STATES & LOCAL FINANCE

The IGR Initiative

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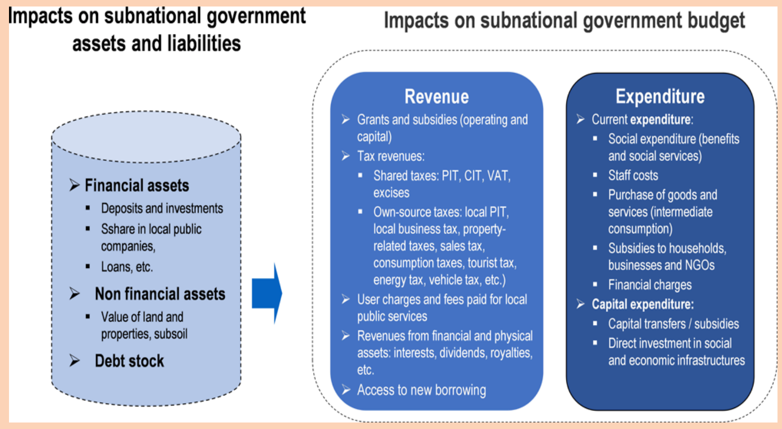
What drives subnational IGR growth?

THE DIFFERENCES IN THE INDEPENDENT REVENUE MOBILISATION performance of Nigeria's subnational governments depend significantly on their relative fiscal capacities, the strength of revenue collection institutions, the degree of the entrepreneurial mindset of their leadership, the extent of technology adaptation and other kindred factors. As should be expected, each subnational government strives to build IGR growth programmes on what works for them and sometimes without sufficiently benchmarking against or understudying what drives the successes of the IGR leaders. Many also do not bother to find out what sustains either their mediocre performance or that of other off-colour performing subnationals. However, all state and local governments can benefit from some measure of structured understanding of what typically drives subnational IGR growth. Such a formalised model explaining the determinants of IGR growth is an invaluable format that each can leverage to develop robust strategies for expanding revenue mobilisation. Of course, learning from the experiences of many subnational governments, we can distil out proven factors that deliver revenue growth to the extent of their expert deployment.

However, since good theories support our understanding and conceptualization of problematic situations, we shall use simple production, profitability, and marketing models to explain the IGR growth model. Elementary economics teaches that output depends on four fundamental factors: land, labour, capital, and the entrepreneur. While land represents all available natural resources, labour stands for human capital availability and capital comprising technology and finance. The entrepreneur is the coordinator of all the other three factors in a way that delivers profit. To that extent, the entrepreneur is a risk taker penalised for mistakes with poor profit performance. Subnational IGR performance also requires a proper understanding of and competitive exploitation of their natural endowments, sound financing mechanisms for solid economic transformation, a competent and committed workforce, and an entrepreneurially minded state governor and local government chairperson. Thus, in much the same way that excellent entrepreneurs are not only concerned about generating maximum output but maximum profitability, solidly driving IGR expansion requires lessons in profit or efficiency optimization. The expectation is that while leveraging the production function to create maximum revenue, substantially minimising the associated collection and compliance costs would greatly enhance subnational revenue outcomes. The third framework encompasses a robust strategy for subnational IGR expansion and strengthening the institutions for collection.

Unarguably, the most important of all these drivers is the entrepreneurial strength of leadership. When the governor of a state or the chairperson of the local government acts as entrepreneurs presiding over sovereign entities, the disposition to drive revenue growth becomes very compelling. On the one hand, the sovereign entity mindset heightens their acceptance of the responsibility to independently source for requisite financing to grow their economy and orchestrate well-being for most citizens. The mentality banishes the present condition of heavy dependency on the centre's statutory allocations for survival. Sovereign entities do not ideally depend on other countries for their economic existence. They work it out by themselves. The extent to which they succeed in this depends substantially on the entrepreneurial mindset of the leader. Excellent entrepreneurs are constantly sniffing for profit-maximising opportunities. Such governors regularly search for exploitable revenue-yielding opportunities within their state and local governments. In general, they identify and find ways of exploiting high-income yielding natural endowments where they have competitive advantages, trigger heightened economic activities within their jurisdiction, support entrepreneurs with public goods that minimise the costs of transacting and ensure accountability. Concerning IGR expansion, entrepreneurially-minded leaders focus strongly on expanding taxation and nontax revenue bases, heightening citizens' trust and building strong compliance performance.

The vast natural resource endowments present enormous low-hanging independent revenue opportunities for transformational state and local government leaders. There is hardly any state government in Nigeria without significant and relatively unique endowments, such as vast arable land for agriculture and varieties of agricultural produce, solid minerals, sprawling exploitable aquatic life, oil and gas and many others. However, without creating expansive economic activities out of them, by exploiting and further processing these resources into other products, they are no more than idle assets. Progressive entrepreneurially-focused leaders naturally use practical incentives to attract investors to exploit these resources, consequently expanding their economy's secondary and tertiary sectors. In other instances, they can directly intervene through workable public-private partnerships or by originating special-purpose vehicles or firms for the same reason and privatise afterwards. These processes create and constantly multiply tax bases for independent revenue harvesting.



