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States' Fiscal Dependency and Implications on Monetary Management in Nigeria

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Abstract:
This study examines fiscal management by States in Nigeria and its potential to sustain growth and development. The study used secondary data from the Bank's Statistical Bulletin and the Nigeria Bureau of Statistics. Information on monthly allocations to States, internally Generated Revenue, Debt stock, total Revenue, and Total expenditure were used to examine fiscal imbalance in the States. Data were collected on statutory allocations to States by the Federation Account Allocation Committee (FAAC), Internally Generated Revenue (IGR), States' debt stock, capital and recurrent expenditure from the Central Bank of Nigeria (CBN) and the National Bureau of Statistics (NBS).

Descriptive statistics was used to analyze the collected data. The findings from the study indicated that despite a decline in revenue from the statutory allocations, most States in Nigeria were still spending in excess of their revenue. The study recommended that there is need for states to strengthen institutions that would enhance Internally Generated Revenue (IGR) in the states that would engender growth and development.

Key Words: Fiscal Dependency, Monetary Management, Descriptive Statistics, Nigeria.

Jel Code:

1.0 Introduction

Nigeria practices federalism as a system of government, bringing into existence a central government, and sub-national governments, which comprise the 36 state governments and the Federal Capital Territory, as well as 774 local governments. Each tier of government is saddled with constitutional responsibilities that border on provision of public services. The idea of fiscal federalism ensures that the government at various tiers is sovereign in terms of decision making and in the allocation of its resources. The Nigerian federal system achieves its macroeconomic objectives by performing the functions of resource allocation, income distribution, and economic stabilisation between the Federal Government and its units Dang D.Y and Bala A. (2016).

Since the discovery of crude oil in the Niger-Delta region of the country, much of the nation's revenue has been derived from the sale of crude oil and its allied products. Hence, government budgetary allocations are dependent dependent on proceeds from crude oil export and this is one of the major tools for the implementation of fiscal policy initiatives in the country. These proceeds are subsequently allocated to the three tiers of the government on a monthly basis from the federation account. The Revenue Mobilization, Allocation and Fiscal Commission (RMAFC) established in 1999 is responsible for the monitoring of the inflow and outflow of revenue from the Federation Account, review of the revenue sharing formula among other functions. Under the present arrangement, Federal Government share 52.68%, while the States receive 26.72%, the balance (20.60%) accrues to the Local Governments. Apart from the Federal Allocation, internally generated revenue is the other source of funding for the States.

Akintoye I. (2013) pointed out a mismatch between the responsibilities and revenue distribution between the Federal Government and the States. While high-yielding sources of revenue accrue to the Federal Government, the State governments are responsible for substantial and growing expenditures. This requires that State governments develop efficient strategies to drive internal revenue beyond their monthly allocations. This will be very important for sustainable development given the rising cost of running the government and increasing infrastructural deficits in the States (Kiabel and Nwokah, 2009).

However, Nigerian States have struggled with this demand over the years as many have failed to generate enough revenue to match their allocations or surpass it. With the exception of Lagos and Rivers States, no other State has generated enough revenue to match its federal allocation in the last five years. As such, the level of growth and development in many States in Nigeria is very low.

The situation has also been compounded by the fall in the price of crude oil, which is the major source of government revenue, resulting in a decline in the allocation to States and Local Governments. This has become a major problem for States as many of them do not generate enough to meet their proposed expenditures and other obligations. Taxation in the form of employees' Pay As You Earn (P.A.Y.E), road taxes, and levies constitute what should be another main source of government revenue. However, weak tax collection systems have limited the capacity of government at all levels in Nigeria to fully exploit this resource base. Another viable option is the fees charged by Ministries, Departments, and Agencies for the provision of services. This is however dependent on the pace of development of the states.

There has been much analysis on the mismatch between the obligations of the regional governments and the dependent nature of their main revenue source which creates a fiscal imbalance. According to the CBN, an average of 52 percent of the revenue available to the 36 states in the country and the FCT were from the Federation Account between 2011 and 2016, while Internally Generated Revenue (IGR) and Value Added Tax (VAT) accounts for 20 percent and 11 percent respectively. This is an indication of the overdependence of States on federal allocation. This may also act as a disincentive for States to generate sustainable revenue from economic activities within their territories. This lack of incentive has implications for national development and most importantly growth in the non-oil sector of the economy, whose resources are more available to majority of the population.

In addition, State governments are under pressure to win elections and most times engage in ambitious, but costly capital projects from their monthly allocations and borrowings. The decline in the price of crude oil and its revenue implication has weakened the states' capacity to finance these projects from their monthly grants. This is further worsened by the burden of debt servicing of previous debts. Most state governments have therefore struggled to meet their recurrent expenditure obligations. Many of them owe salaries stretching back for months. Although the Federal Government has intervened by providing bail-out funds to mitigate the effect of the current financial crisis ravaging the states, but most states are still struggling to meet their financial obligations. It therefore necessary to carry out in-depth comparative analysis of fiscal dependency among the states to identify the plausible reasons for these fiscal differences and dependence. However, most of the past studies on this subject matter have focused mainly on the fiscal responsibilities of the Federal Government and its relationship with the States and Local Governments. Meanwhile, fiscal prudence among the States represents a very critical element in the life of an economy, especially in its quest for sustainable growth and national prosperity. It is on this premise that we examine the fiscal management by States in Nigeria and its potential to sustain growth and development. The objective is to make recommendations on how the monthly FAAC dependence and the imbalance which has been a subject of discuss in the last few decades. Importantly, there is also the need to strengthen institutions that would by extension enhance Internally Generated Revenue (IGR) in the states so as to boost growth and engender enduring development.

Following the introduction is section two. Section three analyses the methodology, while section four dwells on results and discussion, while section five provides the conclusion and policy recommendations.

2.0 Literature Review and Conceptual Framework

The essence of federalism, wherever it is practiced is to contain the spatial and cultural differences existing among the component units of Federation. The creation of the Federation of Nigeria was directed at finding a constitutional solution to the socio-spatial dynamics in the distribution of our natural resources to engender development. The country continued the search for a solution to accommodate the diversities within the spectrum of a unified and integrated Nigeria. In 1914, the Northern and Southern Protectorates of Nigeria were amalgamated. From the three regions in 1954 the fourth region was carved out of the existing three regions in 1962 - the Midwest Region. From twelve states in 1967, nineteen states were created in 1979, twenty-one in 1987, thirty in 1991, and later thirty-six in 1996. The rapid increase in the number of states in Nigeria' has been posing financial and basic administrative problems for the newer states as many find it difficult to maintain fiscal balance in any given year. The individual capacity of each state to raise revenue has been constrained by weak administrative skills, and a low level of economic activities. Therefore, finding enough revenue to satisfy the development plans has proved difficult for quite a number of states and has also resulted in

weakening the political and economic power of these states.

