

SFTAS Program Technical Assessment

A. Program Strategic Relevance

1. **The collapse of oil revenues translated into significant revenue shortfalls at all tiers of government and led to a fiscal crisis at the State level 2015-16.** The fiscal performance of States during 2011-2014 made them vulnerable to the macro-fiscal shocks of 2015-16. Total state revenues fell as a share of national GDP - from 5.5 percent in 2011 to 4.0 percent in 2014 - as FAAC allocation (mostly oil revenue sharing) fell while VAT and IGR stagnated. During this period, recurrent spending increased from 48 percent to 60 percent of total spending at the expense of capital spending. With the oil revenues shrinking, total state revenue fell further to 2.5 percent of GDP in 2016. States had to reduce their expenditures from 4 percent of GDP to 3.4 percent of GDP to maintain their fiscal deficit below 1 percent.

2. **Increased borrowing needs saw total state debt increase from 2.4 percent in 2014 to 4.2 percent of GDP by the end of 2016.** Domestic arrears on contractor payments pensions and salaries increased significantly from 660 billion Naira in 2014 to over 1 trillion Naira in 2016. The total state debt to revenue ratio nearly doubled in one year to 113 percent in 2015 and increased further to 169 percent in 2016, when every state (including FCT) are estimated to have breached the formal debt threshold of 50 percent. The total state annual interest payment to revenue ratio increased from 5 percent to 10 percent.

3. **States continued to constrain their expenditure in 2017 as revenues remain below pre-2015 levels.** 2017 saw total state revenues increase from higher statutory transfers as the oil sector started to recover and higher IGR, which now represents 30 percent of all state revenues (23 percent excluding Lagos). But total revenues remain below the levels of 2011-2014. States constrained expenditures, keeping spending flat in nominal terms and declining to 3.2 percent of national GDP, so that total state fiscal deficit improved slightly to 0.6 percent of GDP. Total state Debt-to-GDP remained stable at 4.2 percent and debt-to-revenue ratio also remained stable at 161 percent.

4. **The need to strengthen state fiscal management and increase sustainability remain, as fiscal conditions will continue to be challenging in the medium-term.** At present, states remain under considerable fiscal pressure, with states having to constrain spending and requesting continuation of the Budget Support Facility beyond the original end date of May 2017. Under assumptions of a fragile economic recovery (with higher oil price and production) and assuming no increase in non-oil revenues or in states' IGR (as a share of GDP), total state revenues are projected to increase slightly to 2.9 percent of GDP by 2018, but will remain much lower than 2011-2014 levels. Furthermore, if we assume that total state fiscal deficits will remain around 0.8 percent of GDP annually through the medium-term to finance expenditures, total state debt stock will continue to increase to 4.7 percent of GDP by 2020, and the total state debt-to-revenue ratio will remain at the elevated levels of 2016-2017. As a result, a higher share of state revenues would be used for interest payments and debt servicing, rather than development spending. In this scenario with no or very limited fiscal adjustment, states remain vulnerable and continue to represent a source of fiscal risks. for the FGN (who guarantees more than 50 percent of state debt) and state expenditures will remain totally inadequate to provide essential public services and support economic development. To avoid this scenario, States need to increase their IGR, manage recurrent spending pressures, prevent arrears accumulation and strengthen debt management.

5. **The Government’s Fiscal Sustainability Plan and the fiscal transparency commitments of the OGP are (and will remain through the medium-term) highly relevant.** The full and sustained implementation of the key PFM reforms and fiscal adjustments contained in the FSP as well as the fiscal transparency commitments of the OGP can help States to strengthen fiscal performance by increasing their internally generated revenues (IGR), managing recurrent spending pressures, strengthening debt management and significantly improving fiscal transparency and accountability.

B1. Technical Soundness of the Program (Fiscal Sustainability Plan)

6. **The technical soundness of the Program has been assessed looking at the level of ownership and commitment to the FSP, the strengths and weaknesses in the FSP design and implementation arrangements, and the extent in which the PforR operation and the TA component can address the gaps and challenges highlighted.** The assessment has been informed by a large body of analytical work by the World Bank, other development partners and by the Nigeria Governors Forum on state-level fiscal management and performance. It has also drawn from the learnings of past and current state-level Bank operations involving governance and PFM reforms. The ongoing assessments by the FMoF and NGF of the FSP implementation status have been used to review progress by States in implementing the FSP. A focused political economy analysis study on the FSP and on broader state-level fiscal reforms has been carried out by the Bank and the findings and implications for the operation form part of the assessment. Finally, extensive consultations with Commissioners of Finance, Budget, Accountant Generals, Chairpersons of Bureau of Internal Revenue from all 36 States in a series of focus groups have been carried out to understand their views on the FSP, the challenges they face in implementing reforms and what can be done to accelerate progress.

Program ownership and commitment

7. ***Broad consensus and buy-in:*** The state fiscal crisis and the two sets of financial assistance from the FGN created a sense of urgency to take actions from both the FGN, concerned with stabilizing the economy, and States that struggled to meet statutory obligations even with financial assistance from the FGN. This urgency created a strategic opportunity for the formulation of the FSP and formal commitment by 35 States participating in the Budget Support Facility to implement the FSP actions. While the Federal Government led the development of the FSP with seemingly only a subset of States involved closely in the development, there is still a very broad consensus across heads of institutions responsible for fiscal management at the State level (Finance, Budget, Bureau of Internal Revenues, Accountant General) that the reforms in the FSP are necessary and are in the self-interest of States to implement. Many States found that the FSP helped draw awareness to the importance of reforms they were already trying to implement and helped managers who previously lacked support from within the State government. This is the case even among States who felt that given the fiscal duress and need for BSF financial support there was not much choice but to agree to the FSP as conditions for the BSF.

8. ***Commitment and accountability:*** Although the FSP has shortcomings (see below), it marks a significant step forward in strengthening the subnational fiscal responsibility framework for States, which to date contains limited safeguards for prudent fiscal management or guidelines/rules for good fiscal management at the state level. While the FSP is not formalized into legislation (although certain elements relate to existing provisions in the federal and domestic

Fiscal Responsibility Acts), the public formal commitment from the 35 States participating in the BSF has created a real sense of obligation and accountability. In consultations, States accepted responsibility for implementation and being held accountable on the FSP as exemplified by the reporting to NEC on FSP implementation.

Program Design

9. **The FSP exhibits the following strengths in its design:** (i) Appropriate and relevant over-arching objectives; (ii) Many actions address key weaknesses in state fiscal management (acute lack of fiscal transparency and accountability; low IGR mobilization; inefficiencies in public spending; and poor compliance with debt management rules); (iii) Actions build on various PFM reforms that have been started by States; and (iv) the FSP encourages parallel fiscal reforms that are complementary in nature.

