STATE OF STATES

The Debt Overhang

Background

In the last year, Nigeria has experienced significant macroeconomic and fiscal imbalances. Following the continued decline in oil revenues since mid-2014 amidst slow policy responses, the economy gradually slowed into negative growth in 2016. Fiscal deficits have remained wide, debts are rising, and governments are faltering on public sector wages. The economy's prospects have continued to diverge from those with more diverse revenue sources. Among urgent reforms needed are actions to rationalize government expenditure and improve domestic revenue mobilization to ensure that the country transits into fiscal sustainability.

The current environment of lower oil prices adds urgency to long-standing efforts to reduce the country's widespread fiscal vulnerabilities. Although the government has initiated significant measures of fiscal reform and consolidation, including four bailout packages for State governments[1], these measures are unlikely to be adequate or consistent with inter-temporal fiscal sustainability. Public sector wage bills are among the key threats to fiscal sustainability at the sub-national level, costing up to 40 percent of the total expenditure of States according to recent reports by the NGF[2].

This paper provides an update on Nigeria's fiscal crisis, specifically on the debt profile of State governments. Debts data are based on details of salary and pension arrears for States, local governments and other agencies and parastatals as at 30th April 2017, and debt servicing from federation allocation, including deductions for contractual obligations (irrevocable standing payment orders), bond issuance, restructured commercial bank loans, excess crude account-backed loans, salary bailout, foreign loans and others.

The paper is organized in two parts. The first part lays out the stylized facts about the debt environment across the 36 States of the federation. It underlines the largely homogenous negative fiscal condition of States, which heightened with the slump in oil revenues and continued to worsen after bailout responses from the federal government. It also shows that government reforms targeted at maintaining fiscal stability through the use of bailouts have not been sufficient in pulling States out of the crisis. The second section suggests more contextualized policy responses given the constrained fiscal space, as part of ongoing reforms to improve fiscal stability in the country.

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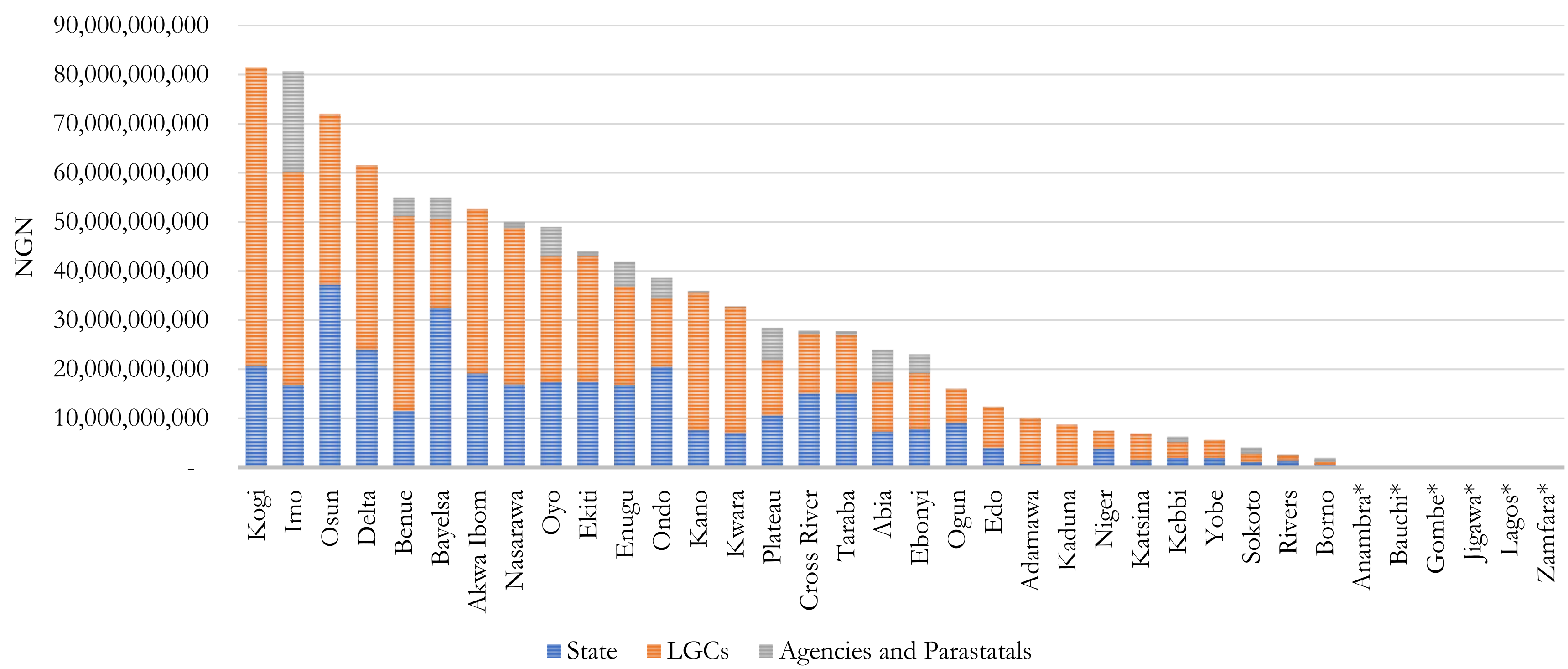
[1] In July 2015, the federal government released three bailout facilities to State governments – an excess crude account-backed loan facility for 34 States, a salary bailout for 31 States, and restructured commercial bank loans for 23 States. One year after, in June 2016, the government announced a one-year budget support facility of N14.16 billion per State to 35 State governments.

[2] Based on the report of the fiscal sustainability of States, April 2017

The Outsized Arrears: salaries, allowances, pensions and gratuities

Total arrears owed to employees of States, local governments and other State agencies and parastatals was recorded as N963 billion – around 1 percent of the country's GDP[3] and nearly 40 percent of the total recurrent revenue[4] of States. The amount is owed by 30 out of the 36 States of the federation excluding Anambra, Bauchi, Gombe, Jigawa, Lagos and Zamfara where no outstanding was reported. These debts vary across States, from as high as N81.5 billion in Kogi State to a median of N28.4 billion in Plateau and N2 billion in Borno State (see figure 1). Overall, the 3 most indebted States were Kogi (N81.5 billion), Imo (N80.7 billion) and Osun (N71.9 billion).