The ultimate implication of this situation on the fiscal position of the states is an increase in the demand for federal revenue to fund states recurrent expenditure as well as other development projects. Apart from this obvious dependence of state governments on the Federal Government, spatial differences in resource distribution appear to have some effect on the relative weight of dependency. Another issue that has been in the front burner in the past decades is the full dependence by all the tiers of government on one revenue source which is centrally collected and disbursed (monthly FAAC), most states, especially local government can have little or nothing without the allocation. Another notable development in Nigeria's sharing formula is that whenever revenue and new taxes are realised, the Federal Government would always assume larger share or jurisdiction, especially when viewed from the horizontal and vertical transfers.

Currently there is scanty literature on fiscal management of States and its capacity to sustain growth and development. Most of the studies focused on the impact of fiscal federalism on national economic growth. Dang D.Y (2013) examined the impact of revenue allocation on economic development in Nigeria and found out that revenue allocations to the Federal, State, and the Local Governments have a causal relationship with economic development in Nigeria. The study further showed that revenue allocation to States has a negative relationship with growth.

Martinez-Vazquez and McNab (2002) also observed that in developing countries, the allocation of revenue significantly reduces the growth of real GDP per capita. Yilmaz (2000) went further with a comparative analysis of unitary systems of government with the federal systems. Findings from the study indicated that decentralisation results in growth of real GDP per capita in the unitary countries while it is insignificant in the growth of real GDP per capita in federal countries.

In an attempt to establish the effect of the monthly allocation on the socio-economic development in the States, Emengini and Anere (2010) discovered that the monthly allocation has no significant influence on socio-economic development in the States. It only fueled political lobbies for State creation by ethnic minorities across the country as they are disenchanted with the fiscal arrangement in their respective States. The study noted that the effectiveness of revenue mobilisation process is independent on the system of government rather than the effectiveness of the implementation process.

Olowolaju *et. al*. (2014) used regression analysis to show how statutory allocation influences economic performance of Ekiti State, Nigeria. The results from the study revealed that internally generated revenue is not a significant contributor to GDP. Statutory allocation, on the other hand, positively influenced the Gross Domestic Product.

Gabriel and Charles (2015) showed that the Federal Government allocation share and the State Governments' internally generated revenue both have positive and significant relationship with growth, while State governments' monthly allocation has a negative and significant impact on growth.

According to Eyraud and Lusinyan (2012), the combination of vertical and horizontal imbalances is damaging to fiscal outcomes. Ezeabasili *et. al*. (2012) also found evidence that fiscal deficit affects economic growth negatively. A 1 percent increase in fiscal deficit reduces economic growth by about 0.023 percent. Also, there is a strong negative association between government consumption expenditure and economic growth. The conclusion from the review of literature is that most studies have focused more on how fiscal allocation among the three tiers of government affects growth at the national level. It is, however, of more importance to examine its impact on the economic fortunes of the states.

Romanus, O. O., & Monday, O. C. (2014) examined the Nigerian fiscal structure and the challenges facing the Revenue Mobilisation, Allocation and Fiscal Commission (RMAFC) in determining an acceptable revenue sharing formula. It also inquired into the revenue generation efforts of the three tiers of government and how the application of true fiscal federalism will boost the Internally Generated Revenue (IGR) which will lead to rapid economic growth and development. The paper employed descriptive survey with secondary method of data collection. Findings revealed near total dependence on the revenue from the Federation Account among the three tiers of government and total abandonment of internal revenue generation efforts. The neglect of IGR efforts have been seen to be responsible for the slow economic growth in the country as revealed by the study.

In the same vein, Ezeabasili, V., & Herbert, W. (2013) analysed the imperatives of Fiscal Responsibility Act. It drew some lessons from Brazil and situated these lessons in Nigeria. The paper explored some theoretical issues surrounding fiscal responsibility in an economy. Major features and similarities of the fiscal responsibility laws in Nigeria and Brazil were highlighted. Some of the fundamental flaws in Nigeria's democracy that impede economic development, as well as, the imperatives of the fiscal

responsibly law in Nigeria were analyzed. The paper concluded that strict adherence to the new fiscal policy law is bound to promote macroeconomic stability in Nigeria.

Babatunde, S. A. (2018) investigated government spending on infrastructure in Nigeria from 1980 to 2016 with the use of both primary and secondary data. The secondary data comprised reported annual spendings on selected infrastructure and annual Gross Domestic Products for Nigeria. Weighted least square was used to test the sample of 37-year annual time series data using vector error correction model. For the primary data, a sample of 242 respondents was utilised for the study. The data analysis was done with descriptive statistics. Findings from the study indicated that government spending on transport and communication, education and health infrastructure had significant effects on economic growth, while spendings on agriculture and natural resources infrastructure recorded a significant inverse effect on economic growth in Nigeria. An element of fiscal illusion was observed in the government spending on agriculture and natural resources indicating that government is not contributing as much as the private sector in spendings on agriculture and natural resources infrastructure in Nigeria.

Nwoba, M. O. E. (2015) examined the fiscal crisis and its impact on the local government Administration in South Eastern Nigeria with descriptive analysis. The study was deemed necessary because of the need for the local government Administrators to be alive to their responsibilities and challenges. The specific objectives of the study were to determine the viability of local government internal revenue and identify the relationship between inadequate tax jurisdiction and the rate of corruption noticed in the local government Administration in South Eastern Nigeria. The study adopted the theory of fiscal federalism as its theoretical framework and stratified sampling technique and simplified random sampling techniques. The outcomes revealed that the internal generation revenue source of local government in south Eastern Nigeria was not viable and the non-specification of local government revenue jurisdiction encourages corruption in the system. The implication of the above findings is inadequate delivery of services by the councils which hampered effective local government administration in the review period.

Ojide, M., & Charles, O. (2014) examined growth evidence of the Federal Government allocation share, state governments' allocation share, and state governments' internally generated revenue in Nigeria from 1970 to 2009. Dynamic Model and Correlation methods were used with aggregate annual data obtained from the Central Bank of Nigeria and Statistical Bulletin. The results revealed that at 5 percent level of significant, the regression result showed that allocations to the federal government (FGAS), allocations to the state governments (SGAS) and state governments' internally generated revenue (SIGR) significantly impact growth. However, while allocations to the Federal Government (FGAS) and state governments' internally generated revenue (SIGR) impacted on positively on growth, allocations to the state governments (SGAS) had negative impact. In addition, civilian administration as against military rule, has led to about 0.35 percent increase in growth vis-à-vis the management of Federation Account.

Oyeleke, O. J., & Ajilore, O. T. (2014) investigated the sustainability of fiscal policy in Nigeria over the period of 1980-2010 to determine whether or not the government has violated intertemporal government budget constraint. Using error correction method of analysis, the study revealed that fiscal policy was weakly sustainable in the economy of Nigeria in the review period.

2.1 The Concept of Inter-governmental Fiscal Relations

The concept of inter-governmental fiscal relations is an integral part of fiscal federalism. Inter-governmental fiscal relations are concerned with issues ranging from tax jurisdiction, to the allocation of revenue accruing to common accounts and component units of government within a federation.

