Fiscal Federalism: Fiscal Discipline and Service Delivery in Nigeria

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1.1 Introduction

Fiscal federalism has a long history in Nigeria. It dates back to 1946, when the Richards Constitution was introduced. Over the years, fiscal commissions were appointed to work out fiscal and financial arrangements that were consistent with the assignment of powers and responsibilities to each level of government (see Ekpo and Englama, Chapter 12 in this study). The idea was that each level of government should have adequate funds to effectively and efficiently discharge its responsibilities.

This arrangement was entirely consistent with the welfare optimization policy and development objectives of successive Nigerian opinion leaders and administrators.

However, with the intervention of the military in politics in 1966, Nigeria was governed more or less like a unitary state. Indeed, state budgets were subject to the approval of the central authorities. Recently, with the return to democratic governance, there has been significant movement towards decentralization. This derives from the perception that the closer government is to the people the better it can respond positively to the demands of the citizenry, in terms of service delivery. Since 1999 substantial amounts of resources have accrued to the various levels of government and that has presented tremendous opportunities for service delivery. For instance, government revenue as a percentage of GDP rose from 16.3 in 1998 to 19.8 in 2003 and 20.4 in 2005. The government of Nigeria has committed its efforts to the implementation of the Millennium Development Goals (MDGs). The above developments have provided an opportunity for realizing the goals of improved welfare of the citizens. Even then, there are acute challenges as anecdotal evidence indicates that performance on the major indicators of MDGs has been less than satisfactory. The challenges include inadequate trained manpower, corruption and lack of good leaders, particularly at the state and local government levels, weak institutions, volatility in funding and political economy issues.

This chapter aims to throw light on these issues as well as suggest options for making progress.

The rest of the chapter is organized as follows: section 1.2 highlights the challenges of fiscal discipline and service delivery in states and local governments; section 1.3 looks beyond the financial disbursements and uses physical indicators to measure the performance of the identified levels of government; section 1.4 examines the options for progress; and section 1.5 summarizes and concludes the chapter.

1.2 Challenges of fiscal discipline and service delivery in states and local governments

1.2.1 The political economy of fiscal relations and service delivery in Nigeria

The debate on Nigeria's fiscal relations hinges on the fundamental question of who gets what of the national cake, when and how. This is fundamental given that Nigeria as a monolithic economy gets over 80 per cent of its revenue from crude oil; by virtue of the constitutional provision, this revenue must be disbursed to the three tiers of government. It also explains why the formula for revenue allocation has continued to be at the heart of public debate, and why public office holders are hardly held accountable for the misuse of revenues derived from the national oil wealth.

Typically, the challenges of intergovernmental fiscal relationship in Nigeria hinge on the equity of the expenditure assignment and revenue-raising functions amongst the three tiers of government. The revenue-sharing and expenditure assignment formula has been generally inadequate in addressing the needs and resource gaps in the three tiers of government.

The strategy and institutional arrangement for redressing the mismatch have been approached incrementally over the years. Beginning with the era whereby a committee was appointed every five years to make recommendations regarding fiscal responsibilities among the tiers of government, the 1999 Constitution of the Federal Republic of Nigeria, under the third schedule, provides for the establishment of a body known as the Revenue Mobilization Allocation and Fiscal Commission. Its functions, inter alia, are to:

> monitor the accruals to and disbursement of revenue from the Federation Account; review, from time to time, the revenue allocation formulae and principles in operation to ensure conformity with changing realities; provide that any revenue formula which has been accepted by an Act of the National Assembly shall remain in force for a period of not less than five years from the date of commencement of the Act; advise the Federal and State Governments on fiscal efficiency and methods by which their revenue can be increased.

The expenditure assignment functions to the three tiers of government fall within shared responsibilities. Accordingly, the federal government is responsible for the criminal justice system (police, justice, prisons and so on), defence, external affairs, higher education and such other functions with national externalities.

