

FINANCING OPTIONS AND DEVELOPMENT PROJECTS IN THE NIGERIAN LOCAL GOVERNMENT SYSTEM

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Abstract

This study is an investigation into the impact of Nigerian local government financing options on successful execution of development projects. Through the ordinary least square regression analysis, the study proved that though there is an established case of under-funding in the entire Nigerian local government system, the propagation of funds misappropriation theory seems to hold true, and both account for the low level of economic development being experienced in Nigeria. Hence, the recommendation includes the upward review of the Federal Statutory Account, strict adherence to the law on the release of State Statutory Allocation to the local governments while checking the unwieldy behaviour of local government practitioners on proper fund management.

Keywords: Local governance, Financing options, Development projects, Economic development.

Introduction

Governments, the world over, have often tried to address two fundamental problems. First, is the primary objective to achieve economic growth through improved national income. Second, there is the equity issue as governments try to address the problem of achieving improved distribution of the national income. Implied in these two objectives is the 'central goal to improve the standard of living and attain the best economic welfare (Squire and van der Tak, 1981). However, these objectives do not come so automatically, as a responsible government must seek out the best ways to bring development to its people.

For instance, Nigeria is a Federation consisting of the Federal, State and Local governments. These tiers of government, through their budgetary actions, collectively strive towards the attainment of economic development of the nation. To achieve this, they embark on development projects, which are financed with the ever-depleting resources (financial and otherwise). Akujuobi (2000) has observed that public revenue in Nigeria is mainly dependent on oil component that is highly unpredictable being exposed to the vagaries of the international oil market prices. Even if stable, such funds are hardly enough to bolster the desired level of economic development through provision of the much-needed development projects.

This perceived scarcity of funds therefore, has constrained the efforts of governments at the various levels towards efficient provision of development projects. However, speculations are rife that these governments even with the acclaimed meagre resources often fail to provide development projects that are in tandem with the available resources. It is no longer news that our leaders now take delight in running "jumbo

government” that end up financing more recurrent expenditures than taking up development projects that impact more on the lives of the citizenry. There is therefore, the need to investigate the impact of government financing options on the provisions of development projects.

The contention in many quarters is that the local governments are closer to the people and hence present the best channel for development to trickle down on the ordinary man in the street. This has therefore, fueled the interest that has continued to be shown on this third tier of governance-local governments. For instance, most people reside in the local government, being rural based, it becomes a vehicle for transmitting the much-orchestrated “dividends of democracy” (schools or education, pipe borne water, good roads, electricity, recreational facilities etc.) to the teeming populace.

Suffice it to say, therefore, that the provision of such basic needs for the populace and hence improvement in the standard of living of the people, as contended, are better done by these “grass-root” governments. Hence, Akujuobi, (2000) opines that if properly carried out, the tendency is to check the recent rural-urban drift.

It must have been in line with such reasoning that successive governments in Nigeria embark on reforms aimed at re-positioning the local governments towards addressing the problem of economic development. Efforts in these directions include reforms at making the local governments autonomous, more efficient and effective, by giving them direct allocations from the Federation Accounts.

It appears, however, that the more such funds are made available to the local governments, the less development the country experiences in our hinterlands. For instance, these areas have continued to be less developed with lack of basic needs (portable clean water, schools, good roads, health and other infrastructural facilities etc) being the order of the day.

Ordinarily, one would have expected to see a lot of development projects being carried out in every nook and cranny of the country given the acclaimed billions of naira that go into the local governments from the Federation Accounts etc. Surprisingly, what we hear instead, are cases of, at best, abandoned projects, and total impoverishment of the citizenry. The million dollar questions then are: Why this ugly trend? Why this disparity between the acclaimed available resources and developments projects in Nigeria? What is the nature of funding available for development projects in the Nigerian local government system? To what extent have the local government financing options helped to achieve successful execution of projects? There is therefore, the problem with the injection of scarce resources within the local government system of Nigeria with the allegation of little or nothing to show for it.