Understanding intergovernmental fiscal relations requires some knowledge of inter-governmental functions, the constitutional tax power of different tiers of government and the appropriation of revenue in the collective (federation) account.

Federalism is generally concerned with the decentralization of government functions from the central (federal) government to other component units of government (ie, the states and the local governments). This naturally results in decentralization of the fiscal system, which is the idea embedded in fiscal federalism: that is, the existence within one country of different expenditure responsibilities and taxing powers among the different levels of government that constitute the federation. Fiscal federalism, therefore, is an all-embracing concept that explains the fiscal activities that take place within a federation. Inter-governmental fiscal relations, on the other hand, refer to the fiscal transactions and coordinating arrangements among the various tiers of government in a federation (Musgrave and Musgrave, 1989).

Inter-governmental fiscal relations involves the balancing of fiscal responsibility with the revenue collection powers of the different levels of government within the Federation. The allocation of responsibilities among the different units of government is normally handled by the constitution.

In Nigeria, the list of responsibilities is stated in the constitution. Basically, there are three lists: the exclusive list of responsibilities, the concurrent list and the residual list. The exclusive list comprised responsibilities which are funded 'exclusively' by the Federal Government; the concurrent list consists of responsibilities shared by both the Federal and state governments; and the residual list is the sole responsibility of the state. The residual list comprise those responsibilities that are not in the first two lists and are not assigned to the local governments.

Issues concerning functions and responsibilities, and the allocation of tax powers to different tiers of government have been variously discussed in detail by Mbanefoh (1993) and Anyanwu (2011). Apart from their discourse, a number of observations about the allocation of responsibilities and tax powers are pertinent. First, the distribution of responsibilities and tax powers usually take into account the effects of such allocation on the general ease of system control and on policy interaction. That is why the local governments are responsible for rates and fees levied on people and activities at the grassroots level. Similarly, for economy of administration, almost all personal income taxes are levied by the state government. The Federal Government, because of its ability to ensure compliance, is vested with the power to collect company income tax.

Second, in allocating responsibilities and tax collection powers, there must be a balance between the principles of efficiency and equity among the tiers of government. Efficiency principles relate to the minimisation of cost in the administration of tax/revenue collection by the different tiers of government, while equity demands an alignment of revenue powers with fiscal responsibilities (Mbanefoh, 1993). In the real world, the issue of balancing responsibilities with tax power has to do with the balance between fiscal concentration and efficiency. There are usually some trade-offs between efficiency and equity in fiscal practices.

The Federal Government, by reason of more robust structure and instrument of state powers may be more efficient at tax collection and administration. The temptation is thus, to concentrate fiscal powers in the Federal Government. The lower levels of government, however, have to begin from somewhere to attain fiscal efficiency and independence (Mbanefoh, 1999). In a developing country like Nigeria with various factors warranting inefficiency, it is only reasonable to highlight the need for fiscal independence without disparaging the esteem of efficiency.

Another issue with the analysis of inter-governmental fiscal relations is revenue allocation among the different units of government. Revenue allocation denotes the consignment of revenue to the different sectors (horizontal allocation) and to different units of government (vertical allocation). Revenue allocation has been discussed extensively with respect to fiscal federalism in Nigeria. Some of the conclusions include: excessive fiscal concentration and control (over 70 per cent) at the Federal level, due to the prolonged impact of military rule (Akpan, 1999). With respect to the horizontal allocation of revenue among states, the various criteria used are controversial, even among scholars in Nigeria. Revenue allocation controversial because of lack of general acceptance of the revenue allocation formulae, which has been adopted in the country. Those states with a rich revenue base are insisting on an allocation formula based on derivation, those with a poor revenue base have insisted on using the principles of equity, population and land mass in the allocation (Mbanefoh, 1999). The allocation formulae is unacceptable to many Nigerians because of its 'exclusive reliance on political rather than efficiency factors as indices for revenue allocation. This has been the fundamental cause of the increasing dependency of the state and local governments on statutory allocation from the federal government. The proliferation of states has reduced the size and capacity of the new states and made them inherently weak and excessively dependent on fiscal subventions from the Federal Government. Shiyanbade, B. W. (2017) was critical of the impact of state creation on political power and resource capability. He warned that the existence of numerous weak states is dangerous in that it erodes the influence, which the states would have on checking the Federal Government excesses. What does the constitution say about the responsibilities on both the concurrent and exclusive list? I think the argument should be made about fiscal federalism with fiscal responsibility).

2.2 States Fiscal Imbalance and Implications on Monetary Policy

2.2.1 Monthly Federal Account Allocations Committee (FAAC): The injection from the monthly allocation through the Federal Account Allocation Committee (FAAC) into the economy without a corresponding instrument at the disposal of monetary authority (CBN) to mop-up the liquidity is worrisome. This has several implications to the price stability mandate of the Bank. The global financial crisis that ravaged the whole world in 2008-2009 invoked heated debate on the appropriateness of

the use of financing/bailout in fighting recessions. Policy makers have continued to argue the rationale behind borrowing and the combination of monetary and fiscal policy in fighting recessions and this has persistently be a reoccurring debate. In Japan, North America and Europe the contentious argument has been how to counter a large recession brought on by an unprecedented fall in private consumption and investment spending. During this period, policy makers in almost all the countries resorted to reduced interest rates. By mid-2009, most central banks' policy rates were close to their minimum feasible levels.

In Nigeria, the Monetary Policy Rate (MPR) directly influences the interest rates at which businesses can obtain debt financing. Therefore, the sale of government securities (Treasury bills) by the CBN decreases the money supply in the whole economy, leading to higher interest rates. Central banks have turned to expansionary fiscal policies as it was agreed to have the ability to further lower interest rates. At the municipal level, literature argues that government spending may be very effective in such environments as it has a critical element of the stimulus packages, especially the use of deficit financing and tax reductions.

To ensure the sanctity of the financial system, Nigeria equally took some measures which included a lot of qualitative and quantitative easing aimed at ameliorating the severity of the crisis on the nation's financial sector. The efforts also resulted in to the slash of CRR from 5.0 percent to 1.0 per cent, liquidity ratio from 40.0 per cent to 30.0 per cent and all FGN bonds traded in the secondary market qualified as eligible instruments for computation of Liquidity Ratio. Tenor of repo at CBN window expanded from 1-7 days to 1-360 days, the up country and local cheques clearing circle were reduced to T+2 days, Discount Houses were allowed to undertake other financial services outside trading in government securities to which they were hitherto restricted to among others. During this period, the MPR was set at 9.50 per cent and remained in force till April, 2008 when the MPC increased it to 10.0 and 10.25 per cent in April and June 2008, respectively. Thereafter, the MPR assumed a downward trend of 9.75, 8.0 and 6.0 per cent in September 2008, April 2009, and July, 2009 respectively. The stance of Monetary Policy has been contractionary standing at 14.0 per cent since 2015 till date.

