

FISCAL RESPONSIBILITY LAW, FISCAL DISCIPLINE AND MACROECONOMIC STABILITY: Lessons from Brazil and Nigeria.

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ABSTRACT

This paper seeks to analyze the imperatives of Fiscal responsibility law. It draws some lessons from Brazil, situating these lessons in Nigeria. The paper explores some theoretical issues surrounding fiscal responsibility in an economy. Major features and similarities of the fiscal responsibility laws in Nigeria and Brazil are highlighted. Some of the fundamental flaws in Nigeria's democracy that impede economic development as well as the imperatives of the fiscal responsibly law in Nigeria are analyzed. The paper concludes advisedly that strict adherence to the new fiscal policy law is bound to promote macroeconomic stability in Nigeria.

Keywords: *Fiscal Responsibility, Fiscal Discipline, Macroeconomic Stability, Nigeria.*

1. INTRODUCTION

Fiscal responsibility relates to fiscal federalism. It is the assignment of revenue and expenditure functions to the different tiers of government, namely Central, State and Local Governments in a federal system of government. However, Fiscal Federalism and inter-governmental fiscal relations are often used interchangeably. Intergovernmental fiscal relations refer to the fiscal transactions and coordinating arrangements among the various tiers of government in a federation (Musgrave and Musgrave, 1989). The nature of intergovernmental fiscal relations constitutes an extremely relevant consideration for the attainment of fiscal nationality and macroeconomic stability in a federal structure of government. Nigerian operates a federal structure of government, with different tiers as noted above.

The 1999 constitution of the Federal government of Nigeria gives each tier of government a set of responsibilities around which programmes are articulated and budgeted for, and for which expenditure requirements need to be funded (Ezeabasili & Herbert, 2007). Government intervention through fiscal policy is geared towards the achievement of macroeconomic stability and real growth. This interventional role is warranted by the failure of market mechanisms, due mainly to market imperfections to efficiently allocate resources and achieve a stable equilibrium and fair distribution of income (Okunroumu, 2000). However, public sector management in Nigeria since independence has failed to deliver the much expected macroeconomic stability. This is evident from the pattern of public spending. Specifically, between 1970 to 2004, government expenditures have shown persistent fiscal deficits. This has led to poor macroeconomic performance, for example, through rising interest and exchange rates, increases in money supply, low real gross domestic product and negative trade balances during much of this three-decade period.

Again, because Nigeria operates a federal system of government, each tier of government adopts its own fiscal policy without proper coordination or alignment and without caring about its systemic effect. The implication is

that resources are not properly coordinated and purposefully deployed to projects with specific macro-economic goals. This, in turn, retards macroeconomic stability. Even with the progressive increase in revenue accruing to governments over the last three decades, there has been growing misplacement of fiscal priorities (CBN 2005) as resources, have been increasingly frittered away or diverted to trivial macroeconomic pursuits. In effect, resources have not been utilized in non-trivial projects. For how long will this seeming fiscal irresponsibility continue to dwarf economic development? How can it be curbed or checkmated?

This is the context of the fiscal responsibility bill which has recently been passed into law. The fiscal responsibility law is designed to improve inter-governmental fiscal coordination in the pursuit of greater macroeconomic stability, promote fiscal prudence and sound financial management of public resources. The law provides legal backing for ensuring compliance with agreed fiscal benchmarks, enabling environment for accelerating economic growth, and seeks to curb excessive expenditure and thus limit the danger of running unsustainable deficits by the different tiers of government.

This paper seeks to analyze and highlight the instrumental imperatives of the fiscal responsibility Act in Nigeria as it is instrument designed for strengthening and improving accountability, transparency, fiscal discipline in public sector resource management and macroeconomic stability. The paper is divided into 6 sections. Following this introduction is the theoretical exposition as Section 2. Section 3 discusses the fundamental issues in the polity that challenge economic development while section 4 analyses the major features of the fiscal responsibility law in Nigeria and Brazil. Section 5 explores the imperatives of fiscal responsibility law in Nigeria, while Section 6 is the conclusion.