The central purpose of this study is therefore, to examine the impact of financing options on development projects in Nigerian local government system. The specific objectives are: (i) to determine the available financing options for successful execution of development projects in the Nigerian local government system. (ii) To ascertain the nature of relationship between local government financing options and its development projects. (iii) to determine whether financing options exert a significant impact on development projects. (iv) To develop a prediction model that predicts the extent of influence of local government financing options on successful execution of development projects in Nigeria. (v) Finally, to isolate policy constraints to the successful execution of development projects and proffer policy recommendations on improving the quality of lives through the local government system.

On the basis of the above-stated objectives some hypotheses were formulated and tested. Other sections of the work include the review of related literature, research design and methodology, data analysis, conclusion and recommendation.

Hypothesis

Ho₁: There is no significant relationship between local government financing options namely; Federal Statutory Accounts, State Statutory Allocation, Value Added Tax, Internally-generated Revenue, Grants and Others, Loans/Overdrafts and Development projects.

Ho₂: Local government financing options namely, Federal Statutory Accounts, State Statutory Allocation, Value Added Tax, Internally-generated Revenue, Grants and Others, Loans/Overdrafts do not have a significant impact on development projects.

The Nigerian Local Government System, Financing Options And Development Projects

The Federal Government of Nigeria, especially during the military era of Generals Obasanjo and Ibrahim. B. Babangida made concrete efforts to reform the local government system. According to Akujuobi (2000), such reforms were directed towards achieving, especially financial autonomy, and with this, ensure that the Nigerian local government system was better positioned to bring development to the citizenry.

In line with this, the Federal Government of Nigeria in 1976, therefore, for the first time saw a need to grant the local government direct federal allocation from the Federation Account. Shehu M. Yar Adua, the then chief of staff, Supreme Headquarters (1976) as cited in Akujuobi, (2000) summed the situation of the local governments as a prelude to the reforms thus:

Local Governments have over the years suffered from continuous whittling down of their powers. The state Governments have continued to encroach upon what would normally have been the exclusive preserve of local government.

It is however, on record, that this direct Federal Statutory Allocation and other revenue sources, as offshoots of the local government reforms have appeared not to adequately address the problem of insufficient funds, and by extension, aid their ability to execute development projects. On the contrary, opponents of the pro-reforms agenda have continued to hit hard on these reforms, especially direct Federal Allocation. It is their view that rather than bring about the desired financial autonomy etc, a direct Federal Allocation has continued to make the local government system “a toothless bulldog” since it now over depends on the so-called direct Federal Allocation, without any move to explore other sources of revenue. It is their contention that, if the much-talked-about autonomy is to be justified and sustained, the local government should be seen to be executing their budgets with mainly internally generated revenue. Their inability to do this, the opponents further stressed, is responsible for the confirmed neglect and under-development of the local government areas. This has been further supported by the survey as conducted by the Administrative Staff College of Nigeria (ASCON) (1996).

According to the survey, greater share (i.e.80 percent) of local government revenue is realized from external sources, most especially the Federal Statutory Allocation. Again, the survey observed that very few states remitted 10 percent state internally generated revenue to local governments as required by the law. It further revealed that less than 2 percent of local governments are able to meet recurrent expenditure from internally generated revenue and that no local government in the country generates 50 percent of its total annual budget. There seems to be therefore, the problem of insufficient funds and over-dependence of the local governments on Federal Statutory Allocation, a situation perceived to jeopardize their autonomous status with further negative consequences for development projects in the local government system.

There are other past studies in the area of local governance (Cowan, 1986; Wraith, 1964; Campbell et al, 1965; Jagu, 1984; Onah, 1986; Ashew, 1987; Campbell, 1988; Uchendu, 1994). For instance, Campbell et al (1965) studied mainly the pattern of local governments in West Africa. This work however, suffered one major setback, it appeared when the states of West Africa had just become independent of their colonial masters, and hence were in a period of rapid sociological and economic change. With this, the work lost touch of those important elements that could give a full picture of trends by helping people appreciate the impact of local governments on national development.

While confirming the above-stated deficiencies, Campbell (1988), advocated among others, the use of comparative study system, which in our own opinion is not too useful in this present study. Kweka and Morrissey (2000) and Asiedu (2005), have questioned the use of comparative studies over country-specific studies since according to both works, no two countries are structurally the same, hence the result of such a comparative study could be quite misleading just as it lacks credibility. Therefore, the present study is intended to avoid such pitfalls.

