Intergovernmental relations in Nigeria: improving service delivery in core sectors

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The World Bank

April 2007

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Introduction

Nigeria's model of fiscal federalism represents a fundamental legal and institutional framework for policymaking in the country. As in other federations, it defines the core rules for resource allocation, distribution of responsibilities for service delivery, and mechanisms for interaction between different tiers of government.

Nigeria's fiscal federalism arrangements are currently attracting increasing attention from both policymakers and analysts. This is a reflection of the fact that longer term perspectives of economic policy reform in the country are critically dependent upon improvements in the organization of inter-governmental arrangements. Such arrangements have direct implications for achieving national growth and poverty reduction targets. Simply put, there is a major need to strengthen the incentives of government agencies at all levels of authority to improve cooperation in designing of their policies and delivery of services. At the same time, capacity will have to be built to support such future inter-governmental cooperation.

The need for stronger cooperation and other reforms in federalism is driven by several factors such as the following:

a) According to the Nigerian constitution, main public sector responsibilities are split across various government levels. Thus, no sole government could deliver radical improvements in service delivery on its own, which means that *coordination and cooperation* are pre-requisites. However, the existing mechanisms and institutions for inter-governmental policy coordination are weak and need strengthening.
b) Significant fiscal decentralization of the public finance system have taken place since 1999. Given the existing resource allocation rules, such decentralization poses the risk of emphasizing – rather than taming - fiscal inequalities across the states. But the extent and trends in horizontal inequality remains undocumented, and no mitigation mechanism has been proposed as yet.
c) Reforms undertaken in Nigeria since 2003 appear to have been more profound at the federal level than in the states. The benefits of drastic improvements in macroeconomic policies and fiscal discipline at the Federal Government of Nigeria (FGN) level are severely constrained by lagging reforms in the states. The FGN is actively exploring options for setting up - within its existing legal and institutional remits - new mechanisms to encourage states to accelerate reforms and to improve intergovernmental coordination in key service areas under joint responsibility.
d) The reform of federal arrangements is politically sensitive. Reforms of the Federal system are likely to be gradual and based on broad political consensus. This underlines a need for broadening a public debate on key challenges in the existing model of fiscal federalism. The post-2007 election period may present a window of opportunity for addressing some of these issues, and it is important

to inform policy makers in advance about existing challenges and available choices.

This paper intends to discuss some of these issues from the perspective of improvements in the quality of service delivery in core sectors, such as education and health.

Insufficient Coordination in the Environment of Growing Inequality

Nigeria's constitution provides for the participation of all three tiers of government in the delivery of core public services, such as education and health. This makes policy coordination an important pre-condition for effective and efficient service delivery. Several factors can be adduced as justification for building workable inter-governmental coordination mechanisms. As an illustration:

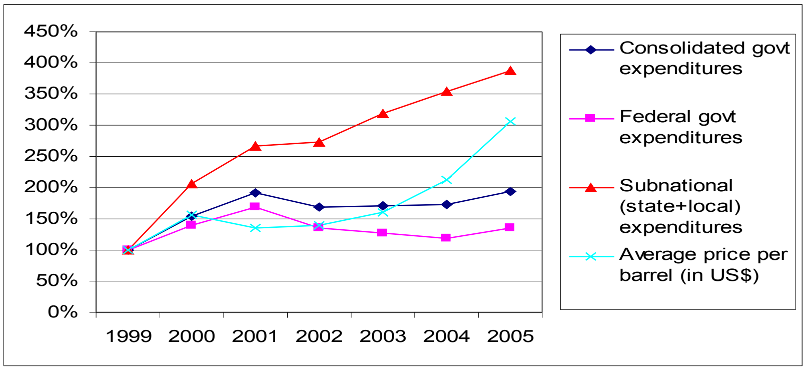
a. in the environment of shared responsibility for service delivery, non-coordinated interventions of different government levels create a risk for duplication of efforts and sub-optimal allocation of resources.
b. when there is an agreement on common national priorities and development objectives, such as those reflected in the National Economic Empowerment and Development Strategy (NEEDS), it is sensible for all government levels to align their actions with such priorities and thus complement each other's efforts. This is because, as in common complex social systems, there is significant potential for synergies between coordinated policies and actions.
c. finally, there is a case for the standard efficiency argument. Coordination could lead to better overall resource utilization through economy of scale, quicker project completion, and more efficient use of limited resources (such as specialized technical expertise). It also helps to facilitate dissemination of best management practices.

What are the policy parameters that may be of special interest for governments that are interested in better policy coordination? The following list, while far from being comprehensive, presents some important components:

i. level and structure of government spending in a particular sector.
ii. technical and quality standards of service delivery, such as curricular and educational standards, as well as immunization rules.
iii. expected levels of service delivery, such as the availability of health services (measured for instance through number of health personnel per 10,000 residents).
iv. management practices (e.g. parameters used for cost-benefit analysis of proposed public projects).
v. reporting and accountability formats to ensure comparability of outcomes across different locations, which would support monitoring of progress towards achieving national policy priorities.

