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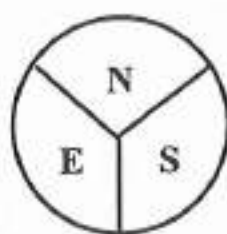


**INSTITUTIONS, INSTITUTIONAL REFORMS AND
ECONOMIC DEVELOPMENT: ANALYTICAL AND
POLICY PERSPECTIVES**

SELECTED PAPERS FROM THE 2013 ANNUAL CONFERENCE

**Institutions, Institutional Reforms and
Economic Development: Analytical and
Policy Perspectives**

**Selected Papers for the 2013
Conference**



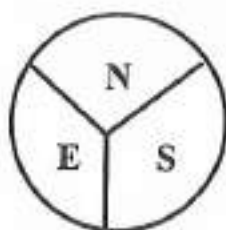
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BUDGETARY INSTITUTIONS AND FISCAL DISCIPLINE IN NIGERIA: EMPIRICAL EVIDENCE FROM KWARA AND KADUNA STATES

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ABSTRACT

Fiscal indiscipline threatens long-term fiscal sustainability. One important role of the budget and budgetary institutions is to instil fiscal discipline in governance. With transition to democratic rule in 1999, the budget process and institutions in Nigeria have changed to a large extent. This study examined whether or not the changes in budgetary institutions have impacted on fiscal discipline in Nigeria. Using panel data on Kaduna and Kwara state governments' finances, a set of alternative empirical models of fiscal discipline were estimated using Hausman-Taylor techniques. The results showed that the changes in budgetary institutions occasioned by the transition to democratic rule have had no significant impact on fiscal discipline in Nigeria.

Keywords: Budgetary institutions, Fiscal discipline, Nigeria

JEL Classification: H61, H72

1. BACKGROUND

The outcomes of sound public expenditure management include aggregate fiscal discipline, strategic allocation of resources, efficient use of public resources and effective service delivery. In all these, the annual budget plays a critical role. The annual budget serves as machinery for instilling fiscal discipline in government financial operations. This largely depends on the effectiveness of existing budgetary institutions. During the military era, the budgetary process was exclusively the responsibility of executive arm of government (the military administrators and civil servants). The

legislative arm was completely absent in the process. During this period, there existed planning commissions, standing budget committees (e.g. Central Budget Committee in states) and ad hoc committees charged with responsibilities akin to those of legislature. The marked absence of budget scrutiny and oversight by an independent arm may have undermined fiscal discipline which culminated in large fiscal deficits and huge public debt profile during the military era. Statistics show that, from 1983 the Federal Government recorded overall fiscal deficits for the all years under military rule except 1996 and 1997. In 1994, for instance, the overall fiscal deficit stood at ₦ 70,270.60 million (about 43.68% of total spending). While the overall deficit spending for all the state government was ₦6, 409.90 million (about 11.46% of the all states' spending) (CBN, 2013).

The transition to democratic government in 1999 ushered in some institutional changes in the country, including budgetary institutions, expected to impact on the budgetary outcomes. The legislators are now involved with some constitutional powers to check the excesses of executive arm of government in the budget process. A pertinent question is how effective are these institutional changes in ensuring fiscal discipline? This is one question yet to be addressed at subnational level with respect to Nigeria in the literature.

Empirical evidences from previous studies such as Poterba (1994), Alesina and Perotti (1996), Perotti and Kotonpolous (2002) and Egger and Koethenbuerger (2010) indicate that budgetary institutions matters for fiscal performance. Thus, the change in budgetary institutions was expected to enhance fiscal discipline. But some other empirical studies (Perotti and Kontopolous, 2002; Fabrizio *et.al*, 2006; Egger and Mcmenamin, 2008, and Egger and Koethenbuerger, 2010) muddled this expectation with the finding that fiscal deficit tends to increase with more legislative fragmentation, number of spending ministers, cabinet and council size. For example, Fabrizio *et.al* (2006) argue that democracy has the tendency to increase fiscal deficit due to political pressures, higher voters' participation, and long-term structural forces triggered by social divisions, representative electoral rules and more fragmented government coalition. There is also the contention that legislative fragmentation particularly, increases fiscal deficit as democracy becomes institutionalised (Egger and Mcmenamin, 2008, and Egger and Koethenbuerger, 2010). From the perspective of fiscal federalism,

Rodden (2002) observes that, large and persistent aggregate deficits occur in subnational governments, when they depend heavily on intergovernmental transfers and these aggravate where the subnational government enjoys autonomy to borrow.

