 5. Comparison of budget transparency between Nigeria and Sri Lanka is presented in section 6. Section 7 presents the policy implication and section 8 concludes the paper.

2. A Brief Review of the Literature

A vast literature has established that budgetary institutions have significant positive influence on fiscal performance. Most of the studies focus on the effects of index of budget institutions on fiscal discipline, measured in deficit and debt (Alesina and Perotti, 1996; Gleich, 2003; Filc and Scartascini, 2004; Krogstrup and Walti, 2008; Shah, 2007; and Hallerberg, et al 2006, 2009; Dabla-Norris, et al, 2010; Gollwitzer, 2011; Martin and Vanberg, 2013).

Focusing on the effects of budget transparency and centralisation procedure, Alesina and Perotti (1996), Gleich (2003), Filc and Scartascini (2004), Krogstrup and Walti (2008), Shah (2007), and Hallerberg et al (2006, 2009) showed that a transparent and hierarchical/centralised budget institutions result in greater fiscal discipline and less debt. Similarly, Hameed (2005) and Benito and Bastida (2009) found significant positive relationship between a measure of budget transparency and primary balance. On the other hand, Alt and Lassen (2006) and Andersen and Holboll (2010) found statistically significant negative relationship between budget transparency and debt.

Using a composite index of budgetary institutions, Gollwitzer (2011) showed that budget institutions have disciplining effect on central governments gross debt and primary balance in Africa. In a similar study for developing countries, Dabla-Norris, et al (2010) provided

evidence that strong budget institutions result to improved fiscal balance and public external debt outcomes. Giuberti (2015) examined the influence of budgetary institutions on primary deficit of the Brazilian Federal Government over a period of budget reforms in Brazil. His results indicate that, budgetary institutions have contributed to a reduce government deficit of the federal government and also results to sustainable debt in Brazil. Furthermore, Martin and Vanberg (2013) argued that budgetary institutions do eliminate the expansionary fiscal pressures associated with coalition in a multiparty system. The position of Martin and Vanberg (2013) is supported by de Haan, Jong-A-Pin and Mierau (2013) who showed that budget institutions influence fiscal performance irrespective of government fractionalization. Von Hagen (2010) showed that the wide difference between actual and projected values of key macroeconomic and fiscal variables in countries can largely be explained by the presence of weak institutions.

Mulas-Granados, et al (2009) studied the effect of hierarchical procedure on fiscal performance and showed that a powerful single fiscal authority such as the finance minister promotes effective fiscal performance. Hierarchical procedure is measured by the extent to which a given central budget authority has power to set the agenda of the budget, enforce compliance with budget rules and regulations, as well as enforce and control budgetary expenditures. Hierarchical procedure also involves the extent of legislative power to increase, decrease or introduce new expenditure item in the proposed budget.

However, Alesina and Perotti (1996, 1999) argued that strict numerical fiscal rules promote inefficient countercyclical fiscal policies. This is because strict rules do not allow countercyclical fiscal policy adjustment described in standard Keynesian macroeconomic policy stance which suggests surplus during economic boom and deficits during recession. In addition, strict budget rules constrain the use of the budget to implement tax smoothing policy as contained in Barro (1979) tax smoothing theory. Related to this, Bowen, et al (2014), Bowen, et al (2017) showed that mandatory budgetary institutions result to inefficient provision of public goods, and that allowing flexibility in mandatory budget institutions that lead to static and dynamic efficient provision of public goods.

3. Theoretical Argument for the Importance of Budget Transparency

Theoretically, the relevance of budgetary institutions is founded on the fact that budgetary institutions usually solve two key problems that confront the budget process. These are the

principal-agent problem and the common pool problems. This paper focuses on the principal-agent problem which has direct bearing with budget transparency.

The principal–agent problem arises because the electorate (principal) give the power to spend public funds to politicians and other budget actors (agent). That is, few people spend public fund on behalf of the general public. Usually, the budget information available to the key budget actors (agents) and non-budget actors (principals) are not the same, hence, creating asymmetric information problem. The agents often have information advantage which they use to manipulate the budget in favour of their interest and at the expense of the principal’s interest. Thus, as argued by von Hagen (2005) politicians and other budget actors can extract rents through the budget process. Hence, the budget process in many countries particularly developing countries including countries, in South Asia and West Africa has failed to deliver the much-expected fiscal dividend to the people. Also, the budget process in most of these countries has resulted in fiscal indiscipline such as huge and persistent deficits, high indebtedness, inefficient and inadequate provision of public goods.

