Effect of Fiscal Decentralization and Revenue Allocation on Local Government Performance: The Nigerian Experience

Madu Abdulrazak Yuguda*
Abbo Usman
Ghazali Shafie Graduate School of Government,
College of Law, Government and International Studies,
Universiti Utara Malaysia, 06010, Sintok,
Kedah Darul Aman, Malaysia

Rohana Yusof
Northern Corridor Research Centre (NCRC),
Universiti Utara Malaysia, 06010, Sintok,
Kedah Darul Aman, Malaysia

*Corresponding author; email: abdurrazakmadu@yahoo.com

ABSTRACT

In federalism, fiscal decentralization becomes an important pre-condition upon which the practice of good governance revolves, because it is anchored on efficient resource mobilization and utilization to ensure widespread participation and adequate representation. To facilitate good governance, the Nigerian state is politically structured into three governmental tiers: the federal, the state and the local government. However, evaluation of the performance of Nigerian local governments in terms of social service delivery depicts a massive failure. This paper therefore seeks to examine whether there is a nexus between local government failure and the nature of fiscal decentralization and revenue allocation in Nigeria. The paper present key issues, trend and challenges in the operation of fiscal decentralization in Nigeria. For instance, all decisions on revenue generation are controlled by the center and the vertical revenue allocation is structurally inclined toward the federal government, which negates the tenets of federalism and hence; grossly affects the capability of both the state and the local government to exercise *financial autonomy. In conclusion, the paper offers some important suggestions which can galvanize the fiscal capacity of the local government, thereby transforming them into viable machineries of social service delivery at the grassroots.*

Keywords: *federalism, fiscal decentralization, revenue allocation, local government performance, Nigeria*

INTRODUCTION

The Nigerian public sector is broadly structured into three separate governmental levels, i.e. the federal, the state and the local government. The sphere of authority and the nature of relationships among these three tiers are defined and guaranteed by the constitution. For instance part 1 of the second schedule of the Nigeria constitution; provide an exclusive legislative list with 68 articles upon which only the federal government reserve legislative power to make laws for the peace, order and good governance. While, part 2 provides 30 items upon which both the federal and the state have concurrent legislative powers, but in an event of inconsistency the federal law supersede. The state law is ignored and all items don't mention in either the exclusive or the concurrent lists are reserved for state and local government to legislate on (FGN, 1999:136-138).

The rationale behind the above separation is to achieve sound public sector management; through fiscal decentralization and efficient resource allocation (Afolabi, 1999). This is because equitable distribution of national wealth in a complex and diverse state like Nigeria requires fiscal decentralization as a pre-requisite for boosting grassroots participation and ensuring adequate representation in governance. However, after five decades of political independence, Nigeria is still tinkering here and there in search of an efficient structure, which can guarantee grassroots participation and fair representation in governance. This is because the evaluation of the performance of the Nigerian public sector in terms of effective service delivery, especially at the grassroots level reveals a tale of pessimism (Ahmad, 2013). So poor is the institutional mechanism for rural development and so devastating they turn out to be; that even their relevance has been questioned by Nigerians.

It is against the above background that, this paper seeks to examine whether there is a nexus between the poor performance of local government and the operationalization of fiscal decentralization in the Nigerian state. In doing so, this paper is an attempt to provide answers to the following questions; of what purpose is local government? What are the functions of local government? How far has the local government succeeded in discharging these functions? Is there a nexus between local government failure and the nature of fiscal decentralization in Nigeria?

For the purpose of analyzing the issue in this paper, secondary sources and published data obtained from literatures and internet sources on the effect of fiscal decentralization and revenue allocation on Local government in Nigeria were sought.

UNDERSTANDING THE VARIOUS KEY CONCEPTS

Three key concepts central to this discussion are: fiscal decentralization, revenue allocation and local government.

Fiscal Decentralization

Federalism as conceptualized by the Nigerian founding fathers is geared toward achieving political and social objective that centers and revolves around integration and decentralization (Akume, 2010). This notion signifies the importance of fiscal decentralization in the political annals of Nigeria; for it is an essential pre-condition for the sustenance of unity in diversity that is a solid foundation for nation building.

Fiscal decentralization connotes the process of disbursing financial control to various unit in an organization or state rather than having all financial control residing at the Centre (Okoli, 2009). It involves an arrangement, which allows component units some jurisdictional financial autonomy and at the same time remains accountable to the center. It is applicable to both federal and unitary political arrangement, as it covers both transfer payment and power of generating independent revenue. In federating state like Nigeria fiscal decentralization depicts a kind of financial transfer among the federal, state and local government to pursue or implement policy objectives

(Akume, 2010). It is a kind of a collaborative framework involving division of administrative and fiscal responsibility with a view to achieving a common goal.

