Towards Subnational Fiscal and Economic Sustainability

Briefing Note

February 2018

Introduction

In the last year, Nigeria has experienced significant macroeconomic and fiscal imbalances. Following the decline in oil revenues since mid-2014 amidst slow policy responses, the economy gradually slowed into negative growth in 2016. Three years after the oil price slump, fiscal deficits have remained wide, debts are rising, and governments are faltering on public sector wages. Over the years, large revenue windfalls recorded during boom periods have destabilized the budgets of both federal and State governments; and have lured governments into unsustainable increases in expenditures, in which they find themselves locked in when revenue falls.

In May 2016, the Fiscal Sustainability Plan was developed as a national policy response to the fiscal challenge. The plan provided a more robust structure for fiscal reform, consolidation and stability. Anchored on five (5) strategic objectives – to improve accountability and transparency, increase public revenue, improve public financial management, and achieve sustainable development, the plan recommends actions to align both short and long term fiscal sustainability objectives of both the federal and State governments.

Nearly two years since its adoption by State governments, new lessons have emerged. This note provides a perspective on the implementation of the fiscal sustainability plan at the sub-national level, including lessons, enablers and indications for achieving fiscal and economic viability. It draws from a series of FSP case studies and assessments conducted by the Nigeria Governors' Forum (NGF) since 2017, supported by LEAP, the Research and Evidencing pillar of Partnerships to Engage, Reform and Learn (PERL), a programme of the UK Department for International Development (DFID).

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Major Lessons from the Implementation of the FSP

The key lessons from State Implementation of the FSP are outlined below:

- Accountability and transparency actions of the FSP recorded the least level of implementation, especially in areas such as IPSAS implementation and publication of financial statements. The major challenge according to States, is the prohibitive cost of technology for managing accounting information. Beyond this however, there is an underlying challenge that governments do not fully recognise the importance of transparency and accountability measures in underpinning an effective reform environment based on legitimacy and credibility.

- Reforms targeted at raising public revenue recorded the highest level of implementation, as the internally generated revenue (IGR) of States grew by over 20% from N687 billion in 2015 to N821 billion in 2016. Governments have also taken tougher measures such as adopting a Treasury Single Account across all government organs to consolidate government receipts and block leakages.

  Importantly, evidence has shown that setting unrealistic revenue targets can be an impediment to proper planning, and in most cases, poor budget performance.

- To rationalise public expenditure, most States have carried out a biometric capture of civil servants to eliminate payroll fraud and set up units that implement efficiency and expenditure controls. Although governments' responses to this objective has been strong, achieving effective results will require a fundamental change in the nature and cost of governance. Public sector wage bills remain among the key threats to fiscal sustainability, reaching over 40% of the total expenditure of many States.

  Arrears for salaries, allowances, pensions and gratuities are unlikely to be cleared in the short term for a number of reasons, including competing budgetary needs, pressures from debt servicing and subdued federation revenues.

- Despite the domestication of PFM laws such as the Fiscal Responsibility Act (FRA) and Public Procurement Act (PPA) across States, challenges in public financial management still persist. This divergence highlights the importance of strong institutional coordination to ensure regulations are strictly adhered to, with specific and stringent sanctions against both government organizations and their heads for compliance failures.

- Reforms targeted at achieving sustainable debt management recorded the highest percentage of actions not implemented including establishing consolidated debt service accounts, sinking funds, benchmark rates for loans and guidelines for municipal bonds. The debt situation has been worsening, more States have exhibited weaker capacities to meet their debt obligations as at when due.

Overall, the fiscal performance of States showed marked linkages with the implementation of the FSP. This relationship is prominent for public revenue measures which recorded high implementation and sustainable debt management measures which recorded low implementation.

There is a strong consensus on the importance of the fiscal sustainability plan, and the reform agenda is taking shape

State governments agree that the fiscal reform agenda is legitimate, and they are keen on addressing inherent challenges affecting fiscal management. A number of States have adopted innovative approaches to achieve fiscal sustainability, including the **adoption of technology** in areas such as tax administration, budget preparation, financial reporting, citizens engagement, and contracting and procurement; **institutional strengthening** for States Internal Revenue Service, Bureau of Statistics and Internal Audit; **strengthening of legal and regulatory frameworks** such as granting administrative and financial autonomy for States Internal Revenue Service, tax harmonisation, and revenue rates/tariffs. Others have leveraged on **collaborative relationships** with the federal government, the NGF HelpDesk and development partners to close capacity and funding gaps.

