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Managing Urban Cities in Nigeria Efficiently by Local Councils: The Capital Market Option

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Abstract

Urbanization is currently a global phenomenon, which has come with the dire need of providing and improving basic infrastructures. Local governments have also been charged with the acceleration of economic development in their municipalities. This has however, generated serious debate on the preparedness of the local governments in accomplishing this goal, considering the level of financial impropriety often leveled against them. To what extent therefore can the local governments manage our cities? This study proposes a capital market option as an alternative to check the financial impropriety of local councils and as a mechanism for involving the private sector in the efficient delivery of urban infrastructure in Nigeria. This paper is essentially of the view that the Nigerian local governments can manage the urban cities in Nigeria efficiently, if they adopt a market approach, by using the capital market sources of funding and not limiting themselves to statutory revenue allocations. It was also noted that there is enough infrastructure in place, to enable the local governments to access the capital market financing. However for this to be successful, further amendments are needed in the Nigerian constitution, to secure the fiscal autonomy of the local governments as contained in the 1989 federal Constitution.

Key words: Local government financing; Municipal Bond; Urban development; Urban Infrastructure

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INTRODUCTION

Urbanization is currently a global phenomenon, which has come with the dire need of providing and improving basic infrastructural facilities for the people (Leigland, 1997). In Nigeria, just like most other developing economies, the growing consciousness on the rising urban population and the attendant demographic challenges became much stronger following the result of the country's 2006 census exercises. Whereas the 1952 exercise showed that there were only about 56 cities in Nigeria, contributing to about 10.6 percent of the total national population, the 1963 census report indicated that urban population had risen by up to 8.5 percent–standing at 19.1 percent of the total population. By 1970, the percentage of urban population was put at 20 percent; and by 1990 it had risen to as high as 35 percent. The 1991 census indicated that the number of urban settlements with a population of at least 20,000 stood at 359; and that the number of cities with population of one million would reach 17 in 2000. As at 1995, out of the estimated 110 million in national population, about 44 million were said to be living in cities and towns. In a World Bank study in 1995, it was estimated that urban population grew at 5.5 percent in Nigeria; and that by 2010, the population would be about 60 percent of the entire national population (Ezeoha & Ekumankama, 2010; World Bank, 1996). Essentially, the growth in the challenges of urbanization is a common one in most of the African countries, and not just peculiar to Nigeria (the Swedish Consultancy Trust Fund, 2004).

Ironically, urbanization is used as a parameter for measuring economic development and growth; this is true when viewed from the perspective that one of the features that distinguish urban areas from rural areas is the level of infrastructure development (Yusuf, 2002). The concept of infrastructure here embraces (1) economic infrastructure – like postal services, solid waste collection and disposal, sanitation and sewage, water supply, telecommunication, power; public works, such as: urban transportation, roads and dams, drainage; and (2) social infrastructure – like health and education. Whereas these are found in large numbers in most urban areas/cities, they are conspicuously absent in most rural communities. It is for instance a common knowledge that shortages in public utilities and infrastructures are the basic features of most developing countries of the world, with relative large population size (Ezeoha & Ekumankama, 2010). According to a World Bank report on sustainable development in 2003, urban cities of the developing countries face a formidable undertaking, as a result of rapid growth in urbanization.

Nigeria, as a developing economy, clearly stands out on issues of urbanization; being Africa's most populous nation, with the highest number of cities and the highest total urban population in the region. As at 2002, for instance, the country has 73 cities with a population above 100,000 each. Five out of these recorded a population of one million and above; whereas 13 have population of over 500,000 (National Population Commission, 1996; Oxford Policy Management, 2004). The five cities with over one million people are Kaduna, Port Harcourt, Lagos, Kano, Ibadan, Benin City. Outside diversity, Lagos – the commercial and industrial nerve center of the country – occupies the 7th position, with an estimated population of 13,488,000 among the top 100 cities in the world (see US Census Bureau and Times Atlas of the World, 10th Edition). It equally ranks as the 8th largest metropolitan area in the world and the 13th most populous city of the world. Another city, Ibadan – Southwest Nigeria, is acclaimed to be the largest city in black Africa – in terms of landmass. However, the country's profile as the largest in Africa, and one of the world's most populous nations, appears not to have translated to any meaningful internal economic development and integration (Ezeoha & Ekumankama, 2010)[1].

The country's fast growing population, without a corresponding growth in economic development has eroded the benefits that would have otherwise accrued from her size and urban diversity. As emphasized above, the most affected here is the urban infrastructure. Facilities such as water supply, electricity, housing, road and transport system, are not only in short supply amidst population induced rising demand, but are subjected to abuse, over use and neglect, especially in the urban areas where they are mostly found. Specifically, the rapid rate of urbanization, as pointed out above, brought with it some significant pressure on these facilities – climaxing to the current situation – shortages of housing and water, overcrowding and traffic congestion, environmental degradation, and high level of inadequacy in supply of other infrastructure facilities. These problems are prevalent in all the major cities in equal proportion, with virtually no exemption (Ezeoha & Ekumankama, 2010).

