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Impact of Public Revenue and Expenditure on Capital Projects of North-eastern State in Nigeria

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Abstract

The study analysed the relationship between revenues and capital expenditure of North-eastern states in Nigeria with the specific objectives to determine the impact of internally and externally generated revenue on capital expenditure of North-eastern states. The data was extracted from secondary source from the annual reports and account of the North-eastern states of Nigeria and ex-post factor research design was employed for the study. The study developed two research hypotheses while pooled ordinary least square regression was used in analyzing the data collected from the annual report and accounts of the sampled North-eastern states in Nigeria from 2009-2020. Capital expenditure was employed the dependent variable while internally and externally generated revenue was considered as the independent variables of the study. The study found that internally generated revenue positively but insignificantly impacted on capital expenditure while externally generated revenue was found to have a significant positive impact on capital expenditure of North-eastern states in Nigerian. In view of the findings, the study recommended among others that state governments in the North Eastern region of Nigeria should diversify their revenue sources to explore other sources like the non-mineral sector as an option as this would help in increasing their IGR.

Keywords: Internally General Revenue (IGR), Externally Generated Revenue (EGR), Recurrent Expenditure (RE).

JEL Classification: B22, B26, H71

Contribution to/Originality Knowledge
This study contributes to existing literature on public revenue and expenditure in developing economies

1.0 Introduction

Government is saddled with the responsibility of addressing issues relating to social justice, poverty alleviation, improvements in human health, education and other services. To execute these enormous responsibilities, governments must raise funds from the sources of revenue available to them. The major sources of revenue available to state governments in Nigeria include Externally Generated Revenue (EGR) and Internally Generated Revenue (IGR). The EGR is made up of, statutory allocations from federal government, loans, grants (local & international). The IGR, on the other hand, is composed of, property tax, personal income tax,

capital gains tax, fines and fees, licenses, land registration and survey fees, rents on government properties, interest repayments/dividends (Ibrahim & Ozioma 2019).

Owing to the oil crisis that began in July 2014, government revenue has been fluctuating that resulted in the inability of the government to positively respond to legitimate public issues. This was evident in 2018 and 2019 where some state governments were unable to pay the workers' salaries and had to depend on bail-out funds from Federal Government to settle recurrent expenditure (Ibeogu & Ulo, 2015). In the most recent period, there was resistance by some state governments to even implement the new minimum wage increment due to shortage of revenue. This had made government operation difficult at all levels so much such that government finds it difficult to meet up with recurrent expenditure let alone the execution of capital project.

The purpose of government expenditure is to stimulate economic growth and satisfying the individual or collective needs of the general public. In view of this subject matter, a number of similar studies have been carried out on the relationship between government revenue and expenditure yielding diverse findings (Peter & Ferdinand 2017; Mbah & Oniora 2018). However, findings from some of the aforementioned studies may not be reliable as the studies covered a shorter period of 5 to 8 years which seems to be inadequate considering the few amount of data involved in the conduct of the study.

This study is motivated by the choice of the North-eastern region of Nigeria and by extension, the scope of the study by studying 12 years period from 2009-2020. This is to improve on previous studies that considered shorter period of 5 years. More so, few studies (Mohammed, Ahmed & Salihu, 2015; Ibrahim & Ozioma, 2019), have attempted to examine the relationship between government revenue and expenditure in some individual or selected states in the region. For instance, the study of Ibrahim and Ozioma, (2019) was carried out in Gombe State while that of Mohammed *et al.* (2015) was conducted in Adamawa State.

Thus, based on the foregoing, it is worthy to note that those studies were carried out in just two separate states in the North-eastern region and did not consider the whole North-eastern states as in this study. Thus, this study has bridged the gap from by studying the entire six states of the North-eastern region which will add to the existing literatures on the subject matter. Similarly, Age of state since existence, Number of Local Government and Population of the state were controlled for, in the model. The reasons for their inclusion are simple; they form part of the indices of statutory allocations.