The issue of inter-governmental policy coordination has become increasingly important in Nigeria in recent times. This is primarily because since 1999 the Nigerian fiscal system has gone through rapid decentralization (Figure 1). Compared to the recent past, a much larger portion of public funds today is spent on the basis of independent, non-coordinated decisions of individual state and local governments. The share of sub-national budget spending in the consolidated budget doubled, increasing from 23 percent in 1999 to 46 percent in 2005. Total sub-national budget expenditure in 2005 was almost four times higher in real terms than the 1999 level. Moreover, spending by local government authorities (LGAs) has been growing even faster than state government spending, which means that sub-national budget systems have become increasingly decentralized.

Figure 1. Real growth in government expenditure, 1999-2005, 1999=100%



Note: Includes off-budget spending, such as cash calls and excess crude account.
Source: World Bank (2007)

The main drivers of such rapid decentralization can be summarized as following (*World Bank*, 2007):

a. stricter enforcement of constitutional requirements; in particular, since the return to the civilian rule, the FGN has been much more disciplined in enforcing the existing revenue sharing rules than was the case in the 90s;
b. restoration of the derivation principle in the 1999 Constitution;
c. Supreme Court decisions of 2002 that reduced the size of the first line deductions from the Federation Account (FA); and,
d. some adjustment in FA allocation shares since 2002 that favored sub-national governments.

Rapid expenditure decentralization has created both new opportunities and challenges for public service delivery in Nigeria. Given that Nigerian sub-national governments are mainly responsible for financing basic public services such as primary health and education, decentralization creates the potential for further improvements in the financing of these priority sectors. At the same time, due to well-known capacity constraints at the sub-national level, this expansion in financing creates a substantial risk of a decline in spending efficiency. It also increases the risk of misuse of funds due to slower pace of public finance management (PFM) reforms in states. So far, fiscal decentralization in Nigeria has not been accompanied by strengthened accountability of sub-national governments for efficient utilization of resources they have now in their disposal. This complicates progress in improving service delivery.

The costs of non-coordinated policies are further aggravated by Nigeria's rather rapid fiscal expansion and by the favorable oil prices of the world market. It is estimated that in 2005-07 total expenditures of the consolidated government in Nigeria (that includes spending of all government levels and extra-budgetary government accounts) in real terms will be growing at an average rate that exceeds 12% a year.

1. *Existing arrangements for inter-governmental policy coordination*

Technically, Nigeria has the full set of institutions necessary to support policy coordination at both the macro and sector levels. Such existing structures are set up at four different administrative levels and these include:

a. National Council for Economic Planning that has state governors as members
b. National Council on Development Planning with a membership of State Commissioners for Planning
c. Joint Planning Board, in which states are represented at the level of Permanent Secretaries from respective planning ministries
d. National Sectoral Councils in all key sectors, representing respective state sectoral ministers and in which the National Planning Commission (NPC) is also represented
e. In addition, NPC has a statutory mandate for monitoring state economic performance and inter-governmental policy coordination.

Overall, these existing arrangements for policy coordination between the federal and state governments remain quite weak. While there have been regular meetings of various councils and due preparation of joint plans, to large extent, the prevailing coordination effort remains at the level of coordination of plans, but not of actual implementation activities. As such, coordination has been often seen as a "paper exercise", which does not have a real impact on either actual project selection or budget spending patterns of state governments. Effectiveness of national sectoral councils is low, and they are seen by many as just "talking shops" for participating officials.

The key indication of existing weaknesses in current coordination arrangements relates to the fact that Nigeria does not have an established system for production of consolidated national reports on performance in individual sectors. At the moment, due to lack of the most basic information on performance of individual governments, nobody can tell, for example, how much money the consolidated Nigerian government spends on primary education, what the structure of this spending is, and what is achieved with these expenditures. A lack of information on outcomes and outputs undermines the whole concept of planning and coordination. Planning without monitoring and evaluation cannot be productive. If actual behavior is not monitored, participants will not take seriously the commitments they make in the course of the planning and coordination phase.

Insufficient information sharing across various governments represents a fundamental weakness of the existing inter-governmental arrangements in Nigeria. Many state governments interpret the concept of state autonomy in a way that complicates information sharing and coordination with the federal government, while the FGN currently has inadequate capacity and policy instruments to encourage states to engage in federal initiatives. This seriously complicates the development of modern evidence-based national policies, in particular in the Millennium Development Goals (MDGs)-related sectors.

The following list points to several specific examples of economic losses due to weak inter-governmental coordination:

i. *Primary Health:* Federal Government has been investing in construction of new primary health centers (PHCs), but states do not provide adequate financing for their operations. As a result, these facilities are heavily underutilized. At the same time, states spend an increasingly large portion of their health budgets on construction and operation of hospitals, which the Constitution defines as federal responsibility.
ii. *Water:* All three government levels have been engaged in uncoordinated activity to drill new boreholes, and this frequently resulted in duplication of efforts. At the same time, there has not been much interest in the development of local water systems.
iii. *Roads:* The national road network has been developed in an uncoordinated way, with too much political influence over technical decisions on priority road projects. Moreover, the lack of an agreed strategic vision resulted in under-financing of maintenance of the existing roads, their over-use, and the poor quality of roads which drive up the costs of domestic transportation.