To meet the challenges of urbanization and economic development, a number of countries have decentralized the governmental structure into central, state and local government (Ekumankama & Ujunwa, 2008).[2] The principles and conceptual issues for fragmenting tiers of government are discussed in Shah (1991) and Ekpo and Ndebbio (1991). However, it may be important to emphasize that one of the major reasons is derived from the fact that for a more efficient macroeconomic management of the economy, certain goods, services and infrastructure are best provided for by the different tiers of government. Thus, issues of efficiency in resource allocation and distribution are paramount at the third level of government. Additionally, it has been advocated that certain taxes, levies and rates should be collected by local governments (Ekpo & Ndebbio, 1998). In Nigeria for instance, the local government reform of 1976 which has been incorporated into the various republic constitution[3] was for the singular purpose of bringing development to the grass roots (Federal Republic of Nigeria, 1976, 1979, 1989, 1999). Hence in order to meet with the challenges of infrastructure provisioning, local governments have been charged with the acceleration of economic development in their municipalities. This has however, generated serious debate on the preparedness of the local government in accomplishing this goal. Most of the arguments centered on financing challenges faced by

[1] On housing, for instance, most of the cities still wear dilapidated look. The unregulated trading activities and the haphazard location of small scale repair outfits along major roads leave city centers cluttered with broken down weather beaten tables, stacks of old tyres, decaying vehicles, etc. to serve as decorative objects in cities up and down the country. As for the mountains of refuse in the cities, they are so much a part of the landscape that they actually serve as landmarks for directing people who may be new to an area. Again in the urban areas people are so unconscious of the environment and pollution that they freely discard refuse about. Links among the cities in the country are very difficult due to bad road network and other infrastructure connectivity.

[2] These decentralization reforms were based on laws passed in the last decade. For example, the Philippines' Local Government Code in 1991; India's Decentralization Acts in 1992; Thailand's law rendering Tambon councils a juridical status in 1994; Republic of Korea's Local Autonomy Act in 1995; and Indonesia's laws on Local Government and Central-Local Financial Fund in 1999.

[3] Nigeria has had four republican constitutions – 1963, 1979, 1989 and 1999; being interrupted by military dictatorships.

this tier of government (Ekumankama & Ujunwa, 2008).

This paper is therefore set to address the issues of Nigeria's local governments financing of urban development in Nigeria, using the capital market financing option. To achieve this objective, the paper is structured into five parts. Following the introductory section is the evolutionary trends in the Nigeria's local government system; this is followed by section three which treats fiscal and governance issues in Nigeria's local government. Section four deals with capital market sources of financing, while section five attempts a practical approach to sourcing capital market funds by Nigeria's local governments. Thereafter the work is concluded.

1. EVOLUTIONARY TRENDS IN THE NIGERIA'S LOCAL GOVERNMENT SYSTEM

Local Government Administration in Nigeria is based on certain assumptions which have been termed local government theory. According to the Official Document No.4, 1971 of Western State Nigeria, the elements of this theory are: Local government is an essential instrument of national and state government for the performance of certain basic services; it is an instrument which unites people in a defined area for common purposes; an instrument to solve local problems and satisfy needs that cannot be achieved by individuals; it is also an instrument of representation. To this end therefore, the effectiveness of local government can be judged through the local developments it generates, social amenities it provides and the extent to which it has catered satisfactorily for the happiness and general well being of the communities for which it has been established to serve (Green, 1976).

Local government administration in Nigeria has undergone several reforms since the early 1950s. Within this period, the system was structured on representative basis. The colonial arrangement at that time allowed local administration to revolve around traditional rulers, with the unit of local administration commonly known as native authority. However, the executive authority resides with the district officer. The authorities at that time created administrative organizations that were ad hoc in nature. This traditional arrangement was more successful in the emirate system of former Northern Nigeria. On regional basis, old regions of the East, West and North, made significant attempts to strengthen their systems of local administration (Ekpo & Ndebbio, 1993; Gboyega, 1983; NCEMA, 1990).

In the years 1950-55, the first largely elected local government council based on the British model emerged in Lagos and the former Eastern and Western regions. Traditional rulers constituted not more than 25 percent of most council in the Western region and Lagos (Orewa & Adewumi, 1983). However, in Northern Nigeria, the changes were more gradual. The legal framework for local government at this period was provided by the Eastern region local government ordinance of 1950, the Western region local government law of 1952 and the 1954 Native Authority law in Northern Nigeria. By this time, the councils were given a wider range of functions including primary education, health, police, judiciary, etc.. This was in line with the implementation of the colonial government's ten-year welfare and development plan (1946-1956). The councils also enjoyed a great measure of autonomy in financial, personnel and general administrative matters. It can therefore be said that the 1950s was the era of pupilage for councils in modern local government throughout Nigeria (Igbuzor, 2005).

Between 1960 and 1966, there was a decline in the prestige and responsibilities of local authorities, which was due mainly to the improper use of the vast powers vested on the local government councils in the years 1950-55, on matters of personnel and market administration. The loss of autonomy was first implemented in the former Eastern Region. In the former Western region, the local government (Amendment) law 1960 abolished the powers of councils to levy education and general rates on the basis of need. In Lagos, there was a high rate of default in the payment of property rates including government institutions, which reduced the revenue of the local councils. The situation in Eastern Nigeria was similar to the West before the outbreak of the civil war in 1967. In Northern Nigeria, there were gradual changes in the structure of the councils with increasing numbers of elected or appointed non-traditional office holders becoming members of local authorities. The result was that the local authorities had a stable administration, which enabled them to assume responsibility, with some degree of success for more complex services like primary education. Between 1969/71, some State governments introduced some changes in the structure of their councils (Ekumankama & Ujunwa, 2008; Igbuzor, 2005; Orewa & Adewumi, 1983). A notable reform for instance was introduced by the Western State of Nigeria, in April 1973, known as the Council-Manager system which was an adaptation of the American Council-Manager System (Green, 1976).