For government to overcome the challenges of executing both recurrent and capital expenditure, revenue must be mobilized through different sources and be utilized in programs and fiscal policies that will impact positively on the lives of citizens. Thus, it is necessary for government to give revenue generation the desired attention to meet up with the increasing demand of the public. The major objective of this study is to analyse the effect of the relationship between revenue generation and recurrent expenditure of North-eastern states in Nigeria. To achieve this, the following research questions are raised in line with the specific objectives of the study:

- What is the effect of IGR on capital expenditure of North-eastern states in Nigeria?
- How does EGR affect capital expenditure of North-eastern states in Nigeria?

This paper is structured as follows. Section 2 reviewed the concepts of internally generated revenue, externally generated revenue, empirical review and theory of taxation that underpins the current study. Section 3 presents the methodology, variables and their measurements and of course the model specification. Section 4 deals with the discussion on data analysis as well as, the robustness tests carried out while section 5 presents the conclusion and recommendations of the study.

2. 0 Literature Review

2.1 Conceptual Review

The conceptual review looked at issues associated with the study. It covered both the concepts of internally generated revenue, externally generated revenue as well as, capital expenditure as used in this study.

2.1.1 The Concept of Internally Generated Revenue (IGR)

Internally Generated Revenue (IGR) is that type of revenue that government generates within the areas of their jurisdiction (Ibrahim & Ozioma 2019). According to Olumide and Adeola (2015) and Morufu and Babatope (2018) the sources of IGR available to state governments even though the sources are not uniform among states, include: direct taxes, licenses, fees and fines, earnings and sales, rent on government properties, interest earned, and miscellaneous income. Similarly, Ofoegbu and Alonge (2016) viewed IGR as that type of revenue that states derive from various sources such as taxes, licenses, fees, fines, among others. Internally Generated Revenue is fund or financial prowess gotten from or accumulated from various means within a nation, state or country that is used for further maintenance or development of the state. Michael (2018) described Internally Generated Revenue as revenue generated by state within the Nigerian federation, independent of their share of revenue from the federation account. Amin (2018) viewed IGR as revenues accruing to the State within their area of jurisdiction.

2.1.2 The Concept of Externally Generated Revenue (EGR)

This type of revenue referred to as the externally generated revenue (EGR) is revenue that is generated outside the jurisdiction of a state. Aregbeyen and Kolawale (2016) described EGR as the major source of revenue at any level of government. The EGR is made up of the following components:

1. **Federal Allocation:** It is an allocation from the federation account where the Federal, each of the 36 states and the 774 Local Governments are entitled to this allocation on an agreed sharing formula which is 52.68%, 26.72% and 20.6% accordingly.

2. **Value Added Tax (VAT):** This is a consumption tax placed on a product at the prevailing rate on a supplier that is taxable individual who are expected to add the amount to invoice for collection from customer for onward remittance to the authorities on a monthly basis (Eita & Mbazima 2018). Currently the VAT revenues formula for sharing is 15% to the Federal Government, 50% to States & FCT, and 35% to Local Governments.

3. **Other Capital Receipts:** These are funds that state governments use to collect from foreign governments, international organizations, federal government, local government, corporate organizations or individual in the form of re-imbursements, contributions to joint projects, grants, donations and the like of them.

2.1.3 The Concept of Capital Expenditure (CE)

Capital expenditures are expenses on capital projects such as roads, buildings, plants property and equipment. It can simply mean spending on assets. It is the purchase of items that will last and will be used over time in the provision of a good or service. Ibrahim and Ozioma (2019) stated that capital spending is sometimes associated to investment or development spending, where expenditures have benefits extending over years into the future. Under this definition, governments may include physical assets for government use (for example, office buildings), public good nature that also enhances private sector development (for example, roads and water systems), and intangibles (for example, education and research).

Again, Alani (2020) described capital expenditure as a plan for acquiring and maintaining long term assets. It is also a means of financing these activities. Typically, capital expenditure includes some of the following: new infrastructural facilities, major renovation and repair to existing facilities, it also covers benefits for several years. Expenditure may also arise from acquiring or improvement of fixed assets or acknowledgement of liability for example, rent accrued/due, which is regarded as expenditure in the accrued period even though it may not be paid until a later date (Ibrahim & Ozioma, 2019). In the case of the government, examples of capital expenditure would be the building of a new hospital, the purchase of new computer, equipment or networks, building new roads (Adegbite & Shittu, 2017). While, Osho, Olemija and Falade (2019) asserted that capital expenditure refers to spending on capital project like roads, airports, education, telecommunication, electricity and acquisition of investment goods.