However, in March, 2016, the oil price crashed to $39.07 per barrel, representing 30.0 per cent lower compared with the level in the corresponding period of 2015. This reduced the Gross revenue allocation shared at the FAAC monthly meeting to N306, 08,757.53 billion, compared with N720, 83 billion in the corresponding period of 2014.

Thus, the FGN took some fiscal measures, including the enforcement of Treasury Single Account, zero-based budget and creation of the ministry of national planning and budget, removal of subsidy on petroleum products, among others aimed at introducing a measure of sanity into the Nation's budgetary system.

The short fall in oil proceeds and the tight monetary policy stance led to the shrinking revenue positions of MDAs. It was on record that at end -December 2015, out of the 36 states of the Federation 22 were in payment of salary arrears to their civil servants between 6 – 8 months. In that regard, the FGN through the CBN embarked on palliatives measure to the states to cushion the effects of the dwindling revenue to the Federation Account:

- The Bank gave 31 states 415.59 billion from the accumulated CRR Arrears domiciled with CBN; and
- The Bank also gave N538.115 billion to 35 states as conditional budget facility with the exception of Lagos.

The bailout fund approved by the Federal Government to assist state governments to pay the arrears of their civil servants has continued to draw criticism especially the monetary policy authority.

2.2.2 The Gravity of State Governments' Indebtedness

States debt, which can be either internal or external, arises when such government borrows to offset its deficits or for the development of its economy. Such debt are incurred by the state through borrowing from the domestic or international markets so as to finance its domestic obligations for its citizenry. It is the resource use at that level, which is not contributed by its owner and does not in any other way belong to them. States debts may be classified into reproductive and dead weight. It is reproductive when the borrowed fund is used to finance some kind of capital projects such as electricity, road, factories, refineries among others. On the other hand, a debt is termed as dead weight, where such is used to finance wars and other recurrent expenditures. The sources of state debt include: the money creation processes by the CBN called Ways and Means. This can be used by the state government to fund budgetary gap. That is why the amended Act of the CBN 2007 stipulated that "the government should not be allowed to borrow more than 5.0 per cent of it previous year actual total revenue".

In specific terms, the 36 states of the Federation and the Federal Capital Territory have been facing serious fiscal challenges as a result of their rising debt profiles. According to data available from the National Bureau of Statistics, Nigeria's total foreign and domestic debt stock at end June 2017 stood at US$15.05 billion and 14.06 trillion respectively. A further breakdown showed that State Governments' debt accounted for about 26 per cent and 21.34 per cent of the country's total foreign debt and domestic debt stock, respectively. This showed that a significant proportion of the country's total debt stock was accumulated by the 36 states of the Federation and the Federal Capital Territory.

In terms of foreign debt stock, Lagos state accumulated the highest with about 37 per cent of the total, followed by Kaduna, Edo, Cross River and Ogun states which accounted for 6, 5, 4 and 3 per cent of the total foreign debt among the 36 states and the FCT respectively. Also, among the 36 states of the Federation and the FCT, Lagos state accounted for the highest proportion of domestic debt stock with 10.39 per cent followed by Delta, Akwa Ibom, and the FCT with 10.39, 8.04, 5.185 and 5.09 per cent, respectively.

As a result of low internally generated revenue collections and federal allocations, State governments have in recent times found it difficult to pay pension, salaries and their contractors which have added to their debt profiles.

Despite the efforts of the Federal Government's efforts to bail out states, so that they can pay the backlog of salaries and pension, arrears, many have failed to utilize the funds for such purpose. Delta State government have about N38.00 billion of unpaid pension while Kebbi state still owes its pensioners a total of N9.90 billion. The Oyo state government owes 41.00 billion to three different categories of pensioners who are the state government pensioners, local government pensioners and primary school teachers. Kano State government pension arrears stood at 11.20 billion at end July 2017.

Similarly, Abia, Anambra, Bauchi, Benue, Borno, Cross River, Edo, Enugu, Ebonyi and Gombe State Governments are yet to clear the backlog of their worker salaries. At end- September 2017, Edo state owed workers between 5 and 10 months, while Benue State owed between 6 and 10 months in salaries. Ondo State government have also a backlog of 5 months arrears yet to be paid, while Nassarawa State owed 9 month workers' wages.

2.2.3 Implications on Monetary Policy Management

Monetary policy and its management is aimed at controlling money supply and the level, as well as structure of interest rates and other factors affecting the availability of domestic credit. The achievement of price and financial system stability objectives of central banks are primarily anchored on liquidity management. The Central Bank owe it as a duty and part of their day-to-day duty to determine optimum liquidity consistent with stability objective for the economy. Fundamentally, an efficient liquidity management serves to foster confidence in the financial system as well as mitigate systemic risk in the entire economy. Stability is achieved in an environment of appropriate liquidity management to mitigate any eventual market failures. The question that occupies the minds of policy makers is whether or not the monetary policy authority has the necessary instruments –besides the traditional treasury bills, FGN bills that the Bank uses at its bi-weekly liquidity mop-up /Open Market Operations (OMO) auction.

When states get the bailout funds, it is expected that the proceeds would enter the monetary system as money in circulation thereby increasing the amount of money in the system. This expansionary tendency lowers interest rates and attract business and personal borrowing because the cost of borrowing is less expensive. As this happens, businesses are expected to borrow to finance new plant and equipment, new hires and expanded their inventory. In the same vein, individuals have the ability to borrow to finance, purchases of homes, cars, appliances, clothing and vacations. At the state levels therefore, businesses would expand and there would also be increased consumer purchases which would results in more business activity, which in turn results in more employment.

Commentators on public policy have equally opined that states fiscal liquidity is pro-cyclical in nature. This is because, they respond to the erosion of illiquidity when they are starved from the federal monthly allocation. Assuming states had used monthly allocation for investment or borrow more from the market, and then the proceeds would in turn raises the asset's price and further strengthens the balance sheets. If states were buoyant – have saved during boom era, one way to avert recourse to monetary authority for bailout is to sell some assets, then use the proceeds to pay down debt. Thus, a fall in the price of the asset can lead to an increase in the supply of the asset, overturning the normal supply response to a drop in asset price. During downturns, the mechanism works in reverse. In a situation when asset prices decline especially following the 2007/08 global crisis, if the states have invested in equity market, then, the net worth of states/institutions will fall faster than the rate at which their assets decrease in value. As the states/institutions' balance sheets weakens, their leverage for bailout will increase. Weaker balance sheets of states will lead to greater

sales of their asset (if any), and this outcome in turn depresses the asset's price and leads to even weaker balance sheets. But weaker balance sheets will kick off another cycle of selling and price declines. Overall, when monetary policy is “loose” relative to macroeconomic fundamentals, central bank expands their balance sheets through collateralised borrowing; as a consequence, the supply of liquidity increases. Conversely, when monetary policy is “tight,” institutions shrink their balance sheets, reducing the stock of repos and the overall supply of liquidity.