Budgetary institutions, specifically institutions that promote transparency at all stages of the budget process minimise the information gap between voters (principal) and politicians (agent). Meanwhile, because of the complex bureaucratic and political procedure involved, it is difficult to completely remove the information lacuna at all stages of the budget process. Therefore, the budget actors (agents) have some residual powers (Seabright, 1996). The weaker the budgetary institutions, the larger the residual powers and the more the opportunistic behaviour of politicians as well as other budget actors. In return, the fiscal outcome will be less satisfactory. On the other hand, strong budgetary institutions would make the entire budget process more transparent and participatory, less illusive, and then the politicians would have limited residual power.

Budget transparency institutions do not have direct bearing with fiscal performance but they influence it through different channels. One of the most common channels identified in the literature is the effect of budget transparency on information asymmetry problem. Budget transparency reduces the information gap between the electorate (principal) and politicians (agents). The more transparent budget process, the more voters have access to budget information and understand the budget process; the lesser the residual power of politicians. The opportunity of politicians to use deficit budgeting and excessive expenditures to achieve their selfish interest will reduce with more transparency. Benito and Bastida (2009) show that lack

of budget transparency usually increase voters' fiscal ignorance and reduce politicians' commitment to be fiscally responsible. Hence, budget transparency leads to more accountability in governance.

Another channel through which budget transparency impacts fiscal performance is through its effects on fiscal illusion. Generally, there are incentives for politicians to overestimate the benefits of the budget while underestimating the cost in terms of current and future taxes, Alesina and Perotti (1996). This creates confusion in the budget process. By presenting ambiguity in budget, the citizens will have little or no clear understanding of how the budget will lead to real outcomes. Hence, policymakers have strategic advantage of using budget deficit and overstated expenditure to enrich themselves. A transparent budget process would reduce the complexity and ambiguity in the budget process, hence making the entire process less illusive.

4. The Link between Budget Transparency and Fiscal Performance

In this section the relationship between transparency and primary balance and between transparency and debt are examined using two dimensional graphs with regression lines fitted.

Following the common practice in the literature (Alesina and Perotti 1999; Jarmuzek 2006; Andersen and Holboll, 2010; Gollwitzer, 2011; Sedmihradska and Haas, 2013; Giuberti, 2015; Gerunov, 2016; among others), fiscal performance in this paper is measured using primary balance and debt, both as ratio of GDP, while the Open Budget Index (OBI) is used to measure budget transparency. The OBI scores each country from 0 to 100, based on the average of the responses to 109 questions in the questionnaire that assess the public availability of budget information. A country's OBI score reflects the timeliness and comprehensiveness of publicly available budget information in eight key budget documents. The index is broadly categorised into three, scores ranging between 61 to 100 are referred to as sufficient transparency. Scores between 41 to 60 and 0 to 40 are categorised as limited and low transparency respectively.

Figure 1 presents the relationship between primary balance and budget transparency. Generally, the figure depicts positive relationship between primary balance and transparency with R-square of 35%. The fitted line shows that a one point increase in budget transparency would improve primary balance by 0.13 point. Though, none of the countries in the sample fall in the sufficient category of budget transparency, yet countries with higher transparency have lower deficits. However, the position of few countries contradicts this general assertion. For

