The public spending crisis: a case study of Nigeria public sector

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Abstract: *The objective of this paper is to discuss the differences in the concept and measurement of efficiency between the private and public sectors, stressing that the lessons from the private sector can only be transferred to the public sector if there is a proper awareness of these issues and constrains imposed by considerations of equity. In evaluating policy initiatives, the governments method for all the talk of "rolling back the public sector" and opposition companies of "cuts," the public expenditure/EDP ration went up steadily during Obasanjo's first term. However deep the divisions over what ought to be in the public sector, it is of paramount importance to all concerned that the resources are managed effectively. The paper argued that an attempt to instill into the public sector the cost consciousness of the best parts of the private sector is wholly admirable. In conclusion, the severity of the impending budgetary crises will make the search for greater efficiency in the public sector of paramount importance. The paper recommends that the common theme of all these cases in that an appropriate set of relative prices can encourage resources to be minimized. very great care has to be taken when introducing piecemeal charging in order to ensure that this does not have side-effects at odds with programme objectives.*

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The public spending crisis

Introduction

The Nigerian public sector is in a state of unprecedented crisis, the immediate cause being the re-election with a huge majority of the PDP government. The speed with which Prof. Soludo, the then Governor of CBN and Minister of Finance launched their December 2008 salary cuts and the budget package destroyed any illusions about what the year 2009 holds in store. This year's Public Expenditure Survey, now in progress with the House of Assembly, decisions being taken, will shape not only the government's strategy for its term of office but will also exert a profound influence for the rest of the century.

But there are much deeper, intractable forces at work, notwithstanding the obvious significance of the government's ideological outlook on the public sector. Putting it crudely, the Treasury of the Ministry of finance is being wrecked by a combination of recession and demography. There are more and more people out of employment requiring support from the social security systems, which we do not have in Nigeria. There are more and more old people not just claiming pensions and other benefits but also making disproportionate demands on the federal as well as the local government. So, unless something breaks, public spending is posed to go up and up, despite having in office a government which believes that much public spending is inherently bad.

Faced with this budgetary crisis, the government's approach is to stress the need for improved efficiency in the public sector but simultaneously to canvas a plethora of privatization measures. Without a damaging admission that its monetarist policies bear much responsibilities for the exceptional severity of the Nigerian recession, it is hemmed in on the macro-economic front and is likely to concentrate on reducing benefits rather than numbers unemployed.

But, although its emphasis on improved efficiency is to be welcomed, there are two serious obstacles confronting its achievement.

First, the government's message of 'public bad, private good' inevitably produces the counter slogan from political opponents, trade unions and interest groups. It thus becomes ever more difficult to command assent for 'better spending', so that increased efficiency and fewer services are not both denounces as 'cuts'.

Second, the government's understanding of the meaning of efficiency in the public sector is seriously defective, witnessed by the way in which it constantly equates 'less spending' and 'fewer public employees' with 'greater efficiency'. It is the purpose of this paper to clarify important public/private sector differences so that a variety of policy initiatives can then be evaluated.

The nature of public/private differences

The exercise of public accountability requires a quantitative element if it is to be effective. Otherwise, it is impossible to answer questions about whether the resources at the disposal of the public sector have been used efficiently and equitablely. Systems for recording how public money is spent are well developed. The UK's system of public accounting provides extensive safeguards, not only against fraud but also against money being spent by governments on different purposes from those voted by Parliament.

But it is difficult to draw conclusions about efficiency or equity until there is a specification of objectives and some method of measuring output. For example, the financial link between consumer and producer is breached by the Nigerian Pricing Board by the almost complete absence of prices. Other mechanisms are therefore required to ensure the efficient allocation of resources, both in the sense of not using more than the minimum required inputs and of injecting practical meaning into rhetoric about responding to needs. If prices are suppressed, there must be devised non-market mechanisms which will allocate resources in the face of competing demands.

Continuing with the example of the Nigerian Pricing Board (NPB), important public/private differences can be established. Complete reliance on private medicine would ensure that those who valued medical care most would receive it. These valuations would be shaped by ability to pay and the resulting distribution of care would bear little relationship to any measure of need. The problem with need as a concept is that, although it has a powerful appeal in such contexts, it is profoundly difficult to produce operational measures.

At an intuitive level, it is impossible to say that the need of a mother for ante-natal care constitutes a higher need than someone's need for cosmetic surgery. Although such stark comparisons are relevant to decisions as to whether medicine should be public or private, the operational choices within the National Health Care, once established, are much more difficult. For example, the claims of potential heart-transplant patients have to be set against those of accident victims, of geriatric and psychiatric patients and of preventive medicine.

