

# Welfare and Economic Effects of Fiscal Behaviour of Local Governments in Nigeria

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## Abstract

The Nigerian constitution recognises the local government areas (LGAs) as the third tier of government, and sets aside for it the responsibility of effective public service delivery at the grassroots. In recent times, debates have ensued on the effectiveness of the 774 LGAs in Nigeria. While a polar group calls for scrapping of the LGAs because of their poor or non-performance due to, among others, corruption; some others have advocated for a reasonable degree of autonomy to guarantee effectiveness and accountability in the discharge of their duty. In view of this, the study examines the fiscal behaviour of the LGAs with a view to investigating whether they enhance welfare or not. Also, the paper studies factors that affect revenue drive of LGAs, identifies main sources of revenue and its applications. Both primary and secondary data from Osogbo Local Government Area of Osun State are employed in the study that utilises descriptive and inferential statistical techniques. On welfare, the fiscal behaviour of Osogbo LGA is felt most in education sub-sector, followed by health and sanitation. The results further show that low internal revenue generation; political interference and inadequate mobility for tax collection are the primary factors affecting the performance of LGAs. Lastly, the study finds that increased spending on essential services would improve standard of living of people at the local level.

**Keywords:** Local government, welfare, fiscal actions

## 1. Introduction

In Nigeria, the constitution (in Section 7, fourth schedule), clearly states and empowers 774 local government (LG) areas to ensure effective service delivery and enhance sustainable development at the grassroots. However, these economic-cum-development functions are either inhibited or enhanced by the system of administration - civilian or military. Since May 29, 1999 legitimate democratic civilian administration has uninterruptedly been at the helm of affairs in Nigeria, at all levels - Federal, State and Local Governments.

Although, most often, local governments (LGs) chairmen are appointees of State Governors to whom they are politically responsible, they are supposed to be held accountable by the people of the grassroots for its development and sustainability. One question that comes to mind is, whether there has been a significant difference in the local authorities' service delivery since the civilian administration that commenced in May 1999. The purpose of the paper is to unfold the welfare and/or economic effects of the fiscal activities of the local government in Nigeria. While the case study of Osogbo LG area at Osun State is examined, the intention of the study is to make inference for the entire country.

Previous studies on impacts of fiscal policy in Nigeria have largely remained at the macro level. The current study focuses on the micro-analysis of the fiscal actions, with a view to drawing implications for improving living standards. Whereas about 70 per cent of the Nigerian populace dwells in rural areas, which are essentially being administered by local authorities; there are bundles of constraints towards its optimal performance. Agbo (2010) lists lack of integrity, transparency and accountability as some of these constraints. Besides Otoghile and Edigin (2011) identify misappropriation or misallocation of funds as another obstacle to the performance of LGs in Nigeria. Whether there has been gains or losses since May 1999's transition to democratic regime, given the challenges affecting local governments, or not, is the whole essence of enquiry in the study. Adesina (2015) and Ezeabasili and Herbert (2007) provide detailed discussion on the evolution of LG administration as well as the theoretical perspective on the role of fiscal policy in enhancing standard of living.

## 2. Nigeria's Local Government Administration: Evolution and Functions

An overview of the local government system in Nigeria is presented in this section to identify likely historical events that have shaped policy actions of local governments nowadays. The origin of local government administration could be traced to the colonial period - before and after the amalgamation of the Northern and Southern protectorates that constitutes the present day Nigeria. Shortly after Nigeria was founded by Lord Lugard in 1914, the then Governor-General discovered in 1919 that the Northern Nigeria was more organized administratively whereas commerce and trade were the dominant activities in the South (see the Guardian, August 7, 2003).

