LOCAL GOVERNMENT FINANCE AND THE CHALLENGES OF GLOBAL ECONOMIC CRISIS

BY

TOMORI M. ADIJOLOLA
lolatomori@yahoo.com

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1.0 INTRODUCTION

As the biggest economic recession in 70 years continues to undermine political support for globalization and threaten the income of more families globally, its negative implications for Nigeria's economy now appear to be incontestable.

According to economic experts, right now, the economy appears stuck with various offshoots of the crisis; shrinking private inflows, weakening naira, nose-diving foreign reserves, and reduced revenues due to plummeting oil prices. If nothing is done urgently to improve the competitiveness of Nigerian industries and diversify the country's revenue base, the ripple effect of the crisis may be difficult to tackle.

Globalization is leading to major restructuring within countries, shifting trade and production away from traditional urban centres towards cities and towns that can demonstrate market advantage. The role of national governments is being refocused to facilitate markets, promote market economic and social stability, and ensure equity. But reforms will not do what is desired for national development until they are adopted and implemented appropriately at the local government level where services essential to individuals and corporate organizations are delivered.

In the present day of economic crisis, local governments have a great role to play in the management of the cities and they have to be equipped with financial, human and technical resources. Moreover, local government budgets should reflect citizens preference for public services.

2.0 OVERVIEW OF LOCAL GOVERNMENT FINANCE:

Urban Local Government finance includes almost all conceivable areas such as **revenue**, **expenditure**, **budgeting** and **financial control**. Within the formal institutional context, Local Governments receive by virtue of the constitution and other legal mechanisms, funds for certain purposes known as transfer. Local Governments however can generate internal revenue locally through direct taxation, fees and user charges. Both sources of funding have different implications on the economy of Local Government.

The ability **to generate internal revenue** implies autonomous fiscal measures and is indicative of the ability of the Local Governments to run its own affairs. However, **inter-governmental transfers** often have as an objective of distribution of resources amongst the Local Governments which, as a general rule, operate in different economic circumstances and have varying taxation possibilities.

Internally generated revenue (IGR), apart from being part of fiscal policy, also enable the Local Government Authority to formulate economic policy, to the extent that the revenues can be used for economic purposes and the Local Government authority can take a stand in that regard.

Local governments are generally assigned expenditure responsibilities for a wide range of services, including roads and transect, water and sewerage services, police and fire protection in some developed countries, solid waste collection and disposal, recreation and culture, land-use-planning, social services, public health and social housing. In many countries, the laws on local governments do not distinguish between large metropolitan areas medium size cities, and towns and villages. This accounts for the funding problems between the rural and urban local government in Nigeria.

"A structure that fails to distinguish between major metropolitan areas and small village makes it difficult to clearly define the functional responsibility of local

government" (Burki, Perry, and Dillinger 1999, P.24). Moreover, the amount of public resources available to different types of local governments is not the same. Larger cities and Metropolitan areas generally have greater capacity to raise revenue.

Whether local governments are likely to be fiscally solvent is as much a function of matching their expenditure obligations with sufficient revenue sources. The type of expenditure responsibilities that rest with local governments should determine in part the revenue sources assigned to local governments in different developing countries with different expenditure assignments.

Table 1: Revenue Assignments for Federal, State and Local Governments in Nigeria

S/No	Federal Taxes	State Taxes	Local Taxes
1.	Company Income Tax (CIT)	Personal Income Tax	Poll Tax
2.	Petroleum Profit Tax	(i) Pay As You Earn	Tenement Rate
3.	Value Added Tax	(ii) Withhold Tax (Individuals)	Licenses Fines and Fees
4.	Education Tax	Capital Game Tax (Individual)	Name of Street Fees
5.	Personal Income Tax in respect of: • The Armed Force • The Police • FCT Residents, Abuja • External Affairs Personnel • Non-Residential	• Markets where State Finances are involve Stamp Duties. • Stamp Duties • Pools Betting and Lotteries • Road Taxes • Business Premises Registration	• Market Fees • Motor Park Fees • Signboard and Advert permit Fees • Building Permits Fess
6.	• Import Duties	• Development Levy	• Radio and Television Licence
7	• Exercise Duties	• Rent on Govt. Property	• Rent on Govt. property
8	• Other Oil Revenue	• Naming of Streets	• Earning on Govt. property
9	• Crude Oil State • Mining parts and royalties • Upstream gas Sales • NLNG gas Sales	• (State Capitals) • Fees on C of O • Other Revenue e.g License, Fines & Fees	• Interest and Dividends on investment
10	• Domestic Crude Sales etc	• Reimbursement Miscellaneous	• Miscellaneous

2.1 Structure of Local Government Revenue Sources

Typically, Local revenue sources are limited and heavily regulated by federal governments. Local governments need more financial autonomy to perform the responsibilities they have been assigned. The principal local revenue sources assigned to local governments in Nigeria and common to local governments all over the world are described below:

2.1.1 Poll or Community Taxes

In Nigeria, poll tax is still a viable tax, especially in rural local governments, where property tax based per capital is very low due to absence of high value property or investments are not pre-dominant. It is currently N20,00 per-head in Oyo State. Even in the United Kingdom where we copied the current tax system, pool tax has been cancelled. Local Governments are currently agitating for increase in poll tax levy due to increase cost of producing receipt booklets and salary of tax officers and enforcement logistics.

