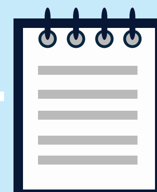
POLICY AND STRATEGY TOOLKIT



Guidance on the Preparation of the Financing Section in State Development Plans

Disclaimer

The opinions expressed in this toolkit are those of the authors and do not necessarily represent the views of the Foreign, Commonwealth & Development Office (FCDO)

1. Rationale and Linkages

The State Development Plan (SDP), or equivalent, is a high-level document that articulates the priority policies of the state and provides detail on how these policy priorities will be cascaded down both to the sector strategy level and also how they will influence the level and allocation of resources.

From a financial perspective, a substantial proportion of the SDP will be focussed on expenditure – what the State wants to achieve (Outcomes and Impacts) with its resources – this is defined as Sector Policies. This will feed into and inform the development of Medium Term Sector Strategies (MTSS), which lay out the detailed Activities and Outputs, and associated costings, that are needed to achieve the desired Outcomes and Impacts laid out in the SDP. The MTSSs are a core element of the Medium Term Expenditure Framework (MTEF) which is a key tool for linking policies to budgets.

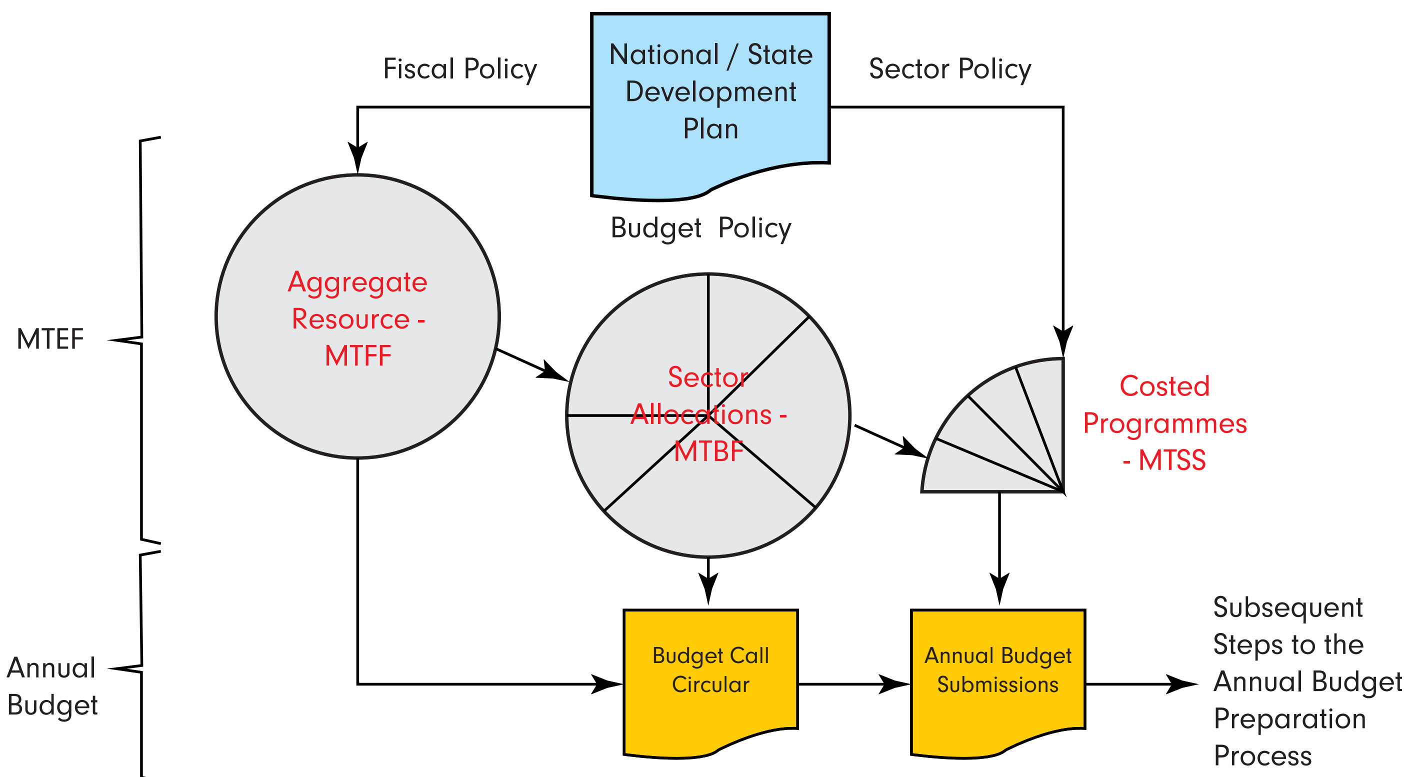
The SDP should also include comprehensive Fiscal and Budget Policies, thus providing a framework for aggregate resource estimation and for allocating these resources across the sectors. In doing this, the SDP lays the foundations for the other two elements of the MTEF:

- Medium Term Fiscal Framework (MTFF); and
- Medium Term Budget Framework (MTBF).

As noted, it is through the MTEF that the SDP translates itself into annual budgetary provisions and actual expenditure which result in activities, outputs, outcomes and impacts.

The MTFF and MTBF should dictate the envelopes issued as part of the annual budget call circular. Annual budget submissions from Line Ministries, Departments and Agencies (MDAs) should be based on their costed MTSSs. These linkages are shown in Figure 1 below.

