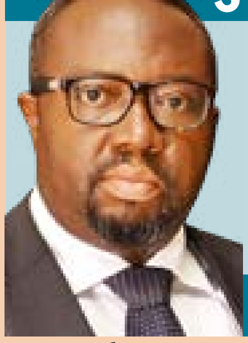
Reinforcing SNGs' non-tax revenue strategy

STATES & LOCAL FINANCE



The IGR Initiative

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IN THE 2020 IGR DATA of 36 states of Nigeria, the tax revenue component was 76.6 percent, while the share of non-tax revenue was 23.4 percent. As of the half-year of 2021 non-tax revenue component of aggregate subnational IGR was 25.2 percent. Non-tax revenue sources are a veritable complement enabling the government to achieve its good governance objectives much better. Unfortunately, while available data show that, on average, the independent revenue of most state governments is approximately 20 percent of their total revenue, non-tax revenue sources only generate about 24 percent of that number (20%). In general, non-tax revenue sources account for approximately 4.8 percent of the total revenue of most state governments in Nigeria. However, if intelligently designed and implemented, and depending on how enterprising subnational governments are and how focused they are on good governance, non-tax revenue sources can make up a significant share of the total revenue.

The argument for tax revenue dominance shares a lot in common with the underlying reason for the paramountcy of statutory allocations in the overall revenue structure. In the latter, governments across the three tiers seemingly folded their hands as the statutory allocations from the federation account largely met their fiscal aspirations. Over the years, that culture of dependency further deadened their capacity to create revenue-generating structures and institutions. Worse still, they became more entrapped in "tax collections" as the drivers of non-tax revenue expansions are primarily government entrepreneurship and the willingness of economic managers and politicians to provide good governance. Ample evidence suggests the substantial absence of both drivers in the leadership of our subnational governments. Currently, statutorily provided revenue is four times that of independently generated revenue for most SNGs.

Based on theory, the government's role in facilitating economic and entrepreneurial growth is through market regulation, providing public goods and strengthening the rule of law. In the first two, governments' interventions reduce negative externalities and the overall cost of transacting. The rule of law intervention provides a level playing ground for entrepreneurial competition. But in recent times, the government has played more courageous roles through financing mechanisms such as public-private partnerships and design-build-divest to intervene and attract enterprises that would benefit the people directly. Generally, the non-excludability of public goods justifies governments' use of taxation to finance them. Untolled public roads and television stations are good examples. Unless toll charges apply, tax collections are the only way to finance roads. Taxation is a much more convenient approach for most subnational governments as the law backs them.

Then again, the financing of quasi-public goods may be through mechanisms requiring their commercialization because of their price excludability. Waste management, tertiary education, housing provision and secondary health services may be some good examples. These revenue-generating quasi-public goods and fees and fines through the implementation of negative externalities minimising regulations provide the non-tax revenues. Therefore, the demand for non-tax revenue increases is synonymous with the demand for good governance, enhanced employment opportunities and output growth. There is no argument that these are the socioeconomic conditions that Nigerian citizens today substantially desire. Non-tax revenue sources, in effect, hold more extensive prospects for IGR expansion because of the equally substantial good governance prospects underscoring their successful exploitation.

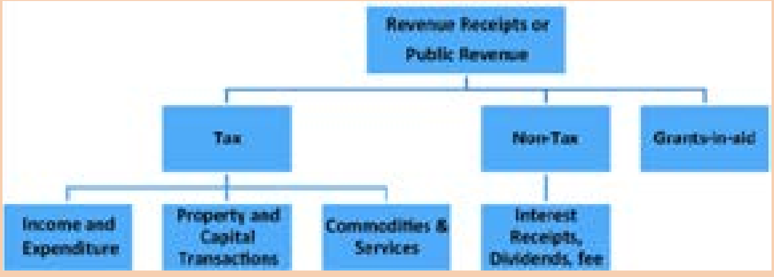
To better understand the enormity of these prospects, we peep into the constituents of non-tax revenue. Non-tax revenue comprises user fees from general, social, and economic services provided by the government, earnings from interest receipts on loans extended to employees in the public sector entities, dividends and profits from government-owned enterprises and investments in equities and other financial instruments, and fines from defaults and violations of laid down rules and donations. On the other hand, tax revenue consists of mandatory payments assessed on the value of transactions for goods and services (indirect tax) and the income earned by an individual or an entity (direct tax). Therefore, governments desirous of boosting their citizens' socioeconomic conditions and significantly earning more revenue in the process would typically opt for non-tax revenue. When thoughtfully planned, non-tax revenue improvement programmes, on the one hand, and the much-desired good governance and economic growth, on the other hand, are symbiotically reinforcing. More revenue means the government would provide more general, social, and economic services, make profitable investments, and efficiently collect fines for infractions that help create an enabling environment for entrepreneurial expansion.

Two other positive effects of properly structured non-tax revenue expansion pursuits are the capacity to influence economic agents' behaviour and expenditure impacts. The first is the behaviour-conditioning effect of fines and penalties for defaulting on regulatory prescriptions. For example, fines for over-speeding typically reduce the rate of accidents on the roads. Again, penalties for not disposing of waste appropriately enhance the health and sanitation status of the environment. On the other hand, the expenditure impacts are vast, culminating in the growth of new businesses and their associated value chains, increased employment, and enhanced citizens' demand capacity in addition to the gross state domestic product [GSDP]. Virtually every aspect of non-tax revenue drive has direct employment generating potential and the attendant income and increased demand capacity effects.

