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FISCAL FEDERALISM AND HORIZONTAL FISCAL IMBALANCE IN NIGERIA: IMPLICATIONS FOR EFFECTIVE SERVICE DELIVERY AT SUB-NATIONAL LEVELS

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Abstract

This study examines the dynamics of fiscal federalism and the persistence of horizontal fiscal imbalance in Nigeria, with particular focus on their implications for effective service delivery across states. Anchored on the fiscal imbalance theory the study argues that the extent to which sub-national governments can efficiently deliver public services is largely determined by their fiscal autonomy, revenue capacity, and equitable access to national resources. A descriptive research design was adopted, utilizing qualitative data from official financial reports, statutory allocation frameworks, government publications, and scholarly literature. Findings reveal that significant disparities exist among states in terms of revenue-generating capacity, largely influenced by uneven natural resource endowment, population differences, and inconsistent levels of administrative efficiency. These disparities create a structural horizontal fiscal imbalance that undermines fiscal equity and weakens service delivery at the state and local levels. The study further finds that the current revenue allocation formula remains heavily centralized and insufficiently responsive to the fiscal needs of economically disadvantaged states, resulting in inadequate funding for sectors such as education, healthcare, and rural infrastructure. Additionally, heavy dependence on federal transfers reduces the incentives of sub-national governments to broaden their internally generated revenue (IGR) base. The study recommends a review of the revenue allocation formula, improved fiscal decentralization, strengthened institutional capacity of states, and the adoption of needs-based and performance-driven fiscal transfers to promote more equitable service delivery across Nigeria.

Keywords: Fiscal Federalism, Horizontal Imbalance, Nigeria, Service Delivery, Sub-National Level

1. Introduction

Fiscal federalism refers to the system through which financial responsibilities, including revenue generation, allocation, and expenditure, are shared among different levels of government in a federal state to promote efficiency, equity, and accountability (Oates, 2022). International best practices emphasize fiscal autonomy, clear expenditure assignments, and equalization mechanisms that reduce regional disparities while encouraging local revenue mobilization (OECD, 2021; World Bank, 2022). Countries such as Canada, Germany, and Australia have successfully implemented

fiscal equalization frameworks to ensure that citizens receive relatively comparable public services regardless of their region, thereby strengthening balanced development and effective governance.

In Nigeria, although the Constitution provides for the distribution of fiscal responsibilities among the federal, state, and local governments, significant horizontal fiscal imbalance persists due to disparities in economic structures, resource endowment, internally generated revenue, and administrative capacity (Adewuyi & Ibrahim, 2021). These inequalities have resulted in uneven service delivery, as fiscally stronger states provide better education, healthcare, infrastructure, and

other public services, while weaker states remain heavily dependent on federal allocations and struggle to meet their development obligations (Okafor, 2020). The situation has been exacerbated by rising socioeconomic challenges, including unemployment, insecurity, and inflation, highlighting the need for effective fiscal equalization mechanisms and stronger intergovernmental fiscal reforms to improve equity, strengthens national cohesion, and enhances service delivery at the sub-national level. Based on the above, this study examines fiscal federalism and horizontal fiscal imbalance in Nigeria: implications for effective service delivery at sub-national levels.

Despite constitutional provisions for fiscal decentralization, Nigeria's fiscal system remains highly centralized and uneven, with persistent horizontal fiscal imbalance creating wide disparities in the revenue capacities of states. These disparities directly constrain the ability of sub-national governments to deliver essential public services effectively. While some states struggle to meet basic governance obligations, others possess relatively stronger fiscal capacity to invest in long-term development projects. This uneven distribution of resources has contributed to poor educational outcomes, inadequate healthcare facilities, infrastructural decay, weak social welfare systems, and inconsistent service delivery across the federation (Adewuyi & Ibrahim, 2021). Moreover, sub-national governments are confronted with increasing expenditure responsibilities without commensurate fiscal autonomy or revenue-generating capacity. A significant number of states depend on federal allocations for over 70% of their budgetary requirements, making them highly vulnerable to fluctuations in centrally collected revenues. Beyond the issue of revenue inadequacy, concerns have also been raised regarding weak accountability and transparency in the management of internally generated revenue (IGR), which further undermines service delivery outcomes. Additionally, sub-national governments face structural and administrative challenges in mobilizing IGR, including poor tax administration, narrow tax bases, and limited institutional capacity. Against this backdrop, the mismatch between fiscal capacity and

service delivery responsibilities continues to undermine the effectiveness, equity, and sustainability of governance in Nigeria. It is therefore imperative to systematically examine the nature of horizontal fiscal imbalance and its implications for effective service delivery at the sub-national level, evaluate the extent to which lack of accountability and transparency in the utilization of internally generated revenue affects service delivery, and ascertain the key challenges associated with IGR mobilization among sub-national governments in Nigeria.