2.1.2 Property Tax

Following the British tradition and the constitutional provision in Nigeria, **the word "Rate" is understood to mean a tax for local purpose imposed by the local authorities the bases of which is the annual value of lands and buildings usually arrived at by using rental methods of valuation**. That is, for residential and commercial buildings, the annual value is the Gross Annual Rent it can reasonably be expected to fetch. From the Gross Annual Value a statutory 25% is deducted to arrive at the annual rateable value.

The amount raised by rating is entirely governed by the local government expenditure. It is therefore equitable that as much as possible, every responsible resident should bear his or her share of the expenses incidental to the running of the local government administration, because every derives benefit from the local government services rendered.

Some high revenue yielding rateable property identified in many urban areas of Oyo State, which has not been fully tapped by local governments are:

- Rates on GSM masts
- Banking and other financial institutions
- Rates on industrials property
- Income generating assets like cinema hall, hostels, hotel, restaurant, petrol
- Federal Government property which attracts payment in lieu of tenement rates
- Rates on agro-allied industrial property e.g poultry, fisheries e.t.c
- Residential property on GRA and Government Housing Estates.

Large cities and metropolitan areas are better able to levy property taxes than smaller cities and rural local government because large cities have a larger per capital tax base than small cities or rural areas, where property value are generally low. The table below graphically shows the revenue generating capacity of local governments in Oyo State.

Table 2: Revenue Generating Capacity of Local Governments in Oyo State (2001 – 2005)

S/No	Revenue Item	2001 N : K	2002 N : K	2003 N : K	2004 N : K	2005 N : K
1.	Community Tax	6.13m	4.92m	3.94m	5.29m	5.47m
2.	Tenement Rate	22.36m	22.215m	27.59m	32.44m	64.65m
3.	Fines & Local Licences	82.42m	75.00m	75.43m	92.57m	131.31m
4.	Commercial undertaken	62.92m	28.19m	31.77m	46.08m	80.33m
5.	Rent on Local Govt. Properties	3.10m	2.76m	6.33m	1.74m	5.56m
6.	Interest and Dividends	6.49m	4.78m	1.68m	3.41m	4.98m
7.	Miscellaneous	6.62m	22.48m	9.89m	99.39m	61.05
	Total IGR	**185.21m**	**160.37**	**168.57m**	**208.34m**	**327.42m**
8.	Grants	312.70m	86.26m	20.00m	733.89m	195.10m
9.	Statutory Allocation &VAT	10,716.26 m	5,544.35m	5,235.95m	6,520.01m	6,682.25m

Source: Oyo State Valuation Office, Min. of Local Government and Chieftaincy Matters, 2007.

It is widely accepted that property tax is the most appropriate and viable source of revenue to finance local government infrastructure investment and the provision of Municipal services. It is an appealing revenue generating option for local governments given the primary store of accumulated wealth tied up in real estate. In addition, it is hard to avoid legally due to its high visibility and immobility.

However, despite this recognition, property taxation continues to be plagued by technical, administrative and procedural problems, especially in the area of collection and enforcement. Property tax collection accounts for only 20-30 per cent of internally generated revenue, an evidence of underutilization.

2.1.3 Urban Service Charge or User Fees

These are charges linked directly to services provided by the local governments. Service charges are a means of recouping the cost of public services from beneficiaries. User charges are also a tool for ensuring efficient use and equitable financing of public services.

When local governments are imposing service charges on activities taking place within their areas of jurisdiction, the two common alternative focus of the policy targets are:

(i) to seek, as far as possible, to recover costs, so as to minimize the burdens to be paced on taxation; and

(ii) to maximize revenue potential, hoping to realize profits by charging what the market will bear.

This aspect of revenue sources has not been utilized by the local governments in Oyo State. Where attempts were made, it was a failure as a result of lack of commitment, political influence and absence of professionalism in the management of the scheme. The sources include:-

(a) Charges for the use of public toilets, street light and parks and garden.

(b) Charges for collection and disposal of solid waste in the markets, residential neighborhoods and corporate organization.

(c) Revenue from mass transit

(d) Hiring of heavy equipments

(e) Rents from office and shopping complex, housing and

2.1.4 Business Licences, Fees and Fines

Local government authorities derive a lot of income from institutions involved in trade and supply of goods in their jurisdictions. These include Licenses to prohibit, control and regulate trading activities and private market establishment, other are:

(a) Market and food vendor licenses;

(b) Non-motorized license,

(c) Entertainment permit fees,

(d) License for operating restaurant, theatres, kiosks, canteens, patient medicine etc

(e) Survey fees, building permit fees and application forms.

(f) Slaughter slab fees and other environmental charges and fines

(g) Development charges on council estates.

2.1.5 Income from Commercial Undertakings

Natural resources systems, both in their natural state and when managed for production, provide vital products and services to urban and rural areas. Which can generate revenue for Local Governments where they are located?

