Fiscal Federalism and Service Delivery in Nigeria: The Role of States and Local Governments

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Introduction

1. The relative roles of the three tiers of government—the federal government, the state governments, and the local government authorities (LGAs)—in public service delivery has emerged as one of the most important topics of open and vigorous debate in the new democratic climate in Nigeria. There have been increasing calls for intergovernmental fiscal relations to be reassessed in light of a widespread belief that although the states and LGAs are assigned primary responsibility for the delivery of basic public services, they are not equipped with adequate revenue resources to fulfill their expenditure obligations because the bulk of government revenues is retained by the federal government. The discussion is overwhelmingly centered around the revenue sharing formula that allocates resources from the Federation Account amongst the three tiers of government—currently 48.5 percent of the resources are transferred to the federal government, 24 percent to the state governments, and 20 percent to the LGAs.[1] The sub-national tiers of government are now demanding that their respective shares be substantially increased.

2. However, there is palpable lack of discussion around whether the current practice of assuming expenditure responsibility and undertaking its implementation is such that a mere shift in resource allocation will achieve the desired objective of delivering better services to the majority of Nigerians. A real issue at stake, which has not received much attention to date, is how effectively do the different tiers of government use their existing resources to perform their functions. In fact, it may be argued that in the context of the Nigerian economy, states and LGAs receive substantial amount of resources, with their total revenues amounting on average to over 5 percent of GDP between 1990 and 1999, and over 10 percent of GDP after the oil price increase in 1999. This report will focus on how the federal system actually works in delivering basic services, and whether there is scope to realign responsibilities—both financial and managerial—to improve accountability and performance. The analysis will seek to provide some informed speculation on what could be expected in terms of outcomes if revenue shares were changed without any reassessment of the sharing of expenditure responsibilities. Thus, it aims to contribute to the process of national dialogue in the country to reach an agreement on which tier is best suited to undertake what expenditure responsibilities and how these should be financed.

[1] The remaining 7.5 percent is distributed between derivation funds for oil and mineral producing areas, a stabilization fund, an ecological fund, and the Federal Capital Territory (FCT).

3. The analysis will draw upon fieldwork undertaken in 6 states and 12 LGAs to determine the impact of the federal arrangements on basic service delivery in four key areas—primary education, primary health care, potable water and sanitation, and local roads linking communities to schools, health facilities, markets etc.—all of which are consistently identified by the poor in consultation exercises as among the most important services for their well-being.[2] These are also services for which primary responsibility is assigned to the states and local governments, and hence suitable areas to study how the federal system works in practice, and what institutional arrangements would enable better performance in the delivery of these essential services. The general insights gained from this exercise is therefore applicable to other sectors and services.

Historical Context

Current structure of fiscal federalism in Nigeria—a legacy of military rule

4. A brief tour through the history of Nigerian federalism reveals sharp turning points in federal and regional fiscal relations, based alternately on principles of derivation, national interest, and the centripetal forces of military governments[3]. With the adoption of a federal constitution in 1954, Nigeria provided fiscal autonomy to its three regions both over expenditure decisions and over a local revenue base (consisting primarily of mining rents, personal income tax, and receipts from licenses). Centrally collected revenues, primarily from export, import and excise duties, was distributed to the regions according to the derivation principle. However, after independence in 1960, the derivation principle was modified in the interest of national unity, and the federal system of government began to be used to accommodate the diverse social and political interests of a multiethnic state.

5. Since 1966, under successive military regimes, revenue administration and collection became increasingly centralized, and regional allocation was engineered at the discretion of the military government. Simultaneously, expenditure responsibilities and government functions also became centralized, with the federal government assuming the role of the engine of social and economic development. Furthermore, it is widely believed (see Bach, 1989[4]) that the federal system began to be perversely used to distribute national resources in a wasteful manner, through the creation of new states and local governments along ethnic and political lines, without regard for economic viability. Nigeria's federal units grew from three to four regions during 1960-6, and then to 12 states by 1967. In 1976, local governments became recognized as the third tier of government, entitled to statutory allocations from both federal and state governments,

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[2] *Nigeria: Participatory Poverty Assessment*, The World Bank, September 1995

[3] This discussion of the history of fiscal federalism in Nigeria is based upon Ekpo (1994) and Ehwarieme (1999). See their papers for further details: Ekpo, Akpan H. 1994. "Fiscal federalism: Nigeria's post-independence experience, 1960-1990", *World Development*, vol. 22, no. 8, 1129-1146; Ehwarieme, William, 1999. "The military, oil and development: the political economy of fiscal federalism in Nigeria", in *Fiscal Federalism and Nigeria's Economic Development*, collected volume of papers presented at the 1999 Annual Conference of the Nigerian Economic Society.