But there are also unpalatable consequences of improperly designed non-tax revenue growth programmes. The first is the invalidation of economic growth objectives in instances where the applicable fees and user charges impose more burdens than benefits. Let us assume that most rural people in a state depend almost exclusively on a publicly provided mass transport system. While such a supply-chain structure would energise productivity by connecting demand and supply sources efficiently, if the fares are a bit high, it would naturally feed into the prices of the produce of these rural communities. The so-called food price inflation can connect with this example. Other examples include high public-school fees and exorbitant bills in public hospitals. Contrariwise, most SNGs treat their investments as a bonanza and pay less-than-desirable entrepreneurial management attention to them. That is why many state and local governments have several abandoned commercial ventures. Some state chief executives also patronise their political cronies by allowing them to default on government-owned properties' rent.

There is a lengthy list of reasons why many subnational governments have not been able to optimise non-tax revenue growth opportunities. Although the delayed and non-remittance of MDAs' collections are more pronounced at the federal level, it remains a big challenge for several subnational governments. Monitoring compliance effectively and taking the desired actions in this respect can be incredibly challenging. This complexity partly explains huge non-tax revenue leakages at the MDA level. A second challenge is the quality of non-tax revenue forecasting. A random check on the financial statements of several state governments shows significant deviations (sometimes exceeding 30%) from forecast estimates. A huge forecast error signifies a poor understanding of the actual realities of the variable in question. And because most subnational governments do not conduct robust revenue audits, they lose out on the opportunity to discover steps necessary to hit the target subsequently.

Solid and stable revenue-collecting institutions of SNGs are



the foundation for achieving target outcomes in virtually every aspect of the government's aspirations. While not a guarantee, they provide an excellent framework for limiting individuals' power and capacity to abuse public trust and funds. Unfortunately, most institutions, particularly at subnational levels, lack robust internal checks and balances to safeguard against corruption and abuse. Even many state governors are largely complicit in this, which consequently attenuates the stability and strength of those institutions. Thirdly, many government institutions would suffer the same fate as other businesses without appropriate infrastructure. Again, most states and local governments in Nigeria lack requisite enterprise-supporting infrastructure, affecting government enterprises' profitability and non-tax revenue prospects.

While many of these infrastructure challenges are solvable, effective relationships between federal and subnational governments, partisan and other considerations usually stand in the way. Federal interventions in roads and other businesses supporting public goods often depend on which political party controls the state. Federal presence manifests much better when the political party at the centre also controls the state. There may also be other ethically and politically motivated marginalisation of some states, such as the claims by the states in the South-east geopolitical zone. Fifth, poor workforce capacity, predominant in the public sector, equally affects the supervisory effectiveness of subnational non-tax revenue collection agencies. This weak capacity gains momentum from inefficient operational procedures and internal control systems in the public sector.

Finally, reforming non-tax revenue sources for subnational governments should be the starting point for improving this revenue channel. Other factors include determining charge standards for public utilities, prioritising quasi-public goods provision, large-scale informatization of the stakeholders, continuous search for new non-tax sources of revenue, and extensive digital transformation in government processes. Reform of non-tax revenue sources would require extensive interventions to make the most of these "other factors" contributing to subnational government revenue. First, a good-governance mindset would require that subnational governments prioritise providing price-excludable public goods such as good hospitals and adequately articulated water supply systems, to mention a few. It also requires strong attention to infringements on the rule of law, which creates a healthy society for business and results in non-tax earnings. However, while prioritising the provision of price excludable public goods is essential, an optimised level of user fees for accessing them is a more satisfying condition. The user fees must balance the profit or surplus income-making objectives of the government-owned enterprises and the economic conditions of the citizens who utilise those services. Neither should suffer unwarranted disadvantages. On the contrary, optimising both objectives is critical regardless of the constraints. Again, efficient communication systems enhancing citizens' patronage of government-owned enterprises are essential. An often-faulty assumption is that there is unlimited knowledge of fee-paying services that governments offer. Enhancing their marketing would benefit all stakeholders if the quality of offered services is reasonably competitive. And like excellent entrepreneurs, subnational governments must continuously scan the immediate environment and benchmark against global models, enabling them to identify more non-tax revenue sources to explore.

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What agenda for the...

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essary political will to 'off-load' the dead refineries and/or initiate the process of bringing them back to life within the remaining 35 weeks of his tenure? The much flaunted strides in agriculture through the initiatives of the Central Bank of Nigeria has since been 'deflated' by persisting insecurity and related social ills. The new Presidential Economic Management Team must therefore expeditiously begin to address food insecurity in the land. Hunger, poverty and insecurity are 'conjoined triplets'.

It also goes without saying that the New Economic Team must ensure that the public finance management of Nigeria is reworked expeditiously to save the country from living largely and lavishly on borrowed funds. Rather than continuing with the massive borrowing spree, the government should be 'winding down' as it ineluctably approaches its twilight. This is no longer the time for excuses or to be appealing to Nigerians for their understanding or advertising phantom projects and achievements of the administration. It's already too late in the day!