example, Burkina Faso has higher deficit than Ivory Coast despite that the two countries have similar transparency levels. Sierra Leone has one of the worst deficit in the sample irrespective of its transparency level which is higher than other countries in the sample. As it was argued by Gerunov (2016), the exceptional cases may be due to fiscal crisis which lead to increased spending and thus resulted to deteriorating deficit situation, irrespective of transparency levels. Figure 2 presents the relationship between transparency and debt. The figure depicts a very weak relationship with R-square of 6.2%. In addition, the figure displays a positive relationship contrary to the negative relationship established in the literature. This result is similar to the findings of Gerunov (2016) who did not find a significant relationship between transparency and public debt, particularly for low income countries, though some levels of significance for middle and high income countries. The relationship failed to be significant when he considered single year cross-sectional regressions for different years (2005 to 2014). This is because the effect of transparency and budget institutions generally depend on the social and economic situations in the country. Similarly, Jarmuzek (2006), Sedmihradská and Haas (2013) did not find a significant relationship between transparency and fiscal performance such as debt and deficit. The positive relationship observed could also be due to the fact that the 2017 data used epitomised the period when many countries were struggling with economic crisis. Hence, debt was likely to grow during this period irrespective of the level of transparency. Garcia and Lopez (2003), De Renzio, et al (2005) argue that the effectiveness of budget transparency depends on the general institutional environment and political economy situation in individual countries.