A cursory look at Nigeria's nascent democracy and the fiscal federalism portray all of these as their defining features. Nigeria harbours more than 250 ethnic groups divided along and across regions, geopolitical zones, 36 states, a Federal Capital Territory (FCT) and 774 Local Government Areas (LGAs). Even within several states and LGAs there are obvious diversities along religions and ethnicity. Thus, governments at all levels are under constant pressures from the diverse groups for their fair share of the so called "dividends of democracy". The most recent and obvious one is that of oil producing Niger-Delta region which resulted in the creation of Ministry of Niger Delta. Pressures on the governments to satisfy the interests of the diverse groups also led to the large number of legislators in the national assembly (360 house of representatives and 109 senators representing states and LGAs respectively). The number of federal ministers also increased for the same reason. The states and local governments are also heavily dependent on federal transfers.

Therefore, with the above peculiarities of Nigeria and empirical evidence, one would not be surprised at seeing increased fiscal deficit and fiscal indiscipline as an aftermath of transition to civil rule in the country. Some other strands of empirical studies show that budgetary procedures more hierarchical and transparent may enhance fiscal discipline (Alesina and Perotti, 1996). This suggests that change in governance may ensure fiscal discipline if accompanied by more transparency and effective implementation of appropriate procedural rules that restrict the push for opportunism among budget actors.

This study examined the impacts of budgetary institutions on fiscal performance especially at subnational level in Nigeria, to either corroborate or contradict the evidence from the previous studies. We used panel data from subnational governments, specifically Kwara and Kaduna state governments between 1994 and 2011. This is because; subnational governments largely share the same characteristics with the Federal Government, the peculiar advantage of panel data analysis over time

series, and the perennial dependence of the state government on federal transfers which may have effect on fiscal discipline.

The choice of these states is explained largely by unavailability of nationwide comprehensive panel data on public finances of all the 36 states of the federation. The fact that there is very high degree of similarities in the fiscal performances of states across the country suffices for generalisation of the findings from these states to other states and the country as a whole.

The expected contribution of this study would be an empirical evidence of the impact of budgetary institutions on the fiscal performance at subnational level in Nigeria which previous studies paid little attention to. It will also enable us ascertain whether or not democracy has impacted on the fiscal performance in Nigeria.

With this background, the rest part of the study is structured as follows. Section 2 presents the concepts of budgetary institutions and fiscal outcomes, section 3 dwells on the budgetary process at subnational level in Nigeria. Section 4 presents an abridged overview of fiscal performance and fiscal discipline in Kaduna and Kwara states. Section 5 is on empirical model of fiscal discipline and data sources. Section 6 focuses on model estimation procedure, results and discussion. Section 7 concludes.

2. BUDGETARY INSTITUTIONS AND FISCAL OUTCOMES

The concept of budgetary institution is vague, institutions could be organisations charged with specific responsibilities. By implication, budgetary institutions could be the organisation or units with specific responsibilities in the budget process. Generally, institutions according to North (1990) "are the rules of the game or humanly devised constraints that shape human interactions in the society". In effect, budgetary institutions shape budgetary process, the incentives and constraints that guide the interactions between and among the actors and institutional units (ministries, department and agencies – MDAs) involved. In the words of Alesina and Perotti (1996) budget institutions are defined as the "all rules and regulations according to which budgets are drafted, approved and implemented". Alesina and Perotti (1996) further identified three rules and regulations. These are: numerical targets, procedural rules which define the formal and informal procedures at the various stages of the budget process, and importantly, set the incentives and constraints the

executives, legislature and bureaucrats will be subjected to at the various stages of the budget process; and rules regarding the information content and level of transparency required at the various stages of the budget process. Table 4.1 presents potential benefits and shortcomings of these rules as they relate to fiscal discipline.