FIGURE 1: ARREARS OF STATES, APRIL 2017



Data Source: State Ministries of Finance, Federal Ministry of Finance, 2017
Notes: * arrears reported as nil.

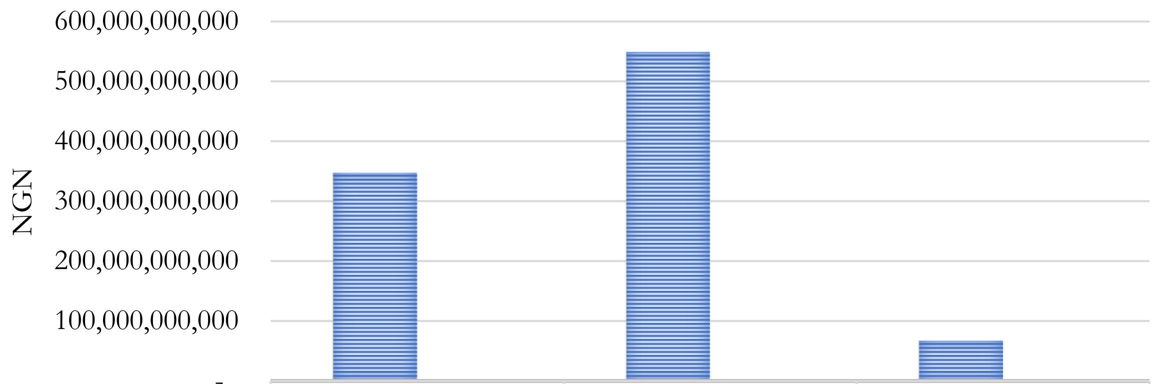
[3] Based on 2016 figures.

[4] Total recurrent revenue includes federation allocation and the internally generated revenue of States recorded as N2.4 trillion in 2016.

Arrears are the highest at the local government level

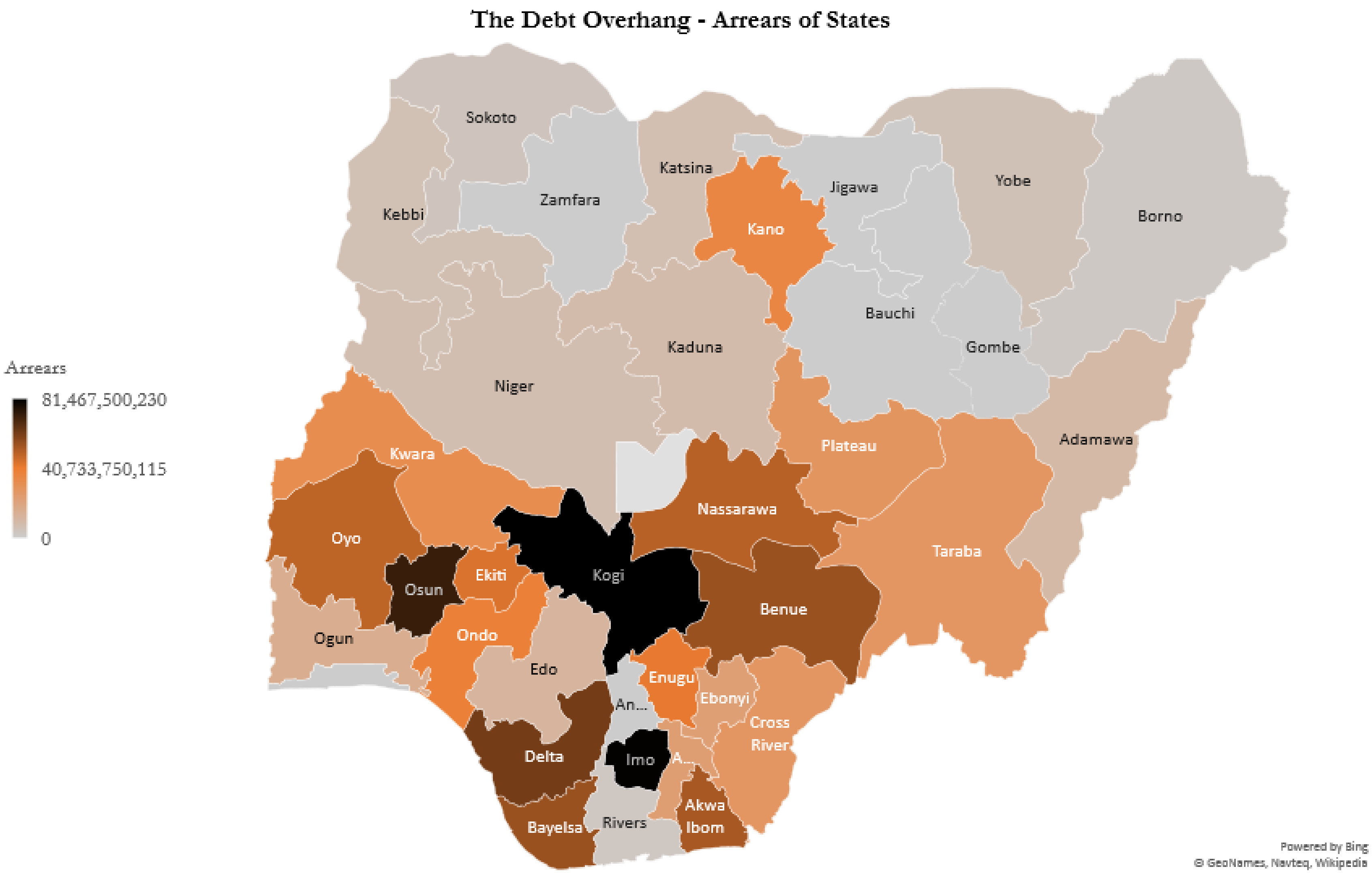
The highest number of employees affected are employed across local government councils (LGCs). Their total share outstanding was N548.6 billion (57 percent), compared with N347.2 billion (36.1 percent) for State officials and N67.2 billion (7 percent) for State agencies and parastatals (see figure 2). Pensions and gratuities for LGCs recorded the longest tenures of default for most States, reaching as far back as 1996 for Nasarawa, 2000 for Edo and 2003 for Borno.