- i. **The over-arching objectives** (improving accountability and transparency, increasing revenue, rationalizing expenditure, improving PFM and sustainable debt management) **are appropriate, given the multi-faceted fiscal challenges of the States.**
- ii. **Many of the FSP actions have the potential to be highly impactful by tackling key weaknesses in state fiscal management.** In particular fiscal transparency and accountability-related actions on publishing budgets, budget implementation reports and audited annual financial statements, revenue-related actions on implementing the TSA at the State level and achieving targets to improve IGR, expenditure-related actions on payroll fraud and improving ratio of capital to recurrent expenditure, and debt-related actions on compliance with FRA and reporting obligations and adherence to debt solvency and liquidity thresholds. See Table 4.1 below for further details.
- iii. **The FSP actions build on various PFM reforms** which have been and are being undertaken by individual States, including those supported by previous Bank TA program, solidifying them into a set of common standards for fiscal management for all States.
- iv. **The FSP supports parallel fiscal reforms and adjustments that can reinforce each other to strengthen fiscal performance.** Increased fiscal transparency and accountability contribute to the achievement of the other objectives by enabling monitoring of adherence to fiscal and debt rules, identification of fiscal pressures and risks, as well as underpinning improvements in the effectiveness of spending. Improving IGR performance will help improve budget credibility as States do not have to rationalize spending due to revenue shortfalls against the budget. Improving IGR will also make the debt servicing less vulnerable to shocks in oil revenue volatility. The actions to rationalize public recurrent spending/statutory obligations, will help states to avoid expanding fiscal deficits and financing requirements when faced with revenue shocks/shortfalls.

10. **However, the design of the FSP also has a number of shortcomings:** (i) The 22 actions are a mixture of activities, outputs, intermediate outcomes and outcomes with varying impact potential but presented without any prioritization; (ii) There are gaps in the set of measures needed in order to fully achieve the five over-arching objectives; (iii) Lack of specificity with many of the actions vaguely described, leaving room for different interpretations, and fiscal targets for revenue and spending not quantified; (iv) There is no accounting for differences in starting points and capacity of States to implement the measures; (v) The timeframe for the implementation is not

long enough for some of the more complex reforms nor does it allow for incentivizing sustained changes in fiscal behavior. See Table 4.1 below for further details.

- i. **The 22 actions are a mixture of activities, outputs and outcomes with varying impact potential but are presented without a sense of prioritization.** Using the FSP to assess compliance progress would mean that every action would have the same weight, even if some are less important and/or are means to achieving others. Moreover, without a defined results framework, it is not clear which outcomes those actions that are defined as outputs (for example: *Establishment of Efficiency Unit*) are trying to influence. Thus, there is a danger of succeeding in form but not function.
- ii. **There are some significant gaps in the set of measures needed in order to fully achieve the set out objectives:** Fiscal transparency and accountability-related actions are mostly supply-side driven without actively engaging the demand-side; the key issue of budget credibility is not addressed which would undermine the benefit of publishing budgets; expenditure-related actions omit measures on e-procurement and open contracting that can help to improve transparency and increase value for money; and debt-related actions do not address the problem of domestic arrears accumulation.
- iii. **The action plan was not accompanied by detailed descriptions of the actions so many of the actions are open for different interpretations,** which makes it very difficult to assess progress in an objective manner. Moreover, the fiscal targets for IGR growth and increase in capital versus recurrent spending are not quantified, leaving individual States to set ‘realistic and achievable’ targets, which may result in States setting too easy or too ambitious targets.
- iv. **There is no accounting for differences in starting points and capacity of States to implement the measures.** Many of the deadlines are December 2016, only 6 months after the start of the BSF. These deadlines are not realistic for States that have not already started implementing the measures. Some of the measures such as those related to gaining a credit rating to issue municipal bonds are only relevant for a very small number of States who are already in a strong fiscal situation. At the same time, some of the measures and fiscal targets are likely to be easy for many States who would benefit from deeper measures and higher fiscal targets. For example, the debt to revenue ratio threshold is set at 250 percent, reflecting the deterioration of revenues and increase in debt during 2015-2016, but does not encourage those States, which have the ability, to meet the threshold in the FRA of 50 percent.
- v. **The original timeframe for the FSP implementation is too short for some of the more complex reforms to be fully implemented nor does it incentivize sustained reforms and improvements.** Even for States that had already embarked on the reforms, some deadlines were unrealistic, for example implementing IPSAS properly requires more time than the original timeframe for FSP and the BSF. In addition, the relatively short timeframe means that it does not require States to sustain the measures, creating risks of policy-reversal.

Program Implementation

11. **While all States have made at least partial progress, implementation of the FSP is far from complete.** Assessments of FSP implementation progress by the Nigeria Governor's Forum (NGF), as well as the interim results of the FMOF's implementation verification exercise, have revealed that implementation is far from complete. NGF administered a self-assessment survey to all 36 States in April 2017 (followed by case studies in 8 States that are still ongoing). On average two-thirds of States report having completed or having work in progress on each of the actions in the NGF self-assessment survey. NGF did not have the authority or resources to verify the results and the lack of specificity means States could be assessing their progress against different benchmarks with a likely positive bias. For example, 60 percent of States report publishing audited annual financial statements with another 30 percent in progress. Yet a check revealed that only 3-4 States financial statements being available online, which implies other States haven't published or published only in print media. The interim results (June 2017) for 23 States of the FMOF verification exercise by independent consultants showed less progress with an average compliance rate of 36 percent.

12. **Several factors have contributed to incomplete implementation of the FSP to date:** (i) The financial incentive was weakened as the FSP was not enforced by the Federal Government as strict conditions for accessing the monthly disbursements from the Budget Support Facility; (ii) Some States with weak capacity struggled to implement measures and there was no program of technical assistance to help them train staff and introduce new processes and systems; (iv) Within the States, in some cases there is a lack of support among the civil servants and a lack of political will and leadership from the State executive.

i. **The Federal Government was not able to enforce the FSP conditions because of the urgent need to maintain fiscal stability and the political economy dynamics between the Federal and State.** While the FGN wanted States to implement the FSP actions, their concerns over the States inability to meet statutory obligations, in particular the accumulation of contractor and salary arrears at a time when the economy was contracting and needed stabilizing, was overriding. It is likely that as disbursements were made to States based on need rather than FSP implementation, it undermined the credibility of the FSP as strict conditions and reinforced the moral hazard that exists where States have less incentive to change as they believe that they will eventually get assistance because the FGN will not let them fail. The inability to enforce the FSP conditions also reflects the political dynamics between States and the Federal Government with States politically powerful independently and having a very high degree of fiscal autonomy (see below section on Political Economy Analysis). States further point out that the Federal Government's influence and ability to lead by example is weaker given that they are not complying themselves with many of the FSP actions and had not fully implemented FSP actions that was the responsibility of the Federal Government - for example: providing IPSAS compliant software and providing consultants to install the FIRS eservice platform in States to automate VAT and WHT remittances (this was completed in August 2017).

ii. **At the State level, some reforms have been hindered by a lack of capacity.** States also cited weak capacity as a constraint and there was no program of technical assistance to help train staff and introduce new processes and systems in these States. However, it should be stressed that many of the reforms require only behavioral change, so weak capacity is not the main reason for slow progress.

iii. **Within the States, some reforms may have been impeded by a lack of support downwards - among civil servants – and upwards, from the political leadership.** Some reforms such as the biometric system to reduce payroll fraud may face resistance from within the civil service due to vested interests. Support from the political leadership, including the Governor, is important for complex reforms requiring resources and investment, for reforms that may be unpopular inside the state government as well as with the public (for example, tax reforms). Some states cited lack of political will and leadership as one of the key reasons for slow implementation. At the same time, there are example of successes due to political will - for example, when the Governor was able to protect the senior civil servants from push-back from the implementation of the biometric system. Whether a Governor is supportive or not depends on several factors, including how they were elected and whether they come from technical backgrounds, with those that do more receptive to reforms.