[4] Bach, D.C. 1989. "Managing a plural society: the boomerang effects of Nigerian federalism", *The Journal of Commonwealth and Comparative Politics*, vol 27.

and seven additional states were created bringing the total number to 19. Over the decade of the ‘90s this number has almost doubled to the current number of 36 states, and 774 local governments, all of which were created under military rule.

6. It would appear, therefore, that the current federal arrangement is a direct legacy of military rule, with the attendant risk that states and LGAs were created to behave more as agents of the center, and perhaps for the primary purpose of political distribution of national resources, and not for effective delivery of public services. Since the death of General Abacha, and the establishment of democratic government in 1999, powerful political leaders have emerged at the state level demanding constitutional guarantees of their fiscal autonomy. The status of the LGAs is somewhat more ambiguous—although the chairmen are clamoring for a greater share of resources and arguing that as grassroots organizations they are most responsive to the people, there is deep distrust at higher tiers about both their capacity and their accountability. The task of reconciling differences and beginning the process of setting-up institutions, so that the federal system inherited from the military regime may become effective and accountable in a democratic environment, fell to the framers of the 1999 Constitution.

Prescriptions of the 1999 Constitution

7. The current distribution of responsibilities is provided in the Second and Fourth Schedules of the 1999 Constitution—Part I of the Second Schedule contains the exclusive legislative list on which only the federal government can act; Part II contains the concurrent legislative list on which both the federal and state governments can act; the Fourth Schedule provides the list of functions of the Local Government Councils. Hence, strictly speaking, the Constitution does not really provide the list of functions to be executed by the Federal Government of Nigeria and the states (as it does for the Local Government Councils), but only the subjects upon which they can legislate. However, these legislative lists form the guidelines for other legal decrees and sector policy reports that lay out the specific expenditure responsibilities of the different tiers of government.

8. The exclusive responsibilities of the Federal Government of Nigeria are broadly in accordance with standard international practice, including matters of national concern such as defense, foreign affairs, regulation, and monetary policy. The responsibility of service delivery in the areas of education, health, infrastructure, agriculture and industry is concurrently shared with states and Local Government Authorities, with the respective assignments apparently derived from the considerations of inter-jurisdictional spillover effects and economies of scale, although there is no formal reference to the underlying principles in the official literature. Table 1 provides a list of expenditure responsibilities by different tiers of government.

Ambiguous status of local governments

9. Reflecting the state of public opinion on this subject, the 1999 Constitution is also somewhat ambiguous with regard to the autonomy of Local Governments from the authority of the state government within whose boundaries they fall. Article 7 empowers

the state government to enact legislation with regard to "*the establishment, structure, composition, finance and functions*" of democratically elected local government councils. Furthermore, even in the Fourth Schedule, which provides a list of functions to be performed by Local Government Councils, some critical areas of basic service delivery that have traditionally been regarded as the responsibility of Local Government Authorities—primary education, health services, and the development of agriculture—are now implied to be the responsibility of state governments, with Local Government Council involvement relegated to that of participation in the state's execution of its functions. To quote from the Constitution: "*The functions of a local government council shall include participation of such council in the Government of a State as respects the following matters: (a) the provision and maintenance of primary, adult and vocational education; (b) the development of agriculture and natural resources, other than the exploitation of minerals; (c) the provision and maintenance of health services; and (d) such other functions as may be conferred on a local government council by the House of Assembly of the State.*"

10. Hence, the basic services which are the focus of this study—primary education and health, water and sanitation, and local roads—are assigned as the responsibility of the state and local governments, with no clear legal delineation between the relative roles of these two sub-national tiers of government. As things stand now, the state-level discretion with regard to the powers of the LGAs has led to wide variation in the extent of autonomy afforded to LGAs both within and across states—in many cases they function as mere administrative extensions of state governments.

Table 1. Nigeria: Expenditure Assignments

Tier of Government	Expenditure Category
Federal only	Defense; Shipping; Federal trunk roads; Aviation; Railways; Posts, telegraphs and telephones; Police and other security services; Regulation of labor, interstate commerce, telecommunications; Mines and minerals; Social Security; Insurance; National statistical system; National Parks; Guidelines for minimum education standards at all levels; Water resources affecting more than one state;
Federal-State (shared)	Antiquities and monuments; Electricity; Industrial, commercial and agricultural development; Scientific and technological research; Statistics and surveys; University, technological and post-primary education; Health and social welfare;
State-Local (shared)	Primary, adult and vocational education; Health services; Development of agriculture and non-mineral natural resources;
Local government	Economic planning and development; Cemeteries, burial grounds; Homes for the destitute and infirm; Markets; Sewage and refuse disposal; Roads, streets, street lighting, drains, other public facilities;