The public sector's objectives are therefore far more complex and multi-dimensional than those of the private sector, where profitability is the key objective. Private firms take market prices as given since they determine their revenues and costs. In contrast, governments are also concerned that existing market prices may be a misleading guide to resource allocation decision: for example, because of externalities or of the existence of unemployed factors. The pollution arising from the activities of private firms does not appear as a cost when they calculate their private profitability. The public sector, however, is concerned about the social profitability of its activities, rather than just the private profitability.

The choice of techniques of measurement is crucial to the evaluation of public sector activities and therefore to the exercise of accountability. To take and extreme example, the cash costs of regional policy are substantial. However, several studies by economists have concluded that regional policy may be a resource-creating, not a resource-consuming policy. If this conclusion is correct, the federal government would be seriously misled if it focused exclusively on the cash costs which appear in the accounts. When the economy is near full employment, regional policy brings into utilization resources which would otherwise be unused by restraining activity in congested areas and redirecting it to those with resources.

This example provides a warning that none of the cash costs may be proper measures of the resources being used. In principle, it is possible to calculate a set of shadow prices which reflect social opportunity costs much more accurately than market prices. There have been attempts to develop systems of shadow prices for implementation but the conceptual and practical difficulties are immense and some of the short cuts adopted in practice are alarming.

Nevertheless, it is clear that some of the activities undertaken by the private sectors which are profitable at market prices may be unprofitable at shadow prices: heavily polluting industries are possible example. In contrast, some public sector activities which are unprofitable at market prices might be profitable at shadow prices: urban public transport (Danfo) might be an example.

Private profitability can therefore no longer be relied upon as a valid test. Although this conclusion has profound implications for public policy towards the private sector and for the internal control framework for public enterprises, they will not be pursued here. Restricting the focus to public expenditure, the analysis casts doubt on some of the valuation placed upon the inputs.

A major reservation relates to the valuation of labour in circumstances of widespread unemployment. Employing people who would otherwise be unemployed can be resource-creating, though imposing financial costs upon the Ministry of Finance. Even at the level of financial costs, the cash costs of particular programmes can be seriously misleading if there are offsetting savings on other programmes such as unemployment pay.

The measurement of output generates even greater difficulties. In the government's accounts, no attempt is made to evaluate output. In principle, where there are multiple objectives, a weight or shadow price must be placed on each so that multi-dimensional output can be evaluated. However, specifying the objective function to be maximized is a formidable if not utopian task. Nevertheless, such a recognition of practical difficulties does nothing to alter the fundamental point that the measurement issues facing the public sector are far more complex than for the private sector.

It is necessary to provide safeguards so that the public sector cannot explain away all adverse results at market prices with reference to what the position would be if all calculations done at shadow prices. There is a danger that such shadow prices would be calculated with the explicit intention of justifying existing practices! If shadow prices are to influence decisions, they should be calculated and published ahead of those decisions. Reporting systems need to be designed with care. Decisions are sometimes taken using shadow prices but results are later reported at market prices, thus provoking (possibly unjustified) criticism of the original decision.

Despite the enthusiasm with which Nigerian economists have encouraged developing countries to use project appraisal methods incorporating shadow prices, practice in the Nigeria is relatively under-developed. After some initial enthusiasm for output measurement and shadow pricing, it rapidly waned. As criticism of public expenditure as inherently wasteful has mounted, shadow pricing, which might portray 'inefficiency' at market prices in another light, has become distinctly unfashionable.

The traditional emphasis on inputs rather than outputs must play some part in perpetuating the belief that public expenditure is 'unproductive', a burden upon the market sector. This view reserves the terms 'productive' or 'wealth-creating' for those activities which are profitably marketed, with prices thereby being attached to consumption. It embodies a very narrow view of the nature of wealth, limited to the building up of financial wealth, itself implicitly backed by physical assets. It incorporates many implicit assumptions about the valuation of both inputs and outputs: for example, that the market prices of inputs properly measure opportunity costs and there are no externality or public good characteristics causing output valuation problems.

If a proper framework of analysis is adopted, public services such as the Health Center clearly produce outputs, however difficult to measure and value. There is something obviously false in the proposition that health care is a productive 'wealth-creating' industry only if private and marketed. Quite apart from any of its other purposes, the Health care center provides medical care for which, under other institutional arrangements, individuals would be willing to pay. Removal from the market eliminates a ready measure of output, though not necessarily the most appropriate one.