2. *Issues of inter-government coordination in education*

Primary education represents an important and interesting example of the status of inter-government coordination in Nigeria. Sectoral analysis reveals nine out of 12 key management functions in the sector are concurrent, i.e. expected to be delivered by more than one government level. Thus, the sector has enormous needs for effective coordination arrangements. This challenge has been taken quite seriously by the sector leadership. According to a recent Department for International Development (DFID) report, based on cross-sectoral analysis, the existing arrangements in primary education currently represent the best example of vertical inter-government coordination *(Improving Intergovernmental Collaboration…, 2005).*

Still, there is a major need for further improvement. In education, similar to other sectors, more attention is paid to coordination of plans than to coordination of their execution. Moreover, the coordination effort is unevenly distributed across various management functions, with some functions being more popular than others. As a result, on one side, there is a noticeable duplication of efforts in some areas (school construction, school supervision) while insufficient attention to others (pre-school education, analysis/evaluation of sector performance).

Another weakness of the current arrangements in education relates to lack of clarity in the accountability framework. It is unclear which government level is responsible for achieving key educational outcomes. There are also major concerns about interactions between the Universal Basic Education Commission (UBEC), a federal structure created to support primary education nationwide, and state ministries of education. There has been a common claim that instead of supporting state efforts to upgrade primary education, UBEC has been trying to run the primary school network without showing much interest in building state capacity to manage its primary education *(World Bank, 2003)*. This undermines longer-term sustainability of the recent reform efforts.

An important function of UBEC relates to the administration of federal matching grants to states in support of primary education. This specific grant scheme has been an important innovation in Nigeria's system of intergovernmental fiscal arrangements. The analysis suggests, however, that the UBE grant program has serious challenges that led in recent years to under-utilization of available program funding. The reasons for such difficulties could be summarized as following:

a. insufficiently strong interest of state governments to improve service delivery undermines their incentives to participate effectively in the program;
b. state governors' concern of becoming dependent on unpredictable sources of federal financing. Governors require greater assurance that a transfer program of this nature is protected from potential political manipulation;
c. the way UBEC runs its business, similar to many other federal parastatals, antagonizes many state government officials. There is insufficient consultation, reflection of local priorities in project selection, and no real desire to engage local officials in implementation and monitoring;
d. insufficient availability of information on actual performance of the UBE program, which limits opportunities for its reform.

Moreover, there is a sign of inadequate policy coordination even among federal entities operating in the education sector, such as the Federal Ministry of Education on one side, and UBEC and Education Trust Fund (ETF) on the other. An example is the latest government strategy document in the sector, the 2007-9 Education MTSS, which did not cover funding administered by the UBEC or ETF. These organizations continue to claim their policy independence from the Federal Government.

Finally, an additional area where there is clear need for strengthening inter-governmental coordination in education relates to the framework for resource allocation in the sector. The World Bank (2003) points to an absence of transparent rules for resource allocation based on clear national guidelines and recommended norms of per student spending, differentiated by type of educational facility. Lack of such rules leads to major horizontal expenditure inequalities within the education system, at the level of both individual schools and states. Within the current system, there is no clear strategy to address horizontal inequalities in education financing.

3. *Summary: Institutional challenges in the area of inter-government coordination*

Overall, the institutional challenges for more efficient inter-government coordination can be summarized as following:

a) federal government entities do not have capacity and an effective mandate to monitor and coordinate state performance. It does not have practical instruments at its disposal to influence states' project and spending choices.
b) states' leaders perceive themselves as "independent to the extreme", with rather weak interest in information sharing and participation in joint projects. Broad powers guaranteed to states by the Constitution in policy making and expenditure allocation policy are seen as a mandate for non-cooperation. This is aggravated by generally weak accountability of sub-national governments.
c) there is a critical lack of information on governments' performance. However, without adequate information, it is impossible to design and operate an efficient coordination mechanism. Three types of informational problems should be highlighted in this context:
    i) *Critical information is not produced on a regular basis.* It is worth noting that this challenge is broadly recognized by the government, and

major effort has been underway to build capacity of the National Bureau of Statistics (NBS). Major recent achievements include the completion of the population census and national poverty survey. However, less progress has been made so far to improve quality and availability of information on expenditure patterns and quality of service delivery.

ii) *Information is available, but it is of poor quality and does not meet recognized international standards.* For instance, Nigeria's budget data are largely incomparable with those from other countries because of fundamental weaknesses in the existing budget classification.

iii) *Information is produced, but not made publicly available.* In part, due to the legacy of military rule, there is considerable reluctance to share information on government performance. As an illustration, the reports of Auditors-General are commonly seen to be "too sensitive" to be made publicly available. The recently prepared Freedom of Information Bill is expected to improve the situation in this area.

Insufficient availability of good social and fiscal information has major implications for government policy. It greatly undermines efficiency of policymaking in general by isolating policy deliberation from realities on the ground. It has particularly grave implications for a design of the system of inter-government fiscal arrangements. International experience suggests that quality information is a key pre-condition for establishing a transparent and mutually acceptable system of sharing a common pool of fiscal resources across different government levels.