Figure 1 Linkages between SDP, MTEF and Annual Budget

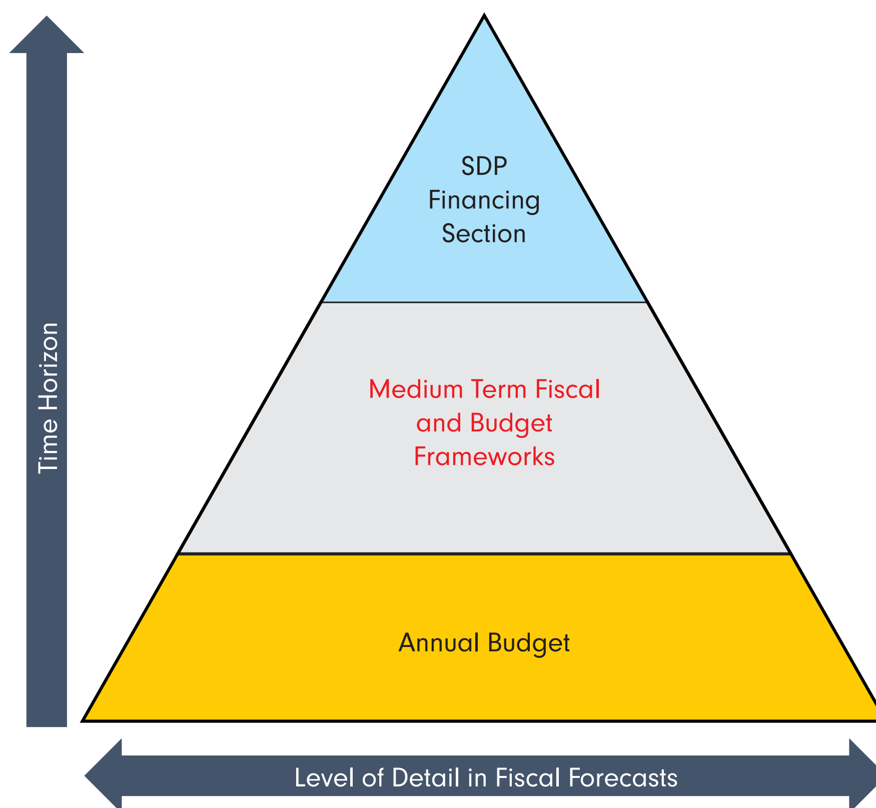


Whilst the SDP should ideally provide an indicative aggregate envelope for the period of the Plan, and indicative allocations to sectors, these will be superseded on an annual basis by rolling over the MTEF through the MTFF and MTBF, and then by the annual budget itself.

However, it is increasingly difficult to forecast resources as the time frame of the plan extends. If the time frame of the SDP is more than five years, it is recommended that any explicit forecasts of revenues and expenditure should be limited to five-year time horizons as forecasts beyond this time frame are highly error prone.

Figure 2 below shows the general principle of detail versus time horizon for the SDP and other top down financial planning documents.

Figure 1 Linkages between SDP, MTEF and Annual Budget

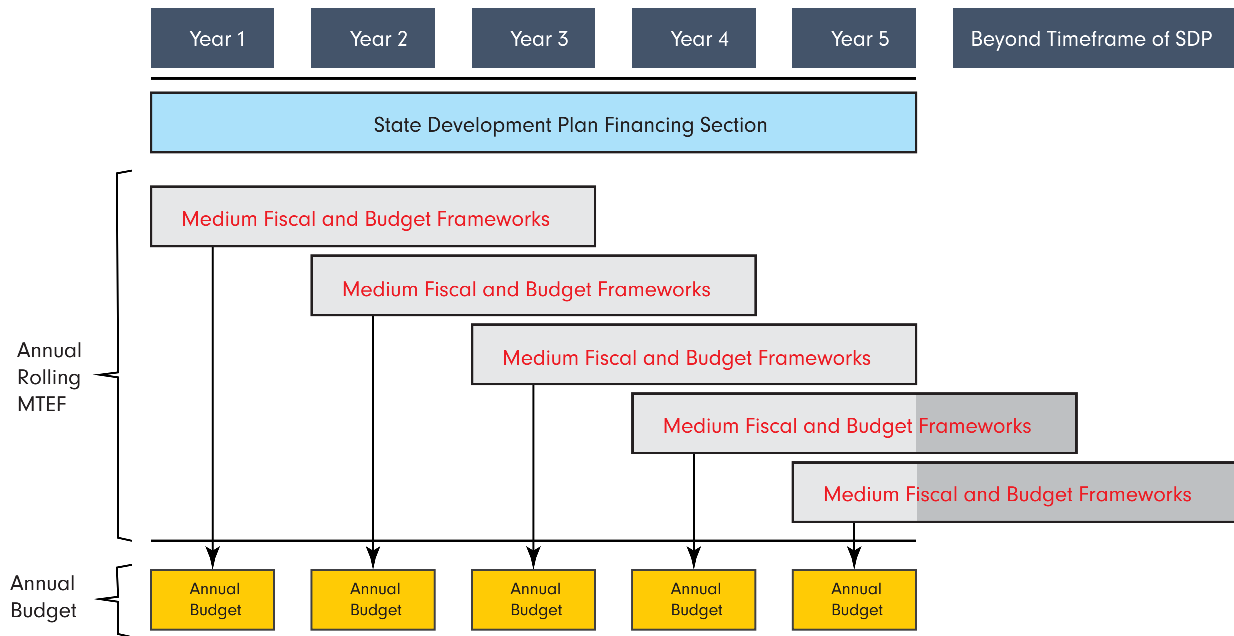


The above principle also applies to the bottom up costings of the SDP initiatives at sector level, costing of programmes in the MTSSs (usually covering three years, similar to the MTFF and MTBF), and the detailed annual budget submissions which are ideally done at activity level.

The overarching Fiscal Policy is what guides the technicians of the Ministries of Budget and Planning in developing the MTFF and MTBF, and guides ExCo and the SHOA in debating and approving the MTEF and the Annual Budget. It also provides citizens with a reference point for assessing the extent to which budgets reflect the fiscal policies of the state.

The intertemporal coverage and relationships between the SDP, MTEF (MTFF and MTBF) and the annual budget are shown in Figure 3 below – it is based on an SDP with a five year time horizon.