Milton Friedman in 1969, was of the view that monetary policy affects output at least in part, especially through its impact on the supply of loans to firms. During a recession, central banks that are charged with the responsibility of regulating the nation's economy adds money to the system to make credit more easily available. Easy credit results in greater economic activity as businesses and individuals borrow to finance purchases and operations. This is called the liquidity effect in economics. This expansionary monetary policy affects three macro-economic variables of the: interest rates, income and inflation.

When viewed from interest perspectives, when the Central Bank adds money to the system through its open market operations, which involve open market purchases of Treasury securities, such as treasury bills, notes and bonds. Through bailout funds CBN injects money with short term interest. This maintains liquidity in the Government capital market by helping bank and brokerage house bond trading desks to carry inventory of bonds for their trading activities. When there is liquidity in the system, interest rates would go down. Secondly, when business activity increases, companies hire more employees. As the demand for new employees grows, the supply of available workers diminishes and companies must pay higher wages to attract the best employees, so average income rises. As consumers take advantage of low interest rates to buy houses, prices of those houses rise because of the increased demand. Homeowners experience increased income as their houses appreciate in value, and they refinance to secure lower mortgage rates or sell the houses to take a profit. This also adds to the average income. The result of higher average income is more money in the system and even greater liquidity.

Thirdly, as more money comes into the system through the bailout funds, it tends to cause inflation. Many people think inflation comes from higher prices, but this is incorrect. Inflation refers to an inflation of the money supply. As there are more Naira chasing a finite supply of goods and services, the prices of those goods and services will rise as consumers have more liquidity at their disposal thus, increasing their ability to acquire the goods and services they desire. The liquidity effect on monetary management is that when the central banks pursues a tight monetary policy, it takes money out of the system by selling Treasury securities and raising the reserve requirement at banks. This raises interest rates because the demand for credit is so high that lenders price their loans higher to take advantage of the demand. Tight money and high interest rates tend to slow economic activity and could lead to recession. During periods of tight money, companies terminate employees and consumers cut back on their spending. Prices will decline as fewer people are able to afford the boom time prices. So, low liquidity has the opposite effect on the economy from high liquidity.

3.0 Methodology

This study collected data on statutory allocations to States by the Federation Account Allocation Committee (FAAC), Internally Generated Revenue (IGR), States' debt stock, capital and recurrent expenditure from the central bank of Nigeria (CBN) and the National Bureau of Statistics (NBS). Descriptive statistics was adopted to analyse the collected data because of the nature of the study. This investigation is limited by availability of data on the finances of States in Nigeria, especially as most of them do not have transparent accounting systems. There is lack of data on States' Gross Domestic Product, not even by the National Bureau of Statistics. Therefore, we attempt to proxy development using the States' Human Development Indices as reported by the United Nations Development Programme (UNDP). This is because of the central role of infrastructure in promoting socioeconomic development. Moreover, human development encompasses both social and economic dimensions of development. An increase in internally generated funds to complement statutory allocations from the National Treasury should translate into increased income for its citizens, employment and productivity gains, amongst others. We therefore explored the relationship between the States' IGR per capita and Human Development Indices (HDI) in the respective States.

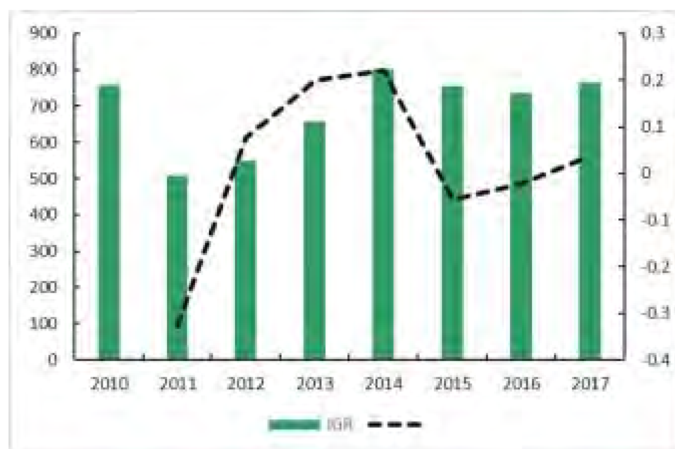
4.0 Results and Discussion

4.1 States' Internally Generated Revenue (IGR)

The total annual amount of internally generated revenue between 2010 and 2017 is shown in Figure 1. The movement of internally generated revenue by States has been in tandem with the general macroeconomic environment. The year 2014 marked the beginning of a tumultuous period for oil dependent countries like Nigeria as oil prices came tumbling down, the result of which was the

economic recession in the country. At the peak of the oil boom, IGR grew by 19.86 per cent and 21.96 per cent in 2013 and 2014 respectively. By 2015 however, States' IGR recorded a huge decline, falling from 801.29billion in 2014 to 755.75billion in 2015, representing a 27 per cent decline in growth rates. The slight improvement on the states IGR recorded in 2017 was occasioned by the need to reduce dependency on the central source for revenue as a result of dwindling oil fortune.

Figure 1: Internally Generated Revenue of States
Source: Central bank of Nigeria, National Bureau of Statistics (2017)

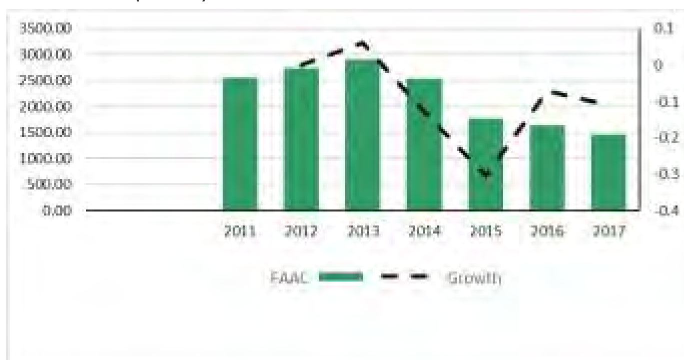


4.2 Statutory Allocations to States

The effect of the fall in oil prices is also clearly reflected in the allocation to States (see Figure 2). Prior to the oil price bust, the allocation to States was trending upwards. However, with the sharp decline in oil prices, allocation to States took a sharp decline too. Governments at all levels had to take a pay-cut as oil revenue shrunk.

In light of the reduction in allocations from the Federation Account, States were forced to become fiscally responsible and took adequate steps towards effective fiscal management. The significant reduction in statutory allocations to sub-national units exposed States' huge dependence on federal allocations. It became evidently clear that almost all states in the country had become lax in their revenue generation efforts and had become totally reliant on these allocations to run their activities.