13. **Despite these challenges, every State has made some progress and there are many success stories that can be used to motivate other States.** Success stories include the increase in IGR that some States were able to achieve in 2016 and 2017, despite the economic slowdown and recession, by reducing leakages from remittance of service fees collected by MDAs through the implementation of the TSA. Kaduna reported that TSA had helped them double their IGR. Many States also noted that they had tackled payroll fraud by using biometric capture, which enabled them to remove ghost workers and bring down their personnel expenditure costs.

14. **The design of the PforR seeks to address the shortcomings in the FSP design highlighted above through the following:**

- **Only selecting a subset of the most impactful FSP actions to include in the Program** – those that are most critical in achieving the objectives. Other areas of the FSP are to be taken up through complementary or future interventions. The success of the Program will not be affected by the implementation of the areas of the FSP not included in the Program;
- **Including complementary demand-side OGP commitments and other interventions that addresses the gaps identified in the FSP.** These include: public budget consultations and citizens budget; improving budget credibility; use of e-procurement and open contracting; clearance of domestic arrears. See Table 4.1 below for further details;
- **Putting in place a specific and clear matrix of DLIs and DLRs, DLI verification protocols and results framework** to eliminate ambiguity on what is needed to be done by states to achieve a result;
- **DLIs and DLRs are designed to account for the heterogeneity of States**, offering incentives for stronger states to improve their performance further, while rewarding weaker/lagging states for strong commitment and effort through scalability and the series of stretch and basic results; and
- **The multi-year program measures results across four fiscal years** giving time for implementing complex reforms and incentivizing sustained performance.

15. **Furthermore, learning from the implementation challenges, the Program proactively seeks to strengthen capacity of States to carry out reforms and create stronger incentives for sustained and full implementation of the DLIs:**

- **Extra care will be given to the disbursement arrangements for the performance-based financing component** so that disbursements are only made on achievement of clearly defined DLRs against detailed verification protocols, verified by an independent verification agent. Any changes to the DLRs will undergo a formal process of review and approval and will be applied across the board for all States. This will strengthen the incentives for states, knowing that the PforR disbursements are strictly conditional on achieving results. The impact of enforcing the conditions can be demonstrated by the process of BSF disbursements in August 2017. The FMOF only disbursed the 1 billion naira to States that had implemented the tax eservices platform at the State level (one of the FSP actions). As a result, there was an upsurge in demand from States for FIRS consultants to come to their States and implement the platform;
- **Capacity building support will be made available to States** through the Technical Assistance component to support them to achieve the DLIs;
- **The Program will proactively create an environment for healthy peer competition and peer learning among States** by publishing individual States performance against the DLI matrix for each result year so that lagging States will want to improve so that it is no longer at the bottom and can also learn from States that are performing better.

16. **As already highlighted, the Bank will develop a parallel program of support to the FGN to strengthen its fiscal management.** Strengthening governance and service delivery within a federal country context requires coordinated policy and implementation actions by the Federal and Subnational Governments. Accordingly, the Bank is proposing to work with the State Governments through the proposed PforR Program while at the same time work with the Federal Government through a parallel operation to support the latter to strengthen fiscal governance and public financial management at the Federal level. This will enable the Federal Government to better implement complementary reforms, act as a positive role model for States to implement reforms.

Table 4.1: Detailed assessment of the FSP actions

Assessment				
#	Action	Responsible	Strengths, weaknesses and enhancements	Inclusion as DLI in PforR?
Objective 1: To Improve Accountability & Transparency				
1	Publish audited annual financial statements within 6 months of financial year end.	State	<ul style="list-style-type: none"> This is the foundation for improving accountability and transparency and strong consensus among States that this is essential Also important for providing source of credible fiscal and financial data for States for verification of other results Most States will not be able to publish within 6 months of financial year end at present, but should be able to by the end of the Program Add that the statements must be published online to improve accessibility 	Eligibility Criteria
2	Introduction and compliance with the International Public-Sector Accounting Standards (IPSAS).	State	<ul style="list-style-type: none"> Audited financial statements should be prepared in accordance with IPSAS (Cash). This will be a stretch for weaker States so require in years 3 and 4 	Eligibility Criteria
3	Publish State budget online annually.	State	<ul style="list-style-type: none"> This is the foundation for improving accountability and transparency and strong consensus among States that this is essential <p>This action should be enhanced and complemented in order to have a significant impact on improving accountability and transparency:</p> <ul style="list-style-type: none"> Budget is prepared according to standard Chart of Accounts in years 3 and 4 to allow for analysis and comparability across States Budget will only be a credible expression of government's fiscal plans if the budget is reliable. Currently budgets are not seen as credible due to the large deviation between budget and outturns. Include in Program PEFA indicator on budget reliability and target reducing deviation between budget and expenditure outturns for total budget Complement with OGP commitments to engage citizens on the budget formulation process: Public consultations and Citizens budget 	Eligibility Criteria DLI #1.2 DLI #2
4	Publish budget implementation performance report online quarterly.	State	<ul style="list-style-type: none"> Also essential for improving accountability and transparency. But action needs timeframe to be meaningful. Should target publishing implementation reports on average within or less than 4 weeks of quarter end by the end of the program 	DLI 1.1
5	Develop standard IPSAS compliant software to be offered to States for use by State and Local Government	Federal	<ul style="list-style-type: none"> Less impactful as States do not have to use FGN software to implement IPSAS 	No – as not state action

Objective 2: Increase Public Revenue				
6	1) Set realistic and achievable targets to improve independently generated revenue (from all revenue generating activities of the State in addition to tax collections) and ratio of capital to recurrent expenditure 2) Implementation of targets	State	<ul style="list-style-type: none"> Both increasing IGR and increasing the share of capital spending to recurrent spending are very relevant fiscal targets for States IGR growth targets should take into account the States' different starting points. However, there is a risk of setting soft targets if States are left to decide what is realistic and achievable. The IGR target could be set as a percentage increase relative to the States IGR collection for the previous year. A basic and stretch result can account for different IGR growth potential. A risk that in focusing on IGR growth, States may impose arbitrary taxes creates an uncertain business environment. The private sector is already concerned with the unpredictability of State-level taxes. To mitigate against the risk, States should also be encouraged to regularize taxes, put all State IGR sources in one tax code to ensure not overlap and make the tax code accessible to all taxpayers by publishing the code. Expenditure ratio: While the growth in recurrent spending has made it challenging for States to consolidate fiscally during the crisis, increasing the ratio may have little benefit if capital spending is inefficient and public investment management is weak. 	<p>DLI #4.2</p> <p>DLI #4.1</p> <p>No</p>
7	Implement a centralized Treasury Single Account (TSA) in each State.	State	<ul style="list-style-type: none"> Potential for fiscal impact is high – to improve cash management and save on financing costs, to improve revenue collection by reducing revenue leakages from MDA remittances of service fees and to reduce liquidity risks. The FGN and some States already have benefit from implementing the TSA There can be different definitions and level of functioning for TSAs. In order to be effective to reduce unnecessary financing costs, TSAs need to be based on a formal cash management strategy. In order to reduce revenue leakages and contribute to increasing revenues, MDAs should not keep any receipts in different bank accounts at commercial banks but bring them into the TSA 	DLI #3
8a.	Quarterly financial reconciliation meetings between Federal and State Governments to cover VAT, PAYE remittances, refunds on Government projects, Paris Club and other accounts	State/ Federal	<ul style="list-style-type: none"> The responsibility for these meetings lie also with the Federal (FIRS). The reconciliation meetings will in the future no longer be necessary when the FIR eservices platform is rolled out to States 	No – as may not be relevant in the future