Local Governments in partnership with the private sector can develop for commercial purposes for the mutual benefits of the citizenry living within the local government area e.g.

(a) Running of Quarries

(b) Building of shopping and office complex

(c) Provision of serviced urban land for private real-estate development

(d) Investment in corporate institutions to generate interest

(e) Investment in fisheries, poultry and other Agro-allied industry either directly or in partnership with public sector

(f) Provision of low-cost housing in partnership with private investor.

(g) Floating staff-housing-loan scheme which is a revolving loan.

2.2 Financing through Intergovernmental Transfer

Revenue sharing in Nigeria is formula-based and also explicitly favour smaller and rural local governments by including an **"Equal share"** component of allocations from federation account. The 1999 constitution allows the Federation to make grants to state supplement its revenue. It stipulates that the terms and conditions under which this is to be done are to be determined by the National Assembly.

There are three categories of revenue accruing jointly to the federation each with a distinct sharing arrangement. There are Federation Account Revenue, Value Added (VAT) Revenue and Educational Tax Fund (ETF) Revenue. The power to determine both vertical (between the levels of government) and horizontal (between State and Local Governments) sharing ratio is constitutionally vested ion the Federal Legislature.)

The constitution specifies some of the principles to be taken into account to determine the distribution formula and it includes population, equality, an internal revenue efforts, land mass, terrain, population density and derivation. The current formulas for horizontal sharing between states and between local governments as at 2003 were put in place by the military. However, the oil producing states are now enjoying 13% derivatives.

The horizontal distribution of VAT attaches some weight to the principle of derivation. However, some highly-industrialized States such as Lagos, Rivers, Ogun and Kano States that produce the bulk of VAT revenue feel deprived of an important source of internal revenue with the failure of the formula to recognized 100 percent derivation. Indeed, Lagos state had enacted a new sales tax law in 2001 in addition to the Federal Value Added Tax Law.

However, a system of intergovernmental transfers that is unclear and not rules-based could allow subnational governments to began and manipulate resources received from the centre. In Nigeria's case, to a large degree, the system of revenue sharing from federation account (Intergovernmental transfers) is rules based; clear and transparent (World Bank, 2002). Federal Government's share was 43.56%, states 28.44%, Derivation 13% and Local Government, 15%.

What is relevant to us in this discussion is the distribution formula of the revenue from Federation Account horizontally among the Local Governments which runs thus;

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- Equality of States - 40%
- Population - 30%
- Landmass/Terrain - 10%

- Internal Revenue effort - 10%
- Social Development factors - 10%

The above formula was adjusted in Oyo State by the State House of Assembly to take care of Primary School Teachers Salaries which had been pulled together as a result of ZERO allocation to urban Local Governments which were left with nothing to finance other social responsibilities and pay staff salary. Consequently, Equality of Local governments was allocated 50% of the net allocation after deduction of primary teachers salaries from allocation, 30% on population basis and 20% on Land Mass.

2.3 Internal Revenue as a Proportion of Total Revenue

In developing countries, revenues raised at the subnational levels as proportion of total government revenue vary from 60 percent in China and around 35 percent in India, to 7 percent in Indonesia and 8 percent in Pakistan (Bird and Vaillancourt 1998: 19-20). The share of local government revenue in total government revenue is a relatively small, averaging about 12 to 13 percent in these countries but about 5% percent in Nigeria according to table 4. Table 3 shows the percentage of the revenue generated internally by the three level of government in selected countries.

Table 3: <u>Share of Revenue Raised by three Levels of Government (IGR)</u>

Location	Year	Central Government	State Government	Local Government
Bolivia	1996	79.36%	5.82%	14.82%
Brazil	1993	72.42%	23.27%	4.31%
India	1997	63.80%	33.40%	2.84%
Malaysia	1996	86.97%	9.74%	3.29%
Peru	1996	94.67%	0.89%	4.44%
South Africa	1995	86.04%	3.40%	10.55%
United State	1995	58.68%	25.45%	15.87%
Israel	1994	90.48%	N/A%	9.52%
Africa & Asia	-	84.53%	1.64%	13.83%
Kenya	1994	94.03%	N/A%	5.97%

Sources: Ebel and Vaillancourt 2001 Note = not available (N.A)

A more recent study (Bird and Slack 2004) confirms that property tax continues to be the most important tax for local governments in developing countries. Institutional arrangement for implementation varies. In some Latin American countries (such as El Salvador) it is a central government tax. In South Africa, local governments raise more property tax revenue than provinces (Bagchi and Chakra Bority 2006). Property Related Tax is the second largest source of revenue is about 29% of the total budget in Rio de Janeiro Municipality with a population of 5.5 million. Property tax in cities in the U.S.A accounts for as much as 75% of the internally generated revenue (D.T Vandana Chaudra, 2002). Tax collection in Nigeria accounts for between 21.6% and 24.6% of the total IGR.

The problem of the tax system in Nigeria is the deficient tax administration, collection system, complex legislation and the apathy of Nigerians caused by lack of value received in return for their taxation money. Also the general perception that the rich do not pay taxes has further worsened the situation.