To this end, fiscal decentralization involves allocation of functions and financial autonomy across the component unit or governmental levels in a state, i.e. each governmental level should be given financial autonomy to enable it discharge its assigned administrative responsibility. It confers on the component units a power of generating independent revenue so as to meet up with the intricacies of policy implementation.

Revenue Allocation

To correctly understand the concept of revenue allocation in the context of this analysis, there is a need to know of public revenue first, with a view to bring the concept of allocation in relation to revenue into proper perspective. Public revenue comprises all the financial accruals available to government to enable it to finance economic activities. Such resources can be generated through several sources such as taxation, loans, sales government property, grant, aid and profit from government investment (Likita, 1999). Public revenue can be classified into tax and non-tax revenue, where tax revenue represents all the financial accruals through the instrument tax such as sales tax, VAT, excise, import and excise duties while non-tax involve earning from government investment, fees, penalty, grant, aids and sale of government property (Dang, 2013). However, in Nigeria public revenue can further be classified into oil and non-oil revenues. Where the former represent all earnings from oil such as royalties on oil, rent of an oil well, petroleum profit tax, and the money generated from sales of oil both for export and domestic consumption, the later involves those monies generated from none oil sources.

Revenue allocation plays an important role in modern political discourse; this is because it determines the structural and functional capabilities of a government, especially in terms of service delivery. It involves the distribution of total income generated by government among its component units. It denotes a policy choice and decisions on how and where to channel and allocate resources to ensure effective service delivery (Ojo, 2010). It also, connotes the allocation tax powers and revenue sharing arrangement among the three levels of government as well as among the state (Dang, 2013). The rationale of sharing public revenue is to facilitate resources and income distribution with a view to promoting national unity and ensure even development (Jimoh, 2003). It, therefore, covers the process of sharing the centrally accrue revenue among the different tiers of government and specifically how the amount allocated to particular tier is diffused among its component units.

Revenue allocation is also, instruments of fiscal policy by which priority is developed through budgeting, i.e. how the money generated through taxation and government investment are shared among the various governmental levels and economic sectors to speed up policy implementation process. It can, therefore, be seen as an important instrument which ultimately determines the power and the capacity of every state in the practice of financial management.

Local Government

Local government plays a very crucial role in stimulating and enhancing grassroots development. This is in the sense that, it is the lowest governmental tier, which serves as a medium of policy communication between the remote areas and the highest governmental levels. The term local government is a political structure where the instrument of power is assigned to a local representative to exercise substantial control and to make authoritative decisions on local issues. It involves devolution of power to the local community within a giving geographical location to confer into them right of managing their affairs (Sambo, 2000).

The local government is, therefore, that tier of government, which is closest to the people; hence vested with certain power to exercise some degree of control over remote and local affairs.

THEORETICAL FRAMEWORK

The equitable distribution of political authority, taxable disposition and expenditure responsibility in government is a complex issue. Hence, this paper considers Local Choice Model and the Principal-Agent Model developed by Gallagher (1998) for in-depth analysis in assessing the nature of fiscal decentralization as its affect local government service delivery in Nigeria: The "local choice model", is basically, more of democratic content, where local government is highly autonomous, its leadership is selected through local election, and it is accountable to the local electorate.

In the local-choice model, local public services is the responsibility of the local government, which has the legal ability to impose local taxation. The local legislations authorize local taxes, which nevertheless must be consistent with the national constitution. Local residents elect their government and there are adequate local economic base and an institutional capacity to enable local governments to both mobilize resources and to use them, to provide public goods and services desired by local constituencies. Local governments mobilize their own resources and decide how they will be used. They prepare budgets that are voted on, either by local councils or by the broader local electorate. In Nigeria, however, the Local government has the political autonomy to elect their leadership and be accountable to the people at the grassroots. Though, this is subjected to the State government. In the sense, that, the constitution allows the state governments in Nigeria to organize and conduct elections of Local government officials. These nevertheless, is not feasible when it comes to financial autonomy, granted to the local government. This is in the sense that, section 162 (5) of the 1999 constitution provides for the state-local government joint account, where all finances of the Local government are coming. The account is being controlled and managed by the State governments on behalf of the Local governments. The composition and functions of the accounts committee are specified under section 7 (1-3) of the Laws of Nigeria. Thereby, making Local government lacks a strong economic base due to the fact that, its revenue and tax base is minimal and ineffective; which affects its performance.