Source: 1999 Constitution and various sector policy reports

Relation with principles of fiscal federalism and international practice

11. The above described distribution of expenditure responsibilities is largely in accordance with the economic principles of fiscal federalism and common practice by other decentralized countries in the world. The most general economic theory of fiscal federalism postulates that the provision of services should be located at the lowest level of government consistent with the incidence of costs and benefits, since lower tiers of governments have greater information about local conditions and can therefore provide services that are better suited to the needs of the local population. In large federations like the US, Canada, and Australia, both financing and supply of basic services are primarily determined locally, with few instances of general sharing of revenues collected by higher tiers of government. The underlying rationale is that communities will choose an efficient level of services in accordance with their preferences, equating the marginal tax cost of providing the service with the marginal benefit they receive from it. If in certain localities, with lower yielding own tax bases, there is a shortfall in delivering services according to some nationally defined minimum standard, the national government may supplement local income through equalizing transfers. Australia, Germany and Canada have policies of fiscal equalization among jurisdictions. Switzerland and US are less so. There is also widespread use made of special purpose transfers to encourage certain types of spending by lower tiers that are considered to be either national priorities or to have positive spillovers to other jurisdictions.

12. Sub-national revenue potential is limited by the inter-jurisdictional mobility of economic agents, and most naturally "local" taxes, that is, those with low inter-jurisdictional mobility, have low revenue yields. Hence, typically, sub-national own-revenue sources are not commensurate with sub-national spending responsibilities, creating a vertical fiscal imbalance across the tiers of government. The sub-national revenue and expenditure gap is then filled by fiscal transfers from the federal government, but in the experience of the developed countries it has usually been possible to design these transfers such that at the margin, additional sub-national expenditure is paid for by locally generated revenues.

Over dependence on federal transfers—risk to accountability

13. However, in developing countries local governments have access to very limited tax bases and face lower potential of cost recovery because the population they service is largely poor. There may also be a larger role of equalizing transfers in the presence of wide regional variations in fiscal capacities. Sub-national governments may therefore be largely dependent on federal transfers. Almost exclusive reliance on federal transfers creates conditions for lack of accountability as local governments may shift blame and responsibility for service delivery to higher tiers of government that control the bulk of

government revenues. The local population may not hold the local government accountable either because they perceive them as having no financial power to deliver the goods, or because they are not as informed or vigilant about monitoring resources that arrived from external sources outside the community. In addition, over dependence on federal resources may lead to soft budget constraints, and accompanying misallocation of resources and macroeconomic instability (see Box 1).

> **Box 1:** *Decentralization and the challenge of soft budget constraints*
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> There has been tremendous concern in international policy circles that developing countries that are rapidly decentralizing are exposed to the risk of macroeconomic instability due to growing fiscal deficits and soft budget constraints at sub-national levels. While similar concerns exist for developed countries as well, the risk is perceived as exacerbated for developing countries because of lower potential revenue bases at local levels, higher dependence on federal transfers, and poor quality of legal institutions. The concern gains credence largely from individual case studies of sizable and persistent sub-national deficits in federal countries like Argentina, Brazil, and India during the 1990s.
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> These individual country experiences serve to strengthen a strong intuitive and theoretical link between fiscal decentralization and perverse incentives for fiscal profligacy at sub-national levels. The main argument is that the sharing of national fiscal resources across different sub-national jurisdictions presents a standard common pool problem of economics, where each sub-national agent will try to maximize its share of the national resources without internalizing the effect on other jurisdictions. This leads to inefficient and over-utilization of the common national resources, which in turn may create macroeconomic instability.
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> Even if the channels of regular fiscal transfers, such as revenue sharing and federal grants, are rules-based and transparent, the problem of soft budget constraints at sub-national levels may be more difficult for the national government to manage. The soft budget problem can be described as follow—suppose a sub-national government spends more than it receives and finances its deficits by borrowing beyond its means from the market; then, when it hits a fiscal crisis and is unable to repay its debts, it approaches the national government for a bail-out. At that stage, the national government may be unable to refuse because of the adverse consequences on the residents of that region. The national government is thus vulnerable to sub-national fiscal manipulations because it cannot commit in advance to punishing errant sub-national governments that borrow and spend beyond their means. This was strikingly illustrated in Brazil in the 1990s by the deficit problem of large states with powerful Governors, which were subsequently bailed out by the national government, but contributed to a national fiscal crisis.
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> Federal OECD countries like the US and Canada, have not faced such episodes of macroeconomic instability arising from sub-national fiscal policies because of historical precedents and strong legal institutions that protect the national government from having to bail-out sub-national governments. This institutional setting creates the right incentives at all levels of government because each level is liable to the voters for its own fiscal decisions and its impact on living standards.