Table 4: Summary of Local Government Finance in Nigeria (Naira Million)

Revenue Items	2000	2001	2002	2003	2004
Tax Revenue	1,758.9	1,612.93	3,262.86	3,471.3	4,852.91
Non-tax Rev.	5,349.0	4,407.43	7,158.06	16,704.20	17,554.84
Total IGR	**7,152.9**	**6,020.36**	**10,420.93**	**20,175.50**	**22,407.91**
Federal Account	118,589.4	128,500.48	128,896.70	291,406.90	375,656.30
V.A.T	13,908.7	20,102.75	18,727.21	39,648.40	45,985.20
Stabilization Fund	5,398.5	12,980.17	9,896.97	4,610.30	6,082.70
10% of state IGR	1,923.1	1,598.57	1,672.26	2,119.80	3,625.70
Grant and others	4,904.7	2,320.72	2,537.07	12,210.00	14,537.5
Grand Total	**151,877.3**	**171,523.1**	**172,151.14**	**370,170.90**	**468,195.15**

Source: Central Bank of Nigeria, 31-12-2004

From the above analysis, it is clear that, the capacity of states and local governments to generate revenue internally is very weak because the Federal Government in all cases control the bulk of the fiscal resources of the nation and they are not ready to grant the subnational governments the fiscal autonomy so as not to be stronger than the central government.

3.0 ASSIGNMENT OF EXPENDITURE RESPONSIBILITIES AMONG THE THREE TIERS OF GOVERNMENT

The expenditure responsibility of local governments varies across countries. The influence of urbanization on the budget of a local government is dependent on the government's expenditure responsibility, revenue raising authority, and fiscal autonomy.

The roles of local governments in Nigeria is yet to be properly defined as there is no precise authority to make laws or raise revenue under the 1999 constitution. However, their spending responsibilities are specified under the constitution to include sewage and refuse disposal, maintenance of public conveniences, construction and maintenance of roads and streets, street lightings, drains and other public highways, parks, gardens e.t.c. and such other public facilities as may be presented by the state House of Assembly, from time to time. They are also charged with the responsibility to maintain cemeteries, burial grounds and homes for the destitute or infirm.

Table 5: Allocation of Responsibilities to Federal, States and Local Governments in Nigeria.

Exclusive Federal Government	Concurrent Fed. And State	Concurrent State and LGAs	Local Governments
▪ Defence ▪ External Affairs ▪ Law and Order ▪ Post and Communication ▪ Interstate ▪ Aviation, Rail/Sea Transport ▪ Currency ▪ Oil and Gas	▪ Tertiary Education ▪ Justice ▪ Electric Power ▪ Banking and Financing ▪ Agriculture and Industry	▪ Secondary Education ▪ Health Care Delivery ▪ Water Supply ▪ State Roads ▪ Fire Service ▪ Hand Use ▪ Health Care ▪ Primary Education	▪ Markets ▪ Cemeteries ▪ Waste Disposal ▪ Local Sheet Construction and Maintenance ▪ Motor Parks and Open Spaces ▪ Abattoirs ▪ Public Conveniences ▪ Destitute Houses

Source: Nigeria Status Finance Study Decision Draft, June, 2002. World Bank AFTP 3 p.28.

3.1 Local Government Development Objectives

Generally, the private sector is concerned with development which occasionally coincides with the desire of the public sector. However, local governments in most cases embark on project development to achieve the following objectives:

(i) to provide basis for economic growth of the local government council in longer term together with stable prices;

(ii) to improve the public image of the institution which may be politically motivated;

(iii) to expand the revenue base of the local government, especially property tax, by encouraging profitable private development without prejudice to spill-over effects and problems of income distribution;

(iv) the desire for economic freedom and security and often, political independence afforded by owning an estate which is deeply set within human nature and forms the basis of the typical peasant's attitude to his land and property; and

(v) investments in real estates developments reduce overdependence of local governments on state grants and statutory allocation from Federation Account and improve their performance efficiency in the provision of amenities to the people in the local government areas as a political weapon for continuity and economic stability.

However, assigning expenditure responsibilities for the provision of service to a specific level of government do not imply that governments should be directly engaged in its production. Limited empirical evidence shows that some services produced by private sectors promote efficiency and equity. Private sector participation can take a variety of forms which provide opportunities for Local Governments to expand their scope of operations and revenue generation such as:

(a) **Contracting out** through competitive bidding;

(b) **Concessioning** is whereby, in return for a negotiated fee, a selected private operator is awarded a license to provide specified services over a certain period of time. Ownership of the principal assets remains with the private firm;

(c) **A franchise** exists when a private firm provides a service to residents within a specific geographic area and when the supplier is paid (price or user fee) directly by the users (customers or clients). Franchises may be exclusive (one producer) or nonexclusive (may). A good example is neighbourhood refuse collection contractors and other services providers;

(d) **Self-Help-Groups** – Self-help programmes are designed so that individuals or neighbourhoods provide services for themselves e.g. neighbourgood watch read maintenance and building of community halls.