It shares responsibilities for social services such as education, health, welfare and housing concurrently with the state governments. While the federal government may determine some broad policies in these sectors, the states implement these policies in terms of actually providing some of those services. States, in addition, have other responsibilities, such as constructing and maintaining roads. The local governments, on the other hand, have the responsibility of providing community-based services and infrastructure, including construction and maintenance of roads, streets, street lighting, drainage and other public highways; parks, gardens and open spaces; provision and maintenance of primary, adult and vocational education; development of agriculture and natural resources, other than the exploitation of materials; provision and maintenance of health services; and/or such public facilities as may be prescribed from time to time by the House of Assembly of a state.

In terms of revenue assignment, the fiscal system in Nigeria grants minimal fiscal autonomy to the sub-national governments. For instance, all broad-based taxes such as company income tax, VAT, custom and excise duties, tax on petroleum products and education tax, are assigned to the federal government. States impose minor levies such as gambling taxes, motor vehicle licence fees and user fees on economic and social services. The local governments on the other hand exercise greater revenue powers than the states. They can levy property taxes, businesses, rates on radio, television, bicycle, canoe, and user charges utilities like water, sewage and waste disposal. In actual practice, as will be discussed later, the sub-national governments do not make serious efforts to generate revenue internally, because of their dependence on the allocation from the federally generated revenue.

While there is an apparent disconnect arising from expenditure and revenue responsibilities, this has not been as visible and controversial as the system of transfers or sharing of the national revenue. The sharing formula is based on arcane principles such as equality of states and land mass. Why should the states be equal in consumption and unequal in production? And why should a huge land mass of unfertile and unproductive soil be rewarded more than a small land mass of fertile and productive soil? The major challenge of fiscal federalism is to ensure equitable distribution of resources to all groups that make up the nation and, at the same time, guarantee that the geese that lay the golden eggs are adequately rewarded.

1.2.2 Funding

There are basically two major sources of funds for the states and local governments. These are allocation from the Federation Accounts (including VAT, Stabilisation Receipts and General Ecology) and internal revenue generation (tax and non-tax).

Revenue allocation from the Federation Account (including VAT and others)

The persistent emotional public discourse on 'resource control' is predicated on the imbalance in the redistribution of the federation revenue. Table 1 shows that

Table 1 Statutory allocations to local government areas (percentage of total; excludes derivation)

Year	North East	North West	North Central	South East	South West	South South
1999	12.7	24.3	15.9	12.0	18.6	16.4
2000	14.6	28.3	14.7	10.7	16.0	15.8
2001	14.6	30.5	15.0	10.2	14.9	14.7
2002	13.2	26.6	15.4	11.8	17.2	15.7
2003	12.6	25.1	16.4	12.1	18.1	15.7
2004	12.6	25.4	16.0	12.1	18.1	15.8
2005	12.6	25.5	15.8	12.1	18.1	15.9

Table 2 Selected welfare indicators

Welfare indicator	North East	North West	North Central	South East	South West	South South
Access to water	87.4	92.6	80.5	63.6	93.6	78.5
Safe water source	30.4	50.2	48.5	40.3	73.1	45.5
Access to electricity	29.5	36.9	43.9	63.9	78.1	61.2
Access to primary school	70.2	74.7	78.8	59.8	87.5	70.3
Access to secondary school	35.3	42.5	46.8	31.9	68.6	47.1
Health access	47.3	54.2	60.1	36.4	72.3	44.6

Source: Eboh and Igbokwe (2006).

allocation to the predominantly oil-producing states of the South (excluding mineral derivation), have been fairly constant and relatively small, compared to the other geopolitical zones of the North West and North Central. The distributional inequality is attributable to the allocation formula which rewards 'land mass'.

The clear paradox emanating from the indicators shown in Table 2 is that states from oil-rich areas seem to perform worse in terms of service delivery than the other states. States in the South South and South East zones benefit from mineral derivation and yet their performance on all the welfare indicators is relatively poor.