Moreover, lack of comparative information on state performance greatly limits inter-state competitive pressures to improve service delivery. In Nigeria, state authorities do not face much of competitive pressure to perform, and this represents under-utilization of a major potential advantage of federal system -- competitive federalism.

4. *Risk of growing fiscal inequality*

The benefits of recent fiscal decentralization have been distributed rather unevenly across sub-national governments. This is because, in keeping with the constitutional requirements, about a third of all allocations from the Federation Account to states reflects derivation oil payments, which are heavily concentrated. The four main oil-producing states (Rivers, Bayelsa, Delta, and Akwa Ibom) jointly received about 90 percent of all derivation oil payments, or about N265 billion (US$2 billion) in 2005. The fact that despite all these additional revenues, the oil producing states of Nigeria did not perform much better than the rest of the country in terms of service delivery and human development indicators suggests that major efficiency gains still remain available through improvements in the expenditure management and accountability systems of these states.

The existing level of inequality in the Nigeria's fiscal system is rather high and has been growing recently due to high oil prices. Table 1 presents some estimates of cross-state inequality in the distribution of funds collected by the federal government, (i.e. what is usually called "federal transfers" in other federal systems). Since such transfers form about

90% of all revenues in most states, these inequalities reflect rather accurately overall inequality in per capita budget expenditures at the state level.

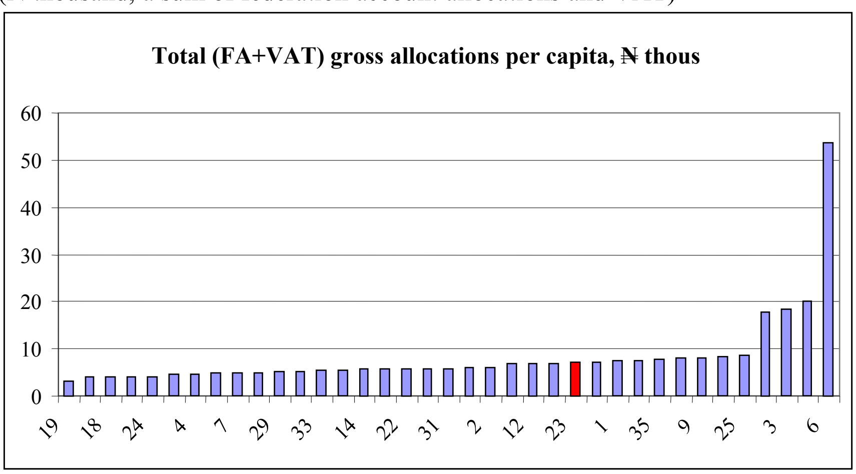
Table 1. Cross-state variation in total statutory allocation per capita,
(Naira thousand, a sum of allocations from the Federation Account and VAT)

	2001	2005
Average allocation per capita	3.11	8.28
Coeff. of variation	62.4%	105.3%
Max/Min ratio	8.80	17.38
Share of 4 oil states in total	25.5%	34.0%

Source: *CBN, Population Census*
Note: Based on the 2006 population data as reported by the National Population Commission.

As Table 1 shows, the difference in per capita transfers between the wealthiest and poorest states increased from about 9 times in 2001 to more than 17 times in 2005. While four richest states, which collectively host only about 11% of Nigerian population, received a quarter of all transfers in 2001, their share increased to more than a third in 2005. Figure 2 presents the full scale of variation in per capita transfers in 2005.

Figure 2. Variation in the level of per capita transfers, 2005,
(N thousand, a sum of federation account allocations and VAT)



Note: The dark column indicates a national average level of per capita allocation.

The reasons for such a high level of inequality are quite clear. It is because the existing formula for horizontal allocation of revenues pays insufficient attention to equity considerations. The following features of the existing federal allocation arrangements are important to mention in this context:

a. 54% of federation account funds are distributed equally across states, which works against more populous states
b. huge derivation premium, as discussed above, which primarily benefit only four states
c. no attention to local revenue capacity of individual states

d. small share (2.5%) of funds is distributed proportionally to local revenue effort, which usually works as a penalty on poor states that have less opportunities to increase their revenue collections

Overall, rapid expenditure decentralization poses a risk of growing inequality across the states, especially with respect to the quality and availability of social services. Moreover, as international experience suggests, high level of horizontal inequality may bring additional political risks. To be able to achieve its national development targets, in particular with respect to MDGs, the federal government will need to develop its capacity for monitoring cross-state differences in access to core social services and at some point expand federal equalization programs to provide additional opportunities to citizens in less developed states.

Reform Directions to Strengthen Inter-Governmental Policy Coordination

Our analysis so far suggests that without better inter-governmental coordination it would be difficult for Nigeria to make sustainable progress in the attainment of the MDGs. This is primarily because, while states and local governments have major responsibilities for MDG-related sectors, without closer cooperation with the federal government, they would not be able to secure adequate funding and necessary improvements in the quality of service delivery. Some states are just too poor and do not have enough resources to provide adequate funding for MDG-related activities due to the inequality in the existing system of resource distribution. At the same time, many states, including those that have a better funding base, do not use their resources in line with national priorities, in particular in such areas as primary education, health, and rural development. Moreover, overall nationwide progress is affected by the loss of efficiency due to duplication of efforts by different governments.