2. THEORETICAL EXPOSITION OF FISCAL RESPONSIBILITY LAW

i. Federalism and Fiscal Adjustment

Emerging economies should devote attention not only to the maintenance of prudent fiscal policies in every budgetary period, but also progressively seek to build over the long-run, a coherent, consistent, and a reliable and stable fiscal policy. It is this perception of the long term trend, based on credible institutional framework and positive socioeconomic development pursuits that generate signals of lower real interest rates and country risk premium as drivers of sustainable economic growth. The sustenance of growth is a desideratum of economic policy across the globe. However, poverty reduction and economic advancement can only be achieved through a period of stable and sustained high rates of economic growth. In other words, the path towards poverty reduction and economic advancement is laced with first the establishment of sound and sustainable fiscal policies, delivering consistent economic results with strong institutions and mechanisms, like the fiscal responsibility law and effective execution (Guardia and Sonder, 2004).

The existence of large and persistent budget deficits in, especially sub-Saharan Africa, is frequently associated with political instability, institutional factors and poor leadership, amongst other factors, that prospectively create incentives for excessive spending, often unbudgeted with negative fiscal consequences (Poterba and von Hagen 1999). According to this view, deficits arise because the government's tax revenue is a "common property resource" from which projects of public policy are financed. In this context, the cost-benefit analysis creates the wrong incentives for excessive spending. The idea that institutions matter reinforces the use of fiscal rules as an alternative mechanism for improving fiscal performance. The definition of simple and credible rules outline and restrict the outcome of the budget process and procedural designs that contribute to align the incentives and constraints that promote and enforce fiscal discipline, transparency and accountability in fiscal performance.

Associated therewith is the design of fiscal federalism. The rules governing the inter-relations between the central and subnational governments define the allocation of public resources and thus condition the outcome of fiscal policy. Expenditure assignment, revenue assignment, intergovernmental transfers, and control of subnational debt are the contextual areas of fiscal federalism that interact with fiscal institutions in determining fiscal performance.

a. Expenditure Assignment

Expenditure assignment issues arise from the decisions that central governments make in relation to the provisioning and financing of public services. Public services vary widely in nature and cost, from national

defence to garbage collection, from government insurance through regulation of public utilities to the provision of education, among many others. There is a theoretical convergence that expenditures should be as decentralized as possible, with each level of government taking responsibility for those services whose beneficiaries it most closely represents. At the lowest end of the spectrum, is the municipal government with responsibility for most day-to-day public services, such as health, schools, public transportation and police. States or provinces stand in the middle with the provision of those services that have offer economies of scale, like highways, inter-city transport services, etc. However, the empirical evidence shows that countries adopt much more complex systems for expenditure assignment that intertwine the roles of states and local governments, not necessarily in accord with the above general theoretical recipe (Guardia & Sonder, 2004).

There are at least three contentious reasons that compel centralization of expenditure assignment (Guardia & Sonder, 2004).

- (i) First is the reality of deep regional disparities within countries. Regional income disparities imbue local and state governments with differential capabilities to respond to the needs of their people. Decentralized expenditure assignment would therefore tend to lead to sub-optimal levels of services and a further deepening of regional inequalities. In order to redress these regional imbalances, a level of central government intervention is required, usually through funding and setting of national standards, but often times through the direct delivery of services by central government agencies.
- (ii) The second reason why decentralization of expenditures is less far-reaching than theory would prescribe is that local and state governments tend to be less efficient in both organizational (administrative) and transactional costs respects. In most countries, the national bureaucracy is better paid, trained, more structured and less corrupt than local and state governments (Guardia & Sonder, 2004). Weak management systems and administrative tools at the local government level make decentralization of expenditures somewhat costly and inefficient. In many instances, it may be preferable to have a small allocative inefficiency caused by inadequate centralization of an expenditure category than to have a large cost-inefficiency occasioned by decentralization to an incompetent level of government. This is particularly relevant for large federal governments, like Brazil and Nigeria, where the number of small municipalities/local governments with less efficient and trained bureaucracy is prevalent.
- (iii) Finally, the third reason that compels more centralization of expenditure assignment is embedded in fiscal policy coordination. More decentralized systems require better coordination in order to achieve macro-economic/fiscal objectives. Countries that have a weak tradition of coordination or that undergo severe economic crises tend to reduce decentralization in order to facilitate fiscal policy implementation. Painful fiscal adjustment measures can be more efficiently and rapidly deployed when the national government controls most macroeconomic expenditures. Although theory in the case of Guardia & Sonder, (2004); Ter-Minassian, (1997); Alesina and Perotti, (1999) suggests a strong link between centralization and fiscal policy coordination, there are country examples – like Brazil where a well-designed system for controlling subnational borrowing could result in an efficient combination between decentralization and fiscal coordination. Otherwise, the evidence on Nigeria and Brazil show how decentralization could threaten economic stability.