14. Even amongst developing countries, Nigerian fiscal federalism is distinguished by the overwhelming concentration of tax jurisdiction and collection at the level of the federal government. All the major sources of government revenue—petroleum profits tax, import duties, excise duties, mining rents and royalties, and companies income tax—are controlled by the federal government. State and local governments have jurisdiction only over minor and low-yielding revenue sources, with the exception of personal income tax at the state-level and property tax at the local level. Between 1993 and 1997, federally collected revenue amounted to an overwhelming 95.62 percent of total government

revenues.[5] In this same period, expenditures by state governments averaged about 21 percent, and by local governments about 7 percent of total government expenditure. Hence, sub-national expenditures are largely financed out of federal transfers. In 1999, federal transfers accounted for 75 percent of the total revenue of states and 94 percent of that of local governments.

15. The problems of accountability indicated above therefore apply singularly to the Nigerian experience. Unless transfers are appropriately designed, sub-national governments may always be able to blame lack of resources as the problem behind lack of performance without having the right incentives to deliver with any given level of resources. There also appears to be a real risk of soft budget constraints at sub-national levels, with states and local governments resorting to excessive borrowing in domestic markets in expectation of federal bailouts. In fact, under the military regimes there had been episodes of reckless borrowing that threatened to disrupt fiscal stability and led to temporary suspension of the borrowing powers of sub-nationals. Recent attempts by the governor of the Central Bank of Nigeria to regulate financial accounting by states and monitor their domestic debt has been furiously rebuffed by state governors as an encroachment on their autonomy and a violation of the principles of federalism. These incidents underscore the need to further study sub-national borrowing, and hold consensus-building and technical workshops with the states to clarify the regulatory authority of the central bank and the federal government in a federation.

16. The vertical fiscal imbalance in Nigeria therefore needs be addressed with proper institutions so that all tiers of government face hard budget constraints within which to decide allocations. Standard principles of fiscal federalism may suggest that states and local governments be granted more autonomy to raise own revenues in order to reduce their dependence on federal transfers, that is, expenditure decentralization be matched to a larger extent with revenue decentralization. However, the geographic concentration of Nigeria's wealth, with oil revenues accounting for 82 percent of total consolidated revenue in 2000, has led to a shared belief that a centralized tax code and administration is appropriate to maintain national unity and integrity, and promote inter-jurisdictional equality. Hence, the onus of achieving fiscal stability and allocation efficiency may continue to fall on the system of inter-government fiscal transfers via revenue sharing and federal grants.

Tension between derivation and redistribution

17. In addition to geographic concentration of oil resources, there exists enormous difference in revenue generation capacity across the Nigerian states due to the uneven distribution of income, wealth, and industrial activity. This so-called *horizontal imbalance* between the different regions in Nigeria has led to a constant struggle between the principles of regional allocation, based on derivation of resources or redistribution across all states. The current framework is largely based upon the recommendations of the Okigbo Commission of 1980—bulk of revenues should go into a Federation Account

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[5] Anyanwu, John C. 1999. "Fiscal relations among the various tiers of government in Nigeria", in *Fiscal Federalism and Nigeria's Economic Development*

(FA) and the proceeds shared between the three tiers of government. Horizontal allocation across the states focused on needs, as defined by their population, and a lump sum transfer to run their administration. It was recommended that the principle of derivation be discarded. However, the federal government rejected this last point and introduced a special fund for mineral producing areas which would receive a share from the FA, and redistribute it to the states according to the derivation principle.

18. Recently, there has been a strong lobby from the oil-producing southern states to give greater weight to the derivation principle in the sharing of resources. Consequently, the new constitution mandates that not less than 13 percent of the revenue accruing to the FA directly from natural resources should be allocated to the states from which they originated. The language of the Constitution is not transparent on this count, and there is still considerable debate as to its implication for revenue sharing. However, the fact is that a move towards federalism based on the derivation principle is gaining ground. This is potentially a highly explosive issue making fiscal federalism in Nigeria more of a political bargaining game than an economic exercise of establishing equitable and minimum standards of basic services throughout the country.

Potential for developing non-oil local tax bases?

19. There have been some calls for developing other, more geographically dispersed natural resources as a local revenue base. (see Akpan, 1999)[6] However, in an environment where the current sources are already generating government revenue in the tune of 50 percent of the country's GDP, and conditions of actual service delivery remain poor, it is unclear whether the marginal benefit of an additional naira of public resources would justify the marginal cost of revenue creation. It may be argued, that the immediate challenge is not one of additional revenue mobilization but rather of undertaking public expenditures more effectively, under the current resource constraints. Further, since sub-national governments have jurisdiction over taxes like the personal income tax and property taxes, increasing economic growth may itself translate into a stronger local tax base.