Wraith (1964) made a different study on the anglophone colonies and Cowan (1985) had earlier

examined trends in local governments in both anglophone and francophone West Africa. Of course, these studies neglected the areas of local government finance in general and how the Nigerian local governments could be financially self-sufficient to support development projects. Uchendu (1994) studied Imo State local governments but his interest was in the area of manpower planning and development of the service. Earlier, Jagu (1984) carried out a study on the financing of Lagos State with interest on determination of the proportion of total revenue allocated for capital expenditure compared with personnel emoluments. The shortcoming of this study by Jagu (1984) is mainly on the basis of its too narrow scope, being a study on only Lagos State. One would have expected a nation-wide study since there is a unified local government system in operation in Nigeria.

While Onah (1986) was interested in how cottage industries could contribute to the diversification of sources of local government finance, Ashew (1987) looked at the contribution of local government finances through property taxation. On the strength of these obvious shortcomings of these past studies, there is therefore, a yawning gap which the present study is set out to fill.

Research Design and Methodology

The study covers the period, 1993-2003 while adopting the ordinary least square regression model as the main statistical tool of analysis. Here, the Total Capital Expenditure (CAPEX_t) as the dependent variable is regressed on the corresponding figures for the explanatory variables namely, Federal Statutory Accounts (FAC_t), State Statutory Allocation (STAL_t), Value-Added Tax (VAT_t), Internally-generated Revenue (INREV_t), Grants and Others (GOT_t), and Loans/Overdraft (LOD_t).

The study employed only secondary data from the Central Bank of Nigeria, (Annual Statistical Bulletin) on summary of local government finances, also for the period under investigation. The test statistics, include therefore, Coefficient of Correlation (R), Coefficient of Determination (R²), the analysis of variance (ANOVA/F-ratio). While the ANOVA/F-test establishes the significance or otherwise, of the model as a whole, the coefficient of correlation seeks to test the strength or magnitude of the relationship between the development projects and the explanatory variables or local government financing options. T-test seeks to test the extent of the contribution or impact of each of the explanatory variables on development projects, proxied by capital expenditure (CBN, 2005).

Model Specification

Specifically, we have the following models;

$$CAPEX_t = f(FAC_t, STAL_t, VAT_t, INREV_t, GOT_t, LOD_t) \dots \dots \dots (1)$$

Mathematically;

$$CAPEX_t = \beta_0 + \beta_1 FAC_t + \beta_2 STAL_t + \beta_3 VAT_t + \beta_4 INREV_t + \beta_5 GOT_t + \beta_6 LOD_t + U_t \dots \dots \dots (2)$$

Rearranging equation 2 above, we have;

$$U_t = CAPEX_t - (\beta_0 + \beta_1 FAC_t + \beta_2 STAL_t + \beta_3 VAT_t + \beta_4 INREV_t + \beta_5 GOT_t + \beta_6 LOD_t) \dots \dots \dots (3)$$

$$U_t^2 = CAPEX_t - (\beta_0 + \beta_1 FAC_t + \beta_2 STAL_t + \beta_3 VAT_t + \beta_4 INREV_t + \beta_5 GOT_t + \beta_6 LOD_t)^2 \dots \dots \dots (4)$$

Summing both sides of equation (4), we have;

$$\sum_{j=1}^n U_t^2 = \sum_{t=1}^n (CAPEX_t - \beta_0 + \beta_1 FAC_t + \beta_2 STAL_t + \dots \dots + \beta_6 LOD_t)^2 \dots \dots (5)$$

In the Regression, $\sum_{t=1}^n U_t^2$, (estimate of the population disturbance) is given by

$\sum_{t=1}^n e^2$, otherwise called the RESIDUAL SUM OF SQUARES (RSS)

$\sum_{t=1}^n \hat{\dots}$

$(\text{CAPEX}_t - \text{CAPEX}_t)^2$, that is the sum of squares of the deviation of the actual Capital $t=1$

Expenditure variables from their mean, while the explained sum of squares (ESS) is gotten with the formula, $\text{ESS} = R^2 * (\text{TSS})$

Where;

R^2 = the coefficient of the determination from the regression, therefore,

$\text{RSS} = \text{TSS} - \text{ESS}$ (Kontsoyianais, 1986; Gujarati, 1985)

And,

CAPEX_t = Level of capital expenditure in year t.