Internally generated revenue (IGR)

Internal generated revenue (IGR) efforts of states and local governments are generally very weak. Between 2001 and 2005, IGR accounted for a paltry 11.9 and 4.8 per cent of the total revenue of states and local governments respectively.

In terms of growth, Table 3 also reveals a declining trend in IGR over the years. This development raises a lot of concerns. Typically, service delivery is more constrained and volatile, as it leads to over-dependence on allocation from the central government. This over-dependence on allocation from the Federation Account weakens institutions responsible for internal revenue generation, such as the Board of Internal Revenue (BIR) and, over time, the capacity to generate more revenue diminishes.

1.3 Service delivery at state and local government levels

The constitution assigns service delivery responsibilities to the three tiers of government with the states and local governments playing the most significant role in the delivery of basic services such as education, health, housing, water, and waste disposal services. Given the Millennium Development Goals and the huge resources that have accrued to the various levels of government it is pertinent to review the performance of service delivery since the return to democratic rule in 1999.

There are a number of performance and non-financial indicators that are used for such assessment. In addition to financial performance, we shall examine other indicators of performance in this chapter.

1.3.1 Education

Under the MDGs, the major goal for education is to achieve universal primary education by the year 2015; in other words, to ensure that by that year children everywhere, boys and girls alike, will be able to complete a full programme of primary schooling. In line with this, one of the major objectives of the national policy on education is to make education accessible to all Nigerians. The policy emphasizes education for self-reliance, self-development and the technological development of the nation. In addition, it stresses the need to raise the quality of education at all levels in order to make the products of the system more useful to the society. While the state and the federal governments are to establish and fund educational institutions at secondary and tertiary levels, the local governments

Table 3 Relationship between allocation, internal revenue and expenditure (percentage growth over preceding year)

	Allocation		**Internal revenue**	
Year	**State**	**Local government area**	**State**	**Local government area**
2002	–3.9	0.3	50.8	73.1
2003	37.8	126.1	32.5	93.6
2004	45.2	28.9	13	11.1
2005	18.5	31.2	–5.75	7.3

are to bear a greater proportion of the cost of financing primary education. Based on the survey of selected states, we shall review the performance of the states over the period 1999 to 2005.

Returns from the survey showed that two out of the four states sampled, Rivers and Enugu, have had significant increases in the total number of enrolment for both primary and secondary schools and staff strength. The other two, Lagos and Kano, recorded just marginal increases during the period of the analysis, 1999–2005. The major implication of the increase in enrolment rate and teacher strength in Rivers and Enugu is the increase in the pupil–teacher ratio from 39 and 29 in 1999 to 52 and 42, respectively, in 2005. This is an indication that each teacher in these states is having more pupils to cope with, a situation that might impact negatively on the performance of both the teachers and pupils. However, there is a slight improvement in the ratio in both Kano and Lagos as the ratios declined from 56 and 33 in 1999 to 30 and 32, respectively, in 2005. Also, the number of classrooms has remained virtually stagnant over the period. Indeed, the ratio of enrolment to classroom has deteriorated significantly in Rivers and Enugu; whereas in 1999 there were on average 28 and 26 pupils to a class at the primary school, by 2005 the number had risen to 49 and 57 pupils per classroom. For Lagos and Kano, the number of pupils per class declined from 31 and 45 in 1999 to 29 and 31 in 2005. However, the adult literacy rate has ranged between 59 and 88 per cent among the states, with Kano having the highest range of 73–88 per cent during the period.

The observed trends in the education indicators above reflect, in part, the low proportion of expenditure on education that is devoted to capital items.

The poor state of services delivery is reflected also in the number of pupils that progress from the primary to secondary schools. The average is 25 per cent. This state of affairs has led to a situation in which the middle and upper classes now send their children and wards to private schools and has led to a wide gap in the quality of education between the products of the two sets of schools.

An attempt to redress the situation has been in the form of the intervention by the central government which has come up with the policy of universal basic education. This is intended to increase funding and accessibility.