8b.	Share the database of companies within each State with the Federal Inland Revenue Service (FIRS). The objective is to improve VAT and PAYE collection.	State/ Federal	<ul style="list-style-type: none"> The responsibility for these sharing of databases is also with the Federal (FIRS) as well as with the States 	No – as not fully within States’ control
9	Introduce a system to allow for the immediate issue of VAT / WHT certificates on payment of invoices.	State/ Federal	<ul style="list-style-type: none"> The e-Services system developed by FIRS is in the process of being rolled to States as this was made as a condition for disbursement of funds (extension of BSF) to States in August and September 2017 	No – as rolled out in most States by end 2017
10	Review all revenue related laws and update of obsolete rates / tariffs.	Local/State/Federal	<ul style="list-style-type: none"> Reviewing and updating revenue laws without an aim is not going to be impactful. Also updating individual revenue laws is not going to address the issue of overlapping taxes. 	Modify with DLI #4.1
Objective 3: Rationalization of Public Expenditure				
11a	Set limits on personnel expenditure as a share of total budgeted expenditure.	State	<ul style="list-style-type: none"> While personnel spending has grown rapidly and requires management, efficiencies also exist on overhead spending (goods and services). This indicator also does not address the issue of falling capital spending as a share of total spending 	No
11b	Biometric capture of all States’ Civil Servants will be carried out to eliminate payroll fraud.	State	<ul style="list-style-type: none"> Many states have done biometric capture but it is not linked to payroll. Those states that have done so have been able to reduce their personnel spending (for example, by removing ghost workers) so states should be encouraged to link the biometric capture to payroll. In addition to biometric data, Bank Verification Number (BVN) data can be linked to payroll to reduce fraud 	DLI #5
12a	Establishment of Efficiency Unit.	State	<ul style="list-style-type: none"> Many states have set up an Efficiency Unit, but it is not clear what these functions these units perform and what strategies they will use in order improve efficiency/value for money in public spending. A more specific and more effective action is to encourage implementation of specific public procurement reforms which aims to improve transparency as well as efficiency: e-procurement and open contracting, which are one of the OGP commitments. 	No No, replace with DLI #6
12b	Federal Government online price guide to be made available for use by States.	State/ Federal	<ul style="list-style-type: none"> This is not a high impact action by itself. Requires States to actively use cost benchmarking data 	No – as not a State action
13	Introduce a system of Continuous Audit (internal audit).	State/ Federal	<ul style="list-style-type: none"> This would be a more impactful measure if the audit system is risk-based and ex-post. Even so, it is unclear what the fiscal impact is expected from the audit system 	No

Objective 4: Public Financial Management				
14	Create a fixed asset and liability register	State/ Federal	<ul style="list-style-type: none"> This is important to support an accrual accounting system but most States are still struggling to implement IFSAS on a cash basis so this is not urgent/priority action at this point 	No
15	Consider privatization or concession of suitable State-owned enterprises to improve efficiency and management.	State	<ul style="list-style-type: none"> Privatization or concession of SOEs is not an option for many States and privatization by itself does not improve efficiency, it requires a strong regulatory and performance framework to be in place. 	No
16	Establish a Capital Development Fund to ring-fence capital-receipts and adopt accounting policies to ensure that capital receipts are strictly applied to capital projects	State	<ul style="list-style-type: none"> Unclear the magnitude of capital-receipts versus general budget allocation to capital spending. 	No
17	Domestication of the Fiscal Responsibility Act (FRA).	State	<ul style="list-style-type: none"> Although adopting the laws are not sufficient to guarantee compliance, it provides an important framework for debt management and fiscal responsibility, strengthening the State Debt Management departments that have been set up, formalizing that what they do is required. To be effective, needs to specify details on the key provisions that need to be included in the state FRA or state public debt legislation 	DLI #7.1
Objective 5: Sustainable Debt Management				
18	Attainment and maintenance of a credit rating by each State of the Federation	State	<ul style="list-style-type: none"> It will be difficult to motivate States to do this at a time when most States would get a poor credit rating and would find it difficult to issue bonds on the capital markets. This would be only relevant to a small number of States already in a relatively strong fiscal situation. 	No
19a	Federal Government to encourage States to access funds from the capital markets for bankable projects through issuance of fast track Municipal bond guidelines	State/ Federal (SEC/DMO)	<ul style="list-style-type: none"> Municipal bond guidelines would only be relevant to a very small number of States already in a relatively strong fiscal situation and looking to issue bonds. 	No – this is a FGN action

19b	<p>Full compliance with the FRA and reporting obligations, including: No commercial bank loans to be undertaken by State [without prior approval from FMOF];</p> <p>Routine submission of updated debt profile report to the DMO</p>		<ul style="list-style-type: none"> This is an important measure to sustain. If the expansion of borrowing by States from commercial banks pre-crisis had been more controlled and there was stronger monitoring of the state debt dynamics, the crisis could have been smaller in magnitude and measures taken earlier to prevent it from worsening. But the enforcement can be done through the CBN supervision of Banks, not relying on the States. The debt profiling reporting needs timelines and quality element to make it impactful as now all States are submitting reports but often late and incomplete 	<p>No</p> <p>DLI #7.2</p>
20	Publish a benchmark rate for Municipal loans to achieve greater transparency.	CBN	<ul style="list-style-type: none"> Only relevant to a very small number of States already in a relatively strong fiscal situation and looking to issue bonds. 	No – this is a CBN action
21	<p>Ensure total liabilities (debt) do not exceed 250 percent of total revenue for the preceding year.</p> <p>Monthly debt service deduction is not to exceed 40 percent of the average FAAC allocation for the preceding 12 months.</p>	State/ Federal	<ul style="list-style-type: none"> Ongoing compliance with solvency and liquidity thresholds are important for ensuring that state debt does not expand in an uncontrolled and unsustainable manner. The use of debt to revenue ratio is necessary as state-level GDP estimates do not yet exist. <p>However, to be effective the following modifications need to be made:</p> <ul style="list-style-type: none"> The ratios should become challenging over time as States fiscal situation improves. The ratio of total debt to revenue in the FSP was set higher than the ratio of 50 percent in the FRA, to accommodate the increased borrowing by States in 2015-16. But as States fiscal situation improves, for example increase in IGR, the FSP ratio is likely to be too easy so the target ratio should fall over time towards the FRA ratio. For some states the target is likely to be very easy but for other states already a stretch, so this target should have a basic target (comply with FSP solvency threshold and falls over time) and a stretch target (debt stock falls more rapidly towards pre-crisis levels) It is more difficult to target a decline in the deductions from FAAC as States will need to pay debt service from the two financial assistance packages from FGN through these deductions 	DLI #9
22	In addition to the sinking fund, States are encouraged to establish a Consolidated Debt Service Account to be funded from the State's Consolidated Reserve Fund Account to a minimum of 5 percent of IGR	State	<ul style="list-style-type: none"> More important is to prevent ex-ante excessive debt accumulation in the first place, in particular domestic arrears which increased significantly during 2015-2016 and which does not have formal mechanisms to ensure that they are cleared in a timely manner (unlike FGN-backed loans or commercial bank borrowing). Even while total domestic arrears increased in 2016, 40 percent of States managed to stop accumulating arrears showing that it is possible even at present 	<p>No</p> <p>Replace with DLI # 8</p>