The realisation by Lugard and other British colonial officials that non-homogenous entity called Nigeria would struggle to govern itself and attain its aspirations led to the introduction of the local government system. In their

opinion, the system was suitable and appropriate to accommodate the diversities of the Nigerian society. Oyediran (1979) documents that a consensus on the use of indirect rule system in local government administration was made to govern and develop the entire country. The adopted indirect rule had existed and succeeded in the former Northern protectorate, where powers were devolved between the colonial government and the elite emirs who had earlier opposed the British system. The perceived success of the indirect rule policy in the Northern region motivated its adoption in the whole country, to oversee and develop the grassroots. Since its introduction local government administration in Nigeria had metamorphosed severally. The military incursion in governance in 1966 and other subsequent coup d'état until 1999 affected not only the structure of the local authorities but also the entire geo-political as well as socio-economic environment in Nigeria. When the military perceived that local administrations were far from the grassroots, the first sets of states were created in May 1967. This further led to deepening and restructuring of local governance. Over the years precisely in 1976, 1988 and 2003 efforts were made to position the local government system to overcome *among others*, constitutional problems, inefficiency and ineffective performance (see Public Service Review Commission, 2003). At present there are 774 local governments in Nigeria and its functions cover social, economic, political and administrative responsibilities as the third tier of government.

In chapter 1, Part 2, Section 7 of the 1999 constitution of the Federal Republic of Nigeria, the political structure of the administration of local government is given thus:

*“The system of local government by democratically elected local government councils is under this constitution guaranteed, and accordingly, the government, of every state shall subject to Section 8 of this constitution, ensure their existence under a law which provides for the establishment, structure, composition, finance and functions of such councils”*

Furthermore, the constitutions states

*“The person authorized by law to prescribe the area over which a local government council may exercise authority shall define such as clearly as practicable; and ensure, to the extent to which it may be reasonably justifiable, that is, in defining such area, regard is paid to the common interest of the community in the area, traditional association of the community, as well as administrative convenience, and the government of a state shall ensure that every person who is entitled to vote or be voted for at an election to a local government council.”*

Concerning the economic/fiscal structure of local governments, fiscal federalism in operation in Nigeria provides a direction. Thus, each tier of government has its specific roles and responsibilities stipulated in the constitution. For instance, the statutory allocation to local authorities is guaranteed by Section 7 of the constitution thus:

*“The National Assembly shall make provisions for statutory allocation of public revenue to local government councils in the federation; and the House of Assembly of a state shall make provisions for statutory allocation of public revenue to local government councils within the state.”*

The functions of local government are contained in the 4<sup>th</sup> schedule Section 7 as follows:

- *The consideration and making of recommendations to a state commission on economic planning or any similar body on the economic development of the state particularly in so far as the areas of authority of the council and of the state are affected; and the proposal made by the said commission or body.*
- *Collection of rates, radio and television licences.*
- *Establishment and maintenance of cemeteries, burial grounds and homes for the destitute or infirm.*
- *Licensing of bicycles, trucks (other than mechanically propelled trucks), canoes, wheelbarrows and carts.*
- *Establishment, maintenance and regulation of slaughter houses, slaughter slabs, markets, motor parks and public conveniences.*
- *Construction and maintenance of roads, streets, street lightening, drains and other public highways, parks, gardens, open spaces or such public facilities as may be prescribed from time to time by the house of assembly of a state.*
- *Naming of roads and streets and numbering of houses.*
- *Provisions and maintenance of public conveniences, sewage and refuse disposal.*
- *Registration of all births, death and marriages.*
- *Assessment of privately owned houses or tenements for the purpose of levying such rates as may be prescribed by the House of Assembly of a state.*
- *Control and regulation of out-door advertising and hoarding; movement and keeping of pets of all description; shops and kiosks; restaurants, bakeries and other places for sale of food to the public; laundries; licensing, regulation and control of the sale of liquor.*

The functions of a local government council shall include participation of such council in the government of a state as respect the following matters:

- *The provisions and maintenance of primary, adult and vocational education.*
- *The development of agriculture and natural resources other than the exploitation of minerals.*
- *The provision and maintenance of health services and;*
- *Such other functions as may be conferred on a local government council by the House of Assembly of the state.*

In embarking on the listed functions local intervenes in the form of policies and fiscal one in particular. Like many policy actions, fiscal actions are public interventions which have both short and long run effects. In the face of recession for instance, fiscal instruments are deployed to stabilize the macro-economy. The long run impacts of fiscal behaviour are essential to determine the growth of an economy. For instance, capital expenditure on socio-economic (infrastructure) investment enhances capital formation, improves labour efficiency; and amplifies the living standard.