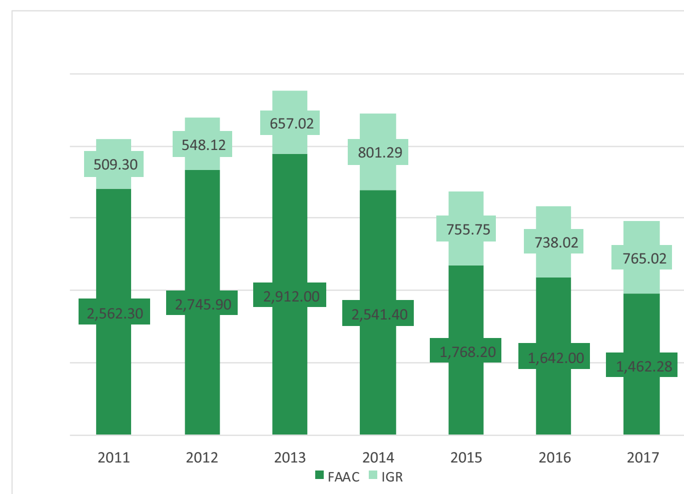
Figure 2: Monthly Statutory Allocations 2011-2017
Source: Central bank of Nigeria, National Bureau of Statistics (2017)



4.3 Statutory Allocation and Internally Generated Revenue (IGR)

The monthly statutory allocation to States and the internally generated revenue (IGR) in billions of naira between 2011 and 2017 are shown in Figure 3. From the graph, there was a steady rise in statutory allocations between 2011 and 2013. This period coincided with periods of high crude oil prices. During this period, statutory allocation to States rose by 13.65 per cent. However, in 2014 when the global price of crude oil took a plunge, statutory allocation declined by 12.73 per cent, and as at end of 2016, it had declined by 43.61 per cent from the value in 2013. By contrast, internally generated revenue only rose by a moderate 12.33 per cent level in the same corresponding period. The result of this weakened financial position is the struggle by most States in the Federation to meet their financial obligations, hence the rampant incidences of unpaid salaries and inability to complete ongoing capital projects in their respective jurisdictions.

Figure 3: States' FAAC Allocations and IGR
Source: Central bank of Nigeria, National Bureau of Statistics (2017)

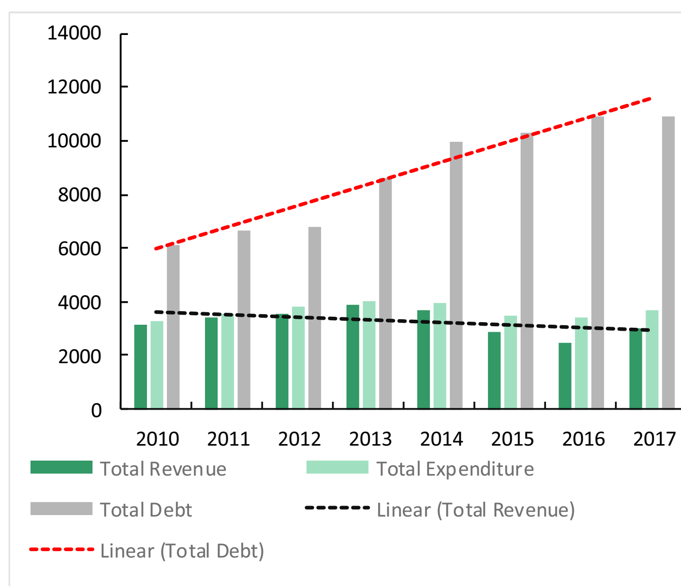


4.4 Total Revenue, Total Expenditure, and Total Debt

The difference between the total revenue and total expenditure is a measure of the fiscal imbalance in the States. Figure 4 presents the States total revenue, expenditure, and debt between 2010 and 2017. While total revenue and total expenditure rose at an annual average of 7 per cent between 2010 and 2013, total debt rose faster, at an annual average of 13 per cent. Also, from 2014 to 2016, the total revenue declined by 32.69 per cent as oil revenue shrunk as a result of the crash in oil prices. Total expenditure also declined on aggregate by 13.65 per cent below the same period. Total debt, however, rose sharply by 9 per cent over 9.99trn between 2014 and 2016. There exists a widening fiscal deficit among the States of the federation and this has been growing at an annual average of 7 per cent since 2010. This trend is not sustainable for growth and development in the States and the national economy in general. Also, the rising debt stock in the face of dwindling revenue to service these debts portends grave economic implications for many States in the near and medium-term. To reverse this trend, State governments will have to be more aggressive and efficient in widening their tax base especially the informal sector to improve on their IGR over which they have more control.

Figure 4: Total Revenue, Total Debt, and Total Expenditure

Source: Central bank of Nigeria, National Bureau of Statistics (2017)



4.5 Total Revenue to Total Expenditure

Table 1 below shows ratio of total revenue to total expenditure and total revenue to total debt. These ratios serve as indicators of fiscal imbalance and poor fiscal management in many States across Nigeria. From Table 1, it is clear that fiscal deficit of the States has been widening in the last 7 years. The States have been consistent in spending in excess of their revenue. The analysis also reveals the shrinking share of total revenue relative to total debt. The implication of this is reflected in much weakened ability to meet basic financial obligations such as salary payment given the burden of debt servicing. As stated earlier, states have taken a relaxed approach towards the internal generation of revenue. With the exception of Lagos State and Rivers State, others have struggled in generating enough revenue to match the allocations from the Federal government or even surpass that which accrues to them from the Federation Account.

Table 1: Total Revenue to Total Expenditure and Total Debt

Year	Total Revenue/Total Expenditure	Total Revenue/Total Debt
2010	0.9683	0.0052
2011	0.9628	0.0051
2012	0.9292	0.0053
2013	0.9651	0.0045
2014	0.9219	0.0037
2015	0.8241	0.0028
2016	0.7187	0.0023
2017	0.8081	0.0237

Source: Central bank of Nigeria, National Bureau of Statistics (2017)

Table 2 below shows descriptive statistics of variables considered in this study. The State Governments recorded their highest revenue, IGR and expenditure when oil prices were at peak levels. However, following the crisis in the crude oil market in 2014, debt levels were at their highest when oil prices were bottoming out.

	Total Revenue	Total Expenditure	Total Debt	IGR	FAAC
Average	3,293.34	3,655.90	4,830.56	681.06	1,450.62
Max	3,905.38	4,046.80	10943.71	801.29	2,912.00
Min	2,471.81	3,266.23	6,113.15	509.30	1462.28

4.6 IGR per capita and Human Development Index (HDI)

IGR per capita was calculated as the ratio of a State's internally generated revenue (IGR) in 2016 by the corresponding population of the State, as projected by the National Bureau of Statistics. The HDIs of States and their IGR per capita are presented in Tables 3 and 4, respectively. The average IGR per capita of the States was ₦3,151.00, with Lagos State recording the highest IGR at ₦21,530.00, while Borno State generated the least revenue per head (₦428.00). It is therefore not surprising that Lagos State was the most highly ranked State, while Borno State ranked 34th out of the 36 States in the country. This is consistent with expectations that an increase in IGR should translate to more spending on infrastructure and consequently the standard of living of citizens of the State.