2.3 Empirical Review on Revenue and Capital Expenditure

Mohammed *et al* (2015) studied expenditure and internally generated revenue relationship, an analysis of local governments in Adamawa state. Panel data was extracted from the local governments audited financial statements for a period of 10 years (2003-2012). Pooled regression was used for data analysis. Findings from the study revealed a significant relationship between government expenditure and internally generated revenue. Capital

expenditure and recurrent expenditure on agriculture and natural resources, roads, rural electrification, market expansion significantly influence the IGR of Adamawa state.

Adenugba and Ogechi (2017) investigated the effect of IGR on infrastructural development of Lagos state. The study used survey research design and purposive sampling method in selecting respondents from the Lagos State Inland Revenue service. The data for the research was analysed using Spearman's rank correlation, descriptive and inferential statistics. The findings showed that there was a positive relationship between internally generated revenue and infrastructural development in Lagos state. More so, Peter and Ferdinand (2017) examined the effect of IGR on capital expenditure utilization in Cross Rivers State. The study used secondary data that was sourced from the Cross Rivers state internal revenue service and budget department in the ministry of finance. The data was analyzed using descriptive statistics, charts and percentages. The study in its findings concluded that increase in government expenditure without corresponding revenue will widen the budget deficit.

In their study, Morufu and Babatope (2018) investigated relationship between IGR and the revenue profile of selected South-western state governments of Nigeria and its effect on the capital expenditure. The study used secondary data extracted from the financial Statements of 3 South Western States for the period 2006-2015. Ordinary Least Square Regression (OLS) was the tool used in analyzing the data. Findings from the study reveal that IGR has no significant effect on capital expenditure.

Furthermore, Onyinyechi, Ekwe and Ihendinihu (2018) examined the effect of IGR on economic development in Nigeria over the period 1981-2016. This study made use of ex-post facto research design to specifically examine the effect of total IGR (TIGR), Federal Government Independent Revenue (FGIR), States IGR (SIGR) and Local IGR (LIGR) Governments IGR on the Real Gross Domestic Product (RGDP) as the proxy for economic development of the country. The data were gathered from the Central Bank of Nigeria (CBN) Statistical Bulletin. The statistical tool used for data analysis was the multi-regression and t-test for test of hypotheses. The findings of the study revealed that TIGR, SIGR and LIGR have robust and significant positive effect on RGDP. More so, FGIR also indicated positive and significant effect on RGDP.

More so, Mbah and Oniora (2018) examined the effect of internally generated revenue on infrastructural development of Southeast states of Nigeria. Ex-post factor research design was used and data was extracted from budget estimates of each of the five south eastern states. The study employed descriptive statistics, correlation and linear multiple regression for data analysis and data interpretation. Findings from the study revealed a positive and significant effect of the independent variable (Internally Generated Revenue) and the dependent variable (cost of infrastructure in the South-eastern states).

Again, Ibrahim and Ozioma (2019) assessed the effect of internally generated revenue on total expenditure of Gombe state for the period of 2008-2018. Secondary data were collected from the Office of the Accountant General of Gombe state through the annual reports and account. Descriptive statistics and Ordinary Least Square (OLS) regression were used in

analyzing the data. A major finding of the study was that, internally generated revenue showed a positive and significant effect on total expenditure of Gombe state. That is IGR contributes significantly to total expenditure of Gombe state. In addition, Olayinka and Phebe (2019) assessed the effect of internally generated revenue on infrastructural development in Lagos state. Data was sourced from State and Local Government Program me (SLGP) Consultants' Report and Lagos state ministry of Planning and Budgeting website. The data was analysed using simple linear regression techniques. The result showed that there is a significant positive effect of internally generated revenue on infrastructural development.

Similarly, Alade, Olaoye and Ojo (2019) investigated the revenue profile and government expenditure in Nigeria from 1987 to 2017. The researchers objectively analyzed the movement of oil revenue, non-oil revenue, capital expenditure and recurrent expenditures. Equally the study considered the effect of revenue on expenditure pattern in Nigeria using four single models in which capital expenditure and recurrent expenditure were made a full function of oil revenue and non-oil revenue. Correlation matrix and simple regression were used by the researchers to analyse the data generated from CBN statistical Bulletin. The findings revealed that both oil revenue and non-oil revenue exerted a significant effect on capital and recurrent expenditure in Nigeria.