A number of deficiencies and weaknesses in the budgetary process of state governments in Nigeria prevail. The World Bank sponsored state-level public expenditure and financial accountability reviews (PEMFAR) in Nigeria at different times in selected states suggest that numerical rules on public spending, budget composition and fiscal deficit are lacking in most states. Access to detailed government fiscal information to the public is also limited while relevant information for thorough legislative and public scrutiny are not contained in most state governments budget documents (World Bank, 2011). More so, the procedural rules guiding budget processes are largely "collegial" than "hierarchical". All these provide a fertile land for fiscal indiscipline to thrive in Nigeria as could be inferred from Table 4.1.

Budgetary Process in Subnational (State) Governments in Nigeria

Budget institutions are a form of "self control mechanism" imposed on budget actors on themselves (Poterba, 1996). In Nigerian context, the 1999 Constitution of Federal Republic of Nigeria (FRN) provides the legal framework for fiscal federalism, with a Federal Capital Territory (FCT), 36 states and 774 local governments as fiscal units. The constitution also defines the assignment of fiscal responsibilities between the federal (national) and states and local (subnational) governments¹. It is within the ambits of these responsibilities that subnational governments operate. For instance, the 1999 Constitution of FRN, Sec. 121(1) provides *inter alia* that *the state Governor shall cause to be prepared and laid before the House of Assembly at any time before the commencement of each financial year estimates of the revenues and expenditures for the next financial year.*

¹ See the 1999 Constitution of FGN for assignment of taxing powers and expenditure responsibilities of state governments in Nigeria.

Table 4.1: Rules and Regulations in Budget Process and their Impacts on Fiscal Outcomes

Rules and Regulations	Description	Benefits	Shortcomings
Rules on Numerical targets	Rules and regulations regarding benchmarks on level of spending (including deficit composition), borrowing, etc within a financial year.	i. Eliminate budget deficit and debt crisis. ii. Ensure aggregate fiscal discipline.	i. Strict numerical targets are not optimal from dynamic optimisation and Keynesians stabilisation points of view ii. Give no room for creative accounting
Procedural Rules for Budget Approval	These rules and regulations define the budget calendar, roles of budget actors (spending ministries, departments and agencies), voting rules, scope and order of legislative amendments to the draft budget and the conditional for approval.	i. Ensure more aggregate fiscal discipline. ii. Restrict "pork parallel spending" iii. Ensure prioritisation and efficiency in the use of public funds.	i. They do not guarantee the interest or projects needs of the minority groups.
Procedural Rules for Budget Approval	These rules and regulations define the budget calendar, roles of budget actors (spending ministries, departments and agencies), voting rules, scope and order of legislative amendments to the draft budget and the conditional for approval.	i. Lay emphasis on check and balances by the legislature. ii. Ensure that the interests of the minorities are captured in the budget.	i. Budgets get unnecessarily delayed before approval especially during periods of tough fiscal adjustment. ii. Huge deficit may arise due to the need to capture everyone's needs in the budget Budget actors often underestimate the cost of some projects in order to get them included in the budget.
Rules Regarding Transparency	Rules specifying what information should be contained in the budget document (beginning from call circulars) and who should have access to such information.	Rules that ensure transparency at the various stages of the budget process promote fiscal discipline, fiscal accountability and good governance.	i. Over optimistic revenue forecasts ii. Fiscal illusion

Source: Adapted from Alesina and Perotti (1996)3.

This particular clause made budgeting by state governments a mandatory annual pilgrimage. Under this context, each state government design its own budget and budgetary institutions to achieve its desired fiscal outcome. The processes of budgeting are generally similar in principle across the states. Table 4.2 presents various stages, actors and outcomes of budget process at the state level.

Table 4.2: Stages of Budgetary Process and Budget Actors at Subnational Level (States) in Nigeria

Stage	Actors	Outcome
i. Budget Formulation	Executive, Bureaucrats and Legislative arms of government.	• Budget priorities, as contained in the guidelines • Medium-term Fiscal Framework (MTFF) • Fiscal Strategy Paper • The Expenditure and Revenue Framework • Call Circular, Budget calendar etc.
ii. Budget Preparation	The Executive arm and Bureaucrats.	• The Draft Budget or Appropriation Bill.
iii. Budget Authorisation	Members of State House of Assembly	• Appropriation Act/laws
iv. Budget Implementation	Mainly the Executive (Bureaucrats)	Projects, Programmes and Services.
v. Monitoring, Evaluation and Review	The Executive and the Legislature (through different House committees)	• In year budget reports • Reports of oversights from the Legislature etc.