B2. Technical Soundness of the Program (Nigeria’s Open Government Partnership Action Plan)

17. **The technical soundness of the Open Government Action Plan has been assessed looking at the level of stakeholder ownership and commitment in the drafting and implementation of the Action Plan (2017-19), the strengths and weaknesses in the Action Plan design and implementation arrangements, and the extent to which the PforR operation and the TA component can help accelerate progress and address implementation gaps.** The assessment focuses on the OGP National Action Plan that has been in implementation since January 2017. The Action Plan is important for creating an environment of openness and for setting priorities that are jointly shared by government and non-state actors. The assessment draws on the midterm self-assessment report prepared by the Federal Government of Nigeria in September 2017, as well as the Bank’s previous and current engagements supporting open government, at global and country levels. International subject matter experts were also consulted on ways to support the implementation of the commitments in the OGP Action Plan.

18. **Action Plan ownership and commitment:** Domestic OGP processes require the equal involvement of government and non-government actors in the action planning process for the resulting Plan to be considered a “co-owned” product. In 2016, a National Steering Committee (NSC) was constituted for this express purpose. The Action Plan was developed in a consultative way that was consistent with OGP Guidelines on country consultations¹. There is indication of high-level commitment from the government as evidenced by the appointment of the Federal Ministry of Justice as the Coordinating Ministry and co-Chair of the NSC. At the subnational level, Kaduna State has formalized its membership to OGP while Kano and Anambra States have sent in letters of intent to join the OGP process and implement its principles. The Action Plan involves MDAs and non-state actors in the implementation and monitoring of the OGP Action Plan Commitments. OGP in Nigeria, like in many countries, is seen as a strong driver of political agenda on a range of issues; for implementing partners, it will be key to support commitments that are both technically and politically sound. A strong, coordinated voice from the non-government sector will also be important in sustaining government’s focus and commitment to OGP considering the upcoming 2019 elections.

19. **The design and implementation of the Action Plan has the following strengths:** (i) alignment with FSP and other state-level reforms through its four thematic areas of fiscal transparency, access to information, anti-corruption and asset disclosure, and citizen engagement and empowerment. Seven out of the 14 OGP commitments apply to state-level reforms in Nigeria; (ii) contains appropriate yet achievable actions that draw on international good practices for fiscal transparency; (iii) establishes the importance of a well-implemented FOI Act in support of more specific mechanisms for fiscal transparency; (iv) promotes cooperation between government and citizens as the norm in governance in Nigeria.

20. **The following are the key gaps in the design and implementation of the Action Plan:** (i) slow or limited² progress on 10 out of 13 Commitments (no information available on mid-term progress of Commitment #7) including Commitment #2 on open contracting; and (ii) strong reliance on technology solutions to engage citizens, which may be risky or ineffective without a

¹ https://www.opengovpartnership.org/sites/default/files/attachments/OGP_consultation%20FINAL.pdf

² https://www.opengovpartnership.org/sites/default/files/Nigeria_Mid-Term_Self-Assessment_2016-2018.pdf

review of access and incentives; (iii) lack of strong incentives for effective implementation at the state-level.

21. **Several factors could accelerate progress on the implementation of the commitments in the Action Plan:** (i) focusing on building CSO capacities on the technical areas of the planned reforms and commitments; (ii) providing technical assistance to states to implement commitments; (iii) creating a stronger coordination and buy-in for open government among states; (iv) strengthening the connection between Federal and state level OGP processes.

22. **The design of the PforR accounts for the gaps and leverages the key factors to support the implementation of the OGP Action Plan:**

- **Focusing on sub-national engagement in OGP.** Fiscal transparency and accountability mechanisms at the subnational level are weak. Seven out of the 14 OGP commitments apply to state level reforms in Nigeria, as concluded at the National OGP Retreat in Kaduna in October 2016. Application of key OGP principles at the state level will enhance service delivery efficiency and effectiveness, reduce corruption, and empower citizens. State governments can be part of the OGP in two ways: first, states implement related commitments in the current FGN Action Plan; and second, states can formally sign on to OGP. Currently, Kaduna State has formalized its membership to OGP while Kano and Anambra States have sent in letters of intent to join the OGP process and implement its principles.
- **Focusing on state-level implementation of OGP Commitments on budget and procurement transparency as the foundations of subnational fiscal transparency.** Commitments #1 and #2 (citizen participation in budget and open contracting) are supported by DLIs #2 and #6, respectively. The DLIs provide specificity to the Commitments and are attainable by the states regardless of their baseline capacity.
- **Increasing coordination across government.** Through the TA component, the OGP Secretariat focuses on systematically building capacities for MDAs and subnational governments on OGP. The OGP Secretariat also engages with the Nigeria Governors' Forum to increase uptake of open government principles among states, and to strengthen the coordination between Federal and State governments. The TA component also provides resources to develop a robust monitoring website that tracks state and MDA performance across the different OGP commitments and relevant DLIs.
- **Participation of actors from non-government sectors.** Not all states may have civil society groups that are actively working on fiscal transparency issues. Through the TA component, partnerships between international expert groups and domestic actors is a way to build local CSO capacity. For both budget and procurement transparency, existing international organizations can provide support to local actors, though this support needs to be responsive to the level of engagement and existing capacity in each State.
- **Supporting a mix of online and offline mechanisms for engagement.** The DLIs are calibrated taking into consideration the varying level of baseline capacities among states, by integrating technology and non-technology mechanisms for disclosing information and engaging citizens.

C. Program Expenditure Framework

23. **The overall expenditure program of the State Governments, represented by the medium-term expenditure framework (MTEF)³ of all 36 States** (extrapolated to 2021), will be leveraged and supported through the truncated program boundary under the PforR. The aggregated MTEFs (2018-2021) of all States shown in Table 4.2 have been disaggregated into (a) recurrent economic classification of expenditures, viz. (i) compensation of employees' (personnel), and (ii) goods and services (overheads), and (b) capital expenditures.