To address these challenges, Nigeria's inter-governmental arrangements may require a thorough review and comprehensive reform in line with the international best practices and Nigeria's own experiences. So far, there has been considerable imbalance in discussions on what is necessary to make Nigeria's fiscal federalism more effective. Discussions focus on issues of resource control and on arguments in favor of further re-distribution of resources from the federal to state governments rather than on better utilization of available resources. Similarly, there is surprisingly little interest in the equity dimension of the resource control problem.

1. New more Cooperative Models of Service Delivery

There is a need to build a broader consensus around the idea that a new, more cooperative model of inter-governmental relations is necessary to ensure better utilization of available resources. Such a model should include the following key elements:

a) jointly developed policies in the sectors of recurrent responsibility;
b) real coordination in implementation, including project selection and spending levels;
c) joint monitoring and evaluation;
d) disclosure of results;
e) encouragement of competition in service delivery.

The new model would also suggest that the FGN should gradually withdraw from the actual delivery of services and instead play a more active role in setting national policy, in co-financing of service delivery undertaken by lower government levels, and in monitoring and evaluation of actual performance.

2. *Two directions for reform*

To ensure progress towards a new model, reforms should be undertaken simultaneously in two inter-related directions: (i) inter-governmental finance, and (ii) improved institutional framework.

With respect to *inter-governmental finance*, the existing system of sharing the common pool of funds may need careful and gradual transformation to provide for (i) more equalization of the system, and (ii) introduction of new financing mechanisms, such as federal matching, conditional, and specific grants to states. The latter are necessary to encourage states to align their interests in line with national priorities, influence states' choices, and strengthen their accountability for spending public money.

With respect to the institutional framework, the immediate priority is to strengthen the effectiveness of existing coordinating institutions, based on their functional review. The recent report sponsored by the DFID *(Improving Intergovernmental Collaboration…, 2005)* could be used as a starting point in this work. A possible strategy could be based on (i) consolidating/rationalizing the existing set of institutions, and (ii) providing the NPC with a bigger and clearly defined mandate for inter-governmental policy coordination. The latter may include responsibility for design and execution of different federal grant schemes, monitoring and evaluation of performance of such schemes, support for sector-specific coordination structures, as well as coordination of various federal efforts to accelerate state level reforms linked to state capacity building and dissemination of best local practices and others. The NPC should also lead the work on developing a set of requirements for effective implementation of joint expenditure programs, including administrative, legal, financial and reporting requirements.

There is also a need for a critical review of governments' expenditure mandates under the current arrangements. Its purpose would be the development of options for their gradual adjustment in light of international experience. As an illustration, in the health sector, the analysis suggests a need for a larger role of the federal government in primary health, health insurance, and disease prevention.

Another priority direction for institutional strengthening relates to improvements in the accountability framework, based on better information on how public money are used and data on quality of service delivery. As emphasized by Paul Collier (2006), a preferable institutional arrangement in ethically diverse societies with resource rents, such as Nigeria, is a democracy with decentralized public spending and unusually strong checks and balances. So far, Nigeria has been doing pretty well with respect to expenditure decentralization, but accountability of government officials remains generally weak, despite the reform efforts of the last few years.

Overall, the transition to the new model of inter-governmental arrangements would require strong federal agencies capable of performing *inter alia* the following functions:

a. participatory development of sectoral strategies, establishment of clear regulatory framework for service delivery
b. establishment of national targets for service delivery
c. costing national strategies and their main components

d. drafting model state-level laws and regulations (where appropriate) and encourage states to adopt them (such as disclosure, reporting, and monitoring rules)
e. designing and delivery of federal technical assistance programs for states, helping states to develop their own efficient strategies and implementation arrangements
f. monitoring of progress in the key sectors, including support for independent evaluation of state performance and spending of FA allocations in the context of SEEDS benchmarking

A separate important federal function within the new model, which would be relatively new for Nigeria, relates to federal support to states with implementation of their sectoral reforms. International experience suggests that such support could be the most effective if it is aimed at providing a mix of federal incentives to states, including financial assistance (grants), political support, and technical assistance. To consolidate federal reform-related assistance to sub-national governments, several countries use a State Reform Assistance Fund mechanism.

3. *International Perspective on Reforms in Federal Transfers*

Inter-governmental finance systems worldwide show several stable common patterns, which could be easily explained on the basis of efficiency considerations. One of such patterns is significant asymmetry in expenditure and revenue-rising responsibilities. This results in a gap between relatively high centralization in revenue collection and much more decentralized pattern of public spending *(Vigneault, 2007)*. Such asymmetry explains a need to design an efficient system of federal transfers that would return a portion of centrally collected revenues back to lower levels of the government to help them finance their expenditure mandates.