Source: Adapted from Abubakar (2013)

4. FISCAL PERFORMANCE IN KWARA AND KADUNA STATES

The state governments in Nigeria depend heavily on federal transfers comprising statutory allocation, VAT and excess crude for at least an average of about 80% of their aggregate revenues. This has been a

defining feature of fiscal federalism in Nigeria. For example, the case study of Kaduna and Kwara state governments are presented in Figures 4.1 and 4.2. The share of internally generated revenue (IGR) in aggregate revenue has not exceeded 10% between 2005 and 2011 in Kaduna State. And in Kwara State except in 2007 and 2008, IGR constituted less than 15% of the total revenue. One major reason adduced to this is the distribution of major taxing powers and tax jurisdiction in favour of the Federal Government in the constitution. This has some theoretical justifications (Taiwo, 1999).

Figure 4.1: Distribution of Kaduna State Government Revenue

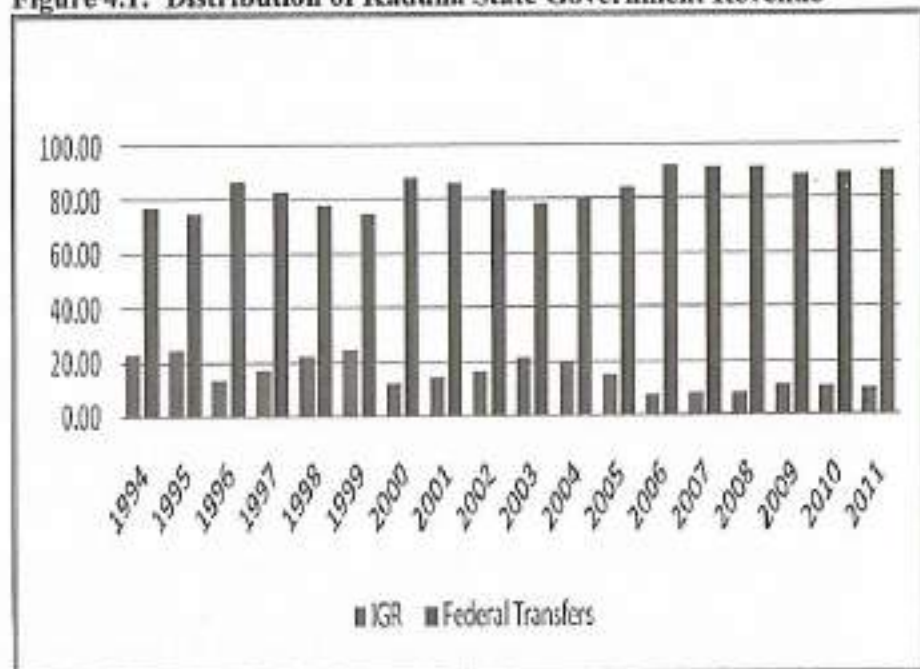
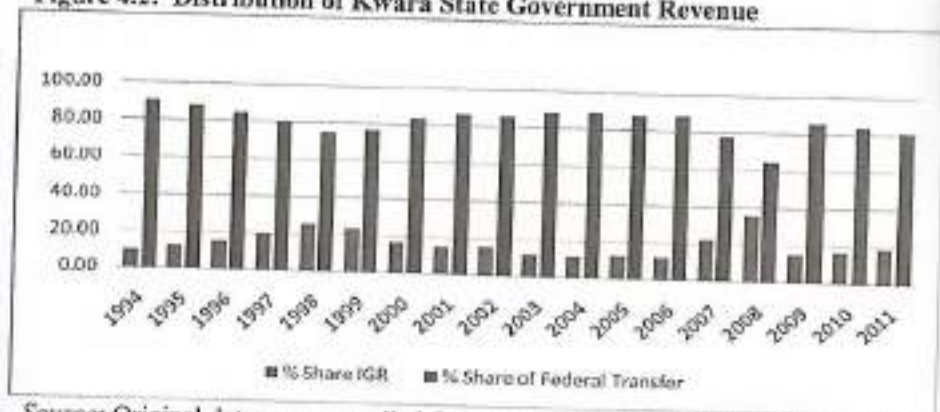


Figure 4.2: Distribution of Kwara State Government Revenue



Source: Original data were compiled from Annual Approved Budgets and Annual Financial Statements in the Accountant General's Reports of the respective state governments while estimations were done by authors.