Table 3: States' Human Development Index (UNDP)

S/N	State	HDI	Rank	S/N	State	HDI	Rank
1	Lagos	0.672	1		Plateau	0.400	21
2	Bayelsa	0.612	2	20	Nasarawa	0.398	22
3	Delta	0.609	3	21	Rivers	0.388	23
4	Akwa Ibom	0.570	4	22	Kano	0.381	24
5	Ogun	0.539	5	23	Adamawa	0.365	25
6	Imo	0.520	6	24	Ebonyi	0.343	26
7	Edo	0.509	8	25	Taraba	0.332	27
8	Osun	0.494	9	26	Niger	0.326	28
9	Abia	0.492	10	27	Bauchi	0.264	29
10	Ondo	0.477	11	28	Zamfara	0.262	30
11	Oyo	0.477	12	29	Gombe	0.237	31
12	Cross River	0.473	13	30	Katsina	0.236	32
13	Kaduna	0.443	14	31	Kebbi	0.218	33
14	Enugu	0.437	15	32	Borno	0.214	34
15	Ekiti	0.433	16	33	Jigawa	0.197	35
16	Kwara	0.432	17	34	Sokoto	0.194	36
17	Anambra	0.428	18	35	Yobe	0.125	37
18	Kogi	0.406	19	36	FCT	0.511	7
19	Benue	0.404	20	37			

Source: United Nations Development Program (UNDP) (2015).

Table 4: States and IGR per capita

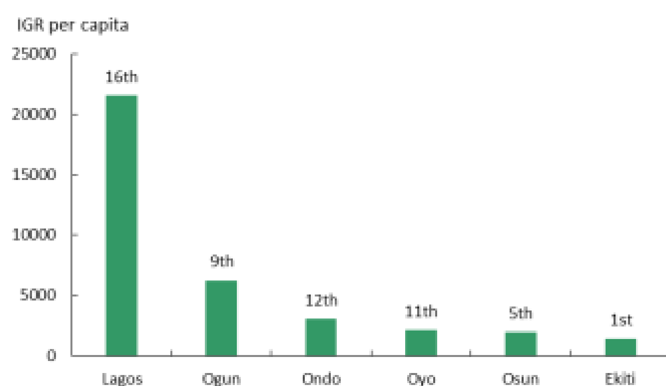
S/N	State	IGR per capita	Rank	S/N	IGR per capita
1	Lagos	21530.21	20	Akwa Ibom	1560.15
2	Rivers	13661.53	21	Gombe	1427.60
3	Taraba	7888.15	22	Ekiti	1416.37
4	Ogun	6252.32	23	Anambra	1405.66
5	Kwara	5476.11	24	Adamawa	1342.16
6	Delta	5415.48	25	Imo	1292.03
7	Edo	5078.46	26	Plateau	1278.27
8	Bayelsa	3602.95	27	Yobe	1149.45
9	Enugu	3227.18	28	Nasarawa	1019.76
10	Cross River	3061.47	29	Benue	1003.09
11	Ondo	3059.45	30	Bauchi	785.55
12	Sokoto	2651.34	31	Niger	777.79
13	Ebonyi	2403.24	32	Kebbi	705.58
14	Abia	2362.35	33	Katsina	630.60
15	Kaduna	2256.67	34	Zamfara	626.43
16	Kogi	2139.07	35	Jigawa	437.46
17	Oyo	2106.34	36	Borno	427.79
18	Kano	2030.40	37	FCT	
19	Osun	1949.04			

Source: National Bureau of Statistics (2017).

4.7 Geopolitical Zones Fiscal Dependence

An examination of this relationship across geopolitical zones in the country also confirmed this expectation although there were a few outliers like Rivers and Sokoto States which had the highest IGR per head in the South-South and North-West zones, respectively, but were the worst ranking States from those regions. This may be due, in part, to the weakness of the HDI as an indicator of efficient public spending, but it is also indicative that other issues bordering on political economy may be responsible for this anomaly. Also, none of the five States, which generated the least revenue, finished higher than 30th based on the HDI rankings. Kebbi, Katsina, Zamfara, Jigawa, and Borno States had the lowest IGR per head and ranked 33rd, 32nd, 30th, 35th, and 34th, respectively. However, of the top ten States that generated the most funds, only 5 ranked in the top 5 of the HDI table (see Table 3). Figures 5-10 show the IGR per capita and HDI of the States across the six geopolitical zones of the country.

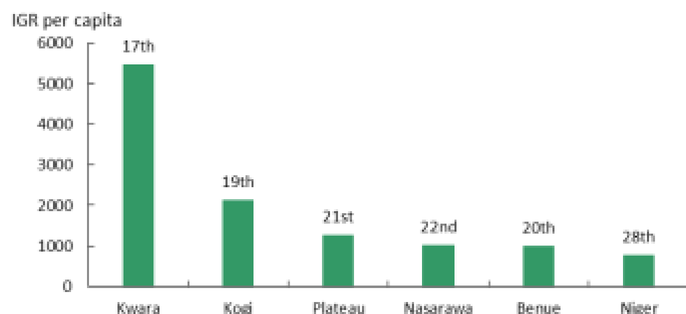
Figure 5: IGR per capita and HDI in the South –West Geopolitical Zone



Source: NBS, UNDP

In figure 5 above, Lagos, Ogun, Ondo, and Oyo States earned more IGR per head and had better human development outcomes accordingly. However, Osun State ranked higher than Ogun, Ondo and Oyo States despite earning significantly less income.

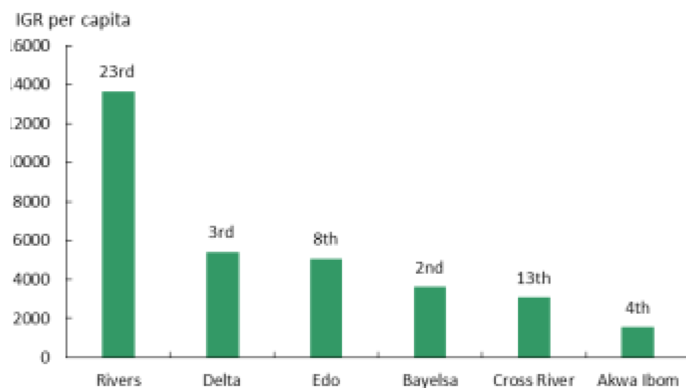
Figure 6: IGR and HDI in the North-Central Geopolitical Zone



Source: NBS, UNDP

In the North-Central geopolitical zone, the same trend can be seen among the States, apart from Benue which had a better human development index having earning a little less than its peers such as Plateau and Nasarawa. States with higher IGR generally fared better in development terms.