The regions had strong grip of the control of local governments for different political reasons. This master-servant relationship did not change until the 1976 local government reforms. For the first time, the federal government changed its posture and championed the course of local government autonomy. In the forward of the guidelines for 1976 local government reforms, it was remarked that "the state government have continued to encroach upon what would have been the exclusive preserve of local government" (Adeyemo, 2005).

Thus confronted with the desire to find a lasting solution to problems facing the Local Governments (problems of finances, staffing, democratization, governance, size, etc.), and also in a bid to hasten socioeconomic development at the grassroots, the Federal Military Government introduced the 1976 Local Government reforms, which were to be implemented by all the states of the federation. The principal objectives of the reforms were as follows: (a) To make appropriate services and development activities responsive to local wishes and initiatives by devolving or delegating them to local representatives body; (b) to facilitate the exercise of democratic self government close to the local government levels of the society, and to encourage initiatives and leadership potential; (c) to mobilize human and material resources through the involvement of members of the public in their local development; (d) to provide a two way channel of communication between local communities and government (both state and federal levels) (Federal Republic of Nigeria, 1976; Okafor,1986).

Unlike previous reform measures, which were highly restricted in scope and range, the 1976 reforms conceptualized local government as the third tier of government operating within a common institutional framework with defined functions and responsibilities. As the third tier of government, the local government gets statutory grants from Federal and State governments, and is expected to serve as agent of development especially in rural areas. According to the 1976 reform, 75 percent of members of the council are to be elected through the secret ballot on a no-party basis under the direct and indirect systems of election. The remaining 25 percent are to be nominated by the State government.

The whole intents of the 1976 reform were incorporated into the 1979 constitution. Section 7(3) of the Constitution reaffirmed that:

> It shall be the duty of a local government council within the State to participate in economic planning and development of the area referred to in subsection (2) of this section and to this end an economic planning board shall be established by a law enacted by the House of assembly of the State (1979 Constitution).

In addition, section 7 of the 1979 Constitution provided for a democratically elected local government council for the country. Unfortunately, during the Alhaji Shehu Shagari regime (1979-1983), the constitutional provisions were neglected. No elections were held and sole administrators were appointed. The Mohammadu Buhari regime (1983-1984) continued with the system of sole administrators. During the Babangida regime (1984-1992) there were certain reforms aimed at ensuring local government autonomy. These included the abolition of the Ministry of Local Government; establishment of executive and legislative arms in local councils; and direct allocation to local government without passing through State government (Igbuzor, 2005).

It is important to point out that the intergovernmental relations between the Federal, State and Local governments have been characterized by both co-operation and conflict; but conflict appears to have predominated State-local Government relation (Adamolekun, 1993). Some state governments have been known to have hijacked and diverted Federal government's allocation to local governments. In some cases some state governments give directives on how the local government allocation is to be utilized. This was why one of the features of the reform during Ibrahim Babangida's regime was to make allocations directly to local governments without going through the state governments. However, the current legal framework upon which the local councils are working in Nigeria has brought back the local governments to the financial and political hegemony of the State governments. Section 162 (6 & 7) of the 1999 Constitution of Nigeria provides for a State Joint Local Government Account (SJLGA), into which all financial allocations from both the federal and state governments shall be paid; it also provides that the expending of the funds should be determined by the State Houses of Assembly. Consequently, most of the governors have exploited this constitutional provision to control local government funds. Moreover, most state governors orchestrate the nomination and subsequent election of their acolytes as local government chairmen. Aspirants who eventually emerge victorious from the tortuous electioneering process are usually those who may have pledged allegiance to the governors, including accepting whatever deductions the governors may make from the SJLGA (Ukiwo, 2006). This is further supported by the report of the Nigeria's Economic and Financial Crimes Commission (EFCC), which alleged that about 31 out of 36 state governors tampered with local government council funds (This Day, 2006). There are current debates on further reforms in the local government system in Nigeria; however most of the debates are on the political structure and tenure of the local councils.

2. FISCAL AND GOVERNANCE ISSUES IN NIGERIA'S LOCAL GOVERNMENT

Due to the assigned functions of the local governments in Nigeria, some sizeable proportion of the federation account has been devoted to it. However issues relating to revenue rights and fiscal jurisdiction have over the years remained the most dominant and intractable phenomena in the relationship between the local governments, on one hand, and the states and federal government on the other hand. In a study by Uzochukwu (2009) it was reported that evidence of monthly payments to all tiers of government in Nigeria since 2003 was found; and that the percentage meant for the local governments is usually transferred from the federation account to state accounts. However, there is no evidence that the state transfers the same percentage to the local governments. In essence therefore, in spite of the some constitutional provisions that could have given the local councils in Nigeria some fiscal relief, there exists evidence of fiscal difficulties for this third-tier of government.