The implications of this on the fiscal operations of subnational governments are serious. Excessive dependence on transfers or grants potentially: undermines the government's ability to accurately predict the flow of funds; promotes wastage, corruption and fiscal indiscipline; and reduces the drive by the citizens to hold government accountable. For example, Ross (2001) finds evidence that excessive dependence on oil revenues allows governments to be less transparent and unaccountable to the citizens. This is because the citizens only contribute meagre amount to revenue.

On the other hand, Tables 4.4 and 4.5 show the pattern and composition of expenditure across the two states. Recurrent items accounted for the lion's share of Kaduna State government's expenditure with at least 70% while capital expenditure accounted for the balance. Similarly, in Kwara State, recurrent expenditure dominated but not as high as in Kaduna State. The states also recorded surplus primary balances in 15 out of the 18 years under review. Primary deficits were recorded in 1996, 1998 and 1999 in Kwara State while Kaduna State recorded deficits in 2002, 2004 and 2005 (Tables 4.3 and 4.4). The primary surplus as percentage of expenditure is higher in Kwara State compared to Kaduna State. The overall fiscal balance was persistently deficit in both states.

Table 4.3: Pattern of Kaduna State Government Expenditure, 1994 -2011

Year	Primary Balance					Fiscal Deficit/ surplus
	Recurrent	Capital	Total Expenditure	% Share of Recurrent	Capital	
					as % of Revenue	as % of Total Expenditure
					Nominal Balance (N million)	
1994	1507.09	376.56	1883.65	80.01	19.99	19.75
1995	1917.19	662.61	2579.80	74.32	25.68	24.53
1996	1874.37	1076.26	2950.63	63.52	36.48	24.15
1997	1791.44	978.75	2770.19	64.67	35.33	84.73
1998	1985.30	4547.22	6532.52	30.39	69.61	99.89
1999	3233.44	4464.71	7698.15	42.00	58.00	49.72
2000	5995.59	10247.45	16243.04	36.91	63.09	36.84
2001	19209.49	11051.05	30260.54	63.48	36.52	50.38
2002	17401.84	8240.03	25641.87	67.86	32.14	-3.41
2003	18886.84	6206.64	25093.48	75.27	24.73	8.13
2004	36375.63	15119.73	51495.36	70.64	29.36	10.53
2005	43439.44	14192.24	57631.68	75.37	24.63	-14.46
2006	50133.03	18196.79	68329.82	73.37	26.63	-13.06
2007	54335.09	23111.01	77446.10	70.16	29.84	26.55
2008	72257.20	28511.23	97768.43	73.91	26.09	26.55
2009	74429.11	26790.73	101219.84	73.53	26.47	36.56
2010	99620.49	36240.09	135860.59	73.33	26.67	22.46
2011	130976.03	51822.36	182798.39	71.65	28.35	21.53
						15.89
						14.70
						-24957.65

Source: Original data were compiled from Annual Approved Budgets and Annual Financial Statements in the Accountant General's Report, Kaduna State Government while estimations were done by authors.