Expenditure assignment is an area where fiscal and adjustment programs have important interfaces. Decentralized expenditures are often funded by legally mandated intergovernmental transfers which add rigidly to the federal budget, making fiscal adjustment, especially emergency measures, more difficult to implement. On the other hand sub-national expenditures can serve to smoothen the effect of harsh federal expenditure reductions, making the adjustment process more palatable in the medium term.

b. Revenue Assignment

Deciding which level of government should raise which type of revenue is among the most delicate aspects of any economic and administrative system. Several countries' experiences indicate that there are major conflicting forces at work that shape the different assignment models. On the one hand, pushing governments towards more centralized revenue collection, forces national governments to exert control over macroeconomic performance and to minimize geographical allocative distortions. On the other hand, tilting the balance towards greater decentralization of revenue assignment, raise a number of issues, such as the need for accountability relations – e.g., those providing the services should be those raising the revenue and the need to adjust taxation to regional

economic realities. The end result of these contrary forces is that governments adopt a wide range of mixed revenue assignment models that combine multi-level taxation with intergovernmental transfers. Still, the literature finds some consensus in defining a few universal ‘best practices’ that can guide governments in reforming or implementing tax regimes. Unfortunately, some of these ‘best practices’ must be set aside in a context of fiscal adjustment, as the Brazilian and Nigerian cases clearly demonstrate.

Taxation by the central government should usually be imposed on bases that are unevenly distributed across regions (such as natural resources like oil). This is to allow the redistribution of revenues generated by such ‘nation’s goods’. Central governments should also collect taxes on the more mobile tax bases. This is to prevent ‘tax wars’ among subnationals that reduce overall revenues and create geographical allocative distortions of factors of production. Finally, tax revenues that are very sensitive to economic activity should, in principle, also be in the hands of the central government. This is to prevent dramatic swings in subnational budgets and also to allow the national government to use these taxes as stabilization mechanisms. Under these principles, most business taxes should be levied by the central government.

The responsibility for raising sales taxes depends on the type of sales taxes implemented. Single stage and excise taxes are more favourable for collection at the state level, particularly when there are small differences among rates in different regions, otherwise, they create opportunities for inter-state smuggling. Multi-stage sales taxes, such as VAT, should preferably be under a national rule, so, there is no need for complex and expensive coordination and information systems among states.

As regards personal income taxes there is no clear consensus on the ideal assignment. Because individuals and households tend to be less mobile than other economic entities, such as businesses, there is a case for state level taxation. Yet, individuals may have sources of income beyond the borders of their state of residence, implying that states must share information efficiently in order to tax all personal incomes of their residents. National income taxes are more advisable when such information sharing is difficult and also when internal migration movements are to be avoided.

Finally, there are some taxes that could be called ‘typically local’. Property taxes, business licenses, user fees for local services and other levies whose base is relatively immobile are to be found under this category. Although these general guidelines derive from practical experience with what works or does not work, countries only adopt a few of these practices because tax systems owe much to political arrangements, historical traditions and broader economic models.