1.3.2 Health

Nigeria's health policy aims at providing affordable health services to all Nigerians. It focuses on preventive health care delivery through the implementation of a primary health care delivery system. The system emphasizes health education, adequate nutrition, safe water, sanitation, and maternal and child health. Health care at the secondary level, which involves the setting up of hospitals, is handled by state governments while tertiary health care delivery is handled by the central government.

The key goals of the health sector under the MDGs are to reduce child mortality under the age of five by two-thirds and to improve maternal health by reducing the maternal mortality rate by three-quarters.

For total coverage, adequate health care delivery involves all the tiers of government ranging from the local to the federal government level. Whereas expenditure has increased in absolute terms, the share of health sector in total state expenditure has been on the decline. The ratio of health expenditure, which averaged 6.9 per cent for the sampled states in 1999, had declined to 5.1 per cent by 2005. Also, as a proportion of GDP, the share of expenditure on health has been dismal.

A cursory look at the sampled states also shows that there has been little or no improvement in non-financial indicators. Life expectancy at birth has remained virtually constant in all the states, ranging between 51 and 55 per cent during the period 1999–2005. Infant and maternal mortality have also remained fairly constant, while staff strength has declined. For instance, the ratio of doctors to health institutions, which in 1999 was 1.1, 7.2 and 0.2 in Rivers, Enugu and Kano, had declined to 0.7, 4.9 and 0.1, respectively, in 2005, while that of Lagos increased slightly from 2.4 in 1999 to 3.0 in 2005. A breakdown of the number of beds per hospital showed that Rivers and Enugu averaged 58.9 and 160.2 during the period.

1.3.3 Housing

The housing needs of the country have been very high as a result of population growth, which has averaged 3.0 per cent per annum, rapid urbanization due to rural–urban migration, and the high cost of building materials. The housing policy of the nation aims at providing affordable housing for all. The target date for accomplishing this goal was year 2000. While the objective has not changed, a new deadline for accomplishing this national objective has not been set. As with the health sector, the outlay on housing has been rather low, as it has always been less than 1 per cent of the total expenditure of the states. For instance, the capital outlay on housing in Lagos between 1999 and 2005 averaged 1.3 per cent of expenditure, while that of Enugu was 0.01 per cent during the period. Housing deficits have been estimated at about 15 million units for the country. Despite the huge housing deficits, the total number of housing units built by the state from 1999 to 2005 was 2289. Also, the total approvals given for plots and Certificate of Occupancy (C/O) in Lagos and Enugu were 20,879 and 21,454, respectively, during the period.

The Land Use Act has constrained the transfer of titles and made mortgage finance extremely difficult. In terms of quality of houses, the standards for residential structures are generally lower than international standards, particularly with regards to enforcement. Most housing schemes do not offer the range of urban services and amenities; water, sewage and waste (garbage) disposal are clearly inadequate if not outright absent. There is therefore the need to evolve policies that will encourage greater participation by the private sector in the delivery of housing to the low-income groups. In addition, it has become critical that local governments take a more focused approach to capacity-building in view of the increasing role they have to play in housing delivery.

1.3.4 Water resources

As with the observed trends in other social indicators, the expenditure on water has been on the decline or increased marginally in most of the sampled states. For instance, in Rivers the ratio of capital expenditure on water to total state expenditure declined from 1.5 per cent in 1999 to 1.0 per cent in 2005. That of Lagos remains constant at 0.2 per cent, while Enugu rose marginally from 0.2 per cent to 0.3 per cent. However, in Kano, much more money was devoted to providing water. As a result, the capital outlay in the state rose from 5.8 per cent of total state expenditure in 1999 to 9.5 per cent in 2005.

One major observation from the survey is that the states have continued to allocate the bulk of their water production to domestic uses.

1.4 Options for progress

Generally, distributive policies can be optimally formulated and implemented under an efficient institutional and legal framework. Service delivery in Nigeria has suffered serious neglect because of institutional weakness. The irony of institutional weakness is that the Nigerian labour market can boast of highly qualified graduates, yet the key ministries, departments and agencies (MDAs), which are responsible for distributive and redistributive policy formulation and implementation, are deliberately staffed with incompetent and corrupt bureaucrats as a result of widespread practices of nepotism in the recruitment of personnel.