On the contrary, the "principal-agent" model, emphasized that, the Local government may be elected, but it has few powers or authorities to make it capable of providing services other than those mandated and funded by the central government. If local governments prepare a budget, this is much the same as any central-government budget entity preparing its annual budget request. A local council or constituency need not review this request. Its approval or alteration is in the hands of a central government agency. It is obvious, that, the full local choice is not given to many developing countries and Nigeria in particular.

This model, better explain the current arrangement of Nigeria fiscal practices. In the sense that, based on the Laws of Nigeria-Allocation of revenue Act, section 4 (2), the local government budgets and project expenditures most be presented to the state government for scrutiny and approval and also elected councils can only make powers in such areas consistent with the provision of the Federal or state laws. Any laws or power exercised that is inconsistent with the provisions of federal or state laws; have to the extent of its inconsistency null and void. This negates the conventional principles of fiscal decentralization practices.

REVENUE ALLOCATION IN NIGERIA: AN OVERVIEW

In Nigeria, revenue is allocated to the component units so as to enable them meet up with their constitutionally assigned expenditure requirement. After five decades of political independent the assignment of administrative responsibilities among the three tiers of government in Nigeria has consistently remained the same with the exception of few modifications here and there especially during the military regimes.

However, despite such modifications, the history of Nigerian constitutional development revealed an emphasis on decentralization of functions from the center of the component units. Though a number of changes regarding fiscal responsibility were witnessed notably the mining rents and royalties. Where prior to 1959 the component units in the Nigerian federation retained 100% of the mining right, but with the discovery of oil in 1958, revenue from mining rent and royalties begin to be shared among the three tiers on a percentage basis (which is subject to change depending on political situation). The VAT that is now to be collected federally on the sales tax was prior to 1994 100% collected and controlled by the state governments, but this has later been replaced and collected and controlled federally (Dang, 2013). Currently, the federal government retains 35% of the VAT; so in all cases the development favors the federal government to the detriment of the component units.

Retrospectively, since adopting federalism as the workable option in 1964 by the Nigerian political leaders all the major changes both constitutional and administrative have been attempt geared toward changing the revenue sharing right of the different tiers of government (Dang, 2013). These occur either vertically (federal, state and local) or horizontally (within states or local governments). For instance, about nine fiscal commissions were constituted in Nigeria between 1948 and 1988 to examine the revenue sharing structures (Jimoh, 2003). The recommendations made by such commissions at different times significantly affect the revenue sharing formula adopted; this is because in all cases, they explicitly and categorically state the rights and areas of jurisdiction on tax and revenues to be collected by each level of governments.

In Nigeria, presently Revenue Mobilization and Fiscal Commission is a body that is constitutionally charged with the responsibility of determining and indeed influencing revenue allocation in the country.

The Purpose of Local Government

The purpose of local government grows out of the need to foster and accelerate grassroots development, hence in Nigeria local government are established to facilitate effective and efficient local service delivery (Okoli, 2009). Local governments are, therefore, expected to achieve the above objective through the provision of housing, water, rural electricity, transportation, health facilities as well maintenance of clean and healthy environment (Likita, 1999).

To this end local government must act as a strong, viable political and administrative mechanism for rural transformation through identification of policy targets, setting of objectives and deployment of resources to the priority area.

Functions of Local Government

The Nigerian constitution in the fourth schedule spells out the functions which local government is expected to discharge as follows:

- Setting out in broad outline economic and social development plans for local areas
- Maintenance of utilities such as cemetery, slaughter slab, public convenient
- Collection of rates, radio and television
- Maintenance of primary health care
- Provision of local and community recreation
- Provision of information and public enlightenment

- Births, death, and marriage registration
- Control and regulation of animals, outdoor activities, bakeries, etc. (FGN, 1999).

ASSESSMENT OF LOCAL GOVERNMENT PERFORMANCE IN NIGERIA

The performance of local government in discharging its functions as stated above remains a subject of much debate among Nigerians. These generate constant accusation and counter accusations, especially between local government and their respective states, there is indeed a general consensus among scholars that local government in Nigeria has failed woefully (Salami, 2011).

For instance, Ukiwo (2006) asserts that instead of rural transformation local government in Nigeria have only succeeded in producing local financial predators. Similarly, Okoli (2009) states that "local government system in Nigeria has entirely collapsed; hence the need for community base administrative system." The performance of local government in service delivery made Nigerian citizens to lose trust in local government as an institution established to respond to the masses needs (Agba et al., 2013). In fact, the general perception about local government in Nigeria is that of a dead and decomposed institution (Ahmad, 2013). For instance a survey conducted in 2008 by Afro-barometer discovered that 55% of Nigerians do not trust local government officials (Salami, 2011).