Another common pattern in inter-governmental finance is that expenditure responsibilities are pretty similar worldwide. States (sub-national governments) are usually responsible for the provision of key public services, including basic health, education, social protection, roads, etc. And many of such state responsibilities, as assigned by national constitutions, are such that they are critical for achieving core national development objectives. This implies that the federal government has considerable interest in the manner in which the regions exercise their legislative responsibilities (*Broadway, 2007*). That is, the federal government is interested in the level of states' service delivery and quality of delivered services. It is expected to monitor sufficiency of resources allocated to services of national importance and try to influence state expenditure choices.

In addition to the need to ensure the achievement of national/common development objectives, the main reasons for such an "interventionist" position of the federal government include:

a) *Equity argument:* the federal government has responsibility for equalizing the level of public service delivery across locations that have equal levels of taxation, and more generally equalize local opportunities for growth.
b) *Efficiency argument:* that relates to a spillover effect of public services, and respectively to possible under-supply of services produced on the basis of decentralized decisions.

Within this framework, it is broadly acknowledged that development and implementation of national poverty alleviation programs should be a joint responsibility of different government levels. The federal government is supposed to provide most of the funding and set up general rules, while day-to-day implementation should be done by sub-national governments *(Rao, 2002b)*.

Respectively, federal grants to states are seen as a common instrument to improve efficiency of inter-governmental cooperation. They are used by federal governments to influence states' resource allocation and encourage them to improve financing of key services in line with national priorities. They do not mean a subordination of one government level to another, while instead aim at aligning interests and strengthening government cooperation. Sato (2007) calls inter-governmental transfers "glue for national unity". In particular, programs of specific grants, linked to particular sectoral programs/services, if properly set up, could provide for both budget autonomy of grant recipients and securing that additional funding is concentrated in key policy areas.

The main lessons from international experience on design of grant schemes could be summarized as following (Shah, 2007):

i. keep it simple
ii. aim at a single objective in each grant program
iii. undertake periodic review of program relevance
iv. build national consensus on objectives and design of grant programs
v. combine (i) block grants to equalize fiscal capacity, using explicit standard of revenue potential with (ii) specific program-linked grants to equalize differences in needs
vi. avoid multi-factor formulas for fiscal equalization
vii. make grants output (not input) oriented at achieving minimum national standards in access to public services

In addition, to become sustainable, grant mechanisms need to be institutionalized and based on a clear legislative framework to ensure that it is implemented in a transparent and predictable way, and the federal government cannot manipulate the system in support of its own political agenda.

Recent Policy Developments in Nigeria

In Nigeria, there has been a gradual building of consensus that the federal government should start the withdrawal from the actual delivery of services and play a more active role in setting national policy, financing of priority services and monitoring. While there is no developed blue print to operationalize this strategy, the government has accumulated important practical experience under the Universal Basic Education (UBE) scheme. Further, as part of the 2007 budget cycle, the FGN has designed a new conditional transfer scheme.

In particular, as part of 2007 federal budget, the following new federal grant schemes were approved and should be seen as pilots, which if successful could be scaled up later:

a) *Conditional grants (N20 bn):* to support eligible state projects in primary health, rural electrification, and rural water supply and sanitation based on the approved federal guidelines

b) *Safety Net Schemes (N10 bn):* specific grants to be channeled to communities across the states for financing pre-selected poverty reduction interventions through National Poverty Eradication Programme (NAPEP) and SME Development Agency (SMEDAN)

In the area of federal monitoring, the federal government has accumulated important experience in 2005-06 through undertaking the first SEEDS benchmarking exercise. The FGN has also made efforts recently to improve its capacity to monitor state expenditure patterns, but these efforts are constrained by the lack of constitutional authority to request proper budget reporting and disclosure by states. It is expected that, when adopted, the Fiscal Responsibility Law would create a better framework for fiscal disclosure and accountability, as well as for federal monitoring of sub-national fiscal performance.

Another major promising recent development in the area of policy coordination relates to the preparation of Medium Term Sector Strategies (MTSS) during the last two budget cycles, i.e. in the course of preparation of 2006 and 2007 annual budgets. Several MTSS documents made a serious emphasis on strengthening inter-governmental policy coordination in respective sectors. For instance, in health, the federal ministry is committed *inter alia* to pursue its Goal 1 - to improve governance in the sector, including policy formulation, regulation, coordination, monitoring, and evaluation. In particular, the FGN has been working to secure a passage of the National Health Bill, which is supposed to strengthen the regulation of the national health system by establishing the standards of service delivery, clarify responsibilities at each level of the government, and set up national health information systems.

Other federal initiatives for 2007-09 to promote inter-governmental coordination in the health sector, as reflected in the MTSS, include the following:

a. construction of national health accounts,
b. providing technical assistance to states and LGAs,
c. strengthening federal monitoring of health sector performance, including through a) the establishment of countrywide monitoring and evaluation of hospital services, and b) undertaking a regular survey of health workers at the LGA level,
d. supporting activities of the National Council on Health.

Relevant International Experience of Using Federal Fiscal Transfers to States

There is a great deal of international experience in the creative use of federal grant schemes to facilitate national development through better inter-governmental cooperation. This section is focused on examples from India and Russia, (two large federations) which still have major unresolved problems in their models of federalism, but which have made considerable gradual progress in this area. Box 1 below presents relevant examples from a number of other, both developed and developing countries.