Horizontal sharing formula creates problems for vertical sharing

20. The formula for distribution of the Federation Account resources across the states and local governments places a large weight on the lump sum element—that is, 40 percent of the sub-national share of federal resources is divided equally amongst all the jurisdictions. Not surprisingly, this created perverse incentives by which federal resources could be distributed for political gains simply by the creation of new states and LGAs, and hence nearly doubling the number of these sub-national jurisdictions in the '90s. Many states are currently attempting to increase the number of local governments within their jurisdiction, much to the concern of the national assembly which is now contemplating legislature to prevent such opportunistic behavior. Thus, the horizontal sharing formula indirectly creates problems for the appropriate vertical sharing of

[6] Akpan, Godwin E. 1999. "Fiscal potentials and dependence in Nigeria", in *Fiscal Federalism and Nigeria's Economic Development*

resources across tiers of government first, because it leads to the ad-hoc creation of economically non-viable states; second, because it puts pressure on national resources by increasing non-productive spending on maintaining the official infrastructure in additional jurisdictions; and third, because it reduces the share of each jurisdiction and compromises its ability to effectively deliver services.

21. The above discussion of the historical evolution of Nigerian federalism, and its continuing tensions due to the over-dependence on a geographically concentrated source of revenue, highlights the point that it is crucial to shift focus from the politically charged scramble over resources, to the establishment of institutions that will enable all the tiers of government to coordinate effectively and improve performance in actual service delivery. The next sections will discuss the type of institutions to focus on given the current practice and problems in service delivery within the federal structure.

How does the federal structure work in practice?

22. In order to gain a better understanding of how the federal system works in practice in delivering basic services in education, health, and infrastructure, interviews were conducted with the responsible government agencies at all three levels—the federal agencies, and through visits to 6 states and 12 LGAs within those states.[7] For example, in primary education, the National Council on Universal Basic Education, the State Primary Education Boards, and the Local Government Education Authorities were interviewed. Questionnaires were designed to elicit responses from each tier of government on:

- Distribution of management responsibilities, with particular focus on who is responsible for supervising that service delivery actually takes place, and enforcing discipline in case of failure to deliver

- Distribution of financing responsibilities and arrangements, including the source of the funds, and provision of details in annual budgets

- Distribution of policy making responsibilities, and issues in policy coordination

- Relative capacities of different tiers to effectively deliver services

- Role of community participation and community based organizations to improve public service delivery

23. Tables 2 through 5 summarize the responses of the different tiers for the 4 sectors interviewed—primary education, primary health, water, and roads. There appears to be much greater consistency and clarity in the responsibilities assumed and executed by each tier in the water and roads sectors—states are essentially responsible for basic services in

[7] The six states were Abia, Akwa Ibom, Borno, Lagos, Ondo, and Plateau. These states were chosen to represent the six geo-political zones with greater emphasis on the oil-producing regions. Within each of these it was attempted to interview one urban and one rural LGA, but the team did not receive cooperation from all the LGAs, and hence fewer than 12 were effectively interviewed.

both these sectors, with varying assistance from LGAs. Primary health care has some coordination issues with regard to vaccines and drug procurement and distribution, but is largely considered an LGA responsibility. Actual practice in the delivery of primary education stands out as being the most ad-hoc in terms of recognition of managerial and financial responsibilities in a federal system—few rules are even understood, let alone followed. There is large variation across LGAs in their perceived responsibility—some think of themselves as agents of the state, some see the federal government as the most responsible agency, few actually assume managerial responsibilities. Each tier points to the others as having the responsibility of providing for maintenance and equipment in their annual budgets. Only the financing of teacher salaries is clearly understood and followed, but it is one of the most contentious issues in present discussions of fiscal federalism. Box 2 provides a more detailed discussion of this issue.

Extensive federal intervention

24. Although the federal government recognizes that the primary responsibility for delivering these basic services rests with the states and local governments, it appears to distrust their capacity and will to do so effectively. Driven by this paternalistic rationale, it chooses to treat certain sectors such as primary health and education as national priorities and intervenes extensively in delivery, largely through direct investments in infrastructure. State governments complain that they are not adequately consulted about the size or location of these federal investments and consequently it distorts their budgeting and planning. Some examples are the construction of schools by the federal government under the Universal Basic Education (UBE) program; construction of primary health care centers by the National Primary Health Care Development Agency (NPHCDA); federal management of rural water schemes and bore-hole construction under the National Water Rehabilitation Project (NWRP). State governments appear to resent this intrusion more than local governments, and complain that they are not fully included in the planning and decision-making. Local governments, on the other hand, appeared to view the federal programs as natural and welcome, and in line with the federal constitutional responsibility.