Figure 3 Example Time Coverage of SDP, MTEF and Annual Budget



The SDP financing section should provide a clear framework by which the technicians (MOF and MOPB), line ministries, the executive (ExCo) and the legislative (SHOA) prepare, review, debate, approve, execute, monitor and evaluate the annual budget.

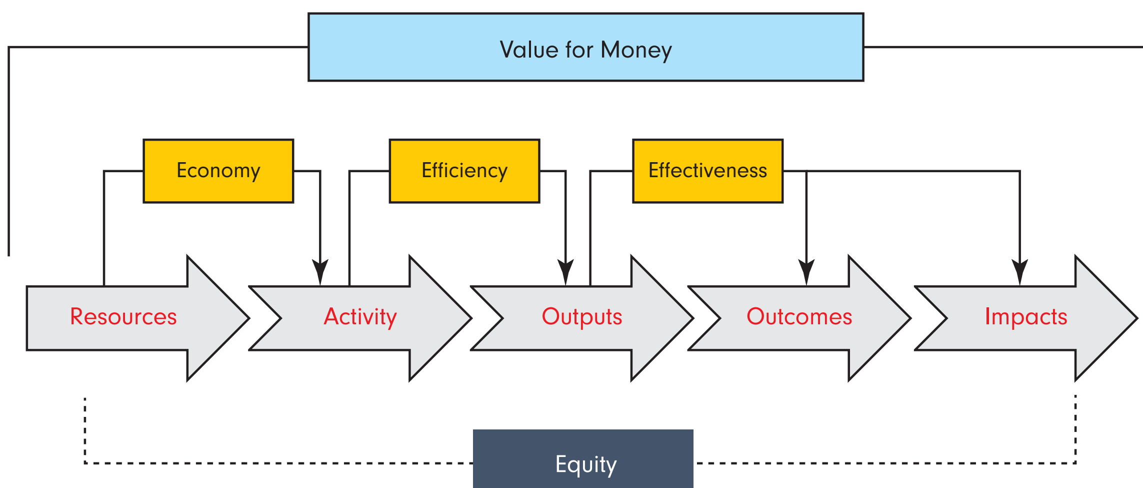
In summary, the Financing Section of the SDP should outline how the state is going to achieve two of the core objectives of Public Financial Management (PFM):

1. Aggregate fiscal discipline (expenditure control) – achieved through the MTFF;
2. Allocation of resources consistent with policy priorities (strategic allocation of resources) – achieved through the MTBF.

The third principle of PFM is "Value for Money" (VfM) which is usually defined in terms of economy, efficiency, effectiveness and equity (known as the Four E's). This is supported by the MTSSs and should be represented in sector specific sections of the SDP.

The main "principles of VfM and how they relate to allocation and utilisation of resources are presented in Figure 4 below.

Figure 4 Principles of Value for Money (VfM)



2. Overview of SDP Financing Section Content

This guidance note provides additional advice on the key elements that should be included in the Financing Section of the SDP and provides guidance on how to prepare it. The following areas are considered key for inclusion either within the Financing Section or other parts of the SDP (some of the areas covered below may well be better placed within a "Public Finance" or equivalent MTSS rather than the Financing Section of the SDP – their inclusion in this briefing note is based on the importance):

1. Current (and historical) Position of State Public Finances:
    - High level analysis of major revenue and expenditure flows – this should include at least commentary and visual representation (graphs) of the dynamics of Federation Account Revenue and IGR, and major classifications of expenditure (Personnel, Overhead, Debt Service and Capital) over the last five years;
    - Current Debt position (as at the end of the last full financial year), including solvency and liquidity ratios; and
    - Any significant financial or yielding financial assets relevant to revenue and expenditure.
2. An overarching Fiscal Policy Statement (and set of Objectives or principles) that provides a framework for medium term and annual budgets over the period covered by the plan. This Fiscal Policy Statement would usually include a number of explicit objective defined targets (e.g. deficit, debt stock, target expenditure ratios etc);
3. Indicative Macroeconomic and Fiscal Framework (at least for the first five years of the plan), and to at least to cover recurrent revenue;
4. Principles for drawing down loans – will financing be through issuance of bonds, bank loans, overdrafts, external debt or other sources? What kind of interest rates, maturity, administrative charges, foreign exchange risk, or other risks would each type of financing instrument attract? This should be consistent with, and be informed by a thorough Debt Sustainability Assessment (DSA) and Medium Term Debt Strategy (MTDS);
5. Principles for drawing grants and other sources of financing including Public Private Partnerships (PPPs);
6. Relationship / financial contributions and flow with Local Government and Federal Agencies;
7. A detailed section on Internally Generated Revenue (IGR) and how it will be developed (it could be that "Public Finance" itself considered a Sector and hence may have its own MTSS or is included within governance / public administration). This should be consistent with and be informed by a Medium Term Revenue Strategy (MTRS);
8. Any key reforms to the PFM system and processes envisaged during the term of the current administration that might have significant impact on resources – for example TSA, IGR reforms, Public Procurement Reforms, Payroll Audits, etc (as above, this might be part of a broader "Finance" sector MTSS);
9. Major Fiscal Risks and how they will be managed; and
10. Relation between the SDP, MTEF and Annual budget in line with the principles laid out in section 1 above.