Unfortunately, one of the first victims of a fiscal adjustment process is the efficiency of the overall tax system of a country. The need to reduce budget deficits is so critical for the economy as a whole and for rebuilding confidence and credibility among economic actors that governments are compelled to implement tax measures that are less than optimal. Centralization of revenues tends to increase because the central government carries the largest responsibility for the adjustment. Often times, new taxes are created, especially those with easy collection such as taxes on corporate incomes, fuels and financial transactions, as well as increases in income taxes for those companies and individuals who already pay. The challenges for countries faced with these emergency fiscal situations that lead to tax distortions are twofold. One is to try to reform the system and correct distortions after the toughest phase of the adjustment is compelled. This is very difficult because each level of government will be very ‘protective’ of its tax revenues (since the adjustment will not yet be consolidated and the economy will not yet be in full recovery). The second challenge is to show to the society at large that those emergency tax measures were necessary because of the fiscal imbalance that needed urgent correction. Stating this clearly would introduce in the ‘political’ discussion the fact that to give room for the dismantling of these inefficient tax models, the country must adopt sustainable long term adjustment measures (usually reduction of government current expenditures).

c. Intergovernmental Transfers

Within a country, regional financial imbalances will occur if there are no mechanisms for intergovernmental transfers. This will be the case for two main reasons. First, because subnational entities typically collect less taxes than what they would need to finance all their expenditures. Second, because regions across the country will have disproportionate tax bases (e.g. industry is unevenly distributed geographically) and financial needs

(e.g. more public health expenditures needed in certain areas). If governments do not transfer resources internally, these imbalances will cause sub-national fiscal crises, excessive sub-national borrowing, poor social services or, all of the above. In most instances, one finds that countries combine two types of intergovernmental transfer mechanisms: grants and revenue-sharing arrangements.

Grants are resources transferred from the national purse to sub-national level with no need for repayment in the future (as opposed to federal loans). Grants can be for a specific purpose (an investment project or social programme), for a broad sector (like education, public safety), or for general purposes. Countries have developed different characteristics in their grant programmes in order to achieve certain objectives. Grants may have a lot of conditions attached to them (social indicators must be under a certain threshold for states to qualify, or the state must meet certain performance targets in order to keep receiving grant resources). These conditions work well for implementing national standards and reducing regional disparities. Yet excessive conditionality works against the principle of expenditure decentralization, because state and local governments lose some control over the use of the money. Also, countries must consider carefully how to enforce conditions imposed for grants. Non-enforcement of conditionality creates a credibility problem, so, sometimes, it might be better to have fewer conditions than to have conditions one cannot enforce.

Another defining characteristic of grants is whether they require or not matched funding from the sub-national subject. Matching has two positive effects: redirection of sub-national spending towards nationally-defined critical areas, and alignment of interest between those who are supplying most of the money (central government), and those receiving them, so it should not be used in all cases. Matching funds to central government grants will force sub-nations to reduce other types of spending which may be more relevant for the local population. Also, if matching requirements are too expensive and inflexible, poorer states and local governments may be unable to participate in grant-funded programmes, which will deepen regional disparities.

In addition to grants, governments also make extensive use of revenue-sharing arrangements to reallocate resources across the levels of government and regions. Two important questions must be addressed when designing these arrangements: (i) How much of the revenues collected centrally will be distributed to states and local governments as a whole? This is the national vs. sub-national question; and (ii) How much of the shared revenues will go to each state or local government? This is the sub-national vs. sub-national question.

In order to deal with the first question, some arrangements define percentages of total centrally collected taxes that will be distributed, or define different percentages for each type of tax. Doing this on a tax-by-tax basis creates incentives for the central government to change rules on certain taxes in a way that reduces transfers to subnations (specially a times of central government fiscal adjustment). Over the long-run this can create several distortions in tax system with repercussions on overall microeconomic efficiency.

The second question has to do with the use of revenue-sharing to correct regional differences. Hypothetically, if a country were to have no regional disparities, it could use a system based only on the derivation criteria (i.e. each state gets a part of the revenue equivalent to its own contribution in collecting that revenue). This is the most efficient way of aligning interest in order to increase collection of national taxes by state authorities. Yet, most countries use their revenue-sharing systems to do intergovernmental transfers. Criteria such as income per capital, education and other socio-economic indicators are used in the formulae that redirect revenues towards poorer regions. The percentage a state will get from a particular tax varies according to these criteria and will change over time. The shapes of these rules are decided on the political arena and will not always be the most efficient in economic terms. The Brazilian case has some interesting mechanisms for transferring revenues between levels of governments and across regions. Nigeria uses revenue sharing formula which comprises derivation for the oil producing states.