Another variant of the same approach is to target the secondary sector's expansion as part of a consciously designed economic transformation programme. Strategically developing and expanding the manufacturing sector to leverage existing natural resources will result in an impressive evolution of the subnational government economy. All three sectors, primary, secondary, and tertiary, will naturally grow, albeit at different rates. For instance, originating two large-output-capacity vegetable oil processing plants in a state with a considerable capacity and advantage in producing corn, sunflower, soybean, cotton seeds, peanuts, pumpkin seeds, sesame seeds, palm oil, and groundnuts will likely lead to the emergence of many other factories along the value chain. It will also grow other service sectors such as health, marketing, transportation, and legal services. Eventually, the local capacity for cultivating these intermediate agricultural produce for extracting refined vegetable oil will balloon to the extent of their demand. Industrial farming of these materials will naturally spring up to meet those raw material demands. Virtually all state governors can originate and privatise manufacturing concerns far above the cited example, depending on their natural resource advantages. And as it is in the processing of agricultural produce, similar opportunities exist in processing solid minerals and many others.

But the government and interested investors will need requisite financing to make these possible. Based on copious cases of Nigerian governments' poor management of investment assets, limiting the government's role to facilitating and incentivizing private entrepreneurs to lead is always advisable. Financing is one of those overly critical areas requiring subnational government intervention. Because of the relatively better capacity to attract and underwrite reasonably copious amounts, governments at state and local levels can deploy such capacity in originating deals and bringing target industries into existence. With an appropriately crafted and realistic exit window, such interventions are not likely to lock in government funds beyond target dates. In any case, it is always advisable for subnational governments pursuing this track to set up capable investment management offices to interface with credible investment banking organisations for professional guidance. Investment financing vehicles such as public-private partnerships (PPP), design, build and privatise (DBP), and other forms of collaborative financing with investment banks, go a long way in ensuring that target industries emerge.

While these efforts will consistently deliver noteworthy results, entrepreneurial activities in any jurisdiction depend largely on minimal transaction costs and robust market access. Good governance primarily consists of actions that provide entrepreneurship-supporting public goods and facilitate market access. Good roads enhance production logistics. Adequate electric supply, on the other hand, is the lifeblood of large-scale industrialization and price competitiveness. Imagine providing efficient or low-priced warehousing and preservation facilities in all the local governments of a state such as Benue that is heavy on agriculture. Again, imagine there are good link roads connecting farming communities to these preservation facilities. Generally, adequate public goods availability significantly reduces the costs of transacting and strengthens the competitiveness of entrepreneurs' output. Therefore, entrepreneurially minded governors and local government chairpersons who pay good attention to improving public infrastructure will attract more investors and heighten the citizens' trust. Such trust is a major motivator for compliance with tax obligations. When people are confident that those in political authority wisely use these resources to provide them with public goods that improve their ability to do business and general well-being, they are more likely to pay taxes.

As subnational governments increasingly succeed in revving economic activity, they must also strengthen the capacity of revenue collection institutions; otherwise, they will achieve less than optimal outcomes. Revenue generation capacity comprising most of the factors already discussed is necessary but insufficient for solid independent revenue performance. Therefore, subnational governments must consider strengthening tax and nontax revenue collecting agencies. For example, some governments focus primarily on building the revenue mobilisation capacities of their Internal Revenue Service and accord less importance to such institutions as hospitals, courts, waste management and schools that equally generate significant revenue. Needless to restate that all institutions that receive monies on behalf of the government require improvements and reinforcements to expand their revenue generation and collection efficiency. For the IRS, utilising a framework such as the Tax Administration Diagnostic Assessment Tool (TADAT) helps understand the capacity gaps. An adequately modified and institution-contextualised version of this tool might also be helpful for other non-tax revenue-generating institutions. The challenge most of the time is that organisations using these tools merely end up at the level of assessment without utilising those assessment scores as inputs to build comprehensive and robust strategies for sustained independent revenue expansion.

A massive error by some IRS is to assume that implementing the TADAT scoring framework is a substitute for an appropriately crafted revenue expansion strategy. TADAT's usefulness is limited mainly to diagnosing and understanding the prevailing conditions of tax revenue administration. Subnational governments must devote time and resources to designing and effectively implementing solid revenue expansion strategies based on TADAT-generated insights. Like all standard strategy documents, subnational government revenue expansion strategy articulates clear direction and executable steps that inevitably lead to desired revenue performance. Without a doubt, this should be one of the essential tools for the subnational leader as an entrepreneur.

Finally, in line with the famous proverb that, " a good soup is a product of reasonable expenditure," solid subnational IGR performance is also a product of wise spending on fiscal capacity identification and optimization and strengthening revenue collection institutions. The former comprises natural resource endowments easily convertible to taxable assets and the entrepreneurial capacity of the leadership to design appropriate strategies to execute the transformation process and finance the same. The latter comprises efforts at strengthening all revenue collection agencies and designing and implementing sound revenue expansion programmes guiding them.

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