FIGURE 2: DISTRIBUTION OF ARREARS



	State	LGCs	Parastatals
Total Arrears	347,225,082,610	548,592,332,194	67,160,070,309
Share	36.1%	57.0%	7.0%

Data Source: Author's computation based on data State Ministries of Finance, Federal Ministry of Finance, 2017



The Debt Overhang - Arrears of States
Arrears
81,467,500,230
40,733,750,115
0
Sokoto
Katsina
Zamfara
Kebbi
Jigawa
Yobe
Borno
Kano
Bauchi
Gombe
Kaduna
Niger
Adamawa
Plateau
Kwara
Nassarawa
Taraba
Oyo
Ekiti
Kogi
Osun
Benue
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Ondo
Edo
Enugu
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Ebonyi
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Delta
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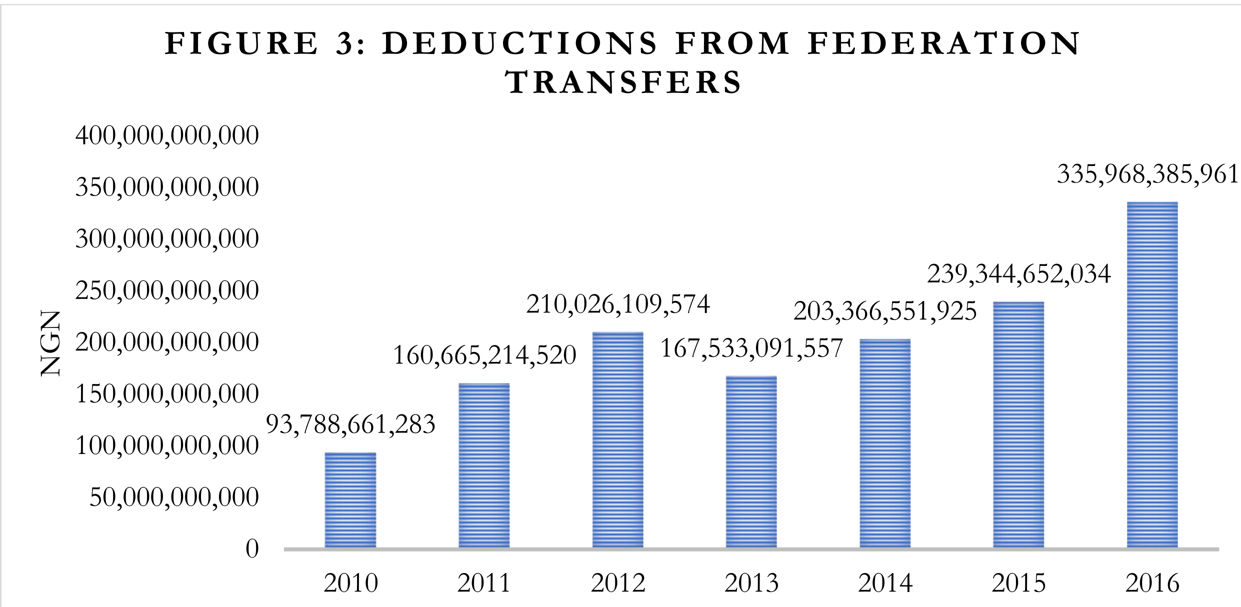
Trend in Federation Deductions

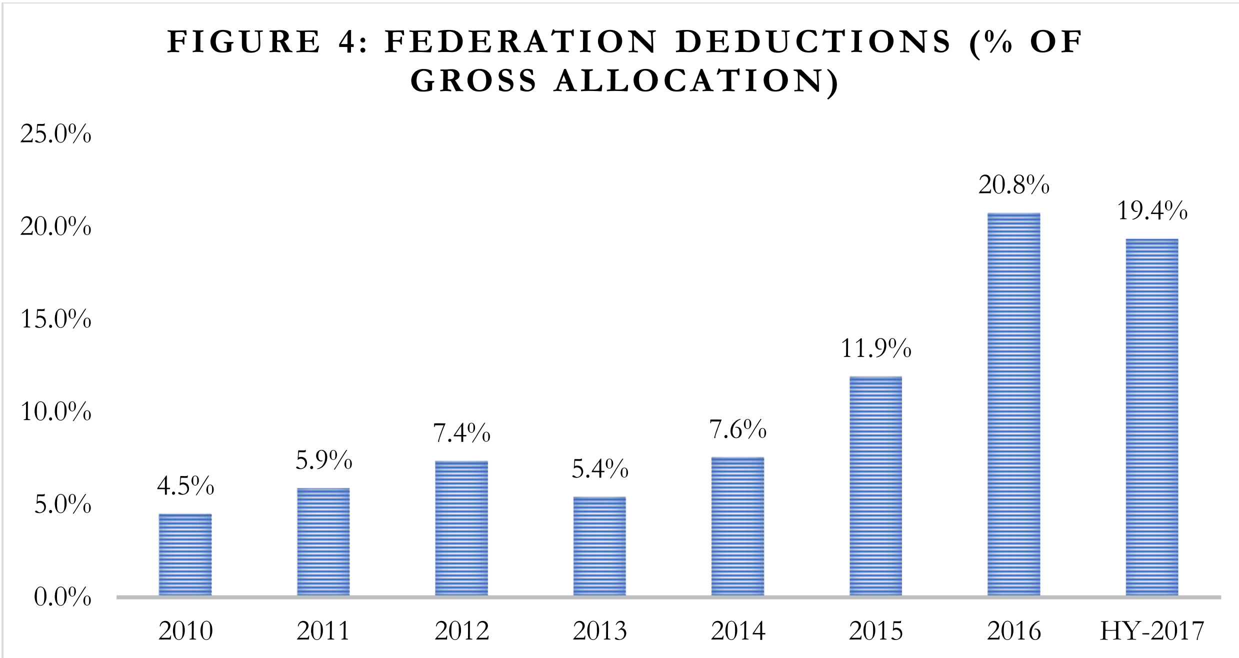
Federation deductions includes service payments for contractual obligations (irrevocable standing payment orders), counterpart funds, bond issuance, restructured commercial bank loans, excess crude account-backed loans, salary bailout, foreign loans and other loans deducted at source from States' gross federation revenues before transfers are made. Over the last 7 years, the amount has more than tripled from N93.8 billion in 2010 to N336 billion in 2016 (see figure 3). Following the introduction of bailout packages to States in 2015, federation deductions rose by more than 40 percent from N239 billion to N336 billion.