The third tier of government in Nigeria for instance receives certain transfers from the federal and state governments, as provided for by the constitution, to enable them meet part of their recurrent and capital expenditures. The transfers range from statutory allocations to primary education funds (see Table 1a for the summary of local governments' finances in Nigeria). Additionally, the local governments also receive statutory allocations, grants, loans and funds for certain projects. A further provision was also made for the states to mandatory allocate 10% of their *internally generated revenue* (emphasis those of the authors) to local governments within their jurisdiction. The justification for this later source of finance is premised on the fact that the local governments do not have constitutional jurisdiction over most revenue sources in their locality[4]. These fiscal difficulties have contributed in a mismatch between the statutory functions and responsibilities of the local governments, and the flow of financial resources available to them. In Nigeria for instance, local government expenditure has constantly surpassed the potentials for revenue sources owing to the gulf between their needs and their fiscal capacity (Akindele & Olaopa, 2002). This is further exacerbated by the over dependence of Nigeria's local governments on statutory allocations from both the state and federal governments.

However there is another school of thought holding the opinion that the local governments have issues bordering on financial impropriety and governance. In the opinion of Obasanjo (2003) the Local Government system in Nigeria is an abysmal failure. In his opinion in spite of the improved funding of the third tier of government from the federation account, the hope for rapid and sustained development has been a mirage, as successive Councils have grossly under-performed in almost all the areas of their mandate. The argument is further supported by the fact that, rather than bring government and development closer to the grassroots, local governments have often times produced absentee chairmen, who are hardly seen at their duty posts save when the monthly "Abuja Allocation" arrives. They only come to superintend over the sharing of the "national cake" to the various stakeholders (Ukiwo, 2006). This however could be attributed to the loss of autonomy as provided the 1999 constitution earlier identified, which has imposed the undue influence of the state governments on the local councils.

As regards the inter-governmental fiscal relationship in Nigeria, a cursory look at various revenue sharing formulae used in Nigeria are attempted here. Before the 1976 local government reform, the fiscal arrangement was between the central government and the regional governments. The use of Revenue Allocation Formulae for sharing Federations Account Revenue among the tiers of government in Nigeria originated from the recommendations of Raisman Revenue Allocation Commission of 1957 (CBN, 2000). The commission's recommendation which was accepted and became operational from 1959/60 fiscal year came out with a revenue allocation as follows: 40:31:24 and 5 percent for the Northern, Eastern, Western regions and Southern Cameroun (Anyafo, 1996). After the Southern Cameroun pulled out of the Federation in 1961, the revenue formula was adjusted to 42:32.8 and 25.2 percent for Northern, Eastern and Western regions respectively. Later in 1963 when the Mid-Western Region was created from the Western Region, the federally accrued revenue to the Western Region was shared 18.9 and 6.3 between Western region and Mid-Western region respectively (CBN, 2000).

As a result of the structural change in the Federation in 1963, the Binns Commission was set-up to recommend appropriate revenue allocation formula that will be operational in Nigeria. The Binns Commission recommended that the Distributable Pool Account (DPA), now Federations Account should be shared 42:30:20 and 8 percent among Northern, Eastern, Western and Mid-Western regions respectively. In 1966, the military took over the governance of the country and suspended the constitution. In 1967, the military government replaced the four-regional structure with twelve states structure, and modified the revenue allocation formula under decree 15 of 1967. The six states of the North shared the 42 percent with each state having 7 percent, and the same adjustment was made for the six Southern states. Although, there were local government councils from independence, this tier of government was not explicitly recognized as an autonomous and interdependent entity until the 1976 reforms. The interest of local government was to be taken care of by the regions under the portfolio of a Minister or Commission for Local Government (CBN, 2000).

The 1976 reform changed the landscape in the development of local government in Nigeria. For the first time, the country was given a common, single-tier structure of local government in place of the different structures of various states. The interest of this paper in the 1976 reform hinges on the restructuring of the fiscal system of the country. The reforms instituted statutory allocations of revenues from the federation account with the intention of giving local governments fixed proportions of both the federation account and each state's revenue. This mandatory allocation was entrenched in the recommendations of the Aboyade Revenue Commission of 1977 (Ekpo & Ndebbio, 1993), which argued for an explicit allocation of responsibilities to the local councils

[4] The fourth schedule of the 1999 constitution of the federal republic of Nigeria states inter alia that the local governments should collect rates and other licences relating to radio, television, vehicles and such related equipment.

(CBN, 2000). In its report, the Aboyade Commission observed that, "It was not until 1975 that a clear mission for the local government was outlined". The Report further observed that, "local government should do precisely what the word local government implies, that is, govern the grass roots or local level" (CBN, 2000).

The Aboyade Commission recommended that the Federation Account be shared 60:30 and 10 percent between the federal, state and local governments respectively (Anyafo, 1996). This recommendation brought the states and local government councils into the most lucrative revenue sources – petroleum profit tax and company income tax. The Okigbo Revenue Allocation Commission was appointed in 1980 to fashion out another revenue allocation formula following the rejection of Aboyade Technical Commission on the ground that it was too technical and unworkable. The commission recommended a revenue sharing formula of 55:34.5:8 and 2.5 percent for federal, state, local government and special fund respectively. The local government council started receiving allocation from the federation's account in 1980 (CBN, 2000). Local government allocation was increased from 8 percent in 1980 to 10, 15 and 20 percent in 1982, 1987 and 1993 respectively (Table 2). However, the status quo was disrupted by the Supreme Court's nullification of Special Fund in April 2002. At the interim, while the National Assembly was still debating on a revenue sharing formula for the different tiers of government, a Presidential Executive order was used in the sharing of the federation Accounts in the ratio of 56%, 24% and 20% for Federal, State and Local governments respectively (Revenue Formula, 2011). The present revenue formula being used is based on the Modified Grant from the Federal Ministry of Finance, which came to effect in March 2004 – which is 52.685, 26.725 and 20.60% for the federal, state and local governments respectively.