More so, Osho *et al*. (2019) examined the effect of tax revenue on government capital expenditure and economic growth in Nigeria. The study specifically evaluated the long run relationship between EGR and government capital expenditure in Nigeria. Secondary data that span from 2009 to 2018 extracted from series of published central bank statistical bulletins were collected and analyzed with the use of descriptive statistics. Inferential statistics in the form of multiple regression, and T-Test were employed. Findings revealed that companies' income tax has a positive relationship with capital expenditure; petroleum profit tax had a negative effect on the financing of government development project; value added tax had positive but insignificant effect on total government capital expenditure.

In addition, Craig, Adetola and Maminu (2020) examined the effect of tax revenue on capital expenditure in Nigeria. Secondary data were collected from audited financial statements of Federal Inland Revenue Service, CBN statistical bulletin and National Bureau of Statistics from 1989-2018. Data collected were analyzed using linear regression method to explain the association between variables of tax revenue, (independent variable), capital expenditure (dependent variable). The study concluded that revenue generated from tax has no effect on capital expenditure allocation.

In their study, Hammayo, Shittu and Abdullahi (2020) examined the impact made by the efforts of Bauchi State government in the development of infrastructure represented by the level of capital expenditure incurred through the utilization of the state's revenues. Secondary data were obtained from the government's annual financial statements for the period 2006-2018. Ordinary least square regression was employed as the technique of analysis. The findings of the study revealed that share of allocation received from the federation account as well as debt both have positive and significant influences on the provision of infrastructure while internally generated revenue showed a negative and significant relationship.

a. Theory of Taxation as a Source of Government Revenue

Economists have put forward many theories or principles of taxation at different times to guide the state as to how justice or equity in taxation can be achieved. The main theories or principles in brief, are:

2.4.1 Benefit Theory

This theory was initially invented by Knutwicksell (1896) and Erik Lindahl (1919) as cited by Escarraz (1967). According to this theory, the state should levy taxes on individuals according to the benefit conferred on them. The more benefits a person derives from the activities of the state, the more s/he should pay to the government (Oshoe *et al.* 2019). The major criticism of the theory is that, if state maintains a certain connection between the benefits conferred and the benefits derived. It will be against the basic principle of the tax. A tax, as we know, is compulsory contribution made to the public authorities to meet the expenses of the government and the provisions of general benefit. There is no direct quid pro quo in the case of a tax.

Similarly, most of the expenditure incurred by the state is for the general benefit of its citizens, it is not possible to estimate the benefit enjoyed by a particular individual every year. And also, if the principle is put to practice, then the poor will have to pay the heaviest taxes, because they benefit more from the services of the state. If we get more from the poor by way of taxes, it is against the principle of justice.

2.4.2 Peacock and Wiseman Theory of Public Expenditure

Peacock and Wiseman theory is focused on the pattern of public expenditure which asserts that public expenditure is not constant but rather, public expenditure increases in steps. Osho *et al.* (2019) opined that the theory is known as displacement hypothesis that is based on the experience of the Great Britain. This suggests that public expenditure tend to increase due to some social or other disturbances as the existing public revenue cannot solve the disturbances and that the fiscal activities of government rise on the basis of step by step over a particular period of time. And thus, when the social disturbances occur, government raises tax that is occasioned by low taxes so as to increase revenue and increase public expenditure to meet up with the social disturbance. This theory is relevant in this current study as the social disturbances in terms of unemployment, inflation and the insecurity challenges facing the North-eastern region of Nigeria has made cost of governance very challenging and government is devising means to increase its revenue generation so as to meet up with the current reality.

3.1 Methodology

Given the nature of the study, which is based on historical data, secondary source of data was considered more appropriate. The study used ex-post factor research design. This type of research design has been used by Onyinyechi *et al.* (2018). The data for the study was extracted from the annual reports and accounts of the six states in the North-eastern region of

Nigeria from 2009-2020. The study uses census sampling technique to arrive at the sample size of the study and the sample size comprises of all the six (6) states in the region. Descriptive statistics and regression analysis was applied to the data to test the relationship between the variables of the study. The data analysis was achieved through STATA software.