Table 4.4: Pattern of Kwara State Government Expenditure, 1996-2011

Year	Recurrent	Capital	Total Expenditure	% Share of		Nominal Balance (N million)	Primary Balance		Fiscal Deficit/ surplus
				Recurrent	Capital		as % of Revenue	as % of Total Expenditure	
1996	1539.15	625.39	2164.54	71.11	28.89	-346.87	-972.26	-29.09	-972.26
1997	846.06	840.82	1686.88	50.16	49.84	755.73	-85.09	47.18	-85.09
1998	2490.89	1136.72	3627.61	68.66	31.34	-715.20	-1851.92	-40.28	-1851.92
1999	3277.52	1545.57	4823.09	67.95	32.05	-1189.93	-2735.50	-57.00	-2735.50
2000	4419.32	2113.88	6533.20	67.64	32.36	256.31	-1857.57	5.48	-1857.57
2001	8436.17	5519.00	13955.17	60.45	39.55	2768.43	-2750.57	24.71	-2750.57
2002	8928.39	2031.16	10959.55	81.47	18.53	4012.51	1981.35	31.01	1981.35
2003	8945.36	1986.13	10931.49	81.83	18.17	4348.78	2362.65	32.71	2362.65
2004	13011.70	4256.25	17267.95	75.35	24.65	5184.41	928.16	28.49	928.16
2005	13562.12	7914.75	21476.87	63.15	36.85	8812.53	897.78	39.39	897.78
2006	14504.61	10555.46	25060.07	57.88	42.12	13155.88	2600.42	47.56	2600.42
2007	21090.21	17878.53	38968.74	54.12	45.88	12411.73	-5466.80	37.05	-5466.80
2008	22209.51	20006.38	42215.89	52.61	47.39	24325.40	4319.02	52.27	4319.02
2009	25207.21	29622.76	54829.97	45.97	54.03	16597.70	-13025.06	39.70	-13025.06
2010	26205.07	25939.13	52144.20	50.26	49.74	17058.92	-8880.21	39.43	-8880.21
2011	37222.56	21333.28	58555.84	63.57	36.43	9917.10	-11416.18	21.04	-11416.18

Source: Original data were compiled from Annual Approved Budgets and Annual Financial Statements in the Accountant General's Reports of Kwara state government while estimations were done by authors.

4. BUDGETARY INSTITUTIONS AND FISCAL DISCIPLINE IN KADUNA AND KWARA STATES

Aggregate fiscal discipline in a state does not necessarily mean the act of maintaining balanced budget by the state. The extent at which actual spending deviated (in absolute terms) from the originally approved budget estimates could be a reflection of the level of fiscal discipline. At subnational level, excessive or persistent fiscal deficit, debt accumulation as well as weak relationship between spending and actual service delivery/output are other indicators of fiscal indiscipline in public financial management. Empirical evidence has shown that budgetary institutions matter for fiscal discipline (Poterba, 1994; Alesina and Perotti, 1995; Woo, 2003; Perotti and Kotonopolous, 2002; and Egger and Koethenbuerger, 2010). For the purpose of this analysis, we measure fiscal discipline is the absolute deviation of actual revenue and expenditure from their corresponding originally approved budgets.

Table 4.5 shows the absolute percentage deviation of actual spending from the budget estimates in Kaduna and Kwara states. The budget among other things served as the document that contains the avowed priorities of government, what it intends to fulfil within a calendar year and how it intends to raise revenue for the purpose. The budget once approved becomes a law binding on government to obey. Hence, deviation from the budget whether in terms of over or under spending reflects fiscal indiscipline. Deviation from the budget might be caused by exogenous factors such as shock in the flow of federal transfers on which the state governments in Nigeria depend heavily on. Optimistic forecast of revenue and sometimes political pressures could lead to unrealistic budget. Substantial and persistent deviations from the budget undermine citizens' trust in their government and credibility of the budget document.

Table 4.5 shows (in percentages) absolute deviation of actual spending from the budget for all the expenditure items during military and democratic rules. In both states, the level of deviation is particularly obvious in recurrent expenditure. Within this class, deviation in transfers and overhead costs are particularly alarming. In Kaduna State, for example, actual transfers (the sum of debt repayment, consolidated revenue charges and pensions) deviated by as much as 445.55% from the budget during the civilian regime. In Kwara State, the deviations were by about 88.6% and 53.74% on the average during the reviewed years under

military and civilian regimes, respectively. Deviation of capital expenditure from budget is particularly moderate in Kaduna State. It ranged between 10.72% and 33.74% (Table 4.5).

Table 4.5: Absolute Deviation of Actual Spending from the Budget in Kaduna and Kwara States