Such crucial differences between the public and private sectors make it imperative that the search for improved efficiency is conducted with due regard being paid to them. A government with sufficient political resolve could cut public spending. Whether that improves the efficiency of the public sector, let alone of the economy as a whole is a very different and more complicated matter.

Evaluating policy initiatives

For all the government's talk of 'rolling back the public sector' and opposition complaints of 'cuts', the public expenditure/GDP ratio went up steadily during General Obasanjo's first and second terms. However deep the divisions over what ought to be in the public sector, it is of paramount importance to all concerned that the resources which it consumes are managed effectively. Commitment to the values underlying the welfare state should not preclude a willingness to recognize deficiencies in the public sector.

It is essential that the current presumption of 'public bad, private good' is not rebounded into 'public good, private bad'. Commitment alone is inadequate: the welfare state needs critical friends, not apologists. This is, understandably, a difficult public position to maintain when the government constantly engages in blanket condemnations of the public sector.

Nevertheless, if a coherent counter-strategy to that of retrenchment and wholesale privatization is to be effective, a commitment to efficient public sector management must be one of its bulwarks.

The earlier analysis of public/private differences casts light on a number of contemporary developments. It is vital that managerial initiatives are evaluated on their merits and not dismissed by those sympathetic to public expenditure simply because they have been originated by a government hostile to many public sector activities.

It is becoming increasingly obvious that there are parallel weaknesses in other parts of the public sector, such as the NHS and local government, where costing information is often perfunctory and unreliable.

Attempts to instill into the public sector the cost-consciousness of the best parts of the private sector are wholly admirable. But cutting expenditure is not synonymous with increasing efficiency. If ministers did not appear to value what the President scrutinizes primarily for their ability to generate loudly acclaimed savings (albeit very small in relation to public expenditure) and for contributions to independently chosen targets for reductions in the size of the civil service, it would be possible to give two cheers rather than one.

What is disturbing about the government exercises is that they are not always sensitive to the point at which genuine public/private differences do emerge. Cases which exhibit externality or public good characteristics are approached as if they did not (for example, the government's statistical services and industrial training). The issue of benefit measurement is glossed over, with profitability and efficiency being confused.

Similarly, the requirements of equity are handled loosely and rather unsympathetically without a recognition that governments must often provide facilities in unpromising circumstances, where profitability would indicate otherwise.

There is a clear role for government-type cost-cutting exercises, provided that the subtleties of costs and benefits in the public sector are understood. More permanent and more ambitious evaluation machinery is nevertheless required. But the lesson of government is that nothing will happen without sustained political commitment.

The government's rhetoric, as opposed to the practical steps it has as yet taken, suggests a major extension of the scope of charges for public services, together with a sharp upwards revision of the level of existing charges. The implementation of such an approval would raise a number of important philosophical and economic questions about the purpose, role and structure of the welfare state. These are sidestepped here, with attention focusing on a number of practical consequences.

Proposals for an extended range of charges in the NHS provide excellent illustrations of the issues involved. For example, the Nigeria Medical Association (NMA) proposed to the Federation on the National Health Service that there should be hotel charges for overnight accommodation in hospitals and charges for each visit to a general practitioner. What will worry economists interested in the efficiency of the NHS is that unpriced inputs will now be substituted for these newly priced inputs. This substitution would not be based on true opportunity costs but on the implicit relative prices established by such charging practices.

For example, the introduction of hotel charges would encourage individual doctors and patients to make a greater use of out-patient clinics, ambulance services and local authority residential accommodation.

This would occur even in those cases where the minimization of all relevant costs would be achieved by the use of in-patient facilities. On occasions, reluctance to use such priced facilities would be clinically damaging, perhaps by inducing delays before proper treatment was sought.

Similarly, consultation fees at general practitioners' surgeries would encourage direct approaches to hospitals if these had no comparable charges, requests for much larger prescriptions and delays in seeking attention which might eventually create the need for much more expensive treatment.

The common theme of all these cases is that an inappropriate set of relative prices can encourage resources to be wasted, in the sense that costs are not minimized. If an activity is to remain in the public non-market sector, very great care has to be taken when introducing piecemeal charging in order to ensure that this does not have side-effects at odds with programme objectives.

Conclusion

The severity of the impending budgetary crisis will make the search for greater efficiency in the public sector of paramount importance. In the last resort, it is the supporters – not the detractors – of the welfare state who stand to gain the most from securing such improvements. They cannot afford to concede the cause of efficiency, not least because their opponents often bring to such issues an exceptionally narrow and unsustainable notion of efficiency.

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