The rapid increase in the number of local government (Table 3), coupled with the upward review of revenue allocation from the federation's account is suppose to have transformed into improved facilities and services at the grass root, but the reverse is the case. Most scholars have attributed the ugly development to corruption, mismanagement and lack of executive capacity (Anyafo, 1996; Awotokun & Adeyemo, 1999; Firduasy, 2004).

However, our analyses of local government finance from 1993 to 2006 seem to suggest that aside corruption, mismanagement and lack of executive capacity, revenue source must have also contributed to the deteriorating local government fiscal balance. The current revenue of the local government increased from N19,874.4 million in 1993 to N60,800.6 million in 1999 and stood at N674, 219.1 million in 2006. The authors' calculation revealed that the bulk of local government revenue is the statutory allocation from the Federation Account. The Federation Account contributed 92.2, 72.2 and 81.7 percent of total current revenue of the local government between 1993, 1999 and 2006 respectively (Table 1b).

The total expenditure of the local government rose from N19,475.3 million in 1993 to N60,441.2 million in 1999 and stood at N665,838.0 million in 2006; it increased to N1,387,900.0 million in 2008. A breakdown of the expenditure of the expenditure showed that recurrent expenditure accounted for 70 percent of the total current revenue in 1993, 64.4, 59.1 and 82.15 percent in 1999, 2006 and 2008 respectively (Table 1a). This shows that the bulk of local government finances are used to service recurrent expenditure. A further analysis of the local government finances show that the local governments' current revenue as a percentage of the national GDP has always been low (Table 4 in appendix). In 1993, it stood at 2.92% of the GDP, while by 1996 it went as low as 0.88%. However, with improved fiscal allocation from the federation accounts coupled with dwindling national GDP, the local government current revenue stood at 13.05% of the GDP. When checked against the revenue sharing formulae, as presented in Table 2, it will be noticed that 13.05% which is supposed to be the local governments' share of the GDP is less than their 20% share from the federation account.

With this kind of meager financial resources coupled with the alleged financial impropriety in the local councils, the authors' are of the opinion that local government in Nigeria may not contribute meaningfully to grass root development. Further analysis of the internally generated revenue showed that the internally generated revenue contributed 5.2, 7.7 and 5.4 percent of the total current revenue in 1993, 1999 and 2006 respectively. The low rate of internally generated revenue can be attributed to lack of good data base on the actual and potential tax payers, inefficient tax administration, lack of high quality staff, underdeveloped legal and accounting system and the general reluctance of people to pay tax, partly because of the level of poverty among rural dwellers.

3. CAPITAL MARKET SOURCE: A VIABLE OPTION FOR LG'S FINANCING URBAN DEVELOPMENT

With the observed low revenue base of the Nigerian local governments, one begins to wonder the viability of the local councils; and the efficiency of their service delivery[5]. This

[5] The local governments in Nigeria are saddled with the following responsibilities amongst others: (i) the provision and maintenance of primary, adult and vocational education; (ii) the development of agriculture and natural resources, other than the exploitation of minerals; (iii) the provision and maintenance of health services; and others (see the Fourth Schedule of the 1999 Constitution of the Federal Republic of Nigeria for details).

calls for the broadening of the local government finances, from sources that will encourage good corporate governance practices for our local councils. This option, in the opinion of the authors, is the ***capital market financing option.*** Capital markets are essentially financial markets where securities of more than one year life span are traded – securities like corporate stocks, corporate bonds, and government bonds (Block & Hirt, 2002; Pandey, 2002). Of interest in this study is the ***municipal bond financing option***.

The municipal bond market can help financially trapped local governments finance critically needed infrastructure with domestic private capital, rather than through sovereign borrowing by national governments (Leigland, 1997). This option is gaining more relevance in recent times in Nigeria, as there are calls for the diversification of revenue sources of the different levels of government. These calls could have been motivated by the growing developmental needs at the different levels of government, which has recently increased the controversy of how to share the oil revenue by different levels of government. A further justification for this call also stems from the renewed quest to instill prudence and accountability in the use of public fund. The proponents of the accountability hypothesis, are of the opinion that a dynamic revenue source like the government bonds could provide the necessary incentives for the level of government involved to show evidence of financial openness and discipline in her operations, thereby serving as an avenue to assess the quality of the public sector management in Nigeria (Aja-Nwachukwu, 2003; Ogamba & Okereke-Onyiuke, 2008).

Essentially, both government and the operators of the Nigeria capital market are of the opinion that the use of securitized debt instruments to finance government operations can bring about fiscal discipline in the affairs of government business. This could have influenced the inauguration of the Bond Market Steering Committee (BMSC) by the Debt Management Office in March 2006; with the key objectives of ensuring speedy development of the bond market in Nigeria, coordinating and harmonizing the activities of all stakeholders, and determining the overall structure of the market (Ogamba & Okereke-Onyiuke, 2008; Vangaurd, 2006). Subsequently 15 financial institutions (comprising 10 banks and 5 discount houses) were appointed to play the role of primary dealers and market makers in respect of the federal government bonds (Guardian, 2006). The essence is to make the bond market active in Nigeria. According to (SEC, 2000, p. 21), an active bond market would also serve as an important avenue for the sourcing of funds for the development of state and local governments and infrastructure financing for the federal government.