Figure 7: IGR per capita and HDI in the South-South Geopolitical Zone

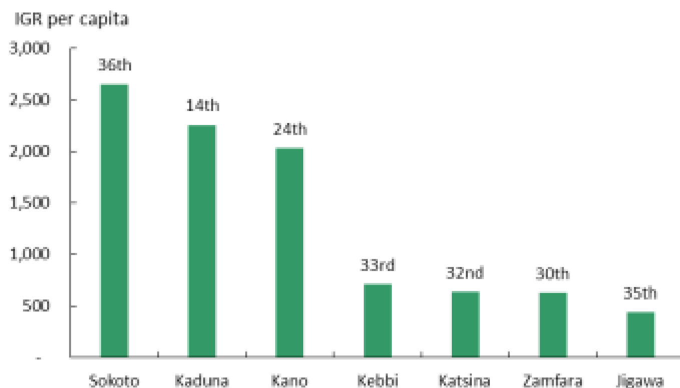


Source: NBS, UNDP

In the South-South zone, Rivers State had the highest internally generated revenue, yet ranked the worst in terms of human development. Akwa Ibom had the least IGR and still performed better than the likes of Rivers and Delta. This is an indication of the limitations of this index as measure of how the IGR of States translate into development in the State. Inferences should therefore be drawn and interpreted with caution.

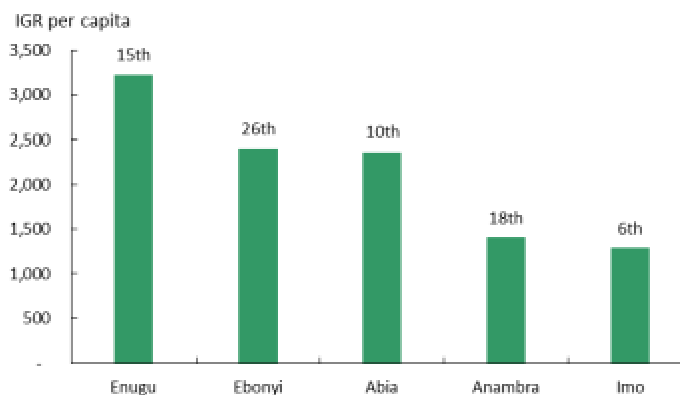
In Figure 8 below, a similar positive relationship is observed between the IGR per capita and the corresponding ranking of a state on the human development index. The States which had the higher IGR ranked higher on the development index, except for Sokoto State, which earned the most, yet ranked the worst. As shown in Figures 9 and 10, there was no consistent pattern between States' IGR and development among States in the South-East and the North East.

Figure 8: IGR per capita and HDI in the North-West Geopolitical Zone



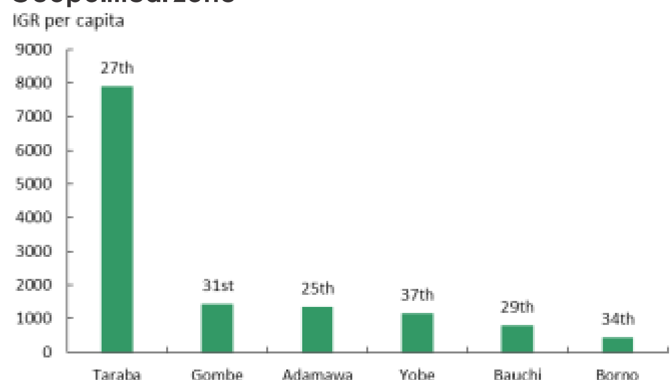
Source: NBS, UNDP

Figure 9: IGR per capita and HDI in the South-East Geopolitical Zone



Source: NBS, UNDP

Figure 10: IGR per capita and HDI in the North-East Geopolitical Zone



Source: NBS, UND

5.0 Conclusion and Recommendations

Fiscal relations between the states and the Federal Government are often described as a one-sided relationship, as the state governments derive over 70 per cent of their budgeted revenue from the Federal Government. Indeed, during the period: 2000-2017, the entire economy depended massively on the oil sector (up to 73.7 per cent) for revenue to finance their fiscal plans (see table 1 above).

The oil sector, or indeed any other sector, does not exist in a vacuum: oil wells are sunk in some states, just as industrial and corporate business activities exist in other states and these activities generate revenue for the Federal Government. The fiscal wealth of the Federal Government is fundamentally dependent on the level of economic exploitation of crude oil in the oil-producing states. The dependency of the states, therefore, on the Federal Government's statutory allocation can be retraced and seen as indirect interstate resource dependency. This dependency is the result of the Federal Government's annexation and exploitation of state resources. Hence, the Federal-state dependency ratio is equal to the ratio of the economy's dependency on oil revenue. It is important that inter-governmental dependency be given a proper anchor on the Federal dependence on states. Importantly, it must be stressed that the burden of this imbalance should be critically looked into in event of any creation of states in Nigeria by successive governments in future. This is because it has weakened the power of states in Nigeria and this situation should be properly debated and analysed in the context of inter-governmental fiscal relations by any successive government.

This study examined fiscal imbalance among States in Nigeria and its implications for fiscal management in these States. The study used secondary data from Statistical Bulletin of the Central Bank of Nigeria and the Nigeria Bureau of Statistics. Information on monthly allocations to States, internally Generated Revenue, Debt level, total Revenue, and Total expenditure were used to examine fiscal imbalance in the States. The data were analysed using descriptive statistics.

The findings from the study indicated that despite a decline in revenue from the statutory allocations, most States in Nigeria were still spending in excess of their revenue. The upward trending in fiscal deficit should be a source of concern given the current dynamics of the global crude oil market. The results of this study also showed that States have not been doing enough in terms of boosting their revenue generation beyond the monthly allocations guaranteed by law. This does not bode well for development both in the States and the national economy in general. As a result, we recommend that State governments should explore alternative sources of revenue, particularly taxation of the informal sector. Mechanisms should be put in place to expand the tax base and other lawful means of jerking up their revenue base. This will boost IGR and allow for a reasonable level of financial dependence that can match the ambition of each State in terms of their deliverables. Also, the success of any aggressive revenue drive will depend on the accountability of the government and prudent use of internally generated revenue.

Ways to Reduce Imbalance between Federal and States

Some of the ways to reduce imbalance and minimise agitations and restructuring currently being canvased across the six geo-political zones of the country include and not limited to the following:

- State governments should initiate incentive programmes that will boost investment in their states. Infrastructural investments by government are one way by which any state can attract investors and so enhance revenue generation opportunities,

- The Federal Government should consciously reduce its tax power and hand over to the states. It is believed that if VAT administration is handled at the state level, more states will become fiscally less dependent on the Federal Government and on oil revenue. However, the regulation of such taxes should be centrally legislated even though the administration is decentralized, and

- The use of the Federal Government power to annex the land resources of states should be discouraged. The Federal Government should only ensure that mining, which is currently on its exclusive list, is carried out according to international requirements for environmental purity and other standards,

Overall, state governments should also provide conducive business environment to attract investments and stimulate economic activities from which they can generate additional revenue. This can also help in the negotiation of public private partnership arrangements, especially in financing developmental projects within their respective States.

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