In the circumstances, dependence on the MDAs per se to deliver quality services, such as health, sanitation (garbage collection), road construction and rehabilitation, could be counterproductive. A pragmatic strategy, which would yield better service delivery at the state and local government levels and at the same time strengthen the capacities of the MDAs, is to allow for private sector partnership with the MDAs. The entrenchment of public–private sector partnership (PPP), will certainly enhance the quality of service delivery at the state and local governments. The PPP can take the form of build, operate and transfer (BOT), which is suitable for road construction, and/or outright outsourcing, which is appropriate for sanitation and primary health care delivery. Public service reform is another option which can be experimented with in the medium to long term.

1.4.1 Rethinking fiscal federalism

The MDAs at the sub-national governments are often caught up in the web of inadequate funding and rent-seeking. The current incentive structure favours the award of contracts to ‘own’ companies in order to extract maximum rent from the transfers received from the central government. The analyses thus far call for a new thinking in fiscal federalism, if Nigeria is to meet the Millennium Development Goals. This new thinking would provide a solution for the problem of fiscal indiscipline and poor formulation and implementation of distributive policies at the state and local government levels.

1.4.2 Economy of scale in the provision of economic and social services

Hitherto, whereas lower tiers of government exclusively own their MDAs in health, sanitation, road construction and other key areas, 'co-ownership' of MDAs with sister states/local governments represent a paradigm shift which can take advantage of economies of scale in major service delivery. Economy of scale can be achieved if contiguous states or local governments pool their resources to provide these services instead of the proliferation of weak institutions within states and local governments. Under this arrangement, efficiency would be achieved in the provision of joint service delivery in the sub-national governments.

1.4.3 Matching grants

The introduction of matching grants instead of direct allocation based on the discredited revenue-sharing formula is hereby advocated. Thus, revenue accruing to sub-national governments from the federation should be in proportion to their internally generated revenue. This would enhance internal revenue generation, restore social contract and good governance, rejuvenate the moribund internal revenue generation institutions, and reduce over-dependence on the central government. Rediscovering and relying more on internally generated revenue will reconnect the governed and the public officials.

1.4.4 City managers

Public office holders in the sub-national governments typically enjoy perquisites of office to the detriment of service delivery. A new institutional framework for responsive and efficient service delivery would be to initiate a political reform that would allow for the appointment of 'city managers' to run the affairs of the local governments. Such managers would be appointed by the elected councillors who would exercise oversight functions over them. As in the United States of America, where the engagement of city managers has been tested and accepted, it is hoped that the introduction of city managers to administer the local governments in Nigeria would usher in a new era of fiscal responsibility and good service delivery to the citizens.

1.5 Conclusion

Nigeria's fiscal federalism is in crisis. The persistent agitation for resource control by the oil-rich states and ethnic minorities of the South South geopolitical zone can be ignored only at great cost to national unity. Against this background, there is a need to revisit the old revenue-sharing and expenditure assignment formula. In particular, there is a need to assign less weight to criteria such as 'land mass' because of its inherent inequality and redistributive distortions. Similarly, merging criteria such as 'equality of state' and 'population' into one should be given serious consideration, since they are essentially duplicative.

Going forward, there is a need to adopt a strategy which will make the sub-national governments less dependent on the central government. A redistributive fiscal policy anchored on matching grants will improve the internal revenue generating efforts and engender healthy competition amongst the sub-national governments. Looking inwards for fiscal sustainability will restore social contract and improve service delivery in the sub-national governments.

Building and strengthening institutional capacities at the sub-national government level represents an urgent task which must be undertaken. However, a short-term solution to improving the quality of service delivery and deriving value for money is via outsourcing, recruiting city managers and engaging in large-scale private–public partnership, as discussed in section 1.4 above.

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