This, involvement of private sector in service deliver systems is appropriate for delivery of local public services, because the financial capacities of local governments are quite limited. Such private participation will enhance accountability, transparency, and good governance.

3.2 Clear Division of Responsibilities

However, there can be no correspondence between revenue and expenditure assignment unless expenditure responsibilities are well defined. Clarity in division of functional responsibilities between the three levels of government is an essential condition of any reform in the structure of urban service delivery (William Dillinger, 1994).

Clarity is not achieved by a mere act of legislation or a constitutional demarcation of functions between tiers of government as shown in table 5 above. Despite the constitutional responsibilities of local governments in Nigeria, they are still saddled with projects initiated by the federal and state governments where they have to commit their financial resources not budgeted for in the annual financial estimates.

Clarity in the division of functional responsibilities requires the central or state government to refrain from ad-hoc interventions in responsibilities that have been nominally assigned to local governments, no matter how disagreeable the outcomes. What is required is a system of revenue assignment and budgetary discretion that permits local governments to perform the roles that have been assigned to them. Moreover, the constitution must legally recognize the different circumstances of different local governments by making distinction between urban or rural local government or between urban local governments of different sizes.

3.3 Classification of Expenditures

The local government expenditure is however classified into capital expenditure and **recurrent expenditure**, which consists of personnel cost and over head cost. The recurrent expenditure also includes salaries and allowance incurred to keep the offices in shape for better productivity.

Capital expenditure is incurred to bring about development and it could be divided into different sectors as follows:

(h) Economic Sector consisting agriculture manufacturing, rural and urban electrification, transportation;

(i) Social Service consisting of primary education, Health care, sports, cultures e.t.c.

(j) Environmental planning and related issues, such as waste refuse disposal, sewage, drainage town planning e.t.c.;

(k) General administration, and

(l) Repayment of liabilities (capital or recurrent).

In 2003, the total recurrent expenditure for all the local government in Nigeria was **₦211,633 million** while the total capital expenditure was **₦50,130 million** out of the total expenditure of **₦361,763 million.** This is about 41.5 percent of the total budget of **₦370,170.90 million** with about **N8,407 million** for miscellaneous expenditures. This means that, the recurrent budget accounted for 57.17 percent.

The analysis has revealed a fiscal gap connoting a wide gap between the internally generated revenue capacity of the local governments and their expenditure needs as **₦20,175 million** was generated internally against the expenditure of **₦361,763 million** in 2003.

Another crucial issue in the fiscal performance of local government is that, services and administration efficiency of local governments would only be enganced if the local government functionaries are more articulate and prudent in managing the resources available for the development of the local governments.

4.0 ADDRESSING URBAN FISCAL PROBLEMS DURING THE ECONOMIC CRISIS

Responsibility for collecting certain taxes, fees and levies by the three tiers of government in Nigeria is regulated by the Joint Tax Board established under the provision of Personal Income Tax Act of 1993.

Whereas, State House of Assembly may, subject to such condition as it may prescribe, make provisions for the collection of any tax, fee or rate or for the administration n by local government council. This implies that, local government is an Agency of the State Government and they lack the autonomy to make by law regarding the collection of the revenues assigned to it by the Nigerian constitution.

However, the Executive Governor of Oyo State is empowered by section 169 of Cap 78 Local Government Law, 2000 to make **adoptive by-**laws which shall be brought to the notice of every local government by publication in the State Gazette or in any other manner as the Executive Governor may determine. This is in respect of increasing charges and fees chargeable by local governments in the state.

Oyo State Local Government Law, Cap 78 of 2000 empowers the local government to raise loans within Nigeria in fulfillment of their function Givens and shall be secured upon the property and revenues of the Local Government.

4.1 Loans and Credit Facilities

Borrowing is an appropriate source of financing capital outlays on infrastructure services, particulars, utilities and roads. However, local governments should note some conditions attached to commercial loans. Funds from commercial banks and other financial institutions are generally securitized by the projects underlying assets. Lenders usually seek:

(i) Projected cash flows that can finance debt repayment with a safety margin;

(ii) Enough of an equity stake from sponsors (i.e local government) to demonstrate commitment;

(iii) Limited resource to sponsors (e.g. sponsors statutory allocation) in the event of specified problems such as cash ever runs; and

(iv) Covenants (or undertakings) to ensure approved usage of funds and management of the projects.

4.2 Financing Capital Expenditures through Grants

In federal economies or decentralized unitary systems, national governments make grants for subnational governments, such as states or provinces, as well as to local governments, either through the states or provinces; who in turn, make grants to local governments. These can be of three types:

(a) Unconditional (General-purpose) grants where the recipient government has complete discretion over how the funds are used;

(b) Conditional grants which can be spent only on certain services or only on infrastructure;

(c) Matching grants requiring a matching contribution (counterpart fund) from the recipient government.

4.2.1 General Purpose Grants

General purpose or unconditional grants are provided as general budget support with no string attached. These form of transfer are typically mandated by law, but occasionally, they may be of an ad-hoc or discretionary nature. They are also termed **"block transfers"** when they are used to provide broad support in a general area of subnational expenditure (such as education or health) while allowing recipients discretion in allocation the funds among specific uses. General purpose transfers simply augment the recipients' resources creating a new budget line.

