

## ANALYSIS OF INTERNALLY GENERATED REVENUE AND CAPITAL EXPENDITURE UTILIZATION IN CROSS RIVER STATE, NIGERIA

Oti Peter A. (Ph.D) and Odey Ferdinand I.

<sup>1</sup>Department of Accounting, Faculty of Management Sciences, University of Calabar, Nigeria

<sup>2</sup>Department of Economics, Faculty of Social Sciences, University of Calabar, Nigeria

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**ABSTRACT:** *The study analyzed the relationship between internally generated revenue and capital expenditure utilization in Cross River State, Nigeria from 2007 to 2015. Secondary data sought from Cross River State budget office, internal revenue service and ministry of finance were used for the study. Descriptive statistics were used to analyze the relationship between internally generated revenue and capital expenditure utilization in Cross River State. Findings from the study indicate that increase in government expenditure without corresponding revenue will widen the budget deficit. It is recommended from the findings that; the Cross River State government should increase the size of its internally generated revenue in order to accommodate the capital expenditure of the state. The state government should diversify its economy and explore especially the non oil minerals sector of the state economy so as to correct the disparity between revenue and expenditure and reduce the attendant budget deficit. Expenditure reforms analysis should be considered vis-à-vis taxes and all other revenues sources. This will help set targets for revenue mobilization and utilization as well as expenditure spreading over the entire state economy. The Cross River State government in order to be sustainable in its development strive must develop the internally generated revenue base, promote fiscal prudence in the management of its resources, enhance infrastructures, eschew corruption and unsustainable spending as well as sustain it capital votes. The Cross River State government should continue to increase its aggregate revenue mostly from internally generated revenue base, since only revenue from internal sources can boost the state income given the dwindling allocations from the federation account. The government should go a step further in intensifying efforts at developing other sources of revenue in order to insulate the economy from the volatility associated with the oil revenues.*

**KEYWORDS:** Internally Generated Revenue, Capital Expenditure, Budget, Cross River State.

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### INTRODUCTION

The slowdown of development expenditures leads not only to lower economic growth rate over the medium and long term, but over the short term run, new development programmes are poorly implemented, resulting in delays, escalation of costs and ultimately, in total abandonment of some projects.

The rebasing of Nigeria's Gross Domestic Product (GDP) by the National Bureau of Statistics (NBS) in April 2014 to better reflect the structure of the economy led to an increase of the GDP by 89 percent in 2013. Following this, Nigeria became Africa's largest economy with an estimated GDP of \$510 billion in 2013, compared to \$270 billion reported in previous year (NBS, 2015). But the country continues to face challenges relating to its fiscal federalism. The tax revenue to GDP ratio plummeted from about 20 percent to 12 percent and non-oil tax from

7 percent to 4 percent. These are some of the lowest ratios in the world. Anchored on a revenue sharing formula that first pools all resources to the centre and thereafter allocates to each tier of government according to a specific sharing formula, it has been a source of friction among federating units since the country transited into full scale federalism in the 1960's (NGF, 2016).

Apart from the daunting challenges experienced with the revenue sharing formula, there are equally challenges emanating from the non-product nature of the funding sources with up to 70 percent coming from oil and other commodity prices are known to be unstable and such instability is often transmitted first to revenue and thereafter to the rest of economy. The instability in oil revenues as a result of the volatility in global oil market is one major source of concern for such dependence of Nigerian state governments on revenue accruing to the federation account.

### **Statement of problem**

There are issues with the options, capacity and opportunities for some of the federating units (state and local governments) to raise internally generated revenues. A number of the revenue line items assigned to states by the constitutions are yet to be developed enough to yield robust revenues to them. As the price of crude oil in the international oil market plunges, dropping from about \$115 in June 2014 to less \$65 in December 2017, government across the three tiers are experiencing fiscal crunch. Federally collected revenue and the amounts of federal transfers to states have significantly reduced. This poses significant challenges to the state governments in managing their budgetary expenditure as a significant reduction in revenue hinders the capacity of state governments to deliver on basic infrastructure.