The general objective is to examine Fiscal federalism and horizontal fiscal imbalance in Nigeria with focus on its implications for effective service delivery at sub-national levels. The specific objectives are to:

- i. To examine horizontal fiscal imbalance in relation to effective service delivery at the sub-nationals level in Nigeria.
- ii. To evaluate how lack of accountability and transparency in the utilization of internally generated revenue by sub-nationals impact on effective service delivery in Nigeria.

The study is guided by the following questions:

- i. How does horizontal fiscal imbalance affect effective service delivery in Nigeria?
- ii. How does lack of accountability and transparency in utilization of internally generated revenue by sub-nationals impact on effective service delivery in Nigeria?

2. Literature Review

2.1 Conceptual Clarifications

Fiscal Federalism

The term "fiscal federalism" is rooted in a political arrangement called federalism as already attested to in our introduction. It is the financial relationships between and among existing tiers of government. Specifically, it is the system of transfers or grants by which the federal government shares its revenues with state and local governments. This is what is generally referred to as revenue allocation (Williams & Orokpo

2014). To Ekeuwei and Akpan (2022) defined fiscal federalism as the interplay of allocation of financial functions and responsibilities between the various tiers of government. It involves the activities of the different levels of government in the financial setup of a state either in the form of revenue collection (taxes and equities) or expenditure. Fiscal federalism allocates responsibilities to the tiers of government through allocation, distribution and stabilization of finances. It is also notable to state that fiscal federalism does not only emphasize the relationship of the tiers of government in managing the revenue and expenditure of the country, but also determines who owns or controls what, who gets what, how, and who losses out as well.

Fiscal federalism is defined as the system by which revenue and spending responsibilities are divided among different levels of government to promote decentralization, equity, and efficient public service delivery. According to OECD, (2022), fiscal federalism involves assigning taxing powers and expenditure roles to sub-national governments and designing intergovernmental transfers to reduce disparities. Similarly, Chenge (2024) conceptualizes fiscal federalism as the framework of vertical organization in public finance, where sub-national governments have authority over revenue generation and spending decisions, but structural imbalances (e.g., resource shortages) create inefficiencies in expenditure. In the Nigerian context, Pillah, (2023) defines fiscal federalism as the “distribution of financial resources and responsibilities between different levels of government, such as the federal government and state governments,” noting that constitutional provisions assign distinct fiscal roles to each tier. Thus, fiscal federalism can be understood as both a normative framework for sharing taxing and spending powers and a mechanism to redistribute resources through intergovernmental transfers in order to balance efficiency and equity across government tiers. From the above definitions, it can be deduce that fiscal federalism has to do with monetary issues and its jurisdictional responsibilities among federating units in a country. In Nigeria therefore it connotes financial relationships and

jurisdictions regarding Tax responsibilities, and revenue generations.

The Concept of Horizontal Fiscal Imbalance

Horizontal fiscal imbalance refers to disparities in the fiscal capacity of sub-national governments, such as states or provinces, which exist at the same level of government within a federal system. It arises when some states possess significantly greater ability to generate revenue and finance public services than others, despite having similar constitutional responsibilities for service delivery (Martinez-Vazquez & Timofeev, 2010). These differences are often attributable to variations in natural resource endowments, levels of economic development, population size, administrative efficiency, and internally generated revenue (IGR) capacity. Consequently, wealthier states are able to provide higher-quality public services, while fiscally weaker states struggle to meet basic expenditure obligations, resulting in regional inequalities in development and citizens' access to essential services.

According to the Organization for Economic Co-operation and Development (2020), horizontal fiscal imbalance reflects differences in the revenue-raising capacity and expenditure needs of sub-national governments, rather than an unequal distribution of constitutional powers. The World Bank (2022) similarly explains that such imbalances are common in federal systems and should be addressed through fiscal equalization mechanisms and intergovernmental transfers designed to ensure that all sub-national governments can provide reasonably comparable levels of public services at similar tax rates. In countries such as Canada, Germany, and Australia, equalization grants have been adopted to reduce these disparities and promote regional equity without undermining fiscal autonomy.