An important point about intergovernmental transfers is that they should not be exclusively tied to the level of revenue collected by the central government. This would make transfers very procyclical; that is, more transfers when economy is well, less when it is in a recession), and create volatility in subnational budgets. Long-term grant and revenue-sharing arrangements with variable rates help to make some of these effects milder.

The system of intergovernmental transfers is an important tool in a context of fiscal adjustment. As discussed above, revenue-sharing mechanisms might have to be circumvented to retain more revenues at the federal level. Also, federal governments will reduce voluntary transfers to subnational governments in order to meet budget surplus objectives. Prior commitments to make regular transfers for social programmes might suffer, sometimes requiring subnational governments to increase the share of matching funds. In sum, a fiscal adjustment program will almost certainly leave its mark on the mechanisms of intergovernmental transfers. When looking at fiscal stability and adjustment in the long run, it is important to understand that sustainable fiscal performance in all levels of government needs to be supported by a well-balanced system of intergovernmental transfers.

d. Control of Sub-national Debt

The control of sub-national debt has been a topic of great interest recently and many countries have adopted new practices in this area. This is so because countries (mostly emerging economies) have found that no fiscal adjustment is complete without a new institution for sub-national borrowing. Although there is no perfect system for controlling sub-national debt, there is some consensus about good practices and at least three broad types of arrangements that countries mix in search of the ideal formula for their situation can be identified. These are: rules-based controls, administrative controls, and reliance on market discipline.

Sub-national debt can be controlled by laws (constitutional or legislative), ministerial instructions and other formal rules-based mechanisms. Some countries impose limits on absolute levels of debt for states and local governments. Other rules set limits, based on debt-service ratios. Finally, rules can be in place to restrict the types of expenditure that may be financed with debt (domestic or foreign).

Administrative controls are also frequently used for managing sub-national debt. These controls can be in the form of establishing annual limitations for sub-national borrowing. Also, central governments may exercise the power to review and authorize the borrowing operations of states and local government. In certain countries, administrative control is exerted via centralized borrowing combined with on-lending to sub-nationals. This type of control can also be implemented through the use of central banks that can lend to sub-national (this is similar to on-lending).

Market based approaches to sub-national debt control have been losing force as is now recognized that sole reliance on market discipline brings more problems than it solves. The failure of a state to meet payments to market investors will force a federal government bail-out which will destroy the credibility of the entire market-based system. Yet, there are several aspects of market discipline that can be incorporated into debt control mechanisms. First is transparency, with rules that require sub-nationals to disclose financial information regularly, timely, accurately and broadly. External auditing of financials must try to contain sub-national attempts to circumvent controls (the same role played in the market by rating agencies, auditors and fixed income analysts). The second valuable feature of market system is apolitical. Sub-national debt control system implemented by the federal government should aim at being fact-based, impersonal and using homogenous criteria for analysis, thus being apolitical.

In general, there is a consensus that rules are better than administrative controls (although both are necessary in any system). Administrative controls (such as annual limits and transaction approvals) are subject to discretionary decision and may be influenced by short-term political negotiations. Another important point is that rule-based system must have very clear definitions. It is critical to know precisely what should be accounted for as debt (or net debt), what are revenues (or recurring revenues), how to calculate indices, etc. One more observation regarding debt control for arrangements has to do with the golden rules present in several countries: borrowing allowed only for investment projects. This is a sound and educative rule (specifically for countries with a tradition of weak fiscal controls). Yet this golden rule is not enough because investment projects (funded by debt) must also have a positive economic and social rate of return. Some scholars and practitioners such as Todaro & Smith (2004), have argued that some types of social expenditures (education or health) have a higher rate of return than capital investment projects. Although this might be the case, funding the former with debt might be a dangerous proposition in the long run, and government should try to reallocate resources to fund these programs with own budget sources, not third party borrowing.