Data Source: Author's computation based on data from the Office of the Accountant General of the Federation, 2017

The pressures of federation deductions are startling when compared in terms of the share of States' gross allocation. The trend became acute and destabilizing in 2016, when deductions (% of gross allocation) rose to 21 percent from 8 percent in 2014 and 12 percent in 2015 (see figure 4). The swing has also continued in 2017, reducing only marginally to 19.4 percent in the first half.

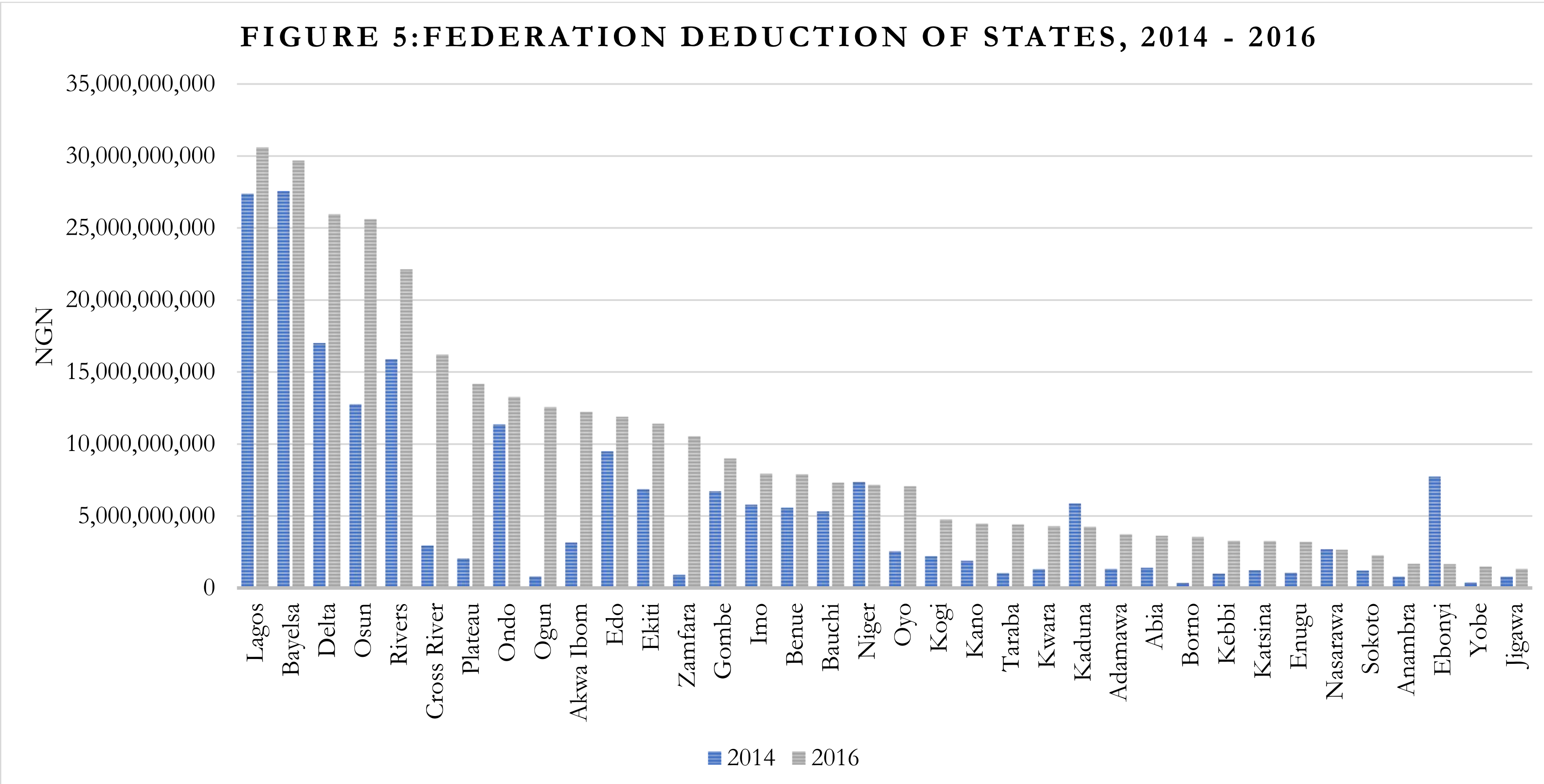
The phenomenon has created significant risks to the implementation of State budgets and even debt risks for others. For instance, Osun State defaulted on these service payments in December 2015, March, June and October 2016, when deductions were higher than the State's gross allocation.