Table 4.2: Total MTEF estimated expenditures for 36 States

Expenditures	Years				Total
	2018	2019	2020	2021	
	(In Naira Billions)				
Recurrent	1,975	2,130	2,299	2,474	8,878
Personnel Cost	1,239	1,295	1,365	1,440	5,339
Overheads	736	835	934	1,034	3,539
Capital	3,068	3,072	3,074	3,078	12,292
Others	629	669	709	749	2,756
Total	5,672	5,871	6,082	6,301	23,926
USD (Billion)	18	19	20	20	77

Source: Federal Ministry of Budget & National Planning

24. **The overall expenditures under the States' MTEFs have been further disaggregated** to extract the States medium-term expenditures **that represent the 'financial and fiscal affairs sub-function of State Governments** under their General Public Services function - as defined by IMF Government Finance Statistics (GFS), 2001, in order to establish a boundary for the program of expenditures for the PforR operation. The key entities constituting the State Governments' 'financial and fiscal affairs' sub-function under the 'General Public Services Function' for the purpose of this Program are: (i) States' Ministry of Finance, (ii) the office of the Accountant General (if separate from Finance), (iii) States' Ministry of Budget and Planning, and (iv) States' Boards of Internal Revenue Services. Table 4.3 shows total MTEF expenditures for the 'financial and fiscal affairs' sub-function, including 996 billion naira of recurrent expenditures.

Table 4.3: Total expenditures under the Financial and Fiscal Services Sub-Function for 36 Statesⁱ

Expenditures	Years				Total
	2018	2019	2020	2021	
	(In Naira Billions)				
Recurrent	226	241	257	272	996
Personnel Cost	58	62	66	70	256
Overheads	168	179	191	202	740
Capital	247	366	485	605	1,703
Others	597	637	677	717	2,628
Total	1,070	1,244	1,419	1,594	5,327
USD (Billion)	3	4	5	5	17

³ Data supplied under courtesy of Federal Ministry of Budget and National Planning

Program Expenditure Framework

25. **The expenditure program boundary for the Program is defined as the total estimated recurrent spending by the states’ key finance entities that will be directly responsible for the Program activities for 2018-2021.** The state-level FSP and the fiscal transparency actions in the OGP NAP supported by the SFTAS Program is implemented by the states’ key finance entities: state ministries of finance⁴, state ministries of budget and planning, state boards of internal revenues (SBIRs), and state office of accountant generals. The key finance entities constitute the state governments’ ‘financial and fiscal affairs’ sub-function under the ‘General Public Services Function’ (Government Finance Statistics based). The state-level FSP and the fiscal transparency actions in the OGP NAP supported by the SFTAS Program covers the full scope of core functions and activities of these institutions.

26. **Implementation of the government program supported by the SFTAS Program** (i.e. the achievement of the DLIs) primarily requires staff time, consultants, workshops and training, which **corresponds to the recurrent spending of these key finance entities.** The expenditure program boundary for the Program is therefore defined as the total/aggregated estimated recurrent spending by the states’ key finance entities across the 36 state governments (given that we expect all states to participate in the Program) for the Program duration period of 2018-2021 as per the states’ latest MTEFs 2018 to 2019 and extrapolated for 2020 to 2021⁵. The expenditure program boundary excludes any capital spending as it is not anticipated that states will need to make material capital investments to implement the Program.

27. **The overall program expenditure framework for 2018-2021 is estimated at 996 billion naira/USD\$3.27 billion** – the total/aggregated estimated recurrent spending by the states’ key finance entities across the 36 state governments for the Program duration period of 2018-2021. Table 4.4 highlights that the IDA contribution amounts to a total of US\$750 million (23 percent) against an overall expenditure framework boundary of US\$3.27 billion over the four years. During the program implementation, the expenditure framework of the participating states will be monitored through the submission of the states’ annual audited financial statements, which contains details of the realized budgeted recurrent spending of the state, broken down by individual ministries, departments and agencies, which will allow the computation of the program expenditure framework.

Table 4.4. Program Expenditure Framework and Financing Sources (in US\$ million)⁶

Program Expenditure USD Million	2018	2019	2020	2021	Total
Financing Sources					
State Governments	588	599	635	694	2,516
IDA (PforR) Component	153	191	208	198	750
Development Partners	0	0	0	0	0
Total Financing	741	790	843	892	3,266

⁴ Which includes typically state treasury, state debt department, fiscal policy department

⁵ MTEFs for all the states were collected and provided by the Federal Ministry of Budget and National Planning

⁶ Relates to States’ expenditures under the Program

28. **Activities Excluded from the Program:** As defined above, the Program expressly excludes activities that do not meet World Bank policy on eligibility for PforR financing. State Governments through the Federal Government (the Borrower) shall ensure that the Program does not include any activities which, in the opinion of the World Bank, are likely to have significant adverse impacts that are sensitive, diverse, or unprecedented on the environment and/or have affected people, as defined in the World Bank policy on PforR financing, and/or Works, Goods, and Consultancy contracts above the Operations Procurement Review Committee thresholds. The World Bank will support Program execution to ensure compliance with PforR policy requirements during implementation. Based on the program activities to be implemented and the related deliverables, the exclusion of these activities will have no impact on the achievements of the results and the objectives under the Program.

D. Results Framework and M&E

29. **One of the major weaknesses of the 22-point FSP is the absence of a results framework that accompanied the plan of action,** compounding the lack of specificity of the actions descriptions in the plan itself. The absence of a results framework and a results chain/explanation of the plan's theory of change means that it is not clear how the different actions, which are a mixture of outputs, intermediate outcomes and outcomes, work together to contribute to the achievement of the 5 over-arching objectives of the FSP. Without indicators and baseline and (realistic) end targets in terms of the number of States achieving each of the indicators, it is also not possible to measure the overall impact of the implementation of the FSP across States.

30. **The FMOF commissioned an independent verification exercise of the implementation of the FSP actions across States.** The FMOF (HFD) engaged professional firms to carry out an assessment of the compliance of state governments with the pre-agreed milestones that each state set for implementing the Fiscal Sustainability Action Plan (FSP). The first phase of the exercise commenced on February 2017 and a preliminary report covering four (4) geo-political zones of North-West, South-West, South-East and North-Central was submitted in June 2017. The exercise is yet to be completed, with one of the source of delays the verification of the findings with individual States in the absence of clearly defined results framework and a verification protocol. The compliance results are also difficult to compare across states as they are relative to the states' individually defined milestones so 50 percent compliance could mean substantively different results in absolute terms across different states. Also, the verification exercise was solely focused on achievement of the individual actions and not on progress towards the 5 over-arching objectives.

31. **The detailed DLI matrix, verification protocols, results chain and results framework that is being defined as part of the Program will significantly strengthen the monitoring and evaluation of the FSP and OGP fiscal commitments.** In addition, as part of the Bank's technical assistance component, the FMOF Department of Home Finance (as the Program Coordination Unit and responsible for the Program M&E) and the OGP Secretariat will receive support to strengthen its monitoring and evaluation capacity.

32. **The strengthened M&E will facilitate demand-side engagement, peer learning and healthy peer competition among States.** Data on individual States performance against the DLRs verified by the IVA during the APA will be published by the PCU. Putting credible and timely information on the individual States performance in the public domain will help bring in demand

side actors who can hold state governments accountable and be another source of pressure for reforms. It will also facilitate peer learning and healthy peer competition between states that will help drive better results. This is one of the key recommendations from the PEA conducted.