3. Guidance on Developing SDP Content

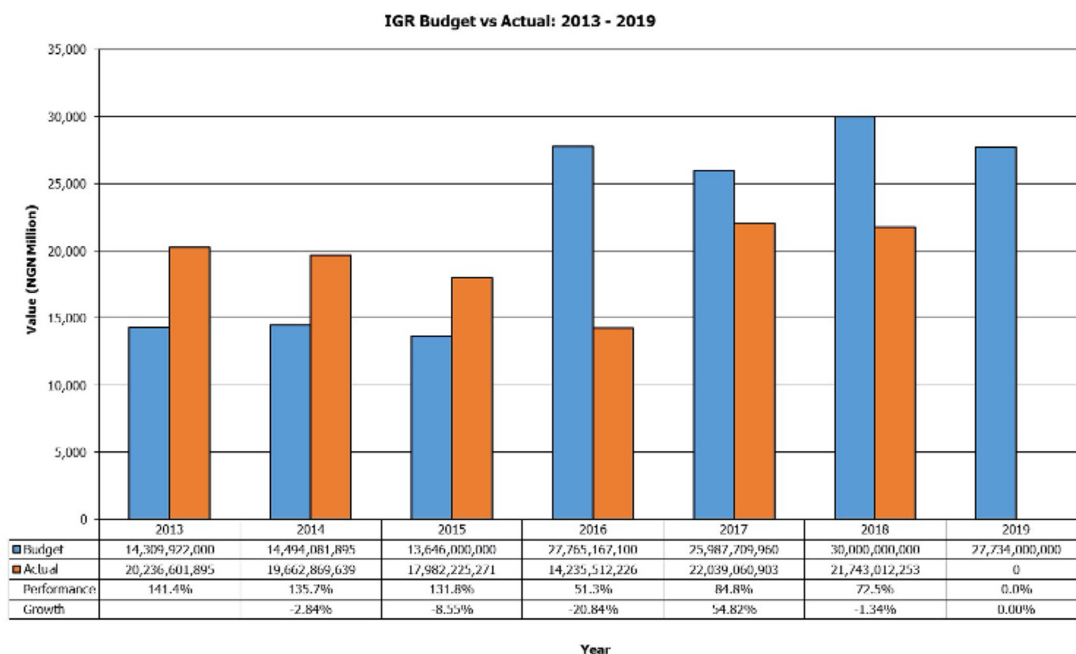
The sub-sections below provide specific guidance on each of the ten areas outlined above. It should be noted that this paper provides more detail than might necessarily be contained in the SDP financing section itself, but the detail is needed in order to guide policy decisions.

3.1 Baseline – Historical and current position of State Public Finances

In formulating a plan for the future, it is always important to take stock of where one has come from and where one is currently. Historical data is not only important and necessary for forecasting, it also provides feedback on the current trajectory and helps identify what was and wasn't achieved and thus providing the opportunity to learn lessons. Sometimes it is also useful to benchmark one's self against peers – this might include IGR to GDP ratio, or compared expenditure levels to population size and landmass.

In terms of historical trend and performance, the macroeconomic, mineral and fiscal items discussed in section 3.3 should all be considered, although without bogging down the audience of the document. Ratios based on some of these aggregates might also be useful – for example the ratio of capital to recurrent expenditure, or the ratio of Federation Account to Internally Generated Revenue (IGR). An example of a prior fiscal performance graphs is presented in Figure 5 below – the format of the graphs shows both the trajectory of actual revenues as well as the accuracy of budgets.

Figure 5 Example of Fiscal Performance Graph



	2013	2014	2015	2016	2017	2018	2019
Budget	14,309,922,000	14,494,081,895	13,646,000,000	27,765,167,100	25,987,709,960	30,000,000,000	27,734,000,000
Actual	20,236,601,895	19,662,869,639	17,982,225,271	14,235,512,226	22,039,060,903	21,743,012,253	0
Performance	141.4%	135.7%	131.8%	51.3%	84.8%	72.5%	0.0%
Growth		-2.84%	-8.55%	-20.84%	54.82%	-1.34%	0.00%

As noted elsewhere in this guide, some of these items may be more appropriately included in a "Finance" sector strategy section of the SDP.

The current debt position is also an important "health check" for the state – it gives and initial indication of whether states are in a position to drawdown new loans (effectively run budget deficits) or if they need to run budget surpluses to decrease their net debt position. Further considerations for drawdown of new loans (looking forwards) are addressed in section 3.4 below.

An example Debt Statement is provided in Table 1 below.

Table 1 Debt Position

	Debt Sustainability Analysis		
A	**DSA RATIO SCENARIOS:**	**Sustainability Thresholds**	**As at 31st December 2018**
	Solvency Ratios	**Percentage**	
1	Total Domestic Debt/Total Recurrent Revenue	50%	45.48%
2	Total Domestic Debt/IGR	150%	170.08%
3	Total External Debt/Total Revenue	50%	47.49%
4	Total Public Debt/Total Revenue	100%	92.97%
5	Total Public Debt/State GDP Ratio	40%	4.45%
	Liquidity Ratios		
6	External Debt Service/Total Revenue	10%	0.61%
7	Total Debt Service/Total Revenue	15%	3.79%
8	Domestic Debt Service/IGR	10%	11.86%
			2018 Actual
B	**PUBLIC DEBT DATA AS AT 31st DECEMBER 2018**		**Naira**
1	Total Domestic Debt		36,979,839,054
2	Total External Debt		38,610,364,642
3	**Total Public Debt**		**75,590,203,696**
4	Total Domestic Debt Service 2018		2,578,681,109
5	Total External Debt Service in 2018		499,457,009
6	**Total Public Debt Service**		**3,078,138,119**
C	**STATE GDP FOR 2018**		
1	**State GDP**		1,700,533,666,211

Finally, the state might want to identify any resources / assets that could yield significant financial return of the period of the plan (either through disposal or by delivering services) – this might include housing stocks that might be sold, or other areas.

3.2 Fiscal Policy Statement

Fiscal Policy can be defined as “the means by which a government adjusts its spending levels and tax rates to monitor and influence the economy”. The policy statement might talk broadly about priorities, principles (prudence, borrowing, etc.) and may also include defined ratios / ranges, some of which are discussed in the following sub-sections.