Fiscal policy actions in a federal system allow local government to plan and implement its own policies, so as to ultimately improve the living standard within its jurisdiction. Therefore, these actions, through various channels can ultimately alter the conditions of living in different ways. The impact of fiscal policy on capital formation is crucial in developing economies like Nigeria. Persistent budget deficits could raise interest rates and 'crowd-out' private investment, which might deter the rate of saving and investment from growing sufficiently. This is more important when the economy is at full employment. Besides, theoretical discussion on fiscal policy also shows that it is vital to ensure environmental safety and protection of the vulnerable through social security. Hence the current study sets out an inquiry into the impacts of fiscal actions on the overall well-being at the grassroots.

### **3. Methodology**

The 774 LG areas in Nigeria comprise the population of the study. However, given the purpose of the study, a case study using Osogbo LG of Osun State is employed. Thus the sampling procedure is purposive or convenience. Time series data between 2007 and 2014 were collected on fiscal variables while a structured questionnaire and interview procedures were employed to elicit primary data from residents and Rate Officer of Osogbo LG.

Both the descriptive and inferential statistics were utilized to analyze the data collected. A mini-pilot survey was embarked upon at Ile-Ife to ensure that the research instruments are reliable and valid enough for the purpose of the study. The questionnaire was given to 50 subjects and it contains items on demographic and socio-economic variables, welfare measures, fiscal activity indicators and so on.

Fiscal behaviour is defined as the mobilization of public revenue including taxes, and the spending of the same on social services or public utilities. Welfare is measures as availability and access to basic public utilities within a locality.

### **4. Results and Discussion of Findings**

The primary data were collected from residents in Osogbo LG while the secondary data on revenue and expenditure were sourced from the books of the LG in their secretariat. Also, the rate officer of the LG was interviewed and made some pieces of data available to complement the secondary data. Table 1 provides an overview of the sample. As indicated in the table 1, majority of the respondents were male (52%) and the female (48%). Of the entire sample, there was domination of the single (64%), the married respondents (36%). The occupational distributions, reinforcing the dominance of unmarried individuals, reveal that self-employed (38%) were in the majority. This was followed by students, 34%; and 14% each for civil servant and artisan cadres. Tertiary level trained respondents accounted for 52% of the sample with the remainder being 28% and people with no formal education 2%. The sample is relatively young with 68% below 31 years and 94% below 51 years. Hence, the sample has relatively high level of literate, self employed, young and single characteristics. The implications of these attributes on fiscal action are explored in further analysis.

The actual revenue and the existed fact of what they were able to generate at the end of each year while the actual expenditure is the amount of money they eventually spent on recurrent items and capital projects. The figure above gives the actual revenue and expenditure of Osogbo LG between 2007 and 2013 in million naira. It could be observed that the actual revenue is higher than the actual expenditure over the years, which implies that they have not maximised their spending economically. Revenue and expenditure are both important in every economy because of their functions in the development of an economy.

Government spends in order to; supply goods and services that the private sectors would fail to do such as public good, to improve sectors of the macro economy such as spending on education and training, to improve labour productivity, to reduce the negative effects of such externalities such as pollution control, to subsidized industries (shops and stalls as in the case of LGs) which may need financial support and which is not available from the private sectors. Local government is extremely important in terms of administration of spending. For example, spending on primary health and education is administered locally through local authorities. Using

public spending to stimulate economic activity has been a key option for the successive governments since the 1930s when British economist, Keynes, argued that public spending should be increased when private spending and investment are inadequate.

There are two main sources of revenue to the local governments and according to the data collected from Osogbo LG, they are statutory allocation (SA) and internally generated revenue (IGR). As indicated in tables 4 and 5, the statutory allocation (SA) comprises value added tax (VAT), 10% state internally generated revenue allocation, statutory allocation from the federation account and capital receipts. The internally generated revenue consists of the community service charges, rates, local license, fines and fees, earnings from commercial undertakings, rent on local government properties, interest, payments, dividends and grants, reimbursements and miscellaneous.

Community service charges include service charges, arrears of service charges and electricity/water rates. Rates consists of tenement rates on residential building, commercial building (of companies, banks, petrol stations, etc), schools, hospitals, sawmills, GSM operators-yearly ground rent, arrears of tenement rates and penalties as well as erection of GSM Mast Fee.