Item	Kaduna		Kwara	
	Military Regime	Democracy	Military Regime	Democracy
<i>Average Deviation of Actual Current Spending (in%)</i>				
Personnel Cost	11.8	16.59	83.39	8.38
Overhead	43.3	20.2	85.65	40.74
Transfers	36.88	445.55	88.62	53.74
Aggregate Current Spending	23.04	58.56	67.71	33.11
<i>Standard Deviation</i>				
Personnel Cost	12.56	9.45	83.2	31.48
Overhead	39.93	12.5	70.63	76.96
Transfers	26.36	438.76	98.67	59.78
Aggregate Current Spending	7.18	33.39	36.34	32.94
<i>Average Deviation of Actual Capital Spending (in%)</i>				
General Administration	18.53	55.22	22.11	54.92
Economic Sector	55.92	50.71	65.79	46.05
Social sector	85.02	54.78	41.98	46.05
Regional Development	33.6	67.62	41.98	46.98
Aggregate Capital Spending	54.57	55.15	37.16	42.63
<i>Standard Deviation</i>				
General Administration	15.33	18.86	23.98	68.17
Economic Sector	33.74	25.10	32.58	86.07
Social sector	13.87	10.72	87.52	28.5
Regional Development	20.98	20.71	50.23	20.87
Aggregate Current Spending	8.13	17.85	54.04	23.01

Source: Original data were compiled from Annual Approved Budgets and Annual Financial Statements in the Accountant General's reports of the respective state governments, while estimations were done by authors.

5. EMPIRICAL MODEL OF FISCAL DISCIPLINE

The discussion in the preceding sections shows a record of persistent fiscal deficit in the two states on focus. This suggests high level of fiscal indiscipline in the public expenditure management at subnational level in Nigeria. In this section, the empirical determinants of fiscal discipline in Nigeria at the subnational level is examined. Panel data analysis consisting of Kaduna and Kwara state governments were used. Both states

are located in the northern part of the Nigeria and made up of many ethnic groups. They also share similar fiscal characteristics with the majority of state governments in Nigeria. Therefore, empirical evidence from these states may adequately explain the determinants of fiscal discipline in Nigeria.

5.1 The Model

The theoretical framework for the model is based on "common pool theory". This theory is relevant in this case for two reasons: the excessive dependence on federal transfers ("common pool") by state governments in Nigeria; and the ethnic diversities in most of the states across the country. We measured fiscal discipline by the level of primary fiscal balance of state governments. And, we captured the influence of social, economic and institutional factors on fiscal discipline by incorporating measures of inter-governmental transfers, ethnic and regional diversity, as well as fiscal needs of the citizens and importantly the role of budgetary institutions, broadly represented by a dummy variable for regime type (0 and 1 for military and civilian regimes, respectively). For transition years or years where we had both civilian and military regimes, we assume the regime with relative longer period of stay in the year.

$$y_{it} = \alpha + \beta E_{it} + \gamma S_{it} + \theta p_{it} + D_{it} \quad (1)$$

y = Fiscal Discipline, S = Inter - Governmental transfers

P = Fiscal Needs of citizens,

E = Ethno - regional diversity in the state,

D = Dummy for budgetary Institutions,

i and t represent state and time respectively, $i = 1, 2$.

5.2 Data Sources

The data for this study were sourced mainly from the annual approved budget estimates and the Accountant General's reports of Kaduna and Kwara states for the various years. The data used cover the period from 1994 to 2011. Missing data from these reports were obtained from the *Annual Abstract of Statistics* published by National Bureau of Statistics (NBS) for various years. Basic information on procedural rules and regulations are obtained mainly through interviews of the state government officials in relevant ministries.

6. ESTIMATION AND RESULTS

A set of three alternative models were estimated using Hausman-Taylor estimation technique. The estimation technique performs better when a panel contains a time-invariant exogenous variable(s) such as the ethno-regional diversity, indexed by the number of local governments in each state. The results are presented in Table 4.6.

The three models were estimated using the same procedure but somehow different specifications especially with regards to indices for measuring inter-governmental transfers. Models 1 and 2 produced similar results. Only two variables came out statistically significant, ethnic and regional diversity proxied by the number of Local Government Areas (LGAs) and population density in each of the state. One implication of this result is that fiscal discipline measured by primary balance reduces with more ethnic and regional diversity. This conforms to the "common pool" dilemma in public financial management in which each ethnic group or LGA would press the government to satisfy its interest which often expands government expenditure and thus, reduce fiscal discipline. It could also be argued as one of the consequences of "collegial procedure" and "bottom-up" approach to budgeting, where there exist no stringent and effective institutional constraints (such as numerical rules and limits) to levels of spending and borrowing autonomy, respectively (Rodden, 2002).