Fiscal Policy must be consistent with, and help implement relevant legislation both at a state and federal levels. Some Fiscal Policies that affect a state will be exogenous (e.g. Federal taxes and revenues that are shared with states). In some instances, Fiscal Policy might require changes to legislation (e.g. the Revenue Code) but the policy cannot be effectively implemented until any legal changes are made.

The Fiscal Policy Statement guides the annual budget preparation and its implementation, and can be used as a reference point to civil society in assessing the budget. Since many of the revenue sources are partially of fully exogenous to the state, tax rates would refer only to IGR as per the Revenue Code (and only to the extent allowed under federal legislation).

Explicit objectively defined ratios might include:

- Maximum Annual Budget Deficit;
- Maximum Debt Stock and/or Servicing (Solvency and Liquidity) ratios either during or at the end of the Development Plan implementing period;

- Target Recurrent: Capital Expenditure ratio;
- Maximum increments in personnel and operation and maintenance based on current policies and programmes of government (this help foster fiscal discipline, VfM and allow maximum resource for investment in new policies and initiatives);
- Size of contingency and planning reserves.

Within the context and suggested format of the Medium Term Expenditure Framework (MTEF), the Fiscal Policy Statement provides the framework and justification for the Medium Term Fiscal Framework which lays out the aggregate budget size and composition of expenditure between the main classifications according to the National Chart of Accounts (NCOA) –Personnel, Overheads, Social Benefits, Grants and Subsidies, Debt Service and Capital.

3.3 Macroeconomic and Fiscal Framework

The Macroeconomic and Fiscal frameworks (often referred to collectively as the Macro-Fiscal framework) may just include the same macro-economic variables as in a Fiscal Strategy Paper (FSP) plus recurrent revenues, or it may include more detailed fiscal forecasts (full recurrent account – i.e. revenue and expenditure, plus transfer to capital account). Capital Receipts – i.e. grants, loans and other receipts are considered in other sections.

Box 1 Budget Realism

The SPARC programme (the predecessor to PERL) produced a 'How to prepare realistic budgets: A step-by-step guide'. This is very relevant to the production of the financing section of the SDP and should be referred to in addition to this paper. The Policy and Strategy 'How to Guide 2 - Preparing a State Development Plan' also briefly mentions financing in the following stages and steps:

1. Stage 1, Step 6 - Liaise with Finance MDA to obtain fiscal projections;
2. Stage 4, Step 4 - Establish revenue projections (and fiscal policy) and assess impact on ambition;
3. Stage 5, Step 3 - Recognise fiscal and human resource constraints on policy options; and
4. Stage 5, Step 4 - Consider capital/recurrent budget balances.

As noted above, the Macro-Fiscal framework should really cover the full period of the SDP however, the further out the forecasts are, the more susceptible they are to error. For this reason, the estimates are **superseded by the three year Macroeconomic and Fiscal Frameworks in the annual iterations of the MTEF document** (as presented in Figure 3 on page 3).

The basis for the figures included in the Macroeconomic and Fiscal framework should be clearly stated in the supporting narrative – what figures have been adopted / adapted and why. This provides additional guidance for preparation of the MTEF document as similar assumptions should be used across the documents presented in Figure 3.

Real vs Nominal Estimates – the value of money typically depreciated over time. What can be bought for N1,000 today might cost N1,100 or more next year. As the SDP has a medium-long term time horizon, the above becomes even more accentuated. What cost N1,000 today might cost N2,000 in five years' time (based on an average annual inflation rate of 15%). Similarly, many non-mineral based revenues will increase with inflation – VAT is a flat percentage of sales price – if prices rise then VAT increases proportionately.

Some advanced economies would budget on a "real" or "constant price" basis, meaning they discount the future cash flows for ease of intertemporal comparison – a GDP "deflator" or a similar version of inflation is used to convert a "nominal" or "current price" to "real".

Nigeria typically budgets on a "nominal" or "current price" basis, i.e. revenues and expenditures in future years are based on the price levels in those years.

There is a specific tool accompanying this guide that will assist states to estimating revenues and main classifications of expenditure. Again, this is based on nominal (current) prices.

Macroeconomic (and Mineral Sector) Framework

Crude Oil Outlook (price, production and mineral ratio) – the assumptions on crude oil benchmarks will play a large part in estimating the resources available to implement the SDP for most states. As noted above, it is difficult to forecast the movements in price, production and other factors over the medium term, underlying the need for prudence and for the annually produced MTEF document to supersede and provide updates.

It is also important to note that distributions of crude oil revenues are based on benchmark price, production and exchange rate, with revenues generated from performance above the benchmarks being funnelled to the excess crude account. The benchmarks, particularly price, are intended to be set some way (25%) below the recent average observed figures.

There are several sources of crude oil price forecasts. The National Development Plan (e.g. ERGP) and the Federal MTEF will provide estimates for Bonny Light Price, however these are often on the optimistic side, and may not cover the full-time frame of the SDP. Various oil sector actors, including the Organisation of Petroleum Exporting Countries (OPEC) and the US Energy Information Administration (EIA), provide forward estimates for crude oil prices as do the IMF as a percentage annual change in price (as part of the bi-annual World Economic Outlook (WEO)). Forecasts for Bonny Light are not widely available – the two main reference grades are Brent and Western Texas Intermediate (WTI). It is possible to derive a forecast for Bonny Light by using historical differentials between Bonny Light and Brent and/or WTI. Historical price data available from OPEC in the monthly oil market report (MOMR) and NNPC monthly reports.

Nigeria's Crude Oil (Bonny Light) production is the second key determinant of mineral revenues. Production has typically fluctuated between 1.8 to 2.2 million barrels per day over the period 2005-2020. In terms of forecasting, using figures in this range would be advisable, noting the most recent production figures. As above, the National Development Plan and Federal MTEF will also include production forecasts but these are often targets, rather than a balanced estimate of what will actually be produced. NNPC and Department of Petroleum Resources (DPR) report (monthly and annually respectively) on actual production, as do EIA in their International Energy statistics portal and OPEC in the MOMR. OPEC quotas and OPEC reports do not contain condensate production so are usually 200,000 to 300,000 barrels per day lower that what is reported by NNPC.