Local License Fees and Fines include fees and fines (hackney permit fees for bus/commercial vehicles, motorcycles, taxi permits, liquor license fees, palm-wine tappers/sellers fees, squatters/hawkers permit fees and local government identification), food control fees (slaughter fees, regulated premises fees, auctioneer license fees), and social charges (marriage registration fees, rent from use of local government hall for marriage, entertainment, drumming and blocking of road fees, control of noise permit, naming of street renewal fees, radio/TV show control fees, birth and death registration fees). Others are economic (general contractor registration fees, renewal fees, tender fees, and dredging and quarry fees, registration of associations and clubs, trade license operational fees, mobile advertisement fees, mill and corn grinding license fees, fees from plant and generator on hire), development regulatory service (approval of building plan and layout plan, application fee for plots, lease of residential plots, documents for allocation of plots).

Earnings from commercial undertakings are rents on market stalls at Adenle and Oja-Oba; rent from shopping centres at Fagbesa; motor parks, proceeds from poultry, eggs, fowls, fish ponds, farm produce, earnings from Prime Football Club games. Rents on LG properties include hire charges on plants (grader X25GRS, road roller, tipper, tar boiler) and the interest, payments and dividends include interest repayment, dividends and reimbursements. Miscellaneous revenue includes revenue from tricycles, towing vehicles, payment for underground cables by GSM operators etc. Table 4 shows that local license, fines and fees contributed most greatly to the IGR of Osogbo LG. However the shares of other categories have relatively been low, even to the extent of zero contribution as in the entries for reimbursement over the years study.

According to the rate officer of the Osogbo LG, there is no private or commercial body to reimburse them and that is why the value had been zero for all the years under study. He further claims that

*“The Agriculture Department has not been functioning for some years because there is no fund to operate it. If Agriculture Department alone is well established in the LG and managed effectively and efficiently, it should be able to cater for at least 50% of the people's welfare and also relieve us on depending heavily on the Local License Fees and Fines and also on Statutory Allocations.”*

This implies that the main source of IGR to the LG is from the local license, fines and fees (accounting for about 61 percent of IGR in the entire study period leaving the balance to seven other different sources).

As for the statutory allocation (see Table 5), the share of the state joint account (federation account) appears to be the core source to the LG. Following this is the value added tax and 10% State IGR being the least. Thus the LG largely depends on the statutory allocation from the federation account. By comparison, over the study period, the total IGR is N114, 150, 000 while the total SA is N8, 471, 870, 000, translating to 1.33 and 98.67 percent respectively. So the LG is not self-reliant given its expenditure profile (in particular the recurrent expenditure). Therefore, a negative revenue shock to the economy will seriously hamper the smooth running of the LG.

Omoigui-Okauru (2012) also supports this fact that virtually all States depend on Statutory Allocation concluding that "States of the Federation have potentials to survive on tax revenue if the right parameters are set out for them which would be a sharp contrast to the present arrangement where virtually all state administrations depend on monthly Federal Government handout in the form of Statutory allocations, for the implementation of their capital and recurrent expenditure programs". As shown in table 2, it could therefore be concluded that appropriate parameters be introduced to make tax revenue the mainstay of local government. The table suggests high potential for tax share in the revenue behaviour of the LG. Although the frequency of payment is relatively low, majority (62 percent) of the sample do make high tax payment. Despite the inadequate finances as observed in the IGRs, they have been useful in opening up the rural areas through the provision of good roads, on the average, which facilitated the rural transformation in the state to fair extent.

In addition, Oseni (2013) claims that IGRs were fully maximised before the 1976 LG reforms and that LG's

functions where duly discharged with little or no assistance from the Federal Government. However with the introduction of SAs, after the 1976 reform, the internal generation as a major means of financing local government activities was abandoned in preference to the revenue from the Federation Account.