It is against the above background that this paper attempts to find out whether fiscal decentralization in Nigeria has a direct impact on the poor performance of local government.

REVENUE ALLOCATION, FISCAL DECENTRALISATION AND THE PERFORMANCE OF LOCAL GOVERNMENT IN NIGERIA

Revenue allocation plays a significant role in ensuring good governance. As a sound revenue system, it is an essential pre-condition for the success of fiscal decentralization and effective service delivery (Anyanwu, 1993). In Nigeria, local government derives its revenue from three important sources, i.e. allocation from the federation account (the 15.21% of the federation account), transfer from the state (10% of state IGR) and the local internally generated revenue (Inyang, 2014).

The Federation Account

Public revenue in Nigeria are classified into the federation accounts revenue head and the consolidated revenue fund also called the federal government account, this represents two important accounts that shape the practice of fiscal decentralization in the country. For instance, while the federation account contains all the revenue, drive by the Federation; which is, being shared monthly among the three tiers on a percentage basis; the consolidated revenue fund represents a fund standing to the credit of the federal government.

Over the last four decades, public revenue in Nigeria comes from the sales of crude oil, taxes, fines, tolls, penalties and charges, with crude oil serving as the primary source contributing about 80% to 85% of the total revenue (Salami, 2011). The Nigerian constitution conferred on the federal government exclusive jurisdiction over sources such as custom, excise duties, VAT, mining tax, education and company tax. The amount generated from these, with the exception of education are paid into the federation account; which is shared among the three tiers on the following basis; federal government 47:19% state 31:10% local government 15:21% (Inyang, 2014). In this regard, both state and local government are constitutionally restricted to the collection of local taxes.

Table 1

Tax Legislation in Nigeria

TAX	JURISDICTION	COLLECTOR	BENEFICIARY
Mining & royalty	Federation	Federation	Federation
Capital gains tax	Federation	State	State
PAYE: armed force, police, external affairs, FCT	Federal	Federal	Federal
VAT	Federal	Federal	Federal/state
Import, export and excise	Federal	Federal	Federation

(continued)

TAX	JURISDICTION	COLLECTOR	BENEFICIARY
Other PAYE	Federal	State	State
Land registration	State	State	State
Capital transfer tax	Federal	State	State
Gift	Federal	State	State
Motor vehicle	State	Local	Local
Entertainment	State	State	State
Pools	State	State	State
Property	State	State/local	State/local
Motor Park	Local	Local	Local
License and fees	Local	Local	Local
Stamp	Federal	State	State
Trading licenses	State	Local	Local

Source: Jimoh (2003)

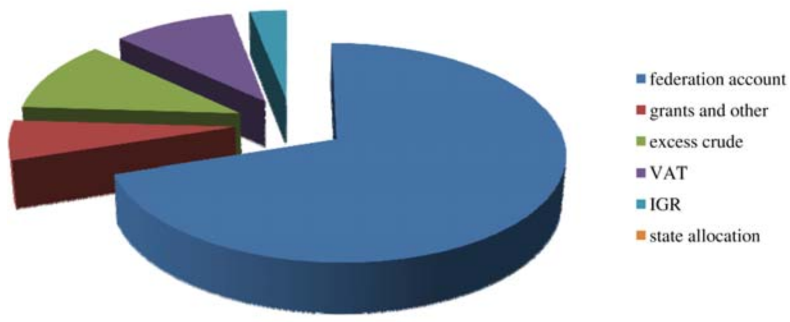
The revenue allocation formula currently being practiced in Nigeria tends to allocate more funds to the federal government to the detriment of the state and the local government. As we can see from the above table the largest portion of the revenue is collected and retain by the federal government. According to (Salami, 2011) "between 1980-2008 about 93% of the total revenue generated were collected by the federal government implicitly state and local government put together share only 7%".

State Transfer to Local Government

The Nigeria law requires states government to remit 10% of their internally generated revenues to local governments under their jurisdiction. However, available evidence shows little or no compliance with this statutory requirement, and this is because the exercise of state creation in Nigeria in itself is politically tale-guided. Hence, most states are not self-reliant in terms of revenue generation capacity, and a significant number of them find it practically difficult to remit 10% of their internally generated revenue to the local government as require by the law (Jimoh, 2003). Worse still, even the local government share of the federation account has been often hijacked and divert by most Nigerian state due to weak revenue generation capacity (Ahmad, 2013). Even states like, Lagos and Kano; who are considered viable in terms of revenue generation use the local government allocation to suit their political motives (Salami, 2011). These and other factors combined to make the local government a mere smokescreen in terms of service delivery.