25. Specific mention may be made in this regard of the structure of the UBE program. The first phase of this program consists of federal construction of new classrooms in each local government area. But there has been difficulty in getting the program off ground because states have complained that they are not adequately consulted as to the appropriate location of these constructions, and would prefer to oversee the contracts themselves. Supervisory committees have been established at the federal level and in each state, who will be responsible for ensuring state and Local Government Council involvement in the selection of school sites, for the supervision of construction, and certification of satisfactory completion. However, the problem of adequately maintaining and equipping these new schools and classrooms remains. From the responses of the different agencies involved in primary education, it appears that this could become a particularly thorny problem since no agency clearly accepts responsibility for these activities.

Box 2: ***Deductions at source of primary school teacher salaries***

In 1981, the federal government withdrew from primary education financing, transferring management to state and local governments. With the oil slump of the early 1980s, funding for primary education contracted sharply, several capital investments were abandoned and routine functions in schools could not be maintained. Widespread failure on the part of LGAs to pay teacher salaries led to national strike action by primary school teachers, and as a response, in 1988, the federal government established the National Primary Education Commission (NPEC) with specific responsibility for paying teacher salaries. NPEC was dissolved in 1991 but reestablished again in 1993 along with the creation of State Primary Education Boards (SPEBs) and Local Government Education Authorities (LGEAs). SPEBs, rather than LGEAs, were invested with the primary authority to recruit teachers, negotiate their salaries, and enforce discipline.

NPEC is authorized to deduct teacher salaries from local government statutory allocations from the Federation Account, with the funds subsequently being transferred to SPEBs and thence to the LGEAs for actual payment. In FY2000, about 36 percent of total Local Government Council statutory allocations in the federation account were deducted at source for payment of teacher salaries. The share of these deductions in the statutory allocations of individual local government areas, ranged from 17 percent for Yobe state LGAs to as high as 59 percent for Ondo state LGAs. (Although the LGAs dramatize the situation by declaring that after deductions they receive "zero allocations".) Thus, while the funds for teacher salaries come from what is considered to be the share of local governments, the states actually control and manage the recruitment of teachers and negotiation of their salaries.

The payment of primary school teacher salaries may be viewed as a specific purpose transfer from the Federal Government of Nigeria to the LGAs, in order to ensure that the historical problems associated with this function do not arise again. In fact, in many countries in Latin America, such as Colombia and Mexico, teachers' salaries are similarly controlled by higher authorities. This arrangement has certainly improved the timeliness and regularity of payment of teacher salaries. However, the actual mechanism by which a perfectly defensible specific purpose transfer is implemented has led to a serious lack of accountability with regard to the delivery of primary education. In Nigeria, there is a tremendous proprietorial attitude on the part of each tier of government with regard to their statutory allocations from the Federation Account. This creates an environment of extreme dissatisfaction amongst LGAs since they view the funds for the salaries as coming out of their pockets, while they have little or no control over how it is to be spent. Thus, local government chairmen feel by-passed and in some instances this has led to them distancing themselves from primary education issues. In interviews with government officials, a widespread opinion was expressed that LGAs do not need to do anything else by primary education since they are already doing "enough" by contributing to teacher salaries. The other LGA responsibilities in the maintenance of school infrastructure may thus end up being neglected.

Tentative recommendations

26. The federal government needs to re-think what would be the most appropriate federal intervention in these primary services that are really the responsibility of state and local governments. At present the situation appears to be one where the country has solid institutions of fiscal decentralization through the sharing of resources in the Federation Account, but with a heavily centralized mentality in terms of executing service delivery. The two are inconsistent and create problems of duplication, coordination, and wastage of

resources by being practiced in conjunction. A perverse incentive may also be created at lower tiers to divert funds from basic services because of the belief that if the quality of these crucial services decline then the federal government will be obliged to step in and bail-out. The situation may be exacerbated due to oil-price induced fluctuations in revenues received—projects may be abandoned with the expectation that the federal government will intervene to stabilize the situation.

27. The federal government should explore the use of alternate instruments for influencing sub-national behavior in view of national priorities, such as matching grants and ear-marked transfers, in lieu of direct investment or deductions at source. Some deductions at source, such as for primary school teacher salaries, may be viewed as specific purpose or ear-marked transfers, but by not being explicitly packaged as such they create dissatisfaction and problems of accountability. Hence, two alternate measures of providing a federal impetus for basic services could be the following—1) ear-marked, lump-sum transfers to each state for a specific service, based on monitoring of indicators of actual delivery and performance in those services; 2) grants designed to match resources generated by sub-national governments, thereby reducing the cost per naira spent by the sub-national government and encouraging higher investment. Both of these would be more consistent with both the constitutional responsibility and the actual practice by state governments, and create better incentives for improving performance.