The above idea is also shared by the World Bank (2001), as they opine that the development of a government bond market will provide a number of important benefits if the prerequisites to a sound market development are in place[6]. It is believed that government bond's market will provide the avenue for domestic funding of budget deficits, at the macroeconomic level, rather than depend on the potentially damaging monetary financing of such deficits by the central bank. As noted in the Hand Book for the developing of bond markets (World Bank, 2001):

> A government securities market can also strengthen the transmission and implementation of monetary policy, including the achievement of monetary targets or inflation objectives, and can enable the use of market-based indirect monetary policy instruments. The existence of such a market not only can enable authorities to smoothen consumption and investment expenditures in response to shocks, but if coupled with sound debt management, can also help governments reduce their exposure to interest rate, currency, and other financial risks. Finally, a shift toward market-oriented funding of government budget deficits will reduce debt-service costs over the medium to long term through development of a deep and liquid market for government securities.

At the local government level, the potential advantages of municipal bond issuance by municipalities have been widely documented in literature. Some of the advantages are as follow: (1) *Local government access to the capital markets strengthens local government fiscal discipline* (emphasis, that of the authors); (2) bond provide municipalities with a cheaper source of financing than domestic bank loans; (3) access to the capital market improves management performance at the local governments; (4) capital markets provide the required funding for urban infrastructure development at the local government level; (5) bond issued in the capital markets are supposed to have maturities that extend to the useful life of the asset they finance (Ekumankama & Ujunwa, 2008; Peterson & Shaman, 1997). These benefits were also collaborated by (Nwite & Onwe, 2008) when they opine that utilizing the capital market sources of financing will accrue the following benefits to the local councils: Increased access to bulk funds for development purposes, inculcation of market discipline in public officers, freeing of the statutory allocations due them for other grass root developments, enhancing market rating of the local government, and the infusion of healthy competition in governance amongst the different levels of government and between different local governments.

Because of the special tax-exempt status of most municipal bonds, investors usually accept lower interest payments than on other types of borrowing (assuming comparable risks). This makes the issuance of bonds an

[6] Prerequisites for establishing an efficient government domestic currency securities market include a credible and stable government; sound fiscal and monetary policies; effective legal, tax, and regulatory infrastructure; smooth and secure settlement arrangements; and a liberalized financial system with competing intermediaries (World Bank, 2001).

attractive source of financing to many municipal entities, as the borrowing rate in the open market is relatively lower than what is obtainable from other borrowing channels (Ekumankama & Ujunwa, 2008). Thus the municipal bonds are seen as low-risk high-yielding investments. According to Detail (2009), bonds are attractive high-return and low-risk investment opportunity. Investors enjoy high and stable returns – up to 17% per annum for tenors of 7 years and above in some cases. Bonds are less risky than stocks, as they attract interest at a predetermined rate and have guaranteed returns. Government bonds enjoy some level of tax exemption and are free from default risk, as they are secured on the Nation's assets. Bonds can be used as collateral for borrowing from Banks and other financial institutions; they also have second hand values, being easily traded on the floors of the Nigerian Stock Exchange (NSE) before maturity.

4. LOCAL GOVERNMENTS FINANCING URBAN DEVELOPMENT USING MUNICIPAL BONDS: A PRACTICAL APPROACH

In Nigeria, there have been calls for the diversification of revenue sources for the different levels of government, and on the management of the government debt burden, as to achieve a sustainable development without macroeconomic volatility. This quest was thought to be achieved through the reinvigoration of the bond market. The reintroduction of Federal Government Bond issues in 2003 was a financial reform designed to deepen the bond market and at the same time subject government borrowing to market discipline. In August 2003, a total of N150 billion First Federal Government bonds (1st FGN Bonds) was issued in two tranches with maturities ranging from 3 years to 10 years. This was followed in 2005 with issue of the 2nd FGN bonds worth N140 billion in seven tranches, with maturities ranging from 2 years to 3 years. The 3rd FGN bond worth N130 billion in three tranches, with maturities ranging from 3 years to 7 years, was issued in 2006 (Arua, 2008; NSE, 2008); while the Lagos state government issued N50 billion oversubscribed bond, also in 2006 (Vanguard, 2006).

The success of the afore-mentioned government bonds and the quest to coordinate and harmonize the operations of the stakeholders in the bond market, led the debt management office (DMO) to inaugurate the Bond Market Steering Committee (BMSC) in 2006. And as earlier mentioned, 15 financial institutions (comprising 10 banks and 5 discount houses) were subsequently appointed to play the role of primary dealers and market makers in respect of the federal government bonds (Guardian, 2006). As for the municipal bonds, a prior arrangement was also made, in addition to that made by the Securities and Exchange Commission (SEC) and the DMO. That arrangement is encapsulated in the Urban Development Bank of Nigeria (UDB) legislation.

Furthering the case of the Capital Market option for the financing of urban development by local governments in Nigeria, the federal government in 1992 established the Urban Development Bank of Nigeria by Decree 51, to finance urban development projects, amidst deplorable urban conditions and the growing need to find alternative financing arrangements for the provision of urban infrastructure. (Ezeoha & Ekumankama, 2010)[7]. To this effect the Urban Development Bank was saddled with the following objectives: (i) To mobilize long-term funds for on-lending to States, Local governments and the private sector for infrastructure projects; (ii) to empower and strengthen the capacity of Nigerian Local Governments to raise additional revenue through tenement rating to provide and maintain urban infrastructure for their residents; (iii) to lead State and Local Governments to raise bonds from the capital market for urban services; (iv) to establish information base for adequate planning and decision making, in conjunction with interested states and urban local governments; and (v) to encourage public-private partnership in the delivery of infrastructure. Since the formation of the Urban Development Bank, only the Lagos Island Local Government has gone to the capital market.