Finally, the Mineral Ratio is the third key element for forecasting mineral revenues. The mineral ratio is used to estimate (forecast) mineral revenue accruing to the Federation Account (for distribution through Statutory Allocation and Net Derivation) based on the above price and production, and the NGN:USD exchange rate (discussed below). Specifically, if a barrel of oil is sold for $55, what proportion of this $55 ends up in the Federation Account as resources to be shared between the three tiers of government as Statutory Allocation. This is referred to as the "Mineral Ratio" and is an implicit value based on observed mineral sector performance and revenue flows to Federation account.

The Mineral Ratio can be calculated using the detailed information in the monthly FAAC packs:

1. The FAAC pack details exactly how much revenue (gross) flows into the federation account each month, how much is deducted for Joint Venture (JV) cash calls, and how much is deducted as excess crude.
2. It also details the level of oil production, the average sales price, and the NGN:USD exchange rate – which allows, through a simple multiplication, to calculate the total sales revenue from Oil.

The ratio between 1 (net mineral revenue for distribution plus any excess crude deductions) and 2 (the total revenue from crude oil sales), which could be considered an elasticity, tells us for a given level (benchmark) of oil price, production and NGN:USD Exchange rate, and via the state sharing ratios, how much Statutory Allocation a state can expect. An example is provided below.

Table 2: Example Mineral Ratio Calculation

No	Item	Example Month	Source	Amount
1	Actual Crude Oil Daily Production (including condensates)	June	NNPC Monthly Reports	2,000,000
2	Actual Bonny Light Price	July	NNPC Monthly Reports or OPEC MOMR	$55.00
3	NGN:USD Exchange Rate average (IFEM)	July	CBN Statistics	305
4	Days in the month (for purposes of calculating monthly production based on barrels per day)	June	Calendar	30
5	Total Sales Revenues from Crude Oi	July	1 x 2 x 3 x 4	1,006,500,000,000
6	Mineral Revenues accruing to Federation Account for distribution as Statutory Allocation and Net Derivation	August FAAC Distributions	FAAC Pack (hard copy) Schedule 1 (this should the net figure, but adding back in any excess crude deductions)	322,080,000,000
7	Mineral Ratio	August	6 divided by 5	32%

The mineral ratio fluctuates on a monthly basis and is to some extent proportional to price - the higher the crude oil price, the higher the mineral ratio (as fixed costs are serviced by a lower proportion of the sales revenue). In order to forecast, it is advisable to look at historical trends over a timeframe of a year of more, and again give consideration to the mineral ratio proportion to the price.

NGN:USD Foreign exchange rate – as shown in the table above, the value of the Naira against the USD is a key determinant of crude oil revenues accruing to Federation Account. The Naira has depreciated several times over the last 5-10 years, either through a deliberate monetary policy or through imbalances in the balance of payments causes by Crude Oil prices declines (e.g. 2016, 2020). It is also impacted by relative weakening or strengthening of the fundamentals of other currencies). At the same time, foreign exchange rates are notoriously hard to forecast, so the previous trend should not necessarily be taken as a robust indictor for future movements.

Historical devaluations of the Naira (2016, 2020) have coincided with significant negative shocks to the crude oil price as crude oil is the major source of foreign reserves. Sustained downward movements in foreign reserves are also an indicator that the exchange rate will come under pressure as supply of foreign currency (again, largely generated through crude oil exports) does not meet demand. Data on exchanges rates and foreign reserves can be found in the statistics section of the Central Bank of Nigeria (CBN) website (as at June 2020, the IFEM (International Foreign Exchange Market) official rate is the rate at which crude oil transactions tend to take place).

It should also be noted that the NGN:USD rate impacts on more than just Crude Oil revenues (hence Statutory Allocation and Net Derivation). Foreign Debt servicing and the price of goods and services will also be impacted directly by the NGN rate. The former should be anticipated and modelled as part of the MTDS, the latter should be considered particularly if large shifts in the exchange rate are anticipated.

Inflation and Real GDP Growth - National real GDP growth and inflation are key drivers of the non-mineral revenues that are distributed through Statutory Allocation (Companies Income Tax and Customs and Excise duties), and VAT. Hence there is a need for these national aggregates in the SDP Macro-Fiscal framework. Inflation also has a knock-on effect on expenditure (wage increases, costs of goods and services).

As with the mineral sector assumptions, the National Development Plan and the Federal MTEF can be reference points, but the estimates are again targets rather than balanced forecasts (balanced meaning with equal probability of over or under performance). A more prudent view can be taken from the IMF World Economic Outlook – this typically includes forecasts for one, two and five-year horizons for real GDP growth and CPI inflation for all countries.

Historical data can be obtained from National Bureau of Statistics (NBS) – monthly and annually for Inflation, and quarterly and annually for real GDP. The IMF WEO also includes around 7-8 years of historical data. This historical data should also be used as part of the forecasting processes for certain revenues based on elasticity modelling (specifically it is used to estimate historical elasticity between revenues and real GDP and inflation – this is discussed further below).