28. Any move towards amending the vertical revenue sharing formula to increase resources accruing to sub-national governments must be based on careful review of expenditure responsibilities, or it creates a significant risk of increasing the overall size of government and worsening the fiscal position of the federation. This risk arises partly because it is unclear whether a reduction in the resources available to the federal government will be accompanied by an appropriate reduction in its expenditure initiatives in matters of sub-national responsibility. In fact, the experience of the 2001 capital budget has shown that the National Assembly can indiscriminately pass bills for federal investment in areas where the federal government lacks jurisdiction, and cannot follow the due process of preparing feasibility studies. A report by the National Planning Commission (NPC) on due process in implementing the 2001 capital budget describes this dilemma.

States versus local governments

29. State governments appear to be ultimately responsible for the actual delivery of these basic services, and often have to take over the activities and responsibilities of local governments in order to ensure delivery. Therefore, they are beginning to complain that even though they oversee and sometimes fulfill LGA responsibilities, their share of the federation account is not commensurately larger. Local governments were often unable to distinguish between the distribution of responsibilities across the three tiers, articulating most functions as the joint responsibility of all three tiers. This was evident in the large variation in their responses—some took full managerial and financial responsibility for maintaining primary services, while others seemed much more dependent on state, and even the federal government. This variation in actually assuming responsibility seemed

consistent with the team's observations of large variation in the capacity to deliver basic services. State and federal agencies also responded that there were serious capacity constraints at local levels.

30. It is not surprising that local governments are characterized by weak capacity to implement their expenditure assignments, since many of them were created out of political exigencies and are too small to be economically viable. A case in point is rural water and sanitation services. LGAs are responsible for rural water supplies and sanitation facilities in their areas, however only a few actually have the resources and the skills to address these problems. Most do not have rural water supply divisions that are able to construct small water systems such as open wells and small impoundments of surface water. In several cases, uncollected domestic refuse fills already inadequate surface water drainage systems and flooding occurs with water polluted by sewage. It may be worthwhile to explore opportunities for collaboration between neighboring LGAs, particularly those that are too small to be economically efficient. However, none of the LGAs responded affirmatively to a question about whether they collaborate with neighboring LGAs to pool resources and talents in order to improve performance.

31. Olaniyi (1999)[8] provides some analysis of capacity constraints at the level of local governments. In a survey carried out by the United Nations Development Program (UNDP) and the States and Local Government Affairs department of the Presidency in 1998, it was found that of the 750 respondent Local Government Authorities only 151 had planning boards, and even amongst these there was no representation on the board of professionals like economists, medical doctors, or engineers. With regard to the basic educational background of the members, about 33 percent were secondary school certificate holders, and another 23 percent had Ordinary National Diploma (OND)[9] as their highest qualification; less than 10 percent had university degrees.

32. It may be argued that educational qualifications of LGA members is not imperative for the allocation of expenditures according to the felt needs of constituents, and for the effective delivery of services. However, a scrutiny of the budgets of some local governments, procured by the team during its fieldwork, shows that it is not obvious that the pattern of allocations is responsive to local needs. Hardly any allocations were made for repair and maintenance, and bulk of the overheads budget across all sectors was dedicated to purchasing vehicles and travel expenses. Under the head of primary education, nothing was allocated to schools for their running expenses—instead, sports development received the bulk of funds. In 1999, local governments as a whole spent only 8 percent of their capital budget on health and education, which is especially surprising in light of federal and state responses that other capital projects in water schemes or roads are largely financed and undertaken by the higher tiers.[10]

[8] Olaniyi, Oyinlola, 1999. "Fiscal federalism and the performance of local governments in Nigeria's economic development: an impact analysis," in *Fiscal Federalism and Nigeria's Economic Development,* collected volume of papers presented at the 1999 Annual Conference of the Nigerian Economic Society.
[9] The OND is a certificate received from vocational training institutes, usually earned after 2 years of further study beyond secondary school.
[10] Based on data compiled by the Central Bank of Nigeria (CBN) from its own surveys

Tentative recommendations

33. From the above discussion it would be tempting to conclude that states be given more resources and authority relative to LGAs, and that LGAs should function largely as agents of the state, at least in the short run. In fact, this is the stance currently adopted in the Constitution. However, many believe that this would throttle the development of grassroots organizations that are truly closest to the people and hence most accountable to them. Hence, only a process of national dialogue can resolve the debate. But the analysis here has certainly pointed out the potential risks of increasing allocations to the LGAs without adequate consideration of their true capacities and accountability. The exploration of more innovative institutional reforms is suggested below.