Local Government Internally Generated Revenues

The IGR of Nigerian local government is generally considered weak. Significant numbers of them just sit and wait for the monthly allocation from the federation account. This makes them financially insufficient in meeting up with the increasing rural needs (Okoli, 2009). Even few local governments who show commitments in revamping the level of their IGR problems such as weak institutional capacity, paucity of record, unreliable statistics, fraud and corruption tends to negatively affect the revenue generation process (Inyang, 2014). These scenarios tend to rob the local government of their financial autonomy. In most cases, these constitute reasons behind their inability to execute a single development project in their respective local communities, thereby curtailing their significance as a vehicle of rural transformation.



Source: Central Bank of Nigeria, Statistics Bulletin; 2011.

Figure 1. *Revenue Structure of Local Government in Nigeria 2003-2010*

From the above it is crystal clear that the bulk of the local government revenue is from the federation account 70%, follow by excess crude 11%, then VAT 10%, grant 6% IGR 3%, while the state's allocation is 0%. These show so much dependence on the federal government by the local government due to ineffective fiscal decentralization, weak revenue generation capacity and lack of allocation by states government which significantly affect the performance of the local government.

CONCLUSION

In conclusion local governments in Nigeria are not viable; because constitutionally, they are confined to non-viable sources of sustenance in addition to the problematic fiscal jurisdiction that exist between them and states government; which impoverish the local government and become a constrain to its service delivery capacity in rural areas. To this end there is a serious need for the National Assembly to critically look at the position of fiscal decentralization in the Nigerian constitution with the view to fine-tune and modified it for better federalism. The financial relationship between state and local government also needs to be addressed, especially, the issue of state/LG joint-account and state allocation committee. There is also a need for the promotion of grassroots democracy where local citizens are given the opportunity to involve in the act of governance; this can only be achieved through free and fair elections, hence the practice where state governors appoint their henchmen as local government chairmen need to be discouraged.

REFERENCES

Afolabi, L. (1999). *Monetary economics.* Ibadan, Nigeria: Heinemann Educational Books.

Agba, M.S, Akwara, A.F, & Idu, A.Y. (2013). Local government and social service delivery in Nigeria: A content analysis. *Academic journal of Interdisciplinary Studies, 2*(2), 455-462.

Ahmad, A.A. (2013). Local government autonomy and effectiveness in Nigeria. *Journal of African & Asian Local Government, 2*(1), *48-59*

Akume, A.T. (2010). The effect of inter-governmental relations on federalism: An examination of intergovernmental (1999-2007). A Postgraduate Seminar Paper, Department of Public Administration, University of Nigeria.

Anyanwu, J.C. (1993). *Public finance: Theory and policy in Nigeria.* Onitsha Joanne Education Publisher's Ltd.

Central Bank of Nigeria (2011). *Statistical Bulletin*. Abuja: CBN.

Dang, D.Y. (2013). Revenue allocation and economic development in Nigeria: An empirical study. *SAGE open July-September,* 1-7.

Federal Government of Nigeria (FGN). (1999). Constitution of the Federal Republic of Nigeria (CFRN). Lagos: Federal Printing Press.

Gallagher, M. (1998). Choices in fiscal federalism: Centre for applied studies in economics, Case Study Bo. 98/1. September.

Inyang, B. (2014). Contending issues in the management of intergovernmental relations in the Nigeria Federal Administration System. *Mediterranean Journal of Social Sciences, 4* (3), 226-233.

Jimoh, A. (2003). Fiscal federalism: The Nigerian experience. Paper Delivers at the Meeting on Fiscal Policy and Growth in Africa UNCC Addis Ababa, Ethiopia Economic for Africa.

Likita, O. (1999). *Elements of public finance.* Lagos: AIP Ltd.

Ojo, E.O. (2010). The politics of revenue allocation and resource control in Nigeria: Implication for federal stability. *Federal Governance Studies, 7*(1), 15-38.

Okoli, F.C. (2009). *Theory and practice of local government: A Nigerian perspective.* Enugu: Bismarck.

Salami, A. (2011). Taxation, revenue allocation and fiscal federalism in Nigeria: Issues, challenges & policy options. *Economic Annals, LV1*(189), 27-50.

Sambo, M. (2000). *Local government and civil service in Nigeria.* Warri: PTI Printing Press Ltd.

Ukiwo, U. (2006). Creation of local government areas and ethnic conflicts in Nigeria: The case of Warri, Delta State. Retrieved 10/09/2014, from http://citeseerx.ist.psu.edu/viewdoc/summary?doi=10.1.1.119.5294.