E. Economic Rationale⁷

33. **Rationale for public provision and financing.** Fiscal and public debt management is a core function of government at all tiers of government. State governments account for on average 37 percent of total expenditure across three tiers of government, including the majority of spending in health and education. The Program seeks to improve fiscal management and sustainability at the State level to establish a foundation for States to eventually spend more and spend better in a transparent, accountable and fiscally sustainable manner to the benefit of its citizens. In addition, improving State fiscal management to prevent future state-level fiscal crises will reduce one major source of fiscal risks for the Federal Government and the need for costly financial interventions.

34. **Value added of the Bank's support.** The Bank's support is expected to add value to the Government's existing efforts in the following ways: (i) Bank financing will increase the financial incentives and capacity building support to States to undertake fiscal reforms, helping to maintain the credibility of the FSP and providing a boost to OGP implementation at the State-level; and (ii) the Bank's global knowledge and experience with implementation of fiscal management and PFM reforms will be helpful in incorporating international good practice to the reform process.

35. **The analysis estimates that the Program could have substantial fiscal impact in terms of increasing the fiscal resources for productive public expenditures at the state level.** The increase in fiscal resources are estimated as the difference between a base case 'without Program' fiscal scenario where states' fiscal performance during 2018-2022 continues on the same trajectory with a fiscal reform 'with Program' scenario where states' fiscal performance during 2018-2022 improves in terms of the Program's key result areas: collecting more revenues, improved expenditure efficiency and allocation, and strengthened debt sustainability.

Fiscal impact analysis methodology

36. **The fiscal impact is assessed in terms of the increase in fiscal resources available for 36 states and FCT for productive public expenditures as a result of participation in the Program.** The increase in fiscal resources is estimated as the difference between a base case 'without Program' fiscal scenario where the aggregated states' fiscal performance continue on the same trajectory with a fiscal reform 'with Program' scenario where states achieve the Program's key result areas. As a result, more resources are available for productive spending due to increased revenues (expanding the overall resource envelope), improved expenditure efficiency in terms of lower recurrent spending growth and shift in allocation of spending from recurrent (excluding interest and transfers) towards capital, and lower fiscal deficits which reduces borrowing requirements and future interest payments.

37. **The specific key assumptions on fiscal management and performance underlying the fiscal simulations for both scenarios are shown in the below table.** They are consistent with the results framework for this Program. The simulation is based on changes in the average

⁷ This section discusses the rationale for public financing of the Program, the valued added from the Bank support, and presents the analysis of the Program's potential fiscal impact. This analysis is consistent with the Bank guidelines. Operational Policy and Bank Procedure, Program-for-Results.

performance of the 36 states and FCT in total/aggregated as all states are expected to participate in the Program. The impact at the individual state level will depend on their starting point and specific improvements during the Program. Additional fiscal gains are expected from the improvements in fiscal transparency and accountability but these have not been quantified in the simulation. The timeframe used in the simulation is limited to 2018-2022 to illustrate the impact of fiscal reforms during 2018-2021. The changes in states' fiscal behavior as a result of the Program is expected to continue beyond 2021, so there would be additional impact beyond 2022.

Table 4.5: Key Fiscal Assumptions for Base Case and Fiscal Reform Scenarios

Key Fiscal Drivers for 36 states and FCT	Base Case 'without Program' Scenario 2018-2022	Fiscal Reform 'with Program' Scenario 2018-2022	Impact of Program
Average IGR annual growth (nominal)	15 percent <i>In line with nominal GDP growth</i>	25 percent	Higher IGR growth
Average annual recurrent personnel and overhead expenditure growth (nominal)	13.5 percent <i>In line with CPI</i>	7.5 percent	Lower growth due to efficiency gains
Average annual capital expenditure growth (nominal)	15 percent <i>In line with nominal GDP growth</i>	20 percent	Higher growth due to increased fiscal space
Average fiscal balance (as a share of national GDP)	-0.9 percent	-0.6 percent	Lower deficit due to higher IGR & lower total spend

38. **The potential increase in the average annual fiscal resources available for productive public expenditures for all states as a result of the Program is substantial.** States increase their annual capital expenditure in the reform scenario compared to the base case by 192 billion naira on average per year. In addition, the average annual fiscal deficit is lower by 710 billion naira in the reform scenario compared to the base case (even with higher capital spending due to increased revenues, lower personnel and overheads expenditure and interest payments). States therefore still have room for additional productive spending while reducing their deficit and gross and net borrowings. The additional fiscal resources are larger than the estimated annual Program costs (as defined by the Program expenditure boundary) for 2018-2021: US\$3.27 billion (N996 Billion) for four years or USD 816 million (N249 billion naira) on average per year.

Table 4.6: Fiscal Outcomes and Indicators for Total/Aggregated 36 States, including FCT, 2018-2022

Nominal Naira (Billions)	Base Case 'without Program' Scenario Average 2018-2022	Fiscal Reform 'with Program' Scenario Average 2018-2022	Impact of Program
Total annual revenue	5,532	5,942	Higher
Statutory Transfers	3,921	3,921	Same
IGR collected	1,537	1,947	Higher
Total annual expenditure	7,277	6,977	Lower
Interest	810	712	Lower
Personnel and Overheads	3,387	2,994	Lower

Capital	2,575	2,766	Higher by 192
<i>Interest/Revenue ratio</i>	13.6 percent	11.3 percent	Lower
Total annual fiscal balance	-1,745	-1,035	Lower by 710
<i>Fiscal balance as a share of national GDP</i>	<i>-0.9 percent</i>	<i>-0.6 percent</i>	Lower
Total annual gross borrowing	3,713	2,843	Lower
Total State debt stock at end of 2022	13,768	10,220	Lower
<i>Total State debt stock to State total revenue at end 2022</i>	189 percent	126 percent	Lower
<i>Total State debt stock to national GDP at end 2022</i>	5.3 percent	4.2 percent	Lower

F. State Fiscal Political Economy Analysis and Implications on SFTAS

Introduction

39. **The proposed PforR Program needs to be responsive to the political economy dynamics that shape State fiscal performance and accountability.** Nigeria is administered through a federal system with three tiers of government (federal, state and local). Within this system, the complex Federal-State relationship is characterized by political incentives that can hinder coordination and cooperative action between the two tiers of government. The ability of the federal government to influence state fiscal management, as well as within state incentives to improve fiscal transparency, accountability and sustainability, shape the space for reform. Understanding the political economy dynamics that shape State fiscal performance and the relationship between the Federal and State level is critical for designing an effective Program. As part of Program preparation, the Bank⁸ undertook a focused analysis of the political economy of fiscal management at the State level. This section provides a summary of the key findings and operational implications of the political economy analysis study conducted during the preparation for the SFTAS operation.

Fiscal federalism – key dynamics affecting State Fiscal Performance

40. **The federal-state relationship is complex and still evolving.** Nigerian federalism has been pivotal for political representation and economic accommodation in a large, ethnically and geographically diverse country. The system devolves extensive political autonomy, financial resources, and service delivery responsibilities to subnational governments, particularly states. A central consideration has been the need to manage perceptions of equity between the six geopolitical zones, as well as states.