The positive impact of population density has dual interpretations in relation to the measure of fiscal discipline used. States with very high population density may face pressure for social capital projects like water projects, health centres and building of schools by citizens which implies more capital expenditure and reduced recurrent expenditure. On the other hand, high population density could reduce primary fiscal balance due to increased fiscal needs in form of more recurrent cost of providing social services and overblown state government payroll. In comparison with previous empirical studies, this conforms to Egger and Mcmenamin (2008), Perotti and Kontopolous (2002) and Egger and Koethenbuerger (2010).

The impact of relative dependence on federal transfers and ability of states to raise internal revenue were not significant in models 1 and 2. However, when we transformed the nominal values to their natural logarithms, the IGR and federal transfers became significant. This is not surprising as increased revenues would potentially improve primary balance.

Table 4.6: Hausman-Taylor Estimation Results

Dependent Variables	Measurement	Model 1			Model 2			Model 3		
		Coefficients	Std. Err	P(Z)	Coefficients	Std. Err	P(Z)	Coefficients	Std. Err	P(Z)
Intercept	Constant	20.0632	5.8369	0.001	1.6117	8.0107	0.007	-23.6571	7.3279	0.001
Time Variant Exogenous Variables										
Budgetary Institution	Dummy variable with Military regime = 0, Democratic regime = 1	-2.2607	1.6136	0.161	-2.3205	1.6444	0.158	-0.8561	0.8261	0.300
Fiscal Needs	Unemployment rate	0.0733	0.0687	0.286	0.0531	0.06827	0.437	0.0137	0.0346	0.696
Ethnic and Regional Diversity	Population density	0.1331**	0.0600	0.026	0.1498**	0.0673	0.026	-0.1782***	0.0507	0.002
	No. of LGAs in the state	-1.3123**	0.5110	0.027	-1.2618**	0.5766	0.029	1.3686***	0.8260	0.003
Time Variant Endogenous Variables										
Inter-governmental transfers	Federal transfers as % of revenue				-0.0072	0.0392	0.855			
	IGR as % of state revenue	-0.0146	0.0412	0.723						
	Log(Federal Transfers)							2.5537***	0.4355	0.000
	Log(IGR)							0.0028	0.3003	0.992
Wald Test										
Number of Obs.		20.45**	20	20.22**	20	117.77	19			
Number of States		2	2	2	2	2	2			

** and *** Statistically significant at 1 % and 5% respectively.

Source: Authors

In the three models, budgetary institutions are broadly indexed by regime type (military regime =0 and democracy =1). The transition to democracy has changed the budgetary process significantly with the constitutional roles of legislative arm of government in budgeting. The legislators are expected to scrutinise the budget at the formulation and approval stages and oversee how it is being implemented. In all the estimated models, budgetary institutions appeared to have had no significant impact on fiscal discipline. The implication is that changes in the budgetary institutions had no serious impact on the level of government's fiscal discipline in Nigeria. This connotes the behaviour of budget actors remains unchanged despite the change in the system of government and/or the legislative arm of government is not effective in its roles on budgetary matters.

7. CONCLUSION AND RECOMMENDATIONS

The study concludes that contrary to general expectation, transition to democracy in 1999 and the attendant changes in budgetary institutions have not impacted on fiscal discipline in the selected states. In other words, the democratic transition in the country did not result in any significant changes in fiscal performance of Kwara and Kaduna states. Instead, fiscal discipline in the two states is largely explained by ethnic and regional factors. This result may be due to lack of transparency in the budget process as argued by Alesina and Perotti (1996). They argue that for democracy to reduce fiscal indiscipline, it should be accompanied by enhanced transparency and effective implementation of appropriate procedural rules that restrict opportunism among budget actors.

We therefore, recommend that laws relating to transparency, numerical targets on spending (both at level and composition), debt accumulation and limit to fiscal deficits be enacted by the respective houses of assembly in the states. This may reduce opportunism and accumulation of deficits to satisfy ethnic and groups' interests. Also, the ongoing reforms and governance capacity building projects by the World Bank in many states should be implemented with high sense of commitment. In addition, government's commitment to achieving fiscal discipline is a key factor².

² ".....no institution will (or should, perhaps) prevent a government from running deficits, if this is what they are really determined to do so" Alesina and Perotti (1996, pp 406). Thus, we can conclude that budgetary institutions can only be effective if the government is determined to achieve fiscal discipline.

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