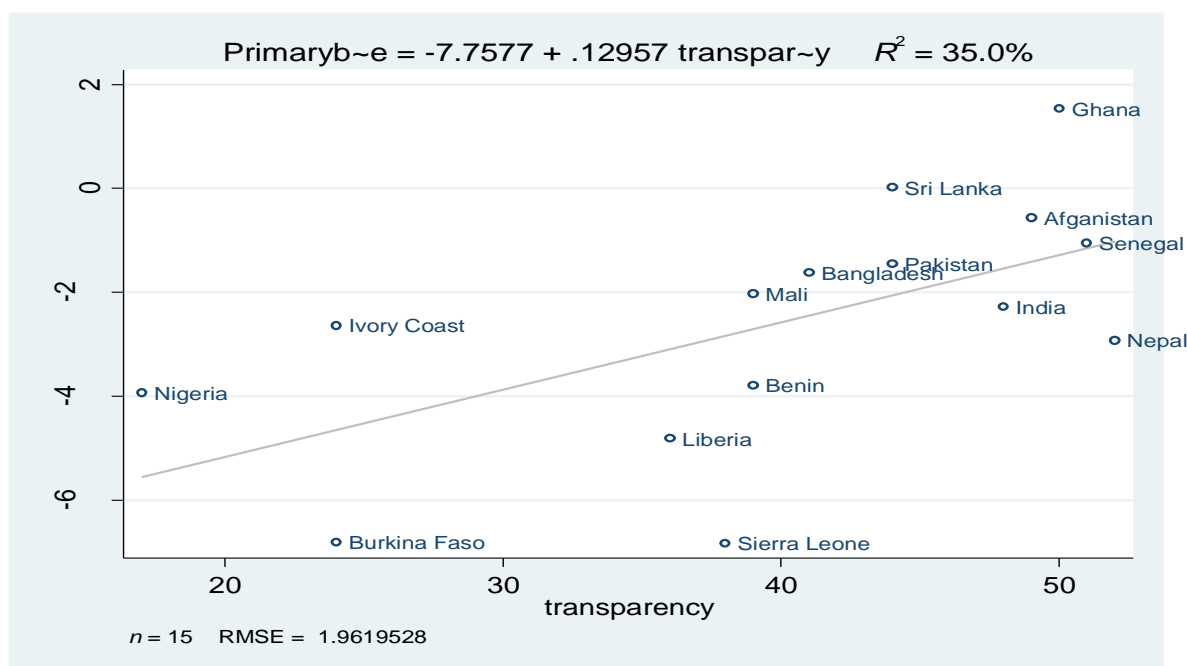


Figure 1: Budget Transparency and Primary Balance

Source: Computed by author using data from OBI 2017 and WEO 2017

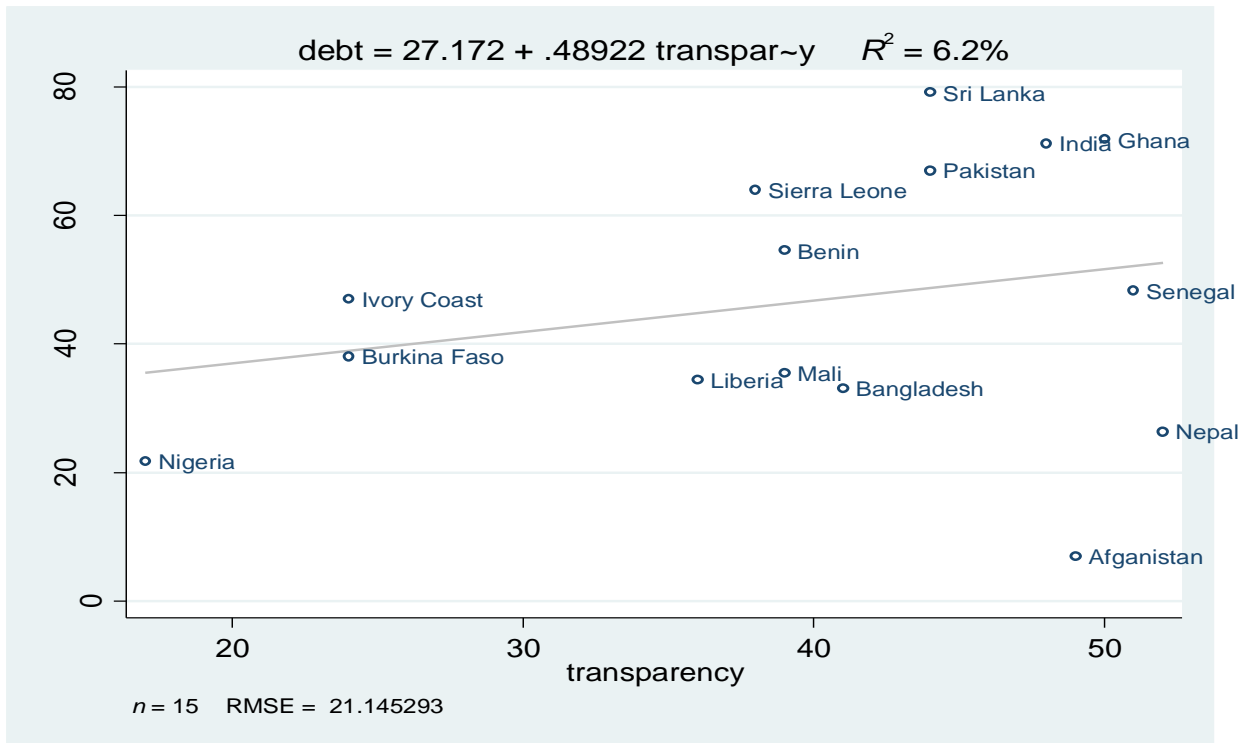


Figure 2: Budget Transparency and Debt

Source: Computed by author using data from OBI 2017 and WEO 2017

5. The link between Transparency and Provision of Key Infrastructure

As shown by Bowen, et al (2017), efficient budget institutions will result to more and efficient supply of public goods. Therefore, a significant positive relationship is expected between budget transparency and provision of key infrastructure. However, the relationship is not as straight forward as it appears. The ability of people to use available fiscal information to hold politicians accountable matter much in attaining the positive relationship. In this section, the relationship between budget transparency and provision of key infrastructure is examined using samples of countries in South Asia and West Africa.

Figures 3, 4, and 5 present the relationship between budget transparency and indexes of total infrastructure, road infrastructure, and electricity supply as computed by Global Competitive Index (GCI), respectively. The three figures depict a positive relationship between budget transparency and infrastructure with varying degree of relationship. The R square is 11.8% for total infrastructure, 19.7% for road infrastructure and 19.3% for quality of electricity. Even though the R squared values do not display very strong relationship, countries with higher transparency have higher levels of infrastructure. Similarly, countries with less transparency have low levels of infrastructure. For example, Nigeria has the lowest transparency level in the sample and correspondingly has the lowest levels of total infrastructure, quality of road and

electricity supply respectively. On the other hand, countries with high levels of transparency such as Sri Lanka, Ghana, India and Pakistan equally have high levels of infrastructure. Nepal represents a counterfactual picture in Figure 4 as the country is seen at the bottom of the road infrastructure ladder despite the relatively high level of transparency.