Data Source: Author's computation based on data from the Office of the Accountant General of the Federation, 2017

Notes: HY-2017 refers to the period from January – June 2017

In 2016, federation deductions were highest for Lagos (N30.6 billion), Bayelsa (N29.7 billion) and Delta (N25.9 billion) and lowest for Ebonyi (N1.7 billion), Yobe (N1.5 billion) and Jigawa (N1.3 billion). Lagos state maintained the highest share as a result of its high foreign debt of N421 billion – nearly 40 percent of the total debts of the 36 States. The state is also financing two bond issuance programmes with the sum of N2 billion monthly. Bayelsa followed as a result of its high cost of ISPOs (N1.2billion monthly[5]) and restructured bank loans. Delta is financing among others, a bond issuance programme (N1.1 billion monthly) and restructured commercial bank loans (N920 billion monthly).

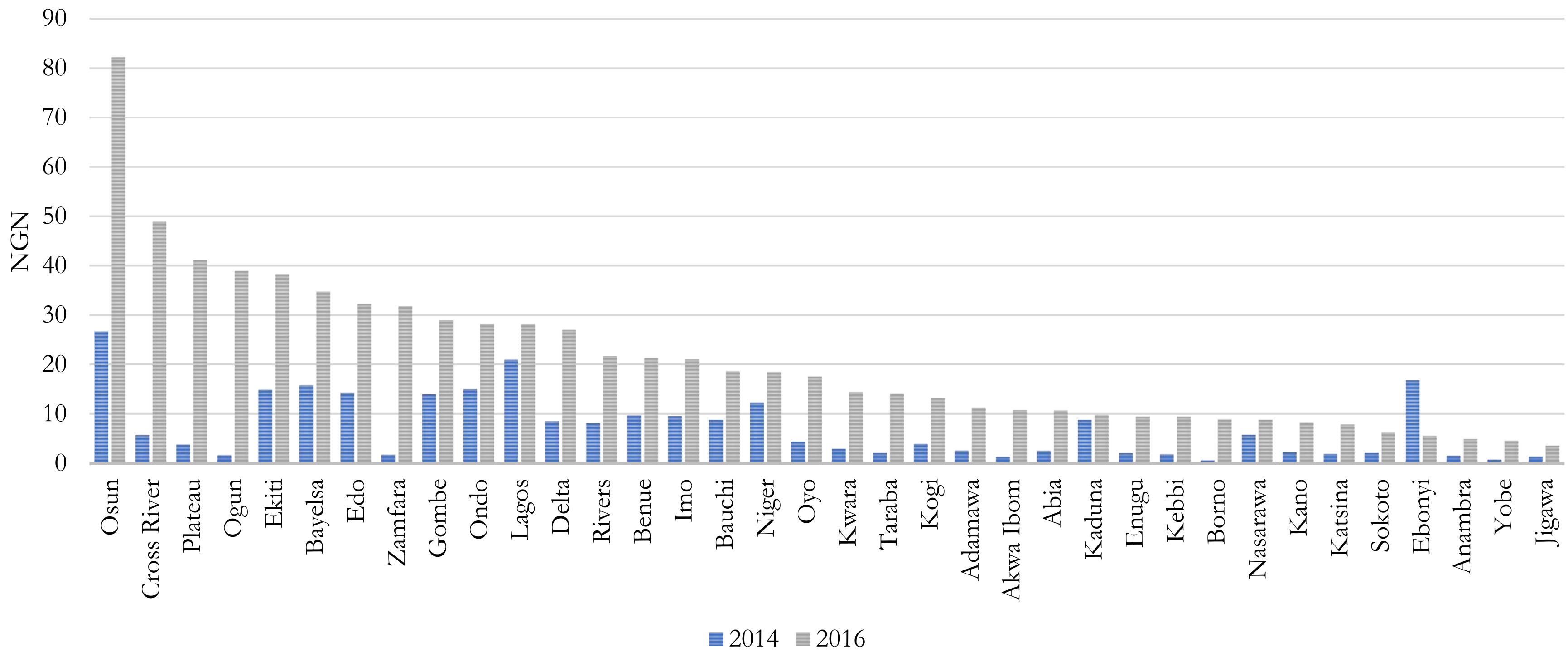


Data Source: Author's computation based on data from the Office of the Accountant General of the Federation, 2017

[5] ISPO financing has declined to N421 billion monthly in 2017.

In relative terms, Osun, Cross River and Plateau recoded the highest cuts from their gross allocation in 2016 – reaching 82 percent, 49 percent and 41 percent respectively. Since these States maintain relatively smaller federation inflows, the impact of deductions has been more destabilising, compared to Anambra (4.9 percent), Yobe (4.5 percent) and Jigawa (3.6 percent) that recorded the lowest share of federation deductions in the year.