To recapitulate, this section has looked at some conceptual and theoretical aspects of fiscal federalism and its relationship to fiscal adjustment. To be sure, there is no clear recipe for how to organize a federation in terms of fiscal relationship between the levels of government, but over the years there have been important experiences and conclusions about what works best. The four key areas discussed above:- expenditure assignment, revenue assignment, intergovernmental transfers, and the control of sub-national debt:- form the core of any federal economic system. This section has attempted to summarise the Brazilian and Nigerian experiences in a more formal context and to point out how fiscal responsibility law is modeled in both countries in the light of their fiscal federalism systems.

3. FUNDAMENTAL ISSUES IN THE POLITY THAT CHALLENGE ECONOMIC DEVELOPMENT

Several factors have been identified as obstacles to the achievement of sound fiscal management and therefore impede economic development in Nigeria. These factors include expansionary fiscal spending, overcentralisation, fiscal dependency, mode of financing fiscal deficit, extended military rules/regimes, corruption, poor accountability and transparency, debt problem, the nature of existing tax structures and low revenue base, leadership indiscipline, ethnic fractionalization and nepotism (Alade et al, 2003).

- i. **Expansionary fiscal spending:** The period after Nigeria's independence was characterized by modest fiscal imbalance as it did not pose serious problems to the economy. But the emergence of oil boom in 1973 coupled with the federal government past-war programmes of reconstruction and rehabilitation created massive imbalances as a result of huge fiscal spending. The fiscal surpluses experienced in the 1960s and early 1970s turned to deficit from the mid 1970s to date. This has been accentuated by low revenue base of the states and local governments. Consequently, the fiscal deficit became unsustainable and led to macroeconomic instability in Nigeria.
- ii. **Over-centralisation:** Agiobenebo (2003) argues that Nigeria practices centralized fiscal federalism in which public expenditures are financed by transfers from the central government to the lower tiers and units of government. This practice has serious incentive problems. The secret of decentralization, aimed at inducing pareto improvements in the macroeconomic performance of the public sector, is designed to bring spending decisions closer to tax payers. This presupposes that public expenditure would be financed by local taxes. However, the financing of public expenditure by transfers is inherently sub-optimal since it has a debasing effect on resources. Since the marginal cost of these transfers to the lower tiers of government is zero, it follows that the optimal conditions yield marginal benefit which is equal to marginal costs. So, these optimality conditions induce serious incentive problems; they can only drive waste since transfers increase the separation of spending and tax decisions. Consequently, there is no incentive to minimize cost or a commitment to a value for money in the procurement system.
- iii. **Fiscal Dependency:** Another consequence of Nigeria's fiscal federalism is that it is deprivative, dispossessive, and victimizes productions, leading to what is known as fiscal dependency (Agiobenebo, 2003). The result of this is that, no tier of government is production-conscious, rather they strategically compete for revenue sharing and transfers from the central government.
- iv. **Ethnic Fractionalization and Nepotism:** Nigeria's fiscal system is engulfed in ethnic fractionalization and nepotism. This makes it virtually impossible to properly coordinate all the tiers of government in matters of fiscal management. The fragmentation of the country into 36 states and 774 local governments introduces nepotism as each unit sees itself as very distinct from the others, unlike what obtained when Nigeria had only four regions. Further consequence of this greater fiscal fractionalization is increase in fiscal autonomy of the lower tiers of government. However, monetary centralization with fiscal decentralisation introduces fiscal competition, strategic behaviour and conflict of interest, all of which engender fiscal indiscipline, thus worsening the abuse of the soft budget constraint in the presence of a rent-seeking society, such as Nigeria (Agiobenebo, 2003). These are serious impediments to economic growth and developmental processes.
- v. **Leadership Indiscipline:** Nigeria has produced leaders that do not respect ethics and laws of governance. This could be seen as a consequence of prolonged military rule. Nigerians' attitudes

equally do not help matters as both government and the governed are engulfed in “what is there for me or the usual 10 percent” syndrome in their dealings in public assignments and services. This increases the quest for power at the centre and the proclivity to loot government treasury. Again, when such corrupt practices are reported to the appropriate authorities against the “high and mighty” in government, nothing results. It appears there are two different sets of people in Nigeria: the privileged few who control state resources and obey laws at their behest, and the masses for whom laws are meant and must be obeyed. These leaders who are above the law would divert government resources for personal gains and this would negatively deplete the resources meant for the general public and the country for developmental purposes. This opportunistic leadership is largely instrumental to our economic retrogression and fiscal indiscipline.