Thus with the existence of the Urban Development Bank, which is a specialized development bank, charged with facilitating urban infrastructure growth and development by offering assistance to States and Local governments; the urban local governments in Nigeria could through them patronize the capital market in their quest to provide urban infrastructures. Being technically equipped for the packaging of the levels of government under its purview of operations, the UDB knows how to complete the other processes of municipal bond issuance. Furthermore, considering the depth of the Nigerian capital market, which was exhibited in the recently concluded consolidation exercises of the financial system, and the over subscription of the federal government bonds; the local governments could rely on it for their infrastructure development funding.

[7] The Decree highlights that: (a) The Bank shall in accordance with the object clause of its memorandum foster the rapid development of urban infrastructure throughout the federation, through the provision of finance and banking services; (b) the Bank may with the approval of the Minister of Finance raise funds of such amount (in foreign currency) from any one or more of the following sources: the International Bank for Reconstruction and Development (IBRD); the International Development Association (IDA); the European Investment Bank (EIB); the African Development Bank; Bilateral loans and grants in government-to-government basis; Shelter Afrique; and other multilateral loans and donor agencies; and that (c) the Bank has the responsibility for the management of all funds obtained from the aforementioned sources and other offshore sources, which are meant for infrastructure development. (Ezeoha & Ekumankama, 2010).

However it should not be assumed that the processes are without challenges. The 1999 Constitution, under which the present republic operates, negates the visions of the UDB being able to lead local governments to the capital market; in the sense that in the 1989 Constitution under which they could effectively help local councils issue bond, the local governments were fiscally independent having their financial allocation coming directly to them without the interference of the state governments. What this means is that under this current dispensation the state governments, who have been accused of tinkering with the local government finances because of the provision of section 162 (6 & 7) of the Constitution, may also be hindrances to the successful issuance of municipal bonds by the urban local governments. This hindrance is found in the multiplicity of Development Areas within a local government (a creation of the State governments in their bid to balkanize the scheduled local governments, so as to control their finances), which has increased the difficulty of delineation of area of influence and operation of Nigeria local governments. Therefore if the question of urban infrastructures are to be tackled adequately by the urban local governments, the fiscal independence of the local governments are to be re-enacted in the Constitution, as provided for in the 1989 Constitution.

Aside some of the issues enumerated above, government and its agencies must promote favourable macroeconomic environment. A robust municipal bond market is unlikely to evolve in a volatile macroeconomic environment. Under such environment, individuals and institutional investors in financial assets develop a preference for assets with shorter maturities such as bank deposits and government treasury bills thus starving the municipal bond markets of fund. Urban local governments must also ensure market transparency. This can be achieved by strengthening local government budgeting, accounting and auditing framework. Municipal bond markets are also characterized by a number of specific agency problems. The first agency problem is that of hidden action, in which municipal bond issuer, as agents may have an incentive not to repay the holders because they perceive that they will be bailed-out by the central government in case of default, resulting in moral hazard. The second agency problem is that of hidden information, in which municipal bond issuer as agents may have an incentive not to reveal certain characteristics about themselves to lenders as principals, resulting in adverse selection. The incidence of both agency problems varies considerably depending on the structure of the local government market in each country. According to Ujunwa (2009), to gauge moral hazard, investors look at the sovereign's behaviour regarding bail-out of sub-sovereign domestic and international obligations. For fear that the sub-sovereign will contaminate the name of the sovereign in the capital markets and drive the latter to bail out sub-sovereign deadbeats which are detrimental to local government fiscal discipline. However, from the bondholder point of view, the lack of additional security in the form of a dedicated revenue source or some other collateral is offset by investors' perception that the sovereign will bail out the municipality in case it gets into trouble and cannot make its debt service payments. Therefore if the government does not eliminate any bail out clause in municipal bond market, moral hazards and adverse selection will continue to play a negative role on the development of the market in Nigeria. The elimination of bail-out clause will allow bond pricing reflect the credit condition of the issuer.

CONCLUSION

This paper is essentially of the view that the Nigerian local governments can manage the urban cities in Nigeria efficiently, if they adopt a market approach, by using the capital market sources of funding and not limiting themselves to statutory revenue allocations. It was also noted that there is enough infrastructure in place, to enable the local governments access the capital market financing. However for this to be successful, further amendments are needed in the Constitution of the federation of Nigeria, to secure the fiscal independence of the local governments as provided for in the 1989 federal Constitution. Additionally, the local governments are to be made fiscally and corporately responsible for their actions in regards to bond issuance. It is the opinion of this paper that encouraging the urban local governments to patronize the capital market for their development projects will instill fiscal discipline, good corporate government practices, and economic development without mounting inflationary pressure on the economy.