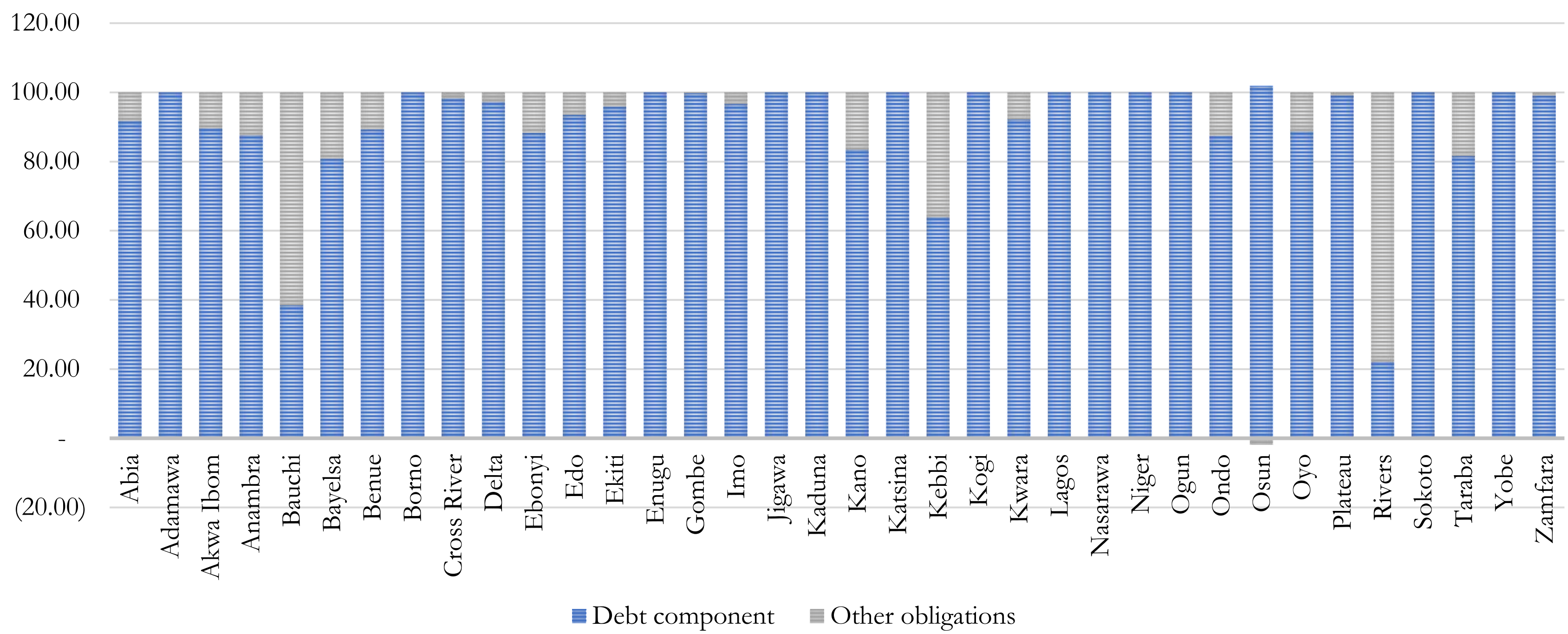
FIGURE 6: FEDERATION DEDUCTION (% OF GROSS ALLOCATION), 2014 - 2016



Data Source: Author's computation based on data from the Office of the Accountant General of the Federation, 2017

Debt financing continue to make up the largest share of federation deductions, with an average of 91 percent in 2016, with bailout-linked debts (ECA loan facility, salary bailout and restructured commercial bank loans) attributing for around 50 percent (see figures 7 and 8).

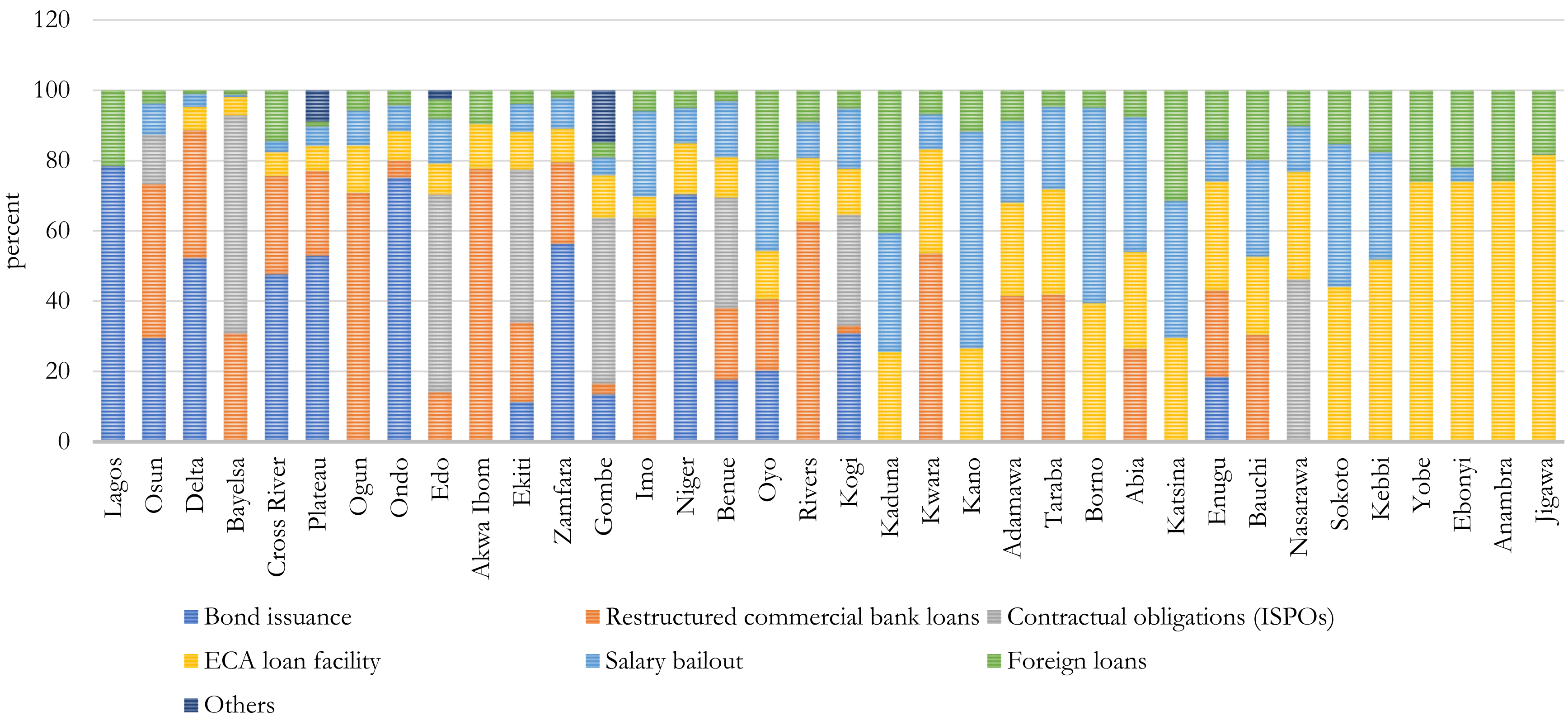
FIGURE 7: COMPOSITION OF FEDERATION DEDUCTIONS, 2016