India has used 3 main complimentary channels to provide federal transfers to states *(Rao, 2002a; McCarten, 2003):*

a. *Finance Commission* (which distributes about 60% of all federal financial support to states) provides unconditional block grants, which are formula based, and mostly aimed at achieving equalization objectives. Distribution of these grants is linked to the size of state population and local incidence of poverty. Individual states' funding shares are linked to the local tax potential, but not to actual tax collection.

b. *Planning Commission* (22% of all transfers) is responsible for formula-based support to implement state development plans provided as a combination of grants and soft loans to states in proportion 30:70. There is a soft policy conditionality attached to this funding in the form of federal certification of state development plans.
c. *Sectoral schemes* administered by sectoral ministries (18% of all transfers): federal co-financing of state programs (in proportion of 50-80% of overall program budget) to improve provision of public services with significant spillover effect and facilitate achievement of national goals, including in the area of primary education expenses, child nutrition, family planning, self-employment support. India has more than 180 of such individual programs, several of which show strong populist flavor.

Overall, about 50% of all federally collected taxes in India is shared back with states though federal transfer programs. The total amount of resources involved exceeds 7% of GDP.

Box 1. International experience with the grant schemes: selected examples

Indonesia operated (before 2001) a highly successful program of federal support to primary schools managed by local governments (LGs). The program included two components: a) operating grant to LGs based on school age population, and b) capital grants for school construction to communities that do not meet national standard of access.

South Africa adopted a Municipal Finance Management Act that introduced a Treasury-managed grant system for municipalities to encourage an upgrade in municipal budget management practices. This represents an example of "money for reforms" type of scheme.

Tanzania operates a Local Government Capital Development Grant (LGCDG) system of allocating performance based grants for local development. Those municipalities that fail to meet performance requirements are eligible for smaller grants for local capacity building.

In 1976, the **USA** operated 412 different federal specific grant programs with the overall budget of $170bn a year.

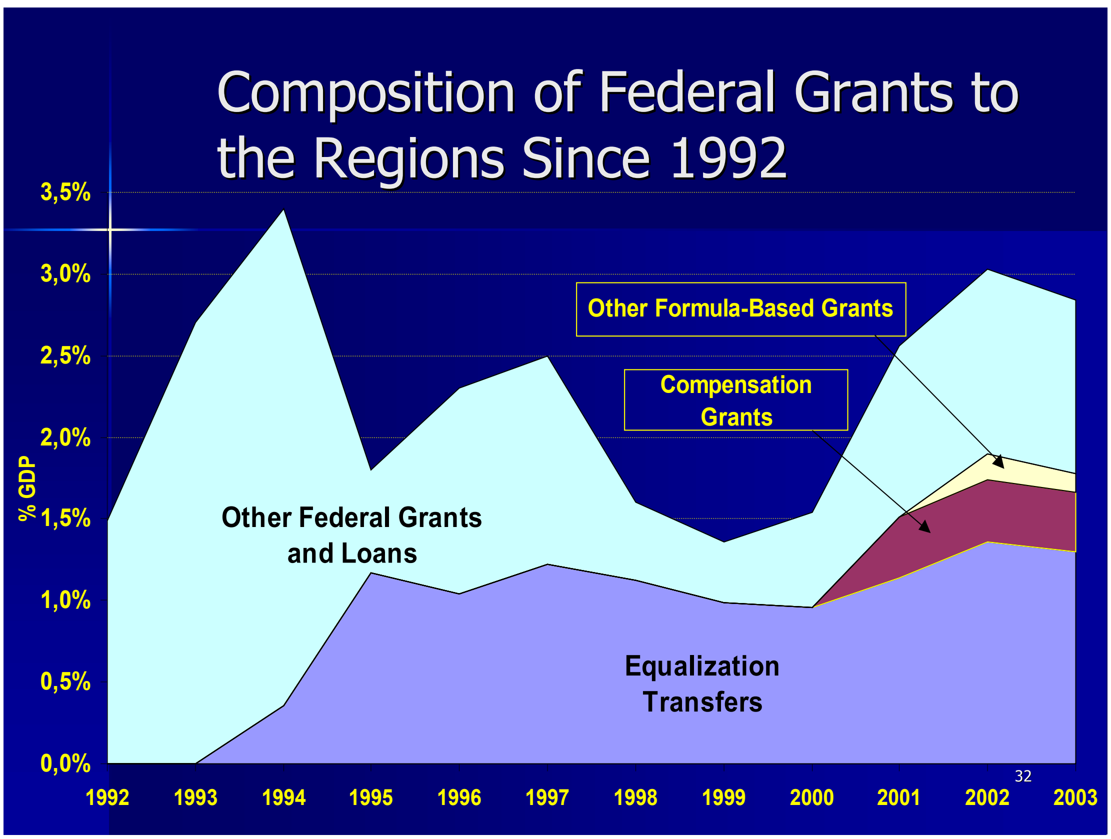
Since 1996, **Germany** has allocated 18% of federally collected oil product excises to states to finance local investment projects in public transportation.