Searching for new institutional arrangements in line with accountability and capacity

34. Based on the above analysis of the working of the federal system in Nigeria what may be expected in terms of outcomes in service delivery if greater resources are devolved to the sub-national governments without a review of expenditure responsibilities? There are significant risks of macroeconomic instability arising from lack of coordination between the three tiers and increasing overall size of government. It is also not clear that the alleged benefits of bringing government closer to the people will be achieved because the incentives at the lower tiers may not be any different from the federal level. Besides, the capacity constraints at the local level may counter whatever gains may be had from greater accountability.

35. The real challenge appears to be to develop a new set of institutions that makes government more accountable, and thereby improve public service delivery within a given level of resources. Decentralization and fiscal federalism has received increasing attention in this regard as several developing countries around the world are experimenting with different institutions to bring government closer to the grassroots and hence potentially more accountable to the people. But as yet no conclusive evidence has emerged with regard to what kind of decentralization reforms actually lead to improvements in service delivery—are directly elected local representatives more accountable than centrally appointed bureaucrats with greater decision-making power? Is *fiscal* decentralization necessary to improve accountability and public service delivery, or can *political* and *administrative* decentralization achieve the same, without substantial fiscal independence?

36. More local governments may have better information of local conditions, enabling better targeting of resources to the poor and needy, better allocation across sectors according to local needs, and better monitoring of implementation by the local community. There is also a widespread belief that local governments are better able to recruit teachers and health workers to provide services in remote or rural areas. However, there is a risk of lower political accountability at sub-national levels for a multiplicity of reasons—because of the presence of local elite that may capture all resources and deprive

the poor; because corrupt practices by local governments and diversion of public funds may be better organized and easily facilitated due to the relative absence of media scrutiny, and lack of checks and balances from other powerful government agencies; and because, as mentioned earlier, over-dependence on federal transfers may lead local governments to shift blame and responsibility for service delivery to higher tiers of government that control the bulk of government revenues. There may also be an issue of administrative and management capacity constraints at lower levels as a process of self-selection—most educated and talented individuals may leave the locality to pursue fortunes in the urban centers of the country.

37. The above discussion highlights two primary issues to be considered when deciding the allocation of responsibilities to different tiers of government—accountability and capacity. Sub-national capacity constraints may be severe enough to counteract any beneficial effects of greater accountability. If capacity problems are particularly severe at the level of the local government, then it may make sense to pursue decentralization sequentially, by first increasing resources to state governments and simultaneously strengthening capacity at local government levels by increasing their responsibilities as agents of the state. Eventually, the autonomy of local governments may be increased as they begin to develop better institutions of accountability and tackle issues of capacity. A new World Bank study on fiscal decentralization in Mexico notes that a lesson learnt in Latin America is that "abrupt decentralization campaigns have generally failed". Countries that tried them, such as Colombia, Chile, Brazil, and the Bolivarian Republic of Venezuela, have had to return to incremental decentralization, with differentiated rules according to the distinct administrative skills of their territories.[11]

38. In addition to decentralization reforms, more direct measures might also be adopted to promote greater citizen vigilance and participation to improve accountability and hence service delivery—initiating citizen complaint mechanisms, encouraging a free and vibrant press, disseminating information about government programs by posting circulars in public places such as markets, public thoroughfares, schools, and places of worship. In Uganda, for instance, service delivery in education improved substantially after the government widely publicized results from a survey of publicly funded schools, showing that public resources meant for the schools were actually not getting there due to substantial “leakage” along the way. Other innovative solutions may surface from detailed sector-specific studies. These are further avenues of reform for Nigeria to explore in conjunction with the debate over fiscal decentralization, in order to make any resultant structure of government more effective.

39. This is in accordance with another current trend in development policy thinking that community participation is key to the successful delivery of public services to the poor. Therefore, the interaction between community participation and fiscal decentralization also needs to be considered. Can giving autonomy to community based organizations and user groups be more effective than decentralizing to general government? Can community participation improve service delivery by all levels of

[11] Giugale, Marcelo and Steven Webb (eds.), 2001, *Achievements and Challenges of Fiscal Decentralization—Lessons from Mexico*, The World Bank, Washington, DC

government? Or, does sustaining community participation require greater fiscal devolution to local governments? All tiers of government in Nigeria expressed interest in exploring the increased role of community development committees whose members are chosen from the community and perform managerial and supervisory functions at the behest of the community. Examples were provided of the activities of such committees in the past, and their integral role in the success of public sector performance was affirmed. Hence, an exciting new area of public sector reform for Nigeria to explore is the revitalization of these agencies and their functions in overseeing general government performance.