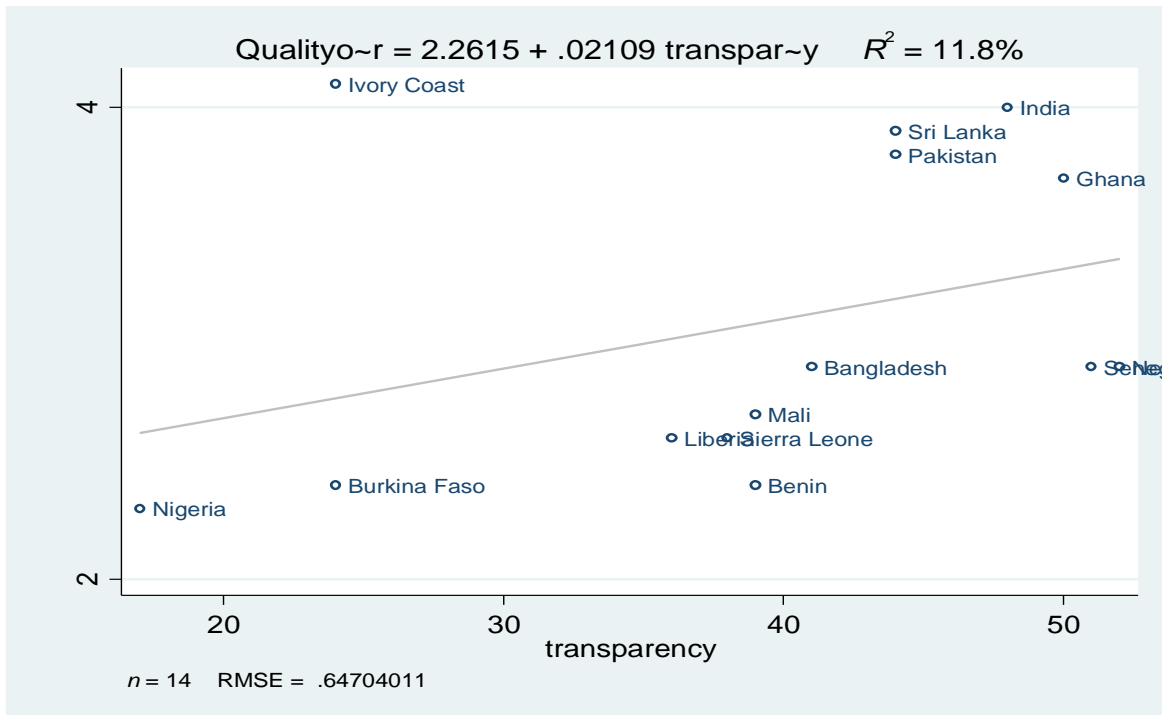


Figure 3: Budget Transparency and Index of Infrastructure
 Source: Computed by author using data from OBI 2017 and GCI 2017