In Nigeria, horizontal fiscal imbalance is manifested in the wide disparities in the revenue-generating capacities of the thirty-six states. While oil-producing and economically advanced states generate substantial internally generated revenue and benefit from

derivation funds, many non-oil-producing states depend overwhelmingly on allocations from the Federation Account Allocation Committee (FAAC) to finance recurrent and capital expenditures (Adewuyi & Ibrahim, 2021; Okafor, 2020). These fiscal disparities have significant implications for the quality and accessibility of public services, particularly in education, healthcare, infrastructure, water supply, and social welfare. Consequently, horizontal fiscal imbalance has become a major challenge to equitable development, effective governance, and national cohesion in Nigeria's federal system.

The concept of sub-national

Sub-national governments refer to the constitutionally recognized lower tiers of government such as states, provinces, and local governments within a federal structure. In a federal system, authority is divided between the central (national) government and these sub-national units, each possessing autonomous legal and administrative powers guaranteed by the constitution (Watts, 2008). The primary purpose of sub-national governance is to bring government closer to the people, ensuring that policies and public services are tailored to local needs. According to Oates' Decentralization Theorem, sub-national governments are better positioned to understand local preferences and provide services more efficiently than a distant central authority (Oates, 2019). As a result, they play crucial roles in education, primary healthcare, transportation, rural development, and local economic planning. In fiscal federalism, sub-national governments must have adequate revenue powers and expenditure responsibilities to function effectively. However, in many federations especially developing ones like Nigeria sub-national capacity is constrained by vertical and horizontal fiscal imbalances, whereby revenue-generating powers remain concentrated at the center while expenditure burdens fall on states and local governments (Boadway & Shah, 2009). This often leads to overdependence on federal transfers and weak internal revenue capacity, limiting effective service delivery (Yusuf, 2021). Overall, sub-national governments serve as critical pillars for decentralization, democratic participation, and

balanced territorial development. Their effectiveness depends on clear constitutional roles, adequate fiscal autonomy, and functional intergovernmental relations.

Horizontal fiscal imbalance and effective service delivery in Nigeria

The standard fiscal-federalism literature identifies three mechanisms through which horizontal fiscal imbalance undermine service delivery. First, resource capacity: richer sub-national units can finance higher-quality services while poorer units cannot meet comparable expenditure responsibilities (Martinez-Vazquez & Timofeev, 2010; OECD, 2020). Second, incentives and accountability: heavy reliance on unconditional transfers reduces the fiscal link between taxpayers and service providers, weakening incentives for efficiency and responsiveness (Boadway & Shah, 2009). Third, volatility and predictability: resource-poor states are particularly vulnerable to transfer volatility (often linked to oil price swings), which disrupts recurrent financing for teachers, health workers and maintenance (World Bank, 2024). These mechanisms are central to explaining Nigeria's uneven service outcomes (Suberu, 2021).

Impact on specific service sectors

Education: Research shows that states with greater fiscal autonomy can hire and retain teachers, procure learning materials, and finance school infrastructure, leading to higher enrolment and learning outcomes; by contrast, states with severe horizontal fiscal imbalance experience teacher shortages, irregular salary payments and school closures (World Bank, 2024; Dike & Ebe, 2024).

Health: Primary health care delivery is highly sensitive to predictable recurrent financing. Studies and policy reviews indicate that FAAC-dependent states face interruptions in drug supplies, staff absenteeism, and facility closures during transfer shortfalls, producing worse maternal and child health indicators (INFF, 2024; UNDP, 2023).

Infrastructure & maintenance: Capital projects require multi-year funding commitments. HFI and

transfer volatility lead many low-capacity states to start but not complete roads, water schemes and school buildings; even where projects are initiated, poor maintenance budgets cause rapid deterioration (BudgIT, 2024; World Bank, 2024).

Social protection: Conditional cash transfers and targeted safety nets are often funded through grants and donor programmes. Where states lack fiscal room, these programmes are thinly scaled and difficult to sustain, reducing poverty-reduction impacts (INFF, 2024).