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APPENDIX

Table 1a
Summary of Local Governments' Finances from 1993-2006 (= N = millions)

Year	FA	SA	IR	CR	RE	CE
1993	18,316.40	253.1	1,035.60	19,874.50	13,966.50	5,508.80
1994	17,321.30	466.4	1,205.90	19,223.10	14,884.20	4,082.90
1995	17,875.50	625.4	2,110.80	24,412.70	16,317.20	6,126.10
1996	17,586.50	685.1	2,211.10	23,789.60	16,620.10	6,045.50
1997	20,443.30	578.9	2,506.90	31,254.40	21,656.50	8,083.40
1998	30,600.90	750.4	3,331.60	44,946.20	29,192.20	14,864.70
1999	43,870.30	419.9	4,683.80	60,800.60	41,613.20	18,827.30
2000	118,589.40	1,923.10	7,152.90	151,877.30	93,899.90	59,964.90
2001	128,500.50	1,598.60	6,020.40	171,523.10	122,712.70	48,661.80
2002	128,896.70	1,672.30	10,420.80	172,151.10	124,701.80	45,118.60
2003	291,406.90	2,119.90	20,175.50	370,170.90	211,633.00	150,080.20
2004	375,656.30	3,625.70	22,407.80	468,295.20	295,654.70	165,395.90
2005	493,000.30	3,243.90	24,042.50	597,219.10	374,514.60	213,463.20
2006	550,796.30	3,434.80	23,225.10	674,255.70	398,181.20	267,666.70
2007	568,300.0	3,000.0	21,300.0	832,300.0	683,600.0	143,800.0
2008	722,258.6	3,317.4	22,731.4	1,387,871.3	1,140,100.0	247,800.0
2009	529,315.0	19,735.7	26,064.2	1,069,365.3	704,610.0	363,003.7

Source: CBN Statistical Bulletin, Vol. 20, 2009
FA = Federation Account, SA = State Allocation, IR = Internal Revenue, CR = Current Revenue, RE = Re-Current Expenditure, CE = Capital Expenditure

Notes Value Added Tax (VAT), Grant and others formed part of the current revenue.

Continuation of Table 1b
The Ratio of LG Revenues to Their Current Revenue

Year	FA/CR*	SA/CR*	IR/CR*	RE/CR	CP/CR*
1993	92.16031	1.273491	5.210697	70.27347	27.71793
1994	90.10669	2.426248	6.273182	77.42872	21.23955
1995	73.22213	2.561781	8.646319	66.83898	25.09391
1996	73.92516	2.87983	9.294398	69.86288	25.41237
1997	65.40935	1.852219	8.020951	69.29104	25.86324
1998	68.0834	1.669552	7.412418	64.94921	33.07221
1999	72.15439	0.690618	7.703542	68.44209	30.96565
2000	78.08237	1.26622	4.709657	61.82616	39.48246
2001	74.91731	0.932003	3.509965	71.54296	28.37041
2002	74.87417	0.971414	6.053287	72.43741	26.20872
2003	78.72226	0.572681	5.45032	57.1717	40.54349
2004	80.21784	0.774234	4.784973	63.13426	35.31873
2005	82.54932	0.543167	4.025742	62.70975	35.74286
2006	81.68953	0.509421	3.444554	59.05493	39.6981

Source: Same as in Table 1a
* Authors' Computation

Table 2
Statutory Revenue Allocation Formular (Percent)*

	1960	1963-1967	1980	1982	1987	1990	1993	1995-1998
1 Federal Government	70	65	55	55	55	50	48.5	48.5
2 Regional/State Govt	30	35	34.5	34.2	32.5	30	24	24
3 Local Government			8	10	10	15	20	20
4 Special Fund			2.5	0.5	2.5	5	7.5	7.5
(i)Federal Capital Territory			2.2			1	1	1
(ii) Derivation						1	1	1
(iii) Development of Mineral Producing Areas					1.5	1.5	3.0	3.0
(iv) General Ecology				0.5		0.5	0.5	0.5
Total	100	100	100	100	100		100	100

Source: CBN, 2000

* The present revenue formula being used is based on the Modified Grant from the Federal Ministry of Finance, which took effect from March 2004 – which is 52.685, 26.725 and 20.60% for the federal, state and local governments respectively.

Table 3
Tiers of Government in NIGERIA 1946-1996

Years	Federal govt	Regional/State govt	Local govt
1946	1	4*	n.a
1960	1	4*	n.a
1961	1	3**	n.a
1963	1	4***	n.a
1967	1	12	299
1976	1	19	299
1979	1	19	301
1981	1	19	781
1984	1	19	301
1987	1	21	449
1991	1	30	500
1991	1	30	589
1996	1	36	774

Source: Compiled from Nigerian Constitutions and Official Gazettes
* Regions
** Excluding Southern Cameroun which pulled out in 1961
*** Mid-West Region was created in 1963

Table 4
The Ratio of LG Current Revenue to GDP

Year	National GDP	LG current revenue	CR/GDP (%)
1993	683869.8	19974.5	2.92
1994	899863.2	19223.1	2.14
1995	1933211.6	24412.7	1.26
1996	2702719.1	23789.6	0.88
1997	2801972.6	31254.4	1.12
1998	2708430.9	44946.2	1.66
1999	3194023.6	60800.6	1.9
2000	4537640.0	151877.3	3.35
2001	4685912.2	171523.1	3.66
2002	5403006.8	172151.1	3.19
2003	6947819.9	370170.9	5.33
2004	3201996.4	468295.2	14.63
2005	4054523.3	597217.1	14.73
2006	5165742.0	674255.7	13.05

Source: CBN Statistical Bulletin. (2006), *17.*