FAC_t = level of Federal Statutory Accounts in year t.

STAL_t = level of State Statutory Allocation in year t.

VAT_t = level of Valued Added Tax in year t.

INREV_t = level of Internally-generated Revenue in year t.

GOT_t = level of Grants and Other Revenue in year t.

LOD_t = level of Loans and Overdraft in year t.

Test of Hypothesis

Test of model significance

The following hypothesis is tested:

$H_{01} : \beta = 0$ (i.e. the regressor, local government financing options as explanatory variables, in a given year have no significant relationship with the Actual dependent variable, Capital Expenditure, for that year).

$H_{A1} : \beta \neq 0$ (i.e. there is a significant relationship between, at least, one independent variable or local government financing option, and the Actual dependent variable, Capital Expenditure).

Table 1 in appendix I shows the summary of local government finances for the period, 1993-2003 in millions of naira. The results of the simple regression are presented in Tables 2 and 3 as found in appendix II.

From the tables, we read the following;

F-tabulated (6, 4), 1% = 15.21; 5% = 6.16 while the F-ratio calculated is 55.049 (see ANOVA table, appendix II).

With the F-ratio calculated (55.049) > F-tabulated (1% = 15.21; 5% = 6.16), we therefore, reject the Null hypothesis; H_0 , and accept the Alternative, H_a to conclude that there is a significant relationship between local government financing options and development projects, the model being significantly explained at 0.001%, alpha level (see ANOVA Result on Table 2).

Test of significance of each explanatory variable:

This hypothesis states thus

H_{02} : Local government financing options namely, Federal Statutory Accounts, State Statutory Allocation, Value Added Tax, Internally-generated Revenue, Grants and Others, Loans/Overdrafts do not have a significant impact on development projects.

T-ratio tabulated; DF (N-K; 11-7=4)

1% = 4.6041

5% = 2.7764

Therefore, since only the t-calculated for grants and others (3.226) > (2.7764) t-tabulated at 5%, we reject H_0 and accept H_a to conclude that only financing option from grants and others contributes significantly to development projects in the local government system for the period under investigation.

Discussion of Results

The result of the test shows that there is a significant relationship between the explanatory variables, local government financing options and development projects with the model well-specified at nearly 0% level of significance. In the same vein, the study showed that a strong correlation exists between the execution of development projects and local government financing options, with the correlation estimated at about 99%. The power of the model to explain the variations in the execution of development projects, equally followed the pattern of correlation among variables. For instance, the model revealed that the explanatory variables have been able to explain at least 98% of the total

variation in the dependent variable, Capital Expenditure (see also ANOVA table, appendix II). Others are the correlation between Capital Expenditure and Grants and Others (96.9%), followed by that between Capital Expenditure and State Statutory Allocation (96.5%), Federal Statutory Accounts (91.8%), Internally-generated Revenue (89.5%), Value Added Tax (88.7%), and the least between the Capital Expenditure and Loans/overdrafts (33.1%).

The above correlation result portends far-reaching implications on development projects and may seem to lend credence to the misappropriation theory, especially when looked from the side of loans/overdrafts. From this weak correlation between Capital Expenditure and Loans/overdraft (33.1%), one can safely infer that most of the loans and overdraft facilities taken in the local government system appear to have ended up being misappropriated.