Data Source: Author's computation based on data from the Office of the Accountant General of the Federation, 2017

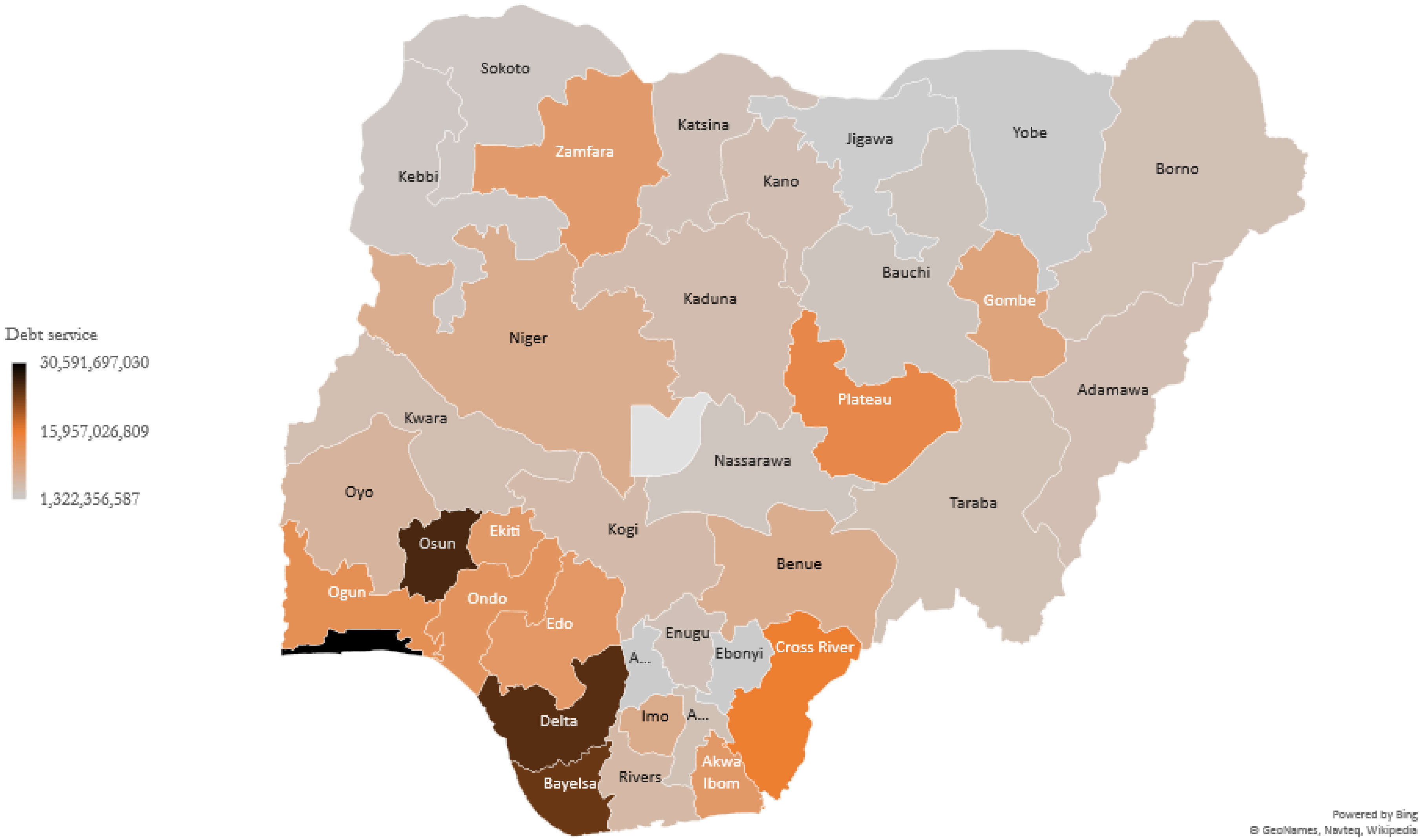
Notes: Debt component includes service payments for bond issuance, restructuring of commercial bank loans into FGN bonds, contractual obligations (ISPOs), ECA loan facility, salary bailout, foreign and other loans; while other obligations are services for counterpart funds such as the commercial agricultural credit and other refunds.

FIGURE 8: FEDERATION DEDUCTIONS, DEBT COMPONENTS, 2016



Data Source: Author's computation based on data from the Office of the Accountant General of the Federation, 2017

The Debt Overhang - Debt Servicing



Lessons

Although government policy responses in the last two years have targeted fiscal stability, risks have remained. Arrears for salaries, allowances, pensions and gratuities put at a record N963 billion as at 30 April 2017 are unlikely to be cleared in the short term for a number of reasons – including competing budgetary needs, pressures from rising federation deductions and low oil prices. This calls for among others, stronger fiscal consolidation and policy adjustments specifically targeted at public sector employment. Some of these include the following:

Full biometric exercise to eliminate payroll fraud. Although 29 States report to have carried out a biometric exercise for public-sector employees, this should cover all workers, including local government employees to ensure that they produce clean sheets for payroll implementation and save cost in the process.