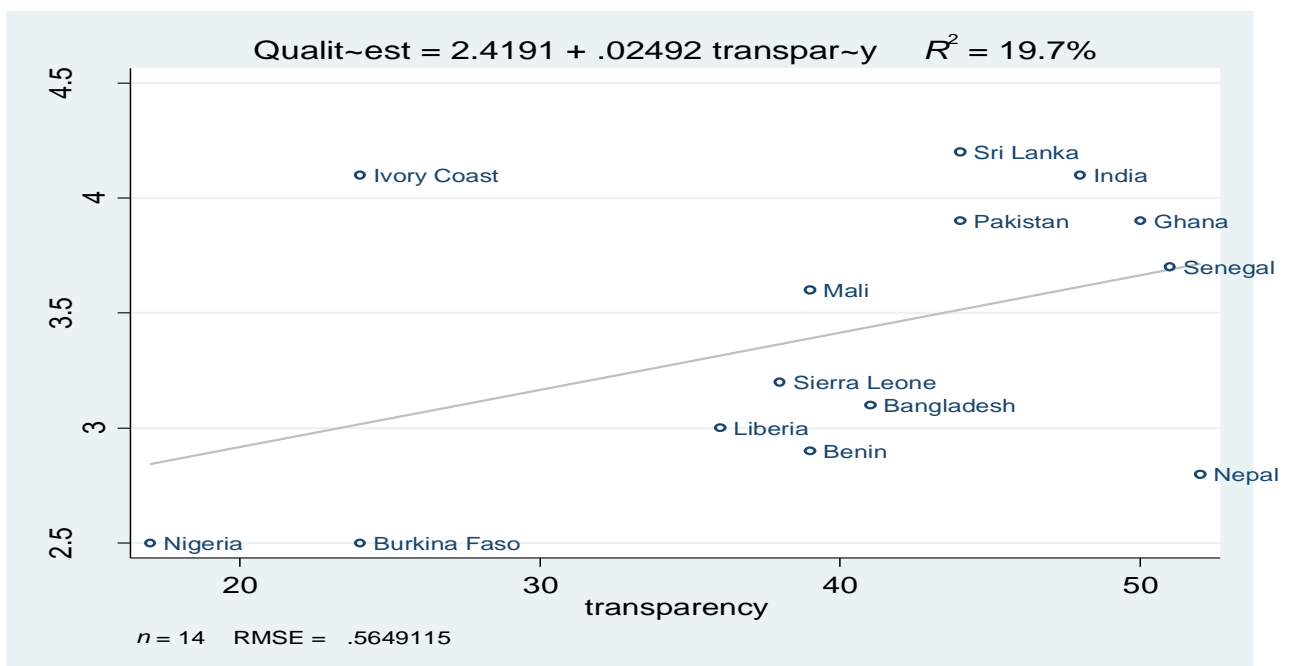


Figure 4: Budget Transparency and Quality of Road Infrastructure
 Source: Computed by author using data from OBI 2017 and GCI 2017

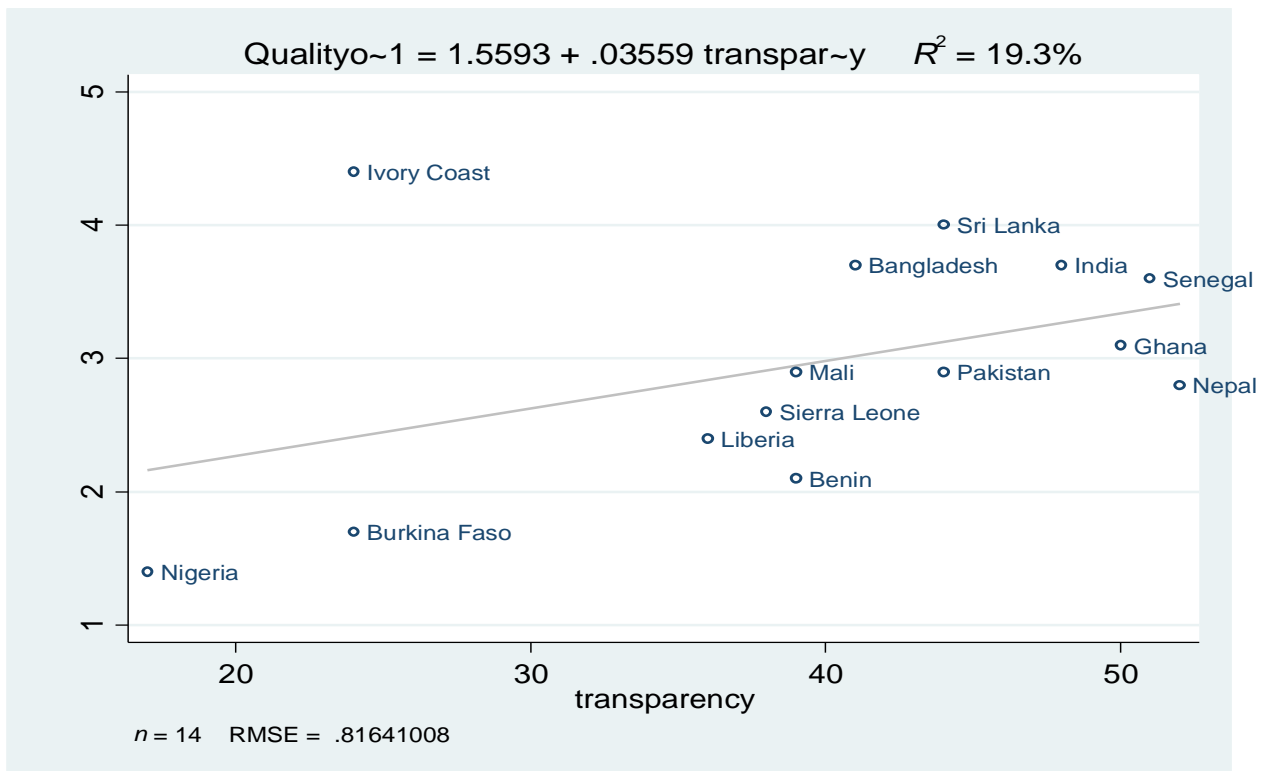


Figure 5: Budget Transparency and Quality of Electricity Supply
 Source: Computed by author using data from OBI 2017 and GCI 2017