On the areas of application of revenue of the LG, the completed capital projects in the LG were grouped into three areas: Road, Electricity and Building. Table 5 shows the percentage share of capital projects from the revenue of the LG. It could be seen from the table that Road had highest percentage of the capital project of Osogbo LG. This is followed by Electricity while Building had the least. Projects on road comprises construction of drainage, drainage box culvert, ring culvert, block-wall lines drainage, retaining wall expansion of culvert, rehabilitation of roads, construction and repairs of line drainage, rubble stones, retaining wall and literate filling. On the Electricity, there is extension of electricity and street lights, purchase and installation of transformers, sub-station and commissioning of transformers. Projects in Building group are conversion of existing or uncompleted classrooms blocks to offices of Osogbo LG area, complete re-roofing of Town Planning building and filing of burglary proof. Capital projects are often called infrastructures and it is a long term investment project requiring relatively large amount to acquire, develop, improve and/or maintain.

On the welfare effects of fiscal actions of Osogbo LG, as in Table 3, welfare evaluation was categorized into five socio-economic services such as Road, Health, Building, Education and Water. There is no welfare gain if the mean value is between 2.00 and 2.49 but welfare improves if the mean value is 2.50 and above. This decision rule was based on the option provided in the Section B of the Questionnaire which is coded as follow in the data analysis: Disagree (1), Strongly Disagree (2), Agree (3), Strongly Agree (4).

Water indicator has the lowest mean of 2.32, which implies that on the average, the provision of drinking water for people at the local level seems poor. Road indicator has the mean value of 2.36 which is also poor value for people at the grassroots. Health indicator's mean is 2.49. On the average, there is a slight welfare gain effect on the Building with a mean value of 2.52 while welfare gain is only significant on Education indicator. This is because it has the highest mean value of 2.83 and the probability value of 0.00 ( $p < 0.05$ ). Since the mean value of education alone is above 2.49 and also significant at 0.00 value in the Table 3 above, we conclude that there is welfare gain in education.

This implies that the performance of the LG based on the analysis of the above five indicators is very poor because, of the five variables considered as indicator of welfare listed above, welfare gain could only be achieved through the provision of primary education. The importance of the above indicators for welfare could also be ascertained through human development index (HDI), which measures the economic development and economic welfare. HDI is based on three dimensions which are health (life expectancy, education, and standard of living (income levels)). All the listed dimensions are important for the attainment of economic development and welfare but only education was significant to the revenue and expenditure of our case study and this seems adequate if welfare is to be enhanced.

With regards to the key determinants of the performance of Osogbo LG of Osun State, various factors were identified. According to rate officer of the LG, this factor includes insufficient IGR, political influence, inadequate mobility of resources for the collection of tax and rates (see Table 4), influence of the State over tax collection and so on. This is supported by Oviasuyi, Idada, and Lawrence's (2010) findings. They conclude that LG which is said to be the best institution that can facilitate efficient and effective service delivery at the grass root level are less effective due to the following factors: lack of financial and human capacity, corruption, outright payment of huge sums of monies to political godfathers, as well as recruitment of persons who do not possess the requisite leadership and managerial skills. All of these have made LGs dumping ground for semi-literate or a starting point for political toddlers.

Ojo and Owojori (1998) also identify lack of adequate resources such as vehicles and personnel for mobilising IGR at the LG levels, the potential sources of IGR at each LG are not being adequately tapped and the potential payers of taxes, rates and charges not willing to pay due to biases and other personal reasons, as some of the factors militating against the performance of LGs in Nigeria.

### **Conclusion and Policy implication**

The study empirically investigated the effects of fiscal behavior of the third tier of government in Nigeria; with a view to assessing its performance and identifying possible challenges confronting local authorities' effective service delivery. It is observed that SAs dominate other sources of revenue in LGs. The inability of the residents to properly distinguish State activities from that of Local Government seems a key challenge in assessing the economic performance of LG areas in Nigeria. An attempt to improve grass root development therefore requires sufficient education of the citizens on the functions and jurisdictions of LGs. Besides, the political influence of the State Governments could be reduced to supervisory and possibly coordination so as to allow enhanced grass root participation in LG governance. Hence as to the gains and/or losses of democratic experiences since 1999, there seems to be relatively no significant improvement in LG performance compared to the military regime experienced before 1999. However, the study may be more revealing if another local government in another

State is studied. This attempt would allow comparison of LGs' activities across States.