⁸ Led by consultants William Kingsmill and Gareth Williams from The Policy Practice, UK, with research assistance from Alisha Patel. They were directed and supported by Rachel Lemay Ort, Public Sector Specialist, World Bank. The work comprised of a literature review, a specialist workshop in London in July, and a mission to Abuja in September 2017. The Abuja mission included 2 focus group meetings with key informants and academics knowledgeable about public financial management reform in Nigeria, 2 focus group discussions with state Commissioners of Finance, Permanent Secretaries and Accountant General, a consultation with the National Assembly and several other bilateral meetings.

41. **The Nigerian Constitution provides States with a high degree of fiscal autonomy.** Most notably, financial allocations to the states from federal revenues, the monthly FAAC allocations⁹, which for most constitute their major source of income, are provided without conditions or accountability requirements.

42. **The federal government does not have many automatic levers it can pull to influence state performance and priorities.** Vertical accountability to the federal government has been difficult to achieve. Given the degree of state autonomy, there have been few formal avenues for the federal government to influence how state resources are managed. The federal government's own performance on achieving fiscal sustainability and transparency is perceived to have been weak, which limits its influence and ability to lead by example.

43. *The FMOF may not be able to fully enforce the reforms in the FSP as conditions for financial assistance when there is a fiscal crisis. The Program should ideally facilitate various sources of pressure and incentives to encourage the implementation of the FSP. This includes: bolstering the oversight capacity of the FMOF; harnessing peer healthy peer competition between states; putting credible information on states' performance into the public domain so that demand-side actors can better engage with the implementation of reforms. The Bank's support to the Federal Government to strengthen fiscal management and governance should help the federal government strengthen its ability to lead by example.*

State fiscal performance heterogeneity

44. **Within state dynamics have a powerful influence on state fiscal performance.** The nature of political leadership and electoral incentives are important non-technical drivers. Examples of public sector effectiveness in Nigeria reveal that leadership plays a critical role in reform. More specifically, strong technical skills can achieve results when state political leaders consign the policy process to specialists, devoting their political energies to removing impediments for technical staff. While leadership (e.g. governors, deputy governors, permanent secretaries) may have interest in strengthened fiscal management, their ability to deliver on this agenda is influenced by the need to manage electoral politics.

45. **Major differences can be observed in the political economy contexts of different states.** This has significant implications for prospects for fiscal reforms and large differences in performance are likely to be observed. For example, some newly elected governments face expectations from supporters for to promote specific agendas through the use of public funds. Second term administrations may be less constrained by these dynamics. Sources of countervailing pressures on special interests include civil society organizations, media, state legislatures, as well as the role of the middle classes and private sector. These pressures are variable between states.

46. *The implications for the Program is that it should be designed so that it creates incentives for a wide range of States with different starting positions and political economy contexts and that large differences in performance between states should be expected. For example, some DLIs should be linked to incremental changes measured against state specific baselines rather than comparison against an absolute standard. These differences can be used as an incentive for*

⁹ Allocations made by the Federation Account Allocation Committee (FAAC). States are keen to point out the resources of the Federation Account do not belong to the federal government

improved performance, so long as differences in rewards do not become too pronounced and lead to complaints of unfairness that undermine the legitimacy of the operation.

Opportunities from Nigeria's fiscal crisis

47. **The Program is being designed against the background of the worst fiscal crisis experienced by Nigeria since the first half of the 1980's (which included President Buhari's first term in office).** The economy is slowly coming out of recession; however, States continue to experience fiscal stress and continue to recognize the need for fiscal reform. Recent financial assistance packages provided by federal government to the states have resulted in a significant strengthening of debt management and control by the federal government.

48. *States can be expected to be receptive to the PforR agenda and the financial incentives attached given their absolute need for additional financing. The Program should take advantage of federal government's increased influence over states' debt management. This creates a strong potential to make progress through DLIs relating to debt management.*

Open Government Partnership

49. **The OGP initiative is closely linked to the current administration. Commitment and buy-in at the state-level has only just began.** *The Program should focus on OGP issues that are linked to the FSP which has broader political commitment (i.e. issues of fiscal transparency). Additional OGP issues could be covered in the future as political commitment to the OGP strengthens.*

Impact of 2019 Elections

50. **The run-up and follow-up to the February 2019 elections may have a significant impact on prospects for fiscal reform.** But the impacts are uncertain (and likely to remain uncertain) and will vary from state to state. In the run-up to February 2019, some states will be expected to show less interest in reforms supporting fiscal sustainability and transparency. On the other hand, some states where the government is seeking re-election may want to showcase their progress in fiscal reforms. The overall prospects for state fiscal reform may be better after February 2019, depending on the outcome of elections, and is likely to vary from state to state.

51. *The implications include that the elections need to be factored into the Program implementation. It would be preferable that the first set of PforR disbursements occur after the election to mitigate risks that the financing could be used towards campaign financing. to the expectations of disbursement levels during the different years of the Program. New Governors should be incentivized to show commitment to sustaining reforms started under predecessors.*

Motivating the civil service

52. **The civil service is critical to implementation of the fiscal reforms.** The motivation of civil servants depends on a broad set of incentives, including remuneration, but also non-monetary incentives including professional pride, association with some high-profile policy initiatives, and opportunities for training and certification. Motivation is easily undermined by some Governors' tendencies to by-pass the civil service and deliver using consultants.

53. *The implications for the Program are that the design should look to strengthen non-monetary incentives for civil servants. This could include using the TA component to support*

attractive training and certification programs for civil servants connected to implementation of the FSP/Program reforms. This could help to build a cadre of professionals or 'FSP teams' to implement the reforms. It would also be highly desirable to find a means of engaging with Governors and their immediate staff - Chiefs of Staff, selected Special Assistants - to build their economic and financial fluency and capacity to lead a reform process.

Communications

54. **There is a danger that many stakeholders will misunderstand the relatively new concept of the Program.** *It is important to have a strong communications strategy that differentiates between the different key stakeholders, including at federal level. The National Assembly is a critical player, as well as the whole Economic Management Team, the media and CSOs. It would be helpful to have tailored messages for each actor. At the state level it is essential that Governors are engaged, as well as Commissioners, civil servants and citizens.*

Credible information on fiscal performance

55. **Credible information is often lacking, often deliberately, on government performance, including on fiscal management.** *States are prepared to accept differences in disbursements if they perceive that the performance of States have been fairly and objectively assessed.*

56. *To be credible, and to maintain confidence and legitimacy, the state performance results need independent verification using credible and appropriate data sources. States need to fully understand the verification process so that it is perceived as consistent and fair to all States.*

Demand-side engagement and harnessing peer competition

57. **The Program should itself be consistent with the transparency and accountability focus of the FSP and OGP.** *Accountability requires active participation by the institutions of accountability and by citizens. Accountability pressures acting on the executive government are currently weak. However, Governors are often influenced by the experiences of peers/other states.*

58. *The Program can facilitate accountability and harness peer learning and competition among States. The Program's monitoring and evaluation activities will put credible and timely information on states' performance into the public domain so that demand-side actors can better engage with the implementation of reforms and at the same time create healthy peer competition between states. The TA component will strengthen mechanisms for regular peer exchange and learning.*