Table 3.1: Population of the Study

S/n	Name of State	Symbol	Sector	Date of Creation
1.	Adamawa	AD	Public	1991
2.	Bauchi	BH	Public	1976
3.	Borno	BO	Public	1976
4.	Gombe	GM	Public	1996
5.	Taraba	TR	Pubic	1991
6.	Yobe	YB	Public	1991

Source: *Researcher's Extraction (2023)*

3.2 The Variables of the Study and their Measurements

This study used three set of variables: dependent, independent and control variables.

Table 3.2: Variables and their Measurement

Variables	Type	Symbol	Measurement	Source
Capital Expenditure	Dependent	CE	Log of Capital Expenditure	Onyinyechi *et al.* (2018) Craig *et al* (2020)
Internally Generated Revenue	Independent	IGR	Log of IGR Collected	Onyinyechi *et al.* (2018) Craig *et al* (2020)
Externally Generated Revenue	Independent	EGR	Log of EGR Collected	Onyinyechi *et al.* (2018) Craig *et al* (2020)
Age	Control	AGE	No of years since creation	FAAC (Federation Account Allocation Committee 2020).
No of LGA	Control	LGA	No of LGAs in the State	FAAC (Federation Account Allocation Committee 2020).
Population of the States	Control	POP	No of People in the State	FAAC (Federation Account Allocation Committee 2020).

Source: *Researcher's extraction from Literatures (2023)*

3.3 Model Specification

The dependent variable of the study is recurrent expenditure, while the independent variable is the total internally generated revenue and the externally generated revenue. The linear model which is adapted from the work of Onyinyechi *et al.* (2018) is presented below:

$$CE = f\left(IGR + EGR\right)$$

$$\mathrm{CE}_{it} = \beta_0 + \beta 1\mathrm{IGR}_{it} + \beta 2\mathrm{EGR}_{it} + \beta 3\mathrm{AGE}_{it} + \beta 4\mathrm{LGA}_{it} + \beta 5\mathrm{POP}_{it} + \ell \qquad (1)$$

4.1 Data Analysis and Interpretation

4.1.1 Descriptive Statistics

The summary statistics for the variables of the study is presented on Table 4.1.

Table 4.1: Descriptive Statistics of the Variables

Variables	Obs.	Mean	Std. Dev.	Min	Max
CE (₦ Billion)	72	23.9	8.3	7.1	44.2
IGR (₦ Billion)	72	4.9	2.2	1.3	12.3
EGR (₦ Billion)	72	66.8	16.5	32.0	107.6
AGE (years)	72	27.7	8.7	13	44
LGA (No.)	72	18.7	5.0	11	27
POP (Million)	72	3.2	0.9	2.3	4.7

Source: *Stata Output 14.0*

Capital Expenditure (CE) recorded a mean value of ₦23.9 billion. It also recorded a minimum value of ₦7.1 billion and a maximum value of ₦44.2 billion for all the states within the study period. This indicates a standard deviation of ₦8.3 billion in CE among the states in the region. More so, the average internally generated revenue for the states in North-eastern region of Nigeria is ₦4.9 billion, with minimum and maximum values of ₦1.3 billion and approximately ₦12.3 billion respectively with a standard deviation of ₦2.2 billion in the region. Again, the externally generated revenue recorded a mean value of ₦66.8 billion. It also recorded a minimum value of ₦32.0 billion and a maximum value of ₦107.6 billion with a standard deviation of 16.5 billion for all the states within the study period.

In addition, the mean value of age (AGE) variable is approximately 28 years, with minimum and maximum values of 13 years and 44 years respectively. the number of local government areas is recorded as a mean value of 19 with a minimum value of 11 and a maximum value of 27. This indicates a low variation in the number of local government areas as depicted by the standard deviation of 5 that is lower than the mean value. Population of the states recorded an average value of approximately three million people 3.2million with minimum and maximum values of approximately two million people and approximately five million people respectively. This indicates a low variation in the population of states as depicted by the standard deviation of approximately one million people which is lower than the mean value.