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Table 1; Socio-demographic characteristics of the respondents

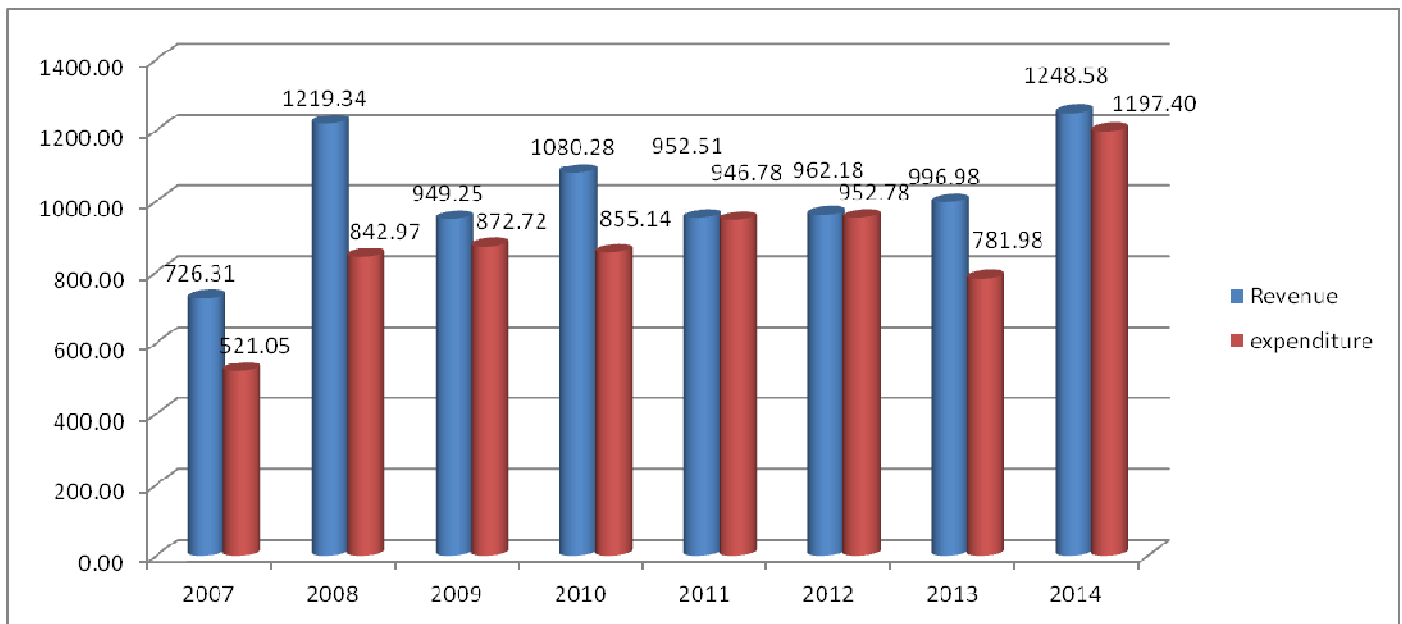
<b>VARIABLE</b>	<b>PERCENT</b>
<b>Gender</b>	
Male	52.0
Female	48.0
<b>Marital status</b>	
Single	64.0
Married	36.0
<b>Occupation</b>	
Civil servant	14.0
Self employed	38.0
Artisan	14.0
Student	34.0
<b>Qualification</b>	
No formal education	2.0
SSCE	28.0
OND	24.0
HND	12.0
First degree	16.0
Others	18.0
<b>Age</b>	
≤20 years	18.0
21-30 years	50.0
31-40 years	10.0
41-50 years	16.0
≥51 years	6.0

Source: Authors' computation based on field work

Table 2: Distribution of sample on tax payments and tax schedule

<b>ITEM</b>	<b>PERCENT</b>
<b>Do you pay tax?</b>	
Yes	62.0
No	38.0
<b>Amount paid</b>	
≤N5000	22.6
N501-N1000	29.0
N1001-N2000	6.5
≥N2000	41.9
<b>Tax schedule/frequency</b>	
Daily	3.2
Weekly	6.5
Monthly	48.4
Annually	41

Source: Authors' computation based on survey.



**Figure 1: Actual Revenue and Expenditure of Osogbo Local Government with the y axis representing in N'000 and the x axis in years.**