- vi. **Corruption and Lack of Accountability and Transparency:** Corruption has been responsible for the instability of successive government in Nigeria, from 1960 to date. Corruption makes sustainable development untenable and unattainable by breeding and feeding on inefficiency and the strangulation of social values of the system. Any sustained effort at combating corruption must start from the leadership and government. A government that is bereft of patriotic spirit, accountability, honesty, the spirit of patriotism, hardwork and transparency in its governance cannot bequeath socioeconomic development. These criminal vices have dealt a severe blow in Nigeria’s quest for economic development. In deed, they have more than any force dwarfed our moral pursuit of economic development.
- vii. **Debt Overhang:** Nigeria’s inability to meet debt service obligation (for external and domestic debt) has been recognized as a major constraint on economic development and a major impediment for inward foreign direct investment. The eventual exit from our external debt burden should hopefully, *ceteris paribus*, speed up a return to a viable and stable macroeconomic framework in Nigeria.

4. MAJOR FEATURES OF THE FISCAL RESPONSIBILITY LAW IN NIGERIA AND BRAZIL

The choice of Brazil and Nigeria in the foregoing analysis is not only hinged on the fact that both countries practice fiscal federalism. The fiscal responsibility law in Nigeria is structured after that of Brazil. Since year 2000, when the law became operational in Brazil, it has diminished chaos and corruption in the public sector management and the economy is on the upswing (see Understanding the Fiscal Responsibility Bill, 2004). It is expected that Nigeria’s Fiscal Responsibility Law will deliver the same benefits as that of Brazil, streamlining economic priorities and manage the economy in a way that delivers significant benefit to the Nigerian people. Finally Brazil is about the first black nation that operates fiscal responsibility law.

The governance structure in Nigeria and Brazil:

Both countries practice fiscal federalism. Whereas Nigeria has three tiers of government (*viz.*: Federal, State and Local Governments), Brazil has four tiers (*viz.*: Federal, State, Federal Districts and municipal governments).

The Medium Term Strategic Plan Vs. the Multi-Year Plan (PPA)

The law stipulates that budget must be conducted within a medium-term fiscal framework (MTFF) in Nigeria or multi-year plan (PPA) in Brazil. The plan shall contain macroeconomic framework, setting out the macroeconomic projections for the next 3 financial years, a fiscal strategy paper, and an expenditure and revenue framework and a consolidated debt statement. The respective laws specify that the medium term expenditure framework or the multi-year plan (PPA) shall be the basis for the preparation of revenue and expenditure estimate required and to be laid before the legislature as prescribed by the constitution.

Public Revenues: The creation, forecast, and effective collection of all taxes levied by the federating units pursuant to the constitution are basic requirements for the responsibility in fiscal management for both Nigeria and Brazil. The laws stipulate that each tier of government shall get the share of revenue/transfers after prompt remittance of collected revenue. Again, revenue forecast revision by the legislature will only be permitted with proof of technical or legal error or omission. At least 30 days before the deadline for submission of their budget proposal, the executive branch of each tier of government must place at the disposal of the legislature the revenue estimates of the following year including net current revenue and the respective memorandum items. Again, while the Nigerian fiscal responsibility law says that the revenue projections should be broken down into

monthly collection targets by the executives and, where applicable, a separate description of measures to combat tax fraud and evasion and the implementation of tax relief which must be included in the appropriation revenue forecast, the Brazilian law requires revenue projections to be broken down into bi-monthly collection targets.