4.1.2 Effect of Internally and Externally Generated Revenues on Capital Expenditure

Table 4.2: Fixed Effect Regression Results

CE	Coefficient	T-Value	P-Value
IGR	0.2851	2.71	0.009
EGR	0.9348	4.62	0.000
AGE	-0.0189	-3.07	0.003
LGA	0.0053	0.04	0.969
POP	-6.13e-09	-0.19	0.848

R-Sq.	
Within	0.3348
Between	0.0427
Overall	0.0336
Prob > F	0.0001
Hausman	0.0185
F-test	0.0000
Hettest	0.5336
Mean VIF	2.36

Source: *Stata 14.0 output*

From Table 4.2, the fixed effect regression result showed a p > value of 0.0000 which suggests that the model is fit for the study. Again, Heteroskedasticity and mean Variance Inflation Factor (VIF) of 0.5336 and 2.36 respectively. This suggest that, Heteroskedasticity and Multicollinearity is not a problem in this model since hettest value is insignificant at 5% while the mean VIF is less than 5.

The result further revealed hausman specification test with p-values of 0.0185 and F-test with a Prob > F of 0.0000 which are significant at 5% and favours the fixed effect result for interpretation. Thus, the choice of fixed effect result for interpretation is considered appropriate based on the underlying assumption of the hausman specification test, as well as, the F-test.

The fixed effect regression result showed the within, between and overall value of the R^2 as 0.3348, 0.0427 and 0.0336 respectively. This explains the multiple coefficient of determination that gives the proportion or percentage of the total variation in the dependent variable explained by the explanatory variables jointly. Hence, it signifies that approximately 33% of total variation in recurrent expenditure of the states in North-eastern region of Nigeria is caused by internally and externally generated revenue, age since creation, number of local governments' areas, as well as, population of the states.

From the fixed effect regression result in Table 4.2, it can be observed that IGR has positive and significant impact on capital expenditure at 5% level of significance with a coefficient of determination of 0.2851 and p-value of 0.009. Based on this result, the study rejects the null hypothesis one (1) which states that IGR has no significant impact on capital expenditure of states in the North-eastern region of Nigeria. This implies that an increase in IGR would result to a significant increase in capital expenditure in the region. This finding is consistent with those of Mohammed *et al* (2015), Mbah and Oniora (2018) who found that IGR has a significant impact on Capital expenditure. However, the result contrast the findings of Adenugba and Ogechi (2017), Peter and Ferdinand (2017) and Morufu and Babatunde (2017) who found that IGR has no significant impact on capital expenditure. These findings will result in heightening the tension between meeting important development goals and containing debt vulnerabilities; and, at worst, lead to default and distress.

Similarly, the fixed effect regression results in Table 4.2, showed that EGR has positive and significant relationship on capital expenditure at 5% level of significance with a coefficient of determination and p-value of 0.9348 and 0.000 respectively. Thus, based on this result, the study rejects the null hypothesis two of the study which states that EGR has no significant relationship on capital expenditure of states in the North Eastern Region of Nigeria. This implies that EGR has positive and significant relationship on capital expenditure. This finding is consistent with those of Hammayo *et al.* (2020), Craig *et al.* (2020), Onyinyechi *et al.* (2018), Osho *et al.* (2019) Alade *et al.* (2019) who found that EGR has positive and significant relationship on capital expenditure. However, the over reliance of states in the north eastern Nigeria on EGR is not healthy as any drop in the EGR allocation will affect the expenditure financing.

5.1 Conclusion

In line with the analyses, the study established that states in the North-eastern region of Nigeria are over-dependent on the externally generated revenue to finance their capital expenditure. This is evident by the insignificant impact of internally generated revenue on capital expenditure while externally generated revenue positively and significantly impacted on capital expenditure.

5.2.1 Recommendations

i. North-eastern states should come up with a tax enforcement policy aiming at increasing internally generated revenue as evident by its insignificant impact on capital expenditure. Such policies will be in the form of review of tax laws to conform with current realities, similarly, data bank containing information on each tax payer should be established where records of each tax payer will be captured. Similarly, states in the North-eastern region of Nigeria should prepare and maintain a realistic budget such that EGR will continue to be significant and relevant in financing recurrent expenditure.

ii. State governments in the region should increase the size of their IGR so as to accommodate their total expenditure. Diversification of revenue sources to explore other sources like the non-mineral sector is an option as this will help in bridging the gap between revenue and expenditure.

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