For most States, implementation lags were recorded as a result of factors such as lack of credible data for problem identification, policy formulation and baseline tracking; poor funding; weak institutional capacity: and poor linkages across government ministries, department and agencies.

Key Enablers for Ensuring Subnational Fiscal Sustainability

The following have been identified as key enablers for achieving fiscal sustainability at the State level:

- High political commitment has been the most important factor that has led to recorded successes in States. State officials have identified this as a necessary condition to facilitate adequate funding, institutional strengthening and inter-agency cooperation.

- Streamlining government expenditure is key to ensuring efficient public service delivery and the required fiscal adjustment. Reforms targeted at rationalising public expenditure require broader public service reforms that will lead to a more unified, efficient, responsive and accountable civil service.

- Good, available, and well-used data can make a difference between a successful and failed plan. Governments must use data extensively to guide decision making and prioritizing goals.

- Strong intergovernmental relations is an overarching framework for strengthening fiscal reforms. To engender a supportive environment for information sharing and peer learning, effective engagement between the federal government and States, and collaboration among State governments are important considerations to address implementation lags.

Beyond Fiscal Sustainability: The need to Build the Capability of States to function as Economies

Implementation challenges hold governments back from realizing their stated development goals. Many governments have huge capacity deficits to overcome repeated implementation failures even after years of reforms designed to strengthen capability.

There have been more debates about what governments choose to do than about how governments can do what they chose to do – *how to build the capability of the State to function as an economy*.

States need to be aware of their capability gaps and carefully think of ways to tackle them. The process of capacity building should not be designed as an activity separate from the work of implementing reforms, rather it should be undertaken as part of the reform implementation process. The levels of iterations in policy implementation form the learning and adaptation mechanisms upon which further capacity is built and applied in consolidating successful reforms.

The orthodox approach to building state capability both politically and pragmatically is to “get institutions right” by passing laws to create them, designing structures and funding them; and training staff to implement policies, or policy reforms. Despite the continuous use of this approach over the years, we still experience inefficiencies in the civil service. The rationale for this lies in the fact that while these aren’t counterproductive measures in and of themselves, they have only resulted in tepid progress, at best because they remain incomplete in that attention isn’t given to learning and innovating during implementation.

To build capability, States need to focus on solving problems locally. Put most starkly, true capability for effective policy implementation is acquired by doing, through persistent practice and learning rather than by imitating others. Thus, understanding successful approaches to implementing policies within the local context is therefore key for building institutions’ and States’ capability.

To better function as economies, States will need to establish/strengthen their Economic Intelligence/Management Units and recruit professionals to provide the requisite technical and analytical skills for analyzing and interpreting economic data.

In developing their budgets, States must ensure valid and accurate evidence is used to inform the identification of priorities and and also that all measures targeted towards addressing the key problems are identified by its citizens using a bottom up approach. *Voice, evidence* and *capability* should be the three most important determinants of annual and medium term sectoral and budgetary content. States need to establish a link between their budget consultative forum meetings with citizen groups and the budgets being prepared.

Asides the need to generate macroeconomic data at State level, proper planning also underscores the need to generate key household demographic data. Priorities must be reflected on the basis of what the citizens’ demand. This in turn should be tested with the state-wide up-to-date baseline household data. States must, of necessity, be able to conduct regular living standard surveys in order to properly assess the growth, poverty and social impact of policies.

To this end, the role of the State Bureaus of Statistics (SBSs) in facilitating the use of data for evidence-based policymaking cannot be over-emphasized. Capacity should also be built within the various MDAs responsible for delivering these policies.

Indications on how to solve local problems in local ways is available at: Building capability by delivering results: Putting Problem-Driven Iterative Adaption principles into practice (Andrews, et al. 2015). https://bsc.cid.harvard.edu/files/bsc/files/governance_notebook_2.3_andrews_et_al.pdf.

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