Impact of horizontal fiscal imbalance on capacity of sub nationals in effective service delivery

Horizontal Fiscal Imbalance is the systematic differences in revenue-raising capacity and fiscal needs across jurisdictions at the same governmental level is a central determinant of whether sub-national governments can provide basic public services equitably and reliably (Boadway & Shah, 2009). In federations where expenditure responsibilities are broadly similar across units, horizontal fiscal imbalance produces a structural problem: some sub-national governments enjoy robust internally generated revenue (IGR) and can fund recurrent and capital spending, while others remain dependent on transfers that are often volatile, inadequate, or poorly targeted (Martinez-Vazquez & Timofeev, 2010; OECD, 2020). There are three principal channels through which horizontal fiscal imbalance reduces sub-national service capacity one of which is fiscal capacity and predictability. Here, states with larger internally generated revenue can sustain teacher salaries, procure medicines, maintain roads and plan multi-year investments while resource-poor states reliant on centralized transfers face unpredictability, which forces them into stop-go budgeting and deferred maintenance (BudgIT, 2024; World Bank, 2024). The other is expenditure-need mismatch. This involves demographic pressures and poverty creates varying service needs. When transfers do not adequately reflect needs, poorer units are unable to meet statutory responsibilities (Martinez-Vazquez & Timofeev, 2010; INFF, 2024). Finally, there are incentive and accountability effects. Heavy transfer dependence weakens the fiscal connection between taxpayers and

governments, reducing incentives to broaden tax bases or improve service delivery performance (Boadway & Shah, 2009; Fjeldstad & Moore, 2020).

In Sector-specific areas, especially in education, states with constrained fiscal capacity face teacher shortages, delayed salaries and inadequate learning materials, undermining enrolment and learning outcomes (World Bank, 2024). In health, interruptions to recurrent funding lead to medicine stock-outs, health worker absenteeism and facility closures in low-capacity states (INFF, 2024; UNDP, 2023). Infrastructure projects roads, water schemes, school buildings require multi-year financing; horizontal fiscal imbalance and transfer volatility cause projects to stall or lack maintenance budgets, accelerating asset deterioration (BudgIT, 2024). Thus, horizontal fiscal imbalance not only reduces the quantity of services but also damages service quality and sustainability.

2.2 Theoretical Framework

The study is anchored on fiscal imbalance theory that explains the dynamics of fiscal arrangements, resource disparities, and service delivery outcomes within federal systems. Theory of fiscal imbalance provides conceptual lenses for understanding how the distribution of fiscal powers influences horizontal inequalities among states and affects their capacity to deliver services. The Theory of Fiscal Imbalance explains situations where the expenditure responsibilities of a tier of government do not match its revenue-generating powers. Fiscal Imbalance Theory examines the structural disparity between revenue-raising capacities and expenditure responsibilities across different tiers of government (Shah, 2007). Basically vertical and horizontal fiscal imbalances are involved. There is vertical imbalance which entails mismatch between national and sub-national revenue capacity relative to their expenditure obligations and horizontal Fiscal Imbalance which involves disparities among states or local governments in their ability to generate revenue and fund public services.

Major proponents of Fiscal Imbalance Theory, including scholars whose works form the theoretical

foundation of vertical and horizontal fiscal imbalances in federal systems are Wallace E. Oates (1972, 1999), one of the earliest scholars to analyze fiscal disparities arising from the assignment of revenue and expenditures in federal systems. His work on fiscal federalism explains how uneven revenue capacities across sub-national units generate structural imbalances requiring intergovernmental transfers. There is Richard M. Bird (1993; 2001) whose extensive work on intergovernmental finance highlights how differences in revenue capacity and expenditure needs across sub-national governments create horizontal fiscal imbalances. He emphasizes the role of equalization grants as correction mechanisms. There is also the work of Robin Boadway (2004; 2007), a leading authority on fiscal decentralization and intergovernmental transfers. He conceptualizes fiscal imbalance as a natural outcome of assigning more expenditure responsibilities to sub-national governments than revenue powers.

Horizontal fiscal imbalance occurs when sub-national units possess unequal fiscal capacities due to differences in economic base, population size, natural resources, and administrative efficiency (Bird & Tarasov, 2020). In a developing federal system like Nigeria, variations in internally generated revenue (IGR), resource endowments, and administrative capabilities create significant fiscal disparities. Nigeria's 36 states and 774 local governments experience stark differences in revenue capacity, with states like Lagos and Rivers generating over 60% of national sub-national internally generated revenues, while states in the North-East and North-West generate less than 10% (National Bureau of Statistics, 2023). This uneven fiscal capacity results in unequal provision of public services such as education, healthcare, sanitation, and infrastructure. The theory helps explain why some states remain dependent on federal transfers while others maintain relative autonomy and higher service delivery performance.