6. Nigeria versus Sri Lanka

The overall transparency measured by the Open Budget Index (OBI) score for Nigeria and Sri Lanka over the period 2006 to 2017 is presented in Table 1. The open budget survey is repeated every two years. The level of transparency in budget processes of the two countries were not consistent through the period. Nigeria scores 20 points in 2006 when the survey was first conducted but the country’s performance consistently declined till it drops to 16 in 2012. However, there was significant jump in 2015 to 24, the highest so far. Meanwhile, this rise was not sustained as it drops again to 17 in 2017. Sri Lanka first score was 47 in 2006 and improves in subsequent two surveys to 64 and 67 in 2008 and 2010 respectively. In 2012 and 2015 when the fourth and sixth surveys were conducted Sri Lanka performance dropped to 46 and 39 respectively. However, there is improvement in 2017 as the country’s score rise to 44.

The extent of comprehensiveness and usefulness of information provided in key budget documents at different stages of budget process in Nigeria and Sri Lanka are presented in Table 2. In the overall budget transparency index, Nigeria scored 17 while Sri Lanka scored 44. Nigeria's score is within the category of scanty transparency and Sri Lanka score falls in the limited transparency category. Both countries failed in three of the indicators by either completely not producing or not publicly providing key fiscal information. The three indicators concern information in the pre-budget statement, citizens budget and mid-year review respectively. The pre-budget statement is expected to publish broad parameters of fiscal policies in advance of the executive's budget proposal. The document should also disclose government forecast of key macroeconomic indicators and fiscal targets such as anticipated revenue, expenditure and debt. On the other hand, the citizens budget is supposed to be a non-technical document which contains key budget information at every stage of the budget process. And the mid-year review is expected to report comprehensive up-to-date information on implementation of budget, review of main assumptions and forecast as of the middle of the fiscal year.

On the comprehensiveness and usefulness of information in the executive budget proposal, enacted budget, and year-end report, Nigeria scores are 11, 45, and 45 while Sri Lanka scores are 57, 72, and 62 respectively. In these three indicators, Nigeria did not score beyond the limited score. Sri Lanka had limited score in the executive budget proposal and substantial scores in enacted budget as well as in the year-end report. Nigeria with 43 points in comprehensiveness of audit report did better than Sri Lanka which did not make audit report accessible to the public.

Availability of budget information though necessary, is not sufficient to make the budget process efficient. Rather, public participation in the entire budget cycle is crucial in achieving an efficient budget. The scores for Nigeria and Sri Lanka on the extent of public participation at the executive preparation and implementation stage, at the legislative approval stage as well as at auditing stage are presented in Table 3. The two countries score scanty scores in the extent of public participation in the budget process at different stages of the process. While Nigeria had 13, Sri Lanka had 11 in the overall index of public participation. As depicted in the table, the executives of both countries do not allow sufficient participation of the public. Nigeria well outperformed Sri Lanka in the extent of public participation in the legislative budget approval stage. On the other hand, Nigeria failed woefully in public participation at the auditing stage while Sri Lanka did relatively better at this stage.

Finally, Table 4 presents the scores of legislature oversight functions. Nigeria did relatively better in legislature oversight functions at the budget execution and audit stage. The involvement of legislature at budget formulation is similar in both Nigeria and Sri Lanka. Sri Lanka performance at legislature oversight functions in the budget execution stage is far lower.