4.2.2 Specific-Purpose Grants

Specific-purpose or conditional transfers are intended to provide incentive for governments to undertake specific progrmmes or activities (e.g. LEEMP or LEEDS projects). These grants may be regular or mandatory in nature or discretionary or ad-hoc.

Conditional transfers typically specific the type of expenditures that can be financed. These may be capital expenditures, operating expenditure, or both. Conditional transfers may also require attainment of certain results in service delivery (i.e out-base conditionality).

4.2.3 Matching Grants

Conditional transfers may incorporate matching provisions by requiring grant recipients to finance a specific percentage of expenditures using their own resources. Matching grants requirements can be either open ended, meaning that the grantor matches whatever level resources the recipient provides only or close ended, meaning that the grantor matches recipient funds only up to a specified limit.

Matching grants encourage greater scrutiny and local ownership of grant-financed expenditures. Closed-ended matching grant is helpful in ensuring that the grantor has some control over the costs the transfer programme.

Local governments with ample resources can afford to meet matching requirements and acquire a substantial amount of assistance. Those with limited fiscal capacities may be unable to match federal funds and therefore fail to obtain as much assistance, even though their expenditure needs may be equal to or greater than those of wealthier states (shah, n1991). Other forms of assistance are needed to equalize fiscal capacities in such cases.

Table 6: <u>Principles and Better Practices in Grants Design for Subnational Governments</u>

S/NO	Grant Objective	Grant Design	Better Practice	Practice to Avoid
1	To bridge fiscal gap.	Re-assignment of Responsibilities, tax-base sharing or Tax	Tax abatement in Canada, Tax-sharing in Brazil, Canada and	Deficit grants tax-by-tax sharing.

		abatement	Pakistan	
2	Reduce regional fiscal disparities	General non-matching fiscal capacity equalization transfers	Fiscal equalization programme of Canada and Germany	General Revenue sharing with multiple factors
3	Compensate for benefit spillovers	Open-ended matching grant with matching rate consistent with spillover of benefits	grant for Teaching Hospitals in South Africa	-
4	Set national minimum standards	Non-matching block grant with conditions on standards of service and access	Roads and Primary education grants in Indonesia, Health grant in Brazil and Canada	Transfer with condition on spending alone; ad-hoc grants
5	Influence local priorities in areas of national but low local priority	Open-ended matching transfers	Matching transfer for social assistance	ad-hoc grants
6	Provide stabilization	Capital grants with maintenance provision	Limited use of capital grants and encouragement of private sector participation by providing political and policy support	Stabilization grants with no future upkeep requirements.

Source: Shahs, 1994, 2004

4.3 Solving Disparity between Revenues and Expenditures of Local Governments

Vertical Fiscal imbalance exists when Municipalities have inadequate own-sources revenues (that is internally generated revenue) to meet their expenditure responsibilities Vertical fiscal imbalance refers to the **difference between expenditures and internally generated revenue (IGR) at different levels of government**. The resulting **fiscal gap** can be closed by an unconditional transfer that allows the municipality to spend the funds on whatever areas it deems appropriate. The amount of the transfer allocated can be determined in three ways:

(a) as a fixed proportion of the revenues of the donor government (known as Revenue sharing)

(b) on an ad-hoc basic, or on the basis of a formula (e.g as a percentage of specific local government expenditures or some other characteristics of the local governments such as population (Bird and smart, 2002).

The first option was contained in the Nigeria Constitution that 10% of the State (IGR) must be given to the local governments in their areas. Tax sharing is also common in Lagos and Oyo State where between 10% and 20% share of the tenement rates goes to the State government and 80% - 90% of the taxes collected are retained by the local government where they are generated.

4.4 Geographic Disparity in Resources Available to Local Governments

Horizontal fiscal imbalance refers to the geographic difference in resources among government the same level. It is also referred to as geographic disparity in resource potential because some municipalities are unable to provide an adequate level of service at reasonable tax rates, whereas other municipalities can. This inability to provide and adequate level of service may occur because the cost of service may occur because the cost of services is higher or the need for services is higher and the tax base is smaller.

There are great differences in the fiscal abilities of local governments across the five geo-political zones in Oyo State of Nigeria considering the level of economic activities in each zone. The inequitable distribution of local resources impedes progress towards achieving major social goals such as better education, improved health care and elimination of poverty.

Property values are generally low in Oke-Ogun Area and other rural areas of Ibarapa local governments where people rely more on agricultural products to generate income. What these areas lack in terms of income from property based taxes, they gain it from other sources of revenue (e.g licenses, fees, fines and earnings from agro-industrial establishments.

4.5 Public-Private Partnership (PPP)

Public-private partnership refers to contractual agreements formed between a public agency and private sector entity. That allow for greater participation in the delivery of infrastructural or social projects. PPP is a situation where the private sector harnesses its financial and managerial resources to provide social amenities and infrastructure (e.g. Housing Estate) on behalf of the government or the public sector agencies.