Public Expenditures: Both Nigerian and Brazilian laws specify conditions under which any tier of government can increase expenditure. Important aspects of the conditions state that each such increase in expenditure must come with:

- i. An estimate of the budgetary or financial impact in the year it became effective and, in the two subsequent years, a statement from the entity (or ministry) requesting for the increase consistent with the budget and the medium-term economic plan in Nigeria and multi-year plan (PPA) and budgetary directive law in Brazil.
- ii. Contract award must satisfy the due process procedure and certification of contract; procurement and award of contract.
- ii. Personnel expenditure must not exceed prudent limits set in the budget.
- iii. Violation of these sections of the law is deemed as unlawful

Debt and the Indebtedness: This section states that government should only be allowed to borrowed for human capital or other capital expenditure on the condition that it shall be on concessionary terms or low interest loan with a reasonably long payment period. It also states that public debt must be held at sustainable level. Servicing of external debt shall be direct responsibility of the government that incurred the debt.

Transparency and Accountability: This section specifies that simplified versions of the federal and the state medium-term economic plans, annual budgets, appropriation act, rendering of accounts and prior statement of opinion, summary budget execution report and fiscal management report are widely publicized in the media. It also specifies that the legislative arm of each government should ensure transparency by encouraging public hearings during preparation and discussion of annual plans, budgets or appropriation bills.

5. THE IMPERATIVES OF FISCAL RESPONSIBILITY LAW IN NIGERIA

The imperatives of well functioning fiscal responsibility law are hinged on the following:

- i. **Adherence to the principle of transparency, accountability, fiscal discipline, due process and good governance:** The adherence to the principle of transparency in the preparation of annual budgets by making the budget sessions public, accountability in publishing the financial statements and accounts of the various tiers of government and restrictions from extra budgetary spending, will go a long way in strengthening this major fiscal policy tool. Also important is the extension of the due process compliance to all levels of government.
- ii. **Tax Structure:** The constitution already provides for tax assignment to the various tiers of government. The federal government tax assignment dominates the tax system, accounting for over 95 percent of total government revenues from this source. This trend contributes to low revenue base at the lower tiers of government, yet they are expected to perform major expenditure functions, presumed to be bigger than their revenue base. There is a need therefore to ignite the revenue potentials of these tiers of government by increasing their tax powers, with a potential for greater economic growth and strengthening fiscal responsibilities.
- iii. **Eradication of Corruption:** Lord Keynes (1936) in his General theory of employment, interest and money, provided robust evidence that fiscal policy could be a very powerful tool for achieving macroeconomic stability. But, in practice, many obfuscating variables entered the picture such that a wide spectrum of outcomes emerges, many of which are sub-optimal. First, using the instrument of soft budget constraint to cure recessions or depressions could be easily opened to abuse, especially in a world ruled by greed, obscene corruption, and rent-seeking behaviour. The evidence suggests that the soft budget constraint has received its grotesque abuse in Nigeria (Agiobenebo, 2003). So the fight against corruption should really start from our homes among the children, at primary and secondary schools and the tertiary levels.

- iv. **Reduction of Deficits/Method of Financing Them through Money Creation:** Nigeria has, since most of the 1970s to date, suffered from unsustainable fiscal deficits in her annual budgets. These deficits are mostly financed by the banking system through money creation by the central bank and/or draw-down of external reserves which have the same effect as money creation. The effect of this is persistent macroeconomic instability in the form of high inflation, external debt overhang, high interest rate, unfavourable balance of payment and exchange rate depreciation and increase money supply. If this phenomenon is left unabated, it is bound to derail the objectives of fiscal responsibility. However, low fiscal deficit is advocated or recommended with financing through the non-bank public (bond financing).
- v. **Training and Infrastructure:** Federal, state and local government staff should be properly trained to acquaint them with new techniques required in budgetary processes with regards to the medium-term expenditure framework. Appropriate, infrastructure such as the information and communication technology (ICT) platform must be provided to every tier of government. This will assist in easy transmission of data to the central point and coordination of fiscal policy.

CONCLUSION

The evolution of the fiscal responsibility law will, no doubt, go a long way in curbing most of the problems that militate against sound public sector financial resource management. Proper compliance is essential in promoting fiscal discipline, transparency, accountability and therefore foster macroeconomic stability. It is therefore imperative that States and Local governments in Nigeria should also embrace this law in order to enhance their fiscal prudence.

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