Table 1: Overall Transparency Index in Nigeria and Sri Lanka (2006 – 2017)

YEAR	NIGERIA	SRI LANKA
2006	20	47
2008	19	64
2010	18	67
2012	16	46
2015	24	39
2017	17	44

Source: Compiled from Open Budget Index (OBI)

Table 2: Comprehensiveness and Usefulness of Information in Key Budget Documents (2017)

Indicators	Nigeria	Sri Lanka
Pre-Budget Statement	Published Late	Produced for Internal Use Only
Executive's Budget Proposal	11	57
Enacted Budget	45	72
Citizens Budget	Not Published Online	Not Produced
In-Year Reports	Produced for Internal Use Only	37
Mid – Year Review	Not Produced	Not Produced
Year – End Report	45	62
Audit Report	43	Produced for Internal Use Only

Source: Compiled from Open Budget Index (OBI)

Table 3: Extent of Public Participation in Budget Process (2017)

Indicators	Nigeria	Sri Lanka
Overall Public Participation	13	11
Executive	12	9
Legislature	25	0
Supreme Audit Institutions	0	33

Source: Compiled from Open Budget Index (OBI)

Table 4: Legislature Oversight Functions (2017)

Indicators	Nigeria	Sri Lanka
Formulation/Approval	52	57
Execution/Audit	53	20
Oversight of Audit Institution	61	67

Source: Compiled from Open Budget Index (OBI)

7. Policy Implications

There are several relevant policy issues that can be drawn from the analysis presented in Sections 4, 5 and 6 for the countries in South Asia and West Africa particularly Sri Lanka and Nigeria. First, the relationship between budget transparency and primary balance is observed to be relatively strong, therefore, countries in South Asia and West Africa need to significantly improve on budget transparency in order to address the persistent deficit crises in the two sub-regions. Second, the weak positive relationship between transparency and debt observed could be due to poor levels of transparency in the countries or weak institutional limits on borrowing. Therefore, there is urgent need to work on the fiscal rules and regulation that will ensure more transparent budget process at all stages of budgeting. As the countries improve on their fiscal transparency, there is need to also address public debt by institutionalising borrowing limits.

Specifically, there is big room for improvement in Nigeria and Sri Lanka. There is need for conscious effort to consistently improve over time on transparency in budget process and other business of governance. Both countries should work on institutions that would enhance the transparency of the budget process. Though, there has been much improvement since 2017 in Nigeria, yet there is need to improve on the comprehensiveness and usefulness of information contained in budget documents at every stage of the budget process and that such information should be made more accessible to the public. The provisions of the law that allow participation of the public in the budget process should be strengthened so as to enhance more participation of the general public.

Nigeria should specifically take the following steps in order to improve the overall budget transparency: (i) produce and publish mid-year review; (ii) publicly publish in-year-report; (iii) improve on the citizens budget document; (iv) publish the pre-budget statement early; (v) make laws that will allow public participation by the supreme audit institutions at the auditing stage;

(vi) improve on public participation at the executive preparation and implementation stage; and
(vi) make the budget proposal more informative and understandable.

Sri Lanka needs to strengthen the institutions that would enable citizens not only to have full access to budget information at the right time, but also to understand and use the information. Citizens participation at the preparation, approval and implementation stages require urgent improvement. In particular, for Sri Lanka to improve the overall budget transparency, the following steps should be taken: (i) produce and publish citizens budget and mid-year reports; (ii) publicly make available the pre-budget statement and audit report; (iii) allow public participation at the legislature approval stage; (iv) encourage more public participation at executive preparation and implementation stages as well as at supreme audit institutions; and (v) increase legislature oversight functions at the budget execution and audit stage.

8. Concluding Remarks

This paper examined the relationship between budget transparency and primary balance, debt as well as key infrastructure. A relatively strong and positive relationship is observed between budget transparency and primary balance. A moderately strong positive relationship between budget transparency and provision of total infrastructure, road infrastructure and quality of electricity supply is equally observed.

Public debt is high and budget transparency is limited across almost all the countries in South Asia and West Africa. Some vital budget documents are either not produced or not publish in Nigeria and Sri Lanka. Participation of the general public in the budget process at every stage is also observed to be limited in both Nigeria and Sri Lanka.

It is important for countries in South Asia, West Africa and particularly Nigeria and Sri Lanka to improve on the quality, comprehensiveness and usefulness of information provided in key budget documents, and make budget documents available to the general public on timely basis. Rules to limit borrowing should be strengthened, and public participation in the entire budget cycle should be allowed and encouraged.

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