Traditionally, private sector participation had been limited to planning, design or construction on a fee for service based on the public agency's specifications. Expanding the private sector role allows the public agencies to tap rivate technical, managerial and financial resources in new ways to achieve certain public objectives.

Large projects can be better managed through public-private partnership between private land developers, construction contractors and government agencies. A good practical demonstration of public-private partnership is the contractual agreement between Ibadan Norht Local Government and a Private Developer for the redevelopment of Old Sabo Market into a modern Housing Estate. The council's equity contribution was the land and the old market structures while the developer sourced for funds and carried out the construction. The council is getting returns on the investment in terms of hack rents from these who occupied the furnished facilities:

(a) They provide a source of funds to finance capital intensive projects not readily available to local government council;

(b) PPP enables the local government to draw on private sector expertise and skill in order to minimize costs. This advantage may be especially important for rural or less urbanized local governments with limited resources, which may have greater difficulty than large ones in attracting expertise.

(c) The private sector involvement tends to lead to more innovative and efficient operations than if the public sector provides the services to its own. The state government approach to redevelopment of round-abouts in Ibadan

Metropolis along Moshood Abiola Way and Total Garden – U.I Road are good examples of what private sectors can offer.

(d) the involvement of private registered Estate Surveyors and Valuers in the assessment of property collection of tenement rate has actually increase the revenue from property tax and restored the transparency and accountability in the system making monitoring and evaluation by the Ministry much easier.

Local governments involved in partnership deals need not be involved in the construction of the asset nor in the day-to-day management and delivery of services provided by this asset. Instead, the government should through a carefully drawn-up contractual agreement, set the terms and quality and establish performance standards or measures to be met. Local governments also by the service providers to protect consumers and tax payers from inefficient and unfair increases.

5.0 RESPONSIBILITIES OF LOCAL GOVERNMENTS IN FINANCIAL MANAGEMENT

A financial management system involves the planning, controlling and allocation of financial resources of an organization and includes accounting, auditing payroll, cash management and costing financial reports. This is of great importance to the Local Government Fiscal Administration.

Management of financial resources involves more than budgeting or accounting or auditing. The implication is that no chief executive of an organization can absolve himself or herself from financial responsibility of the organization. The responsibility for the management of financial resources of an organization starts with:

5.1 Local Budgeting System

Budgeting is the process of planning, adopting, executing, monitoring and auditing the fiscal programmes for the government for a year or more. The local budgeting systems are intended to serve several important functions. These functions include setting of budget priorities consistent with any mandate of the government, planning of expenditures tyo pursue a long-term vision for development, exercise of financial control over imputs to ensure fiscal discipline, and management of operations to ensure efficiency of government operation. Another function is to enhance accountability of government performance to citizens.

The budget process should be comprehensive, including all fiscal entities associated with or connected to the government and there are no extra budgetary funds to interfere with fiscal discipline, transparency, accountability and the struggle against corruption. Effective budget process are those which support good outcomes at three levels namely:

(a) Determining the size of budget, that is, aggregate spending must be consistent with available resources;

(b) Allocation of resources must be consistent with policy and programme priorities; and

(c) Efficient and effective use of resources.

5.2 The Use of Cash Budgeting

Cash budgeting is the management of cash paid to the governments, payments made by the government, use of funds while they are held by the government and accommodation strategies when revenues fail to cover approved expenditures. Cash management serves the following purposes:

- ❖ Controlling government spending in the aggregate;
- ❖ Implementing the budget efficiently minimizing the cost of government borrowing; and
- ❖ Maximizing return on excess operating cash management

Control of cash is a key element in microeconomic and budget management. When there is no such control, the result is revenue driven budgeting. For example, when national oil revenues are rising, spending increases through annual and supplementary budgets to absorb the available resources. **When an economic downturn occurs, governments revert to cash budgeting, leaving the existing budget in place, but managing the release of funds so that only the highest political priorities are funded. Several states and local governments in Nigeria have sought to cover shortfall in expected revenue by borrowing from local banks to meet the fiscal targets.**

Sufficient cash management is having the right amount of money in the right place and right amount of money in the place and at the right time to meet the government's obligations in the most effective way (Storkey, 2003). It does not mean trying to control the timing of government expenditure to match the timing of cash receipts

5.3 Institution Arrangement for Budgeting and Financial Management

There are two areas where the institutional framework seems to operate in practice at the State and Local Governments levels:

(i) The first is the role of the legislature in budgeting, they are called legislative councils at the local government level; and House of Assembly at the state government level.

(j) Greater engagement of Governors in budget preparation and implementation at the state government level. Similarly, the Chairmen are also involved in budet preparation and implementation.

At the State Level, the organization of budgeting and financial management is similar to the structure at the federal level. A key player is the Finance Ministry headed by the Honourable Commissioner for Finance, which traditionally had the responsibility of preparing and monitoring budgets through a Budget Department.

Each State has an Accountant-General, a critical figure in the management of State finances, usually under the Hon. Commissioner for Finance, but in practice enjoying considerable independent authority. In addition, all states have an Auditor-General, responsible for conducting external audits, and protected by the constitution from arbitrary removal from office.