The failure of intergovernmental transfers (e.g., FAAC allocations, derivation funds, ecological funds) to adequately equalize fiscal capacity across states exacerbates horizontal fiscal imbalance. As a result,

poorer states face difficulty meeting statutory obligation such as paying teacher salaries, providing healthcare facilities, and maintaining public infrastructure creating a cycle of underdevelopment. Nigeria's fiscal federalism is heavily centralized. The Federal Government controls most buoyant tax handles petroleum profits tax, corporate income tax, customs duties leaving states with weaker revenue bases such as personal income tax etc. while vertical imbalance results from federal dominance in revenue generation, horizontal imbalance stems from unequal economic opportunities, uneven natural resource distribution, population differences, and administrative inefficiencies across states. The theory suggests that for effective service delivery, fiscal equalization mechanisms such as grants, needs-based transfers, or revenue formula adjustments must be employed to bridge inter-state disparities. However, Nigeria's limited and often politically influenced equalization measures have failed to address these deeper structural gaps. This theory directly frames the central issue of the research. It explains why some states can provide better services than others and why revenue disparities persist, thereby hindering uniform development across Nigeria.

3. Methodology

This study adopted a descriptive research design relaying on secondary materials for analysis. Data were sourced and retrieved from peer-reviewed and reputable journals articles and other relevant documents relevant to the study and other credible online data base. Relevant materials were identified through systemic searches in reputable websites. Validation of data was done through cross referencing across multiple sources to ensure accuracy and consistency.

4. Results and Discussion

Findings reveal that there are both vertical and horizontal fiscal imbalances which affect sub-nationals in Nigeria to provide effective service. Vertical and horizontal fiscal imbalance result in inadequate funding for sectors such as education, healthcare, and rural infrastructure. According to Martinez-Vazquez and Timofeev, (2010) and OECD, (2020) heavy

dependence on federal transfers reduces the incentives of sub-national governments to broaden their internally generated revenue base. Also, richer sub-national units can finance higher-quality services while poorer units cannot meet comparable expenditure responsibilities. Heavy reliance on unconditional transfers reduces the fiscal link between taxpayers and service providers, weakening incentives for efficiency and responsiveness (Boadway & Shah, 2009). Resource-poor states are particularly vulnerable to transfer volatility (often linked to oil price swings), which disrupts recurrent financing for teachers, health workers and maintenance (World Bank, 2024). Other findings indicate that disparities creates structural and horizontal fiscal imbalance that undermines fiscal equity and weakens service delivery at the state and local levels. The study further finds that the current revenue allocation formula remains heavily centralized and insufficiently responsive to the fiscal needs of economically disadvantaged states, resulting in inadequate funding for sectors such as education, healthcare, and rural infrastructure.

Findings

Findings revealed that horizontal fiscal imbalance has a strong negative relationship with effective service delivery at the sub-national level in Nigeria. However, the study also reveals that improved revenue generation alone does not guarantee better service delivery, as weak accountability and lack of transparency in the utilization of internally generated revenue often limit development outcomes even in relatively wealthy states. Poor public financial management, corruption, weak budget oversight, and inefficient expenditure reduce the developmental impact of available resources. Furthermore, challenges such as narrow tax bases, weak

tax administration, widespread informality, political interference, multiple taxation, and limited economic diversification continue to constrain internally generated revenue across many states. Therefore, improving effective service delivery in Nigeria requires not only strengthening internally generated revenue but also enhancing fiscal accountability, expanding revenue sources, improving intergovernmental fiscal equalization, and ensuring transparent and efficient utilization of public resources to reduce regional disparities in development.

5. Conclusion and Recommendations

Fiscal federalism in Nigeria has historical antecedence one of which is a perverse of fiscal centralization of fiscal powers to the detriment of sub-national governments. A more contentious issue is horizontal Fiscal Imbalance which has substantially constrains sub-national capacity for effective service delivery. Stark internally generated revenue differences, uneven transfers, governance weaknesses, and political economy distortions combine to produce regional disparities in education, health, infrastructure and social protection.

Based on the findings and conclusion, the study recommends that:

- i. Addressing horizontal fiscal imbalance requires a better equalization design, strengthened sub-national revenue systems, predictable transfers, and governance reforms that ensure funds reach sub-national
- ii. Strengthen sub-national tax administration through constitutional provision to promote effective service delivery in education, health and rural infrastructure.

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