Russia's example is interesting from the perspective of relatively rapid progress made by the country in reforming its fiscal federalism arrangements. It took Russia about a decade to introduce rather a modern system of federal transfers basically from scratch (Figure 3). Most federal funding currently distributed in Russia to sub-national governments is formula-based, quite transparent and predictable. Significant attention is paid to the equity dimension of federal funding, while local differences in revenue potential are explicitly taken into account. Since 2000, Russia has introduced specific grant schemes to compensate regional governments for administering and financing federal responsibilities in the area of social protection *(World Bank, 2004).*

In 1998 Russia piloted an innovative federal grant scheme called the “Fund for Regional Fiscal Reforms”, a special grant window to encourage fiscal reforms in line with the federal priorities. To qualify, regions had to meet specific policy targets in the PFM area, such as reduction in debts and deficits, establishment of regional treasury, improvement in cost recovery in the utility sector, etc. One could see this policy conditionality as an IMF-type of reform program run by the Federal Ministry of Finance for regions that are interested in policy adjustment.

The program is administered by the designated Department in the Federal Ministry of Finance, which also has responsibilities for federal monitoring of regional fiscal performance, technical support to sub-national governments, and dissemination of regional-best practice. It is worth noting that the overall size of the program has been relatively small (participating regions have been awarded grants in the range of $10mn per region). However, many reform-minded governments found participation in the program beneficial because of its attractive combination of cash and non-cash benefits.

Figure 3. The structure of the federal transfer system



Source: *World Bank (2004)*

Lessons for Nigeria from recent Russian experience with fiscal federalism reforms could be summarized as following:

a) fiscal federalism reform is a long term process, which could not be completed in 1-2 years,
b) it is extremely politically sensitive, and may need a popular central government to facilitate a consensus building across different government levels,

c) the environment of strong economic recovery and broadly shared growth is very conducive to reduce states' opposition to reforms and facilitate consensus building,
d) improvements in social and fiscal statistics are important to illustrate deficiencies of the pre-reform situation (e.g. inequalities) and properly estimate potential reform impact (e.g. winners and losers of the proposed change)
e) clarification of expenditure/revenue mandates and improvements in equalization formula is not enough to improve efficiency in the intergovernmental finance system. To encourage adjustment in states' performances, these must be complimented by adequate fiscal rules and intergovernmental policy coordination mechanisms.

Nigeria: Is there a need for some more radical changes in the system of inter-governmental transfers?

Given the above analysis, this paper suggests the following priority directions for reforming inter-governmental financing arrangements in Nigeria:

a. more attention to the equity dimension of revenue sharing
b. strengthening government accountability for utilization of public money in general, and for use of a common pool of funds such as the Federation Account in particular, and
c. introduction of specific grant schemes directly linked to expansion of sub-national government financing in key sectors

With regard to these innovations, in particular specific grant schemes, the natural question then is: "what should be a source of their funding?" In this respect, it may be worth considering some relatively radical changes to the existing revenue sharing arrangements, such as the following:

a. conversion of allocations from the existing VAT account into a specific grant scheme, tied to spending on primary health: all sub-national governments would continue to receive the same shares of the common VAT pool, but they would agree to channel those proceeds to primary health within the agreed national framework.
b. use of off-shore oil revenues, which are not produced at the territory of any state, for a new fiscal equalization scheme, (i.e. distribute this money across states differently than on-shore oil revenues). Should off-shore oil revenues be freed from the derivation principle to improve general equity of fiscal allocations to states?
c. agreement that future revenues from natural gas production be distributed across government levels differently from the existing arrangements with respect to oil revenues in order to focus these funds more directly on improvements in service delivery in key sectors, such as education and health.

If there is an appetite for these type of reforms, Nigeria could start with a pilot program to test block grant arrangements tied to the implementation of a particular national program of primary importance by sub-national governments, such as child immunization. The underlying rationale for this innovation could be (a) the need to encourage a nationwide increase in sub-national spending in the selected area, and (b) potential efficiency gains from better coordination across governments. This could be viewed as a federal policy aimed at accelerating the achievement of core MDGs and the implementation of SEEDS in key sectors.

Conclusions and Recommendations

The analysis in this paper suggests the following main directions for reforms to strengthen inter-governmental coordination:

a) shift from joint service delivery towards co-financing, state/local delivery, and joint monitoring,
b) more attention to equalization dimension of federalism,
c) expansion in specific grant schemes focused on key MDG areas,
d) strengthening accountability arrangements for how public money is spent, especially at state level,
e) strengthening capacity of institutions responsible for inter-governmental policy coordination with NPC becoming a central player,
f) facilitating inter-state competition on the basis of quality of service delivery.

Development partners could support Nigeria's efforts in this area by:

i. helping the FGN to carry out unbiased evaluation/monitoring of state performance
ii. support FGN efforts to accelerate capacity building in states
iii. concentrate donors' support in reform-minded states, in particular states that are eager to cooperate with the federal government in service delivery
iv. providing advice on the best international practice in organization of inter-governmental fiscal relations

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