However, in terms of the contribution of each of the individual financing options to development projects, with the t-tabulated of; 1% = 4.6041 and 5% = 2.7764, only funds from Grants and Others contribute significantly to the execution of development projects at slightly above 3% level of significance. All other sources the study revealed are non-significant contributors to the execution of development projects. This result seems to lend credence to the pro-reform and canvass-for-more-fund theory. The conclusion from this result is that there is actually an established case of under-funding in the local government system, a factor which may account for the abysmal development of capital projects in the local government system. The display of contributions of the explanatory variables in order of importance to development projects is as follows:

$$GOT_t > LOD_t > INREV_t > STAL_t > VAT_t > FAC_t$$

$$[3.226] [2.215] [0.890] \quad [0.635] [0.134] [0.101]$$

The resulting estimated prediction model is however presented thus;

$$CAPEX_t = 1483.399 + 0.009 FAC_t + 5.081 STAL_t + 0.067 VAT_t + 1.085 INREV_t + 2.055 GOT_t + 2.642 LOD_t \dots \dots \dots (6)$$

The model estimated above is in line with the a-prior expectation since all the explanatory variables bear a positive sign and therefore contribute positively to development projects.

Conclusion

On the basis of these findings, the study concludes that there is a significant relationship between local government financing options and development projects, thus meaning that the financing options taken together exert a significant impact on development projects. Also, the financing options are all positive contributors to development projects, though only the revenue from Grants and Others as a subhead makes a significant contribution to the execution of development projects in the Nigerian local government system.

Recommendation

The results of the findings therefore inform the following recommendations

There is need to review the current revenue sharing formula upward in favour of the local governments in order to support execution of development projects.

Similarly, state governments need to adhere strictly to the requirements of laws in terms of release of State Statutory Allocation to the local governments. This way, more development funds would be made available to the local government for project execution.

As most of the development projects will be moribund with funds misappropriation there is therefore, a need for the authorities/government to check the perceived recklessness in the application of funds among local government operatives.

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Appendix 1

TABLE 1: Summary of Local Government Finances, 1993-2003 (#Million)

YEAR	FACT	STALt	VATt	INREVt	GOTt	LODt	CAPEXt
1993	18316.4	253.1	0	1035.6	269.4	39.9	5508.8
1994	17321.3	466.4	0	1205.9	229.5	71.5	4082.9
1995	17875.5	625.4	3558.1	2110.8	242.9	50.5	6126.1
1996	17586.5	685.1	3306.9	2211.1	0	-11	6045.5
1997	20443.3	578.9	7586.1	2506.9	139.2	-1519.1	8083.4
1998	30600.9	750.4	10170.8	3331.6	94.5	2888.9	14864.7
1999	43870.3	419.8	9559.8	4683.8	2266.9	259.6	18827.3
2000	118589.4	1923.1	13908.7	7152.9	12434.1	3734.6	59964.9
2001	128500.5	1598.6	20102.7	6020.4	15300.9	0	48661.8
2002	128896.7	1372.3	18727.2	10420.9	12434.1	0	45118.6
2003	277500.6	2054.2	36957.6	15098.3	15956.8	0	65945.8

Source: CBN Survey of Local Government Councils and Federation Accounts Reports

Appendix II

TABLE 2: Summary of Results

Parameters	Coefficients	T-valus	Level of Significance
Coefficient of correlation (R)	0.994		
Coefficient of determination (R) ²	0.988		
Adjusted R ²	0.970		
Standard Error of Estimate	4171.61909		
F-Value	55.049		0.001 **
Model			
Constant	1483.399		
FAct	0.009	0.101	0.925
STALt	5.081	0.635	0.560
VATt	0.067	0.134	0.900
INREVt	1.085	0.890	0.424
GOTt	2.055	3.226	0.032*
LODt	2.642	2.215	0.091

Source: Result of Computer Analysis of Table, Data using Spss 13.0

N:B * Significant at 5%
 ** Significant at 1%
 *** Significant at 0%

TABLE 3: CORRELATIONS BETWEEN THE VARIABLES

	CAPEXt	FAct	STALt	VATt	INREVt	GOTt	LODt
Pearson Correlation							
CAPEXt	1.000	.918	.965	.887	.895	.969	.331
FAct	.918	1.000	.892	.965	.963	.904	.085
STALt	.965	.892	1.00	.859	.849	.937	.344
VATt	.887	.965	.859	1.000	.955	.868	.064
INREVt	.895	.963	.849	.955	1.000	.863	.092
GOTt	.969	.904	.937	.868	.863	1.000	.169
LODt	.331	.085	.344	.064	.092	.169	1.000

Source: Result of Computer Analysis of Table, Data using SPSS 13.0