In the Local Government Councils, organizational machinery of budgeting and financial management is rested in the Department of Finance and Supply which translates the call-circular from the Ministry/Bureau Department of Local Government and Chieftaincy Matters.

There is supposed to be a management team comprising all Heads of Departments to consider local government budgets but in practice, it is not so. However, there is a Local Government Treasury Board to examine the Budget which is set up b the supervising Ministry headed by the Commissioner for local government. Thereafter, the budget is passed to the Local Government Legislature Council (LGLC) to finally approve the Budget.

6.0 COMBATING CORRUPTION AND ENFORCING FISCAL DISCIPLINE

in a document forwarded to the Revenue Mobilization and Fiscal Commission (RMAFC) President Umar Musa Yar'adua ordered for a drastic downward review of salaries and allowances of all political office holders in the country which he considered unjustifiable in the present economic circumstances.

The Revenue Mobilization Allocation and Fiscal Commission had late in 2008 increased the monthly salaries of all public officers in line with powers conferred on it by the constitution from **N731 billion** per annum to **N1.125 trillion.** The salaries and allowances of political office holders at the Local Government level alone is **N592 billion** about 50% of the total purchase.

6.1 Curbing Waste and Reducing Recurrent Expenditures

Besides the huge sum of money spent on salaries and allowances of political office holders, the statistics of waste of resources and human life is colossal. According to Vanguard Newspaper and other financial reports, the Central Bank of Nigeria sold about **N1.180 billion** worth of foreign currency to 15 firms in January, 2009 for the importation of power generating sets. The residential expenditure on fuelling power generator was an average of **N1.56 trillion** in 2008 alone while the estimate for commercial and industrial fuelling of generating sets was **N4 trillion**. Many industries have closed down as a result of chronic electricity shortages leading to mass sack of workers while unemployment is rising everyday.

It is unfortunate that Nigeria with her installed capacity of 6,500 raw supplies power to Benin Republic and Niger Republic is facing power generation crisis while the two countries do not face the energy problem. Ghana only recently celebrated 10 years of uninterrupted power supply.

A government that keeps on voting billions of naira to fuel generators for its own comfort cannot have serious commitment to resolving the national power. The crisis of power generation is now the crisis of our nation and the enormity of the problems challenges our collective conscience. The global economic meltdown can only be mitigated through a responsive review of costs of recurrent expenditures to maintain the momentum of the country’s development of capital projects especially the decaying infrastructure that needs urgent attention.

The fight against corruption in Nigeria is not going to be easy if only because of its magnitude and the fact that many Nigerians are not yet ready for the fight. The fight against corruption cannot be won until the general public treats corrupt officials in public and private sectors as lepers. **So long as we give chieftaincy titles and other honours to well known corrupt people, so long will the fight against corruption be elusive**.

6.2 Combating Corruption in Tax Collection

According to Galtung (1995), "One of the areas of government activities where the impacts of corruption loom largest is the assessment and collection of taxes. Governments everywhere is facing this reality." This is as a result of collusion between the tax payers and tax officials in the assessment of tax values, unauthorized collection, and manipulation of tax bills by local government officials.

The effect of these sharp practices is high operating costs, low productivity and ability to compete both in domestic and foreign markets. Consequently, unemployment soars to an all time high level resulting in crime rise. Many of the unemployed youth enlist into banditry as an inglorious means of livelihood. The impact of official corruption is so rampant and has earned Nigeria a very bad image at home and abroad. Besides, it has distorted and retrogressed development.

The widespread corruption in governance makes it almost impossible for the leadership to command respects for its plans and judgments and to enlist the support of the people for development programmes.

Corruption in urban governance can be reduced considerable if the people, the stakeholders, are allowed to participate in all planning and budgetary processes. There must be openness and the people should have full access to information about incomes and expenditures. There must be **transparent tendering and procurement procedures and monitoring mechanisms must be put in place by the government at all levels.**

Expectations form Local Fiscal Administration includes fiscal discipline and responsibility, responsive resource allocation, and efficient and effective government operations. Local governments should therefore have capacity to respond to fiscal pressure in so many ways such as:

(i) They can seek to raise additional revenue by increasing their user fees and charges, crating additional local taxes, or selling off assets such as land;

(ii) They can seek to improve the efficiency of their financial operations by improving their planning, programming and budgeting capacity and by developing productive programmes or seeking out lowest-cost means to deliver services; and

(iii) They can enhance private and non-governmental participation in the provision of services;

To undertake each of these strategies successfully, local governments must have the capacity to assess their revenue streams and expenditure demands accurately and to make the difficult choices and control expenditures in accordance with those choices.

Improving own revenue sources by local governments is a cornerstone of local fiscal discipline, particularly in a decentralized environment. When communities bear the cost of local services through local taxes and user charges, citizen will realize the true budget constraint and will discipline their demands. Therefore, without access to their own venue, local governments have fewer options when faced wit fiscal pressure (or even with year-to-year infrastructure development needs).

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