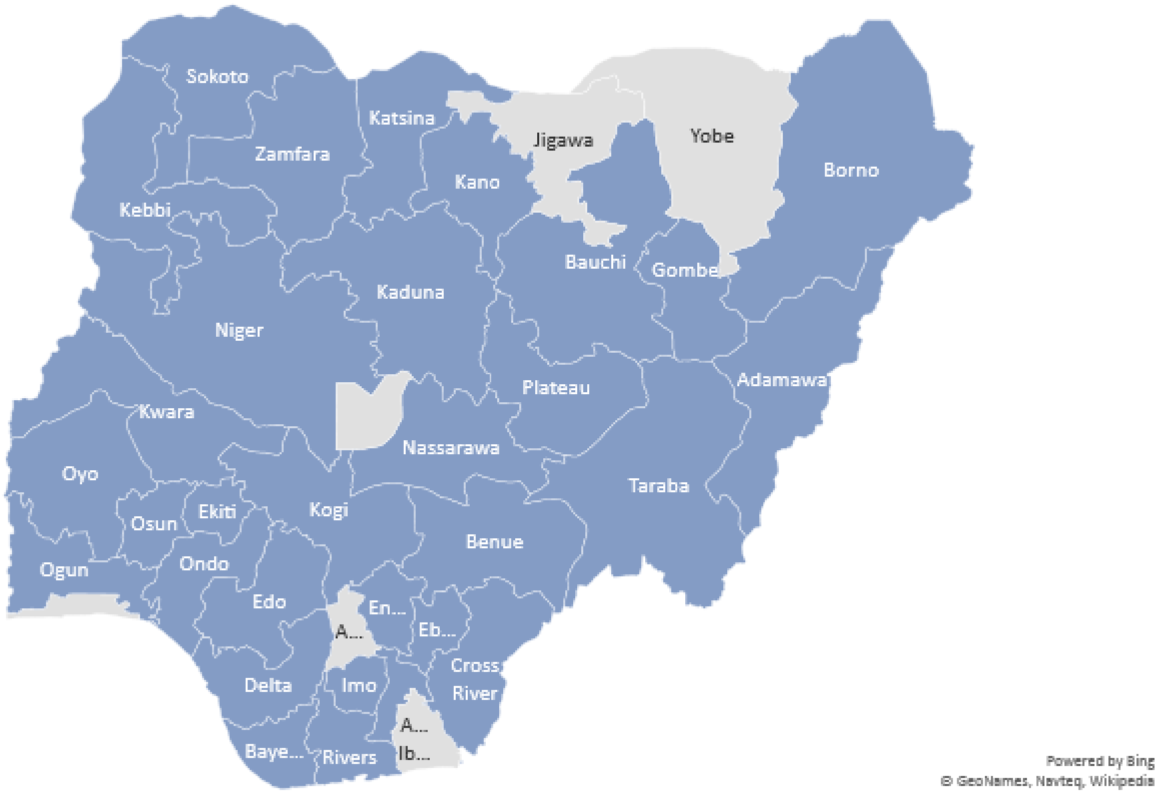
Reducing the excesses of public employment. Government must take deliberate steps to support a progressive reduction in the size of the public workforce and public wage moderation while also strengthening private-sector led employment growth. To support a reduction in the size of public employment, a civil service review can help identify nonessential positions that should not be renewed when they become vacant. This will facilitate a gradual rebalancing that will bring about productivity. Governments must also curtail the lure of using the civil service for patronage and as employers of last resort.

Improving the quality of government spending in education. Over the years, public sector jobs have continued to remain attractive to job seekers who are unable to find opportunities in the private sector. Notwithstanding the recuring wage crises, pressures for public employment has remained significantly high. Education investment should target skills most needed in the private sector, including entrepreneurship and vocational skills that are required to facilitate labour mobility from public to private sector jobs.

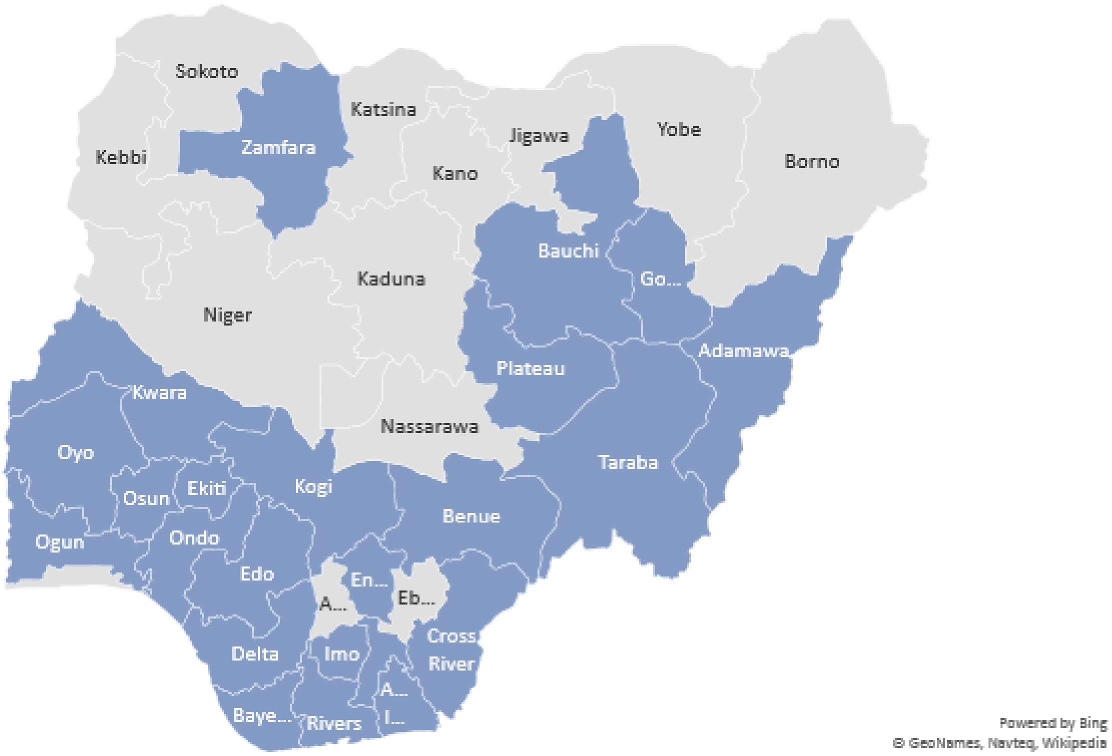
Providing unemployment insurance. Fiscal social contracts and other social investment programmes provide opportunities for governments to develop insurance schemes that provide the unemployed with a minimum income or social service in health, education or agriculture, while developing other long term measures.

APPENDIX

31 Recipients of FGN Salary Bailout



23 Recipients of FGN Restructured Commercial Loans



34 Recipients of ECA-backed Loans