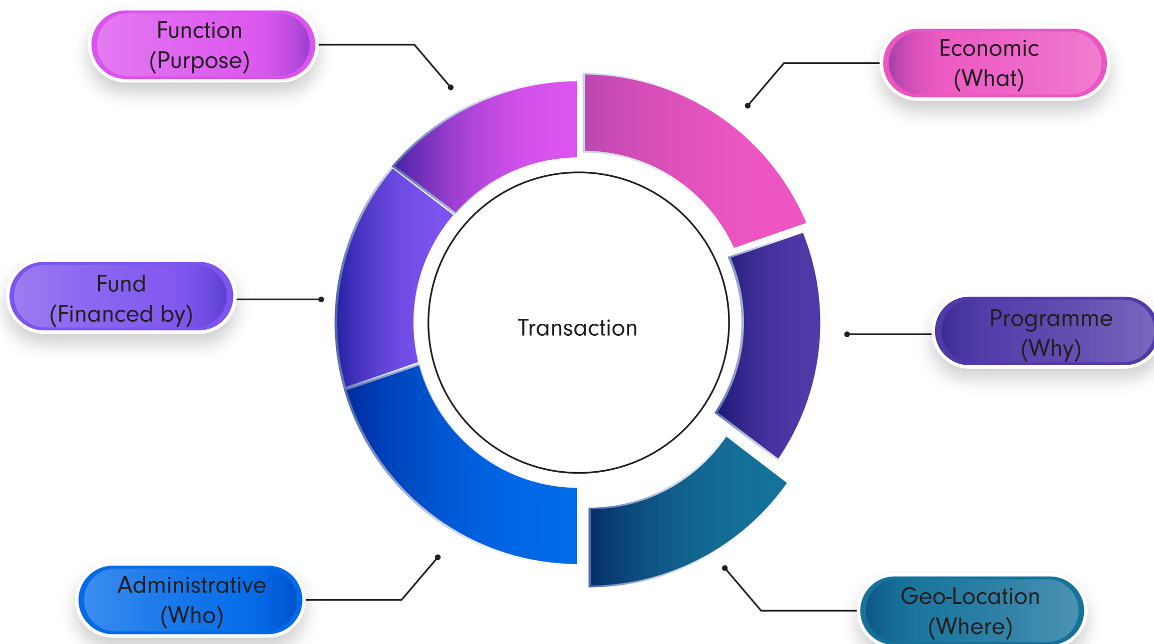
All states should be encouraged to compute state level GDP estimates – these are useful both in terms of monitoring the impact of the government's economic growth policies and can also be used, in time, to support elasticity-based forecasting of IGR. NBS provides estimates of state level inflation which again might be considered when estimating expenditures.

As noted earlier, the basis / source for all forecasts should be clearly included in the narrative that supports the macroeconomic framework itself.

Fiscal Framework

To the extent possible, the SDP should be presented consistently with the National Chart of Accounts (NCOA). The NCOA governs the recording and reporting of all revenue and expenditure transactions. The NCOA has six segments, each with its own hierarchical structure, as presented in Figure 6 below.

Figure 6 National Chart of Accounts Structure



The Fiscal Framework should be based on the Economic Classification, but the SDP should also be presented consistently with the Programme, Functional and Administrative classifications of the NCOA. The NDP and SDP will also help dictate the coding of the Programme Classification.

More information on the NCOA can be found at the Nigeran Governors Forum Help Desk (Domestication of the NCOA Toolkit).

The following sections refer to sub-account classes of the Economic segment of the NCOA.

Federation Account Transfers (Sub-Account Class 11) – this includes Statutory Allocation, Net Derivation and VAT which should be based on elasticity forecasting that is advocated as part of the MTEF process. These will be based on the macroeconomic and mineral (crude oil benchmark) assumptions as discussed above.

IGR and other Recurrent Revenues (Sub-Account Class 12) – the state's internal revenue generation (IGR) is an important, although somewhat underdeveloped in most states, source of revenue for financing the State Development Plan. As noted above, very few states have their own real GDP and/or inflation data (historical, let along forecast) so estimating IGR cannot usually be done in the same way (elasticity forecasts) as Federation Account Transfers. The trajectory of IGR might be based on specific annual percentage increments (these should take into consideration inflation, and any specific reforms

to Tax Policy and Administration). Alternatively, if state GDP is available, there might be a target IGR : State GDP ratio to be achieved within the time frame of the SDP.

Whatever the basis for the IGR estimates, they should be consistent with a Medium Term Revenue Strategy (MTRS) and should be fully justifiable.

Recurrent Expenditures (Sub-Account Classes 21 and 22) – this covers personnel costs (salaries, allowances), pensions and gratuities, operation and maintenance, subventions to parastatals and debt servicing.

Pensions, Gratuities and Debt Servicing are obligatory in nature and are effective first line charges to the Consolidated Revenue Fund, as are some personnel costs (Judiciary, Auditor General, SHOA members and alike) and are not explicitly linked to the policies and strategies of governments.

Line Ministry (and parastatal) personnel costs and operation and maintenance are linked to the service delivery and maintenance of assets.

Debt Servicing costs should be consistent with a Medium Term Debt Strategy and reflect existing debt stock and servicing obligations as well as the servicing of any new debt draw down during the SDP implementation period.

Transfer to Capital Development Fund (CDF) – States should have a surplus of financial resources after personnel and overhead costs are accounted for. As a minimum, States should be aiming to use resources generated from Crude Oil (i.e. part of Statutory Allocation and all of Net Derivation and Excess Crude distributions) for capital investment (through the CDF) although it is not easy to distinguish the mineral revenue element of Statutory Allocation from the data provided by the Federation Account Allocation Committee (FAAC).

Further sources of funding for the CDF, in terms of Capital Receipts, are discussed in sections 3.4 (loans), 3.5 (Grants) and-3.6 (LGC contributions) below.

Within both the Capital Development Fund and also Recurrent Expenditures, States might want to consider identifying the costs of providing existing services (Personnel, Operation and Maintenance, Grants and Subventions), statutory payments (pensions and gratuities, debt servicing) and completing current capital projects, with the balance of resources being available for new policy initiatives.

3.4. Debt and Loans / Financing

There is little doubt that state governments will have ambitions beyond the scope of their recurrent revenue resource. Borrowing is one source of additional financing - borrowing to invest in social and economic initiatives that yield positive returns is a perfectly reasonable policy.

Decisions on drawing down debt, which will have to be repaid by future generations, should be done within a broader Debt Sustainability Assessment (DSA) and Medium Term Debt Strategy (MTDS). This would help ensure that the liquidity (looking at debt servicing costs) and solvency (looking at debt stock) ratios are within accepted norms, and that the State is managing risk by drawing resources from varying sources (domestic or foreign) and with varying maternities. The MTDS should help identify risks (e.g. a sudden fall in recurrent revenue that inhibits states' ability to service debt, or an exchange rate depreciation which would result in an increase in the naira value of foreign debt stock and increase foreign debt servicing costs) and propose suitable risk management initiatives. The PERL programme has developed a toolkit for supporting states to undertake a DSA and prepare an MTDS – the toolkit can be found on the Resources section of the PERL website.

As noted above, the Fiscal Policy Statement might also dictate maximum annual budget deficits, and specify the debt solvency and liquidity ratios that the state will adhere to during the implementation period of the plan.

Finally, as noted in section 3.3 above, the MTDS should help inform the Debt Servicing Costs over the period of the SDP implementation – the form part of the Fiscal Framework.

3.5 Grants and Other Contributions

Grants are another source of financing beyond recurrent revenue sources. Grants should be considered both within the main financing section of the SDP but also, and probably to a larger extent, within the sectors and line ministries. MDAs should be actively seeking grants from a wide range of sources including the Federal Government, private sector, Development Partners and Philanthropists. Grants should be calculated before allocations to sectors are made. They should not be included in the overall resource envelope for allocation to sectors but should be taken into consideration when looking at the total allocations to sectors.

On a wider point, states should also work together with development partners to ensure that grants are properly captured in the budget and accounts. This can be difficult, particularly when the grant is received in kind (for example Technical Assistance from PERL), but ultimately the figures will be available from the origin of the funding.

Grants often require the State to undertake specific actions or meet certain conditionalities, for example matching the grant funds with state resources. It is very important that the State and specific MDAs take this into consideration when preparing budget submissions and annual work-plans. Grants are usually ring fenced for specific activities, so the recipient MDA can be assured of receiving the funds as long as the meet all conditionalities (including matching funds as necessary).

Finally, States should explore opportunities for Public Private Partnerships (PPPs) to deliver services that the state alone is not in a place to provide (doesn't have the required resources or expertise). Whilst these might be considered more at a sector level (transport, roads, etc.), some overall guidance and principles should be in place and discussed in the SDP. These might include reference to an existing PPP policy or the intention to create a PPP Policy.

3.6 Local Government Contributions

Local Governments (LG) are a key stakeholder and actor in the development and implementation of the SDP, including the financing of the plan. Local government often contributes towards capital investment and provides key services within the state either through contributions that will be spent by the state, or expenditures directly from the LG budget. Individual sector plans should clearly articulate the roles of the two tiers of government and identify funding that will come from LG budgets. As with the State finances, LG contributions obviously need to be estimated and agreed within an aggregate revenue estimate for Local Government Councils.

3.7 IGR Strategy

Many states will feel that they are not achieving the full potential in terms of IGR receipts, and they will also be desirous to reduce dependencies on Federation Account receipts (particularly crude oil-based revenues). IGR forecasts will be presented in the Fiscal Framework and these might be premised on significant reforms to Tax Policy and Administration in the state. It is important that these reforms are clearly articulated in a Medium Term Revenue Strategy (MTRS) which should be summarised in the SDP – either within the Financing section and/or within the policies within a Public Finance sector.

3.8 PFM Reforms

As with IGR, there may be a section within the SDP specifically on Public Finance as a "Sector" in which case PFM reforms should form part of the Sector plan and then the MTSS. Otherwise it should be summarised in the Financing section.

This should cover any institutional, legal, business process, systems and other reforms that are likely to have an impact on resource availability and VfM in terms of both revenue collection and expenditure and should support any significant shifts in fiscal items from previous trends.

Again as with the IGR and MTRS, there should be a separate and comprehensive PFM Reform Strategy and Action Plan in place to drive PFM reforms in the State. It is often useful to undertake a thorough diagnostic assessment (e.g. Public Expenditure and Financial Accountability (PEFA) assessment) to serve as a baseline for a PFM Reform Strategy.

3.9 Fiscal Risks

There are a number of sources of risk – political, economic, environment, social, security, etc. Some will have financial implication for the state – these are fiscal risks. For example, overdependence on crude oil revenues, risks around debt (e.g. an exchange rate devaluation causing a shock to foreign debt stock and servicing costs), risk of flooding.

As the SDP is being developed, these fiscal risks should be identifying with the sector plans (including potentially the "Public Finance" sector) and should be briefly referenced and summarised in the financing section including and specific strategies for mitigating and managing the risks.

More guidance on identifying, quantifying, mitigating and managing fiscal risks can found in the IMF Report on Analysing and Managing Fiscal Risks – Best Practices.

3.10 Relationship between SDP, "Finance" Sector MTSS, MTFF and MTBF and the Annual Budget Process

The SDP is an ideal location for a clear statement on the relationship between these documents. As noted in section 1, there should be a clear relationship and clear statement of what takes precedence (e.g. the MTEF supersedes the financial estimates in the SDP).

It might then go into further detail to define the following:

- The relationship between the MTFF, MTBF and the MTSSs (are MTSSs prepared/updated and costed based on the sector envelopes in the MTBF?);
- What is included within the envelopes in the MTBF - capital only; recurrent and capital separately; personnel, overheads and capital all separately; or a single envelope covering both recurrent and capital, but with some upper limits on increments to personnel and overheads.

It should also define whether non-discretional loans and grants are considered as part of the envelope setting process, or if these are left to sectors to determine.

Finally, it might define the relationship between the envelopes in the MTBF and the envelopes in the annual budget call circular – i.e. how are sector envelopes disaggregated to MDA ceilings.

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