Many state governments including Cross River State are genuinely eager to grow their internally generated revenue base but seem largely unable to harness available opportunities to do so. Many legitimate sources of revenue in the state remained untapped, while procedures for the collection, remittance and accountability for the ones exploited often fall short of expectations, giving room for avoidable leakages. The consolidated revenue account of the Cross River State is made up of internally generated revenue and other receipts from the federation account. It is assumed that when the internally generated revenue is low, the state is forced to apply most of its federation account allocation to service recurrent expenditure, whereas when the internally generated revenue is high a greater percentage of the federation account will be used for capital expenditure. Does the state operate such a stringent fiscal policy as to ensure that all the federation account allocation is used for capital expenditure in spite of the low level of internally generated revenue? This study seeks to find answers to this when the data is analyzed.

The main objective of this study is to ascertain the nexus between internally generated revenue and capital expenditure utilization in Cross River State, Nigeria.

## **LITERATURE REVIEW AND THEORETICAL FRAMEWORK**

### **The Concept of Internally Generated Revenue**

Internally Generated Revenues (IGR) are those sources of government finance generated majorly by the federal, states and local councils, which help in broadening and widening the overall non-oil revenue structure of the state. The current challenges of the three tiers of

government in Nigeria is the dwindling level of revenue generation, mostly by the state governments and the absolute dependence on federal allocation which is tilted more in favour of the Federal Government, hence giving rise to annual budget deficits in the states and inadequate financial resources for meaningful growth and viable projects development (Adewoye & Fasina, 2008). Udeh (2002) asserts that the poor financial status of states in Nigeria has escalated due to the non-provision of grants by the federal government which under the constitution are needed to be made available annually during budgetary disbursement to leverage sub-national governments in crisis to address challenges of inadequate financial resources needed to cope with their ever increasing areas of assigned services which include; shelter, health services, water supply, food, as well as qualitative education at primary and post-primary schools level which usually engulf huge sums of money. An observation of the income profile of Cross River State from 2007 to 2014 showed that the internally generated revenue is less than one fourth of the total inflows accruing to the state.

### **The Plummeting Trend of Public Expenditure in Cross River State**

Capital expenditure averaged about 56.1 percent of spending as the share of capital expenditure in Cross River State consistently declined from 2008 to 2010. From a high of 65.6 percent in 2008, capital expenditure fell to 49.1 percent in 2010 (Cross River State Budget Office, 2014). On the other hand, current spending gradually raised its profile to fill the space vacated by capital expenditure. By 2010, current expenditure, which started in 2008 with a share of just over 35 percent, had assumed the majority share of spending at 51 percent. Steady increases in both personnel and overheads expenditure explain the rising trend of current spending, with personnel expenditure rising more sharply. Wages and salaries rose annually to 25.1 percent in 2010. On the average personnel expenditure average 20.4 percent, and overheads, 23.5 percent. Domestic debt service average 0.4 percent (CDSNTFs, 2006).

In 2008, consolidated revenue outstripped recurrent expenditure thereby leading to a large transfer of capital funds in the state, and the total capital expenditure was lower than the total capital receipts plus transfer from consolidated revenue fund. The year of revenue challenges resulting from the geo-politics of oil wells which impacted adversely on the budget performance was 2009. Recurrent expenditure outstripped consolidated revenue thereby transferring a deficit to capital development and making it difficult for the state to finance budgeted capital projects for the year as planned. In line with fiscal target in 2010, an overall structure of 69.31 capital expenditure and recurrent expenditure ratio was set with ambitious revenue projections (both recurrent revenue and capital receipt). Since the realization of projected revenues was cloudy, funding capital projects became challenging and budget performance was dismal.

Since 2007, budget deficits have been much more common in real terms than surplus. The leading cause of unrealistic budgeting inflow is grant aids projections. However, about 70 percent of short falls in budgeting inflow is attributable to grants, excess crude and loans expectations (CRS Budget Department, 2013).

### **Fiscal Target and Public Expenditure Framework in Cross River State**

An effective public sector is central to the government plans over some fiscal years. The state government in the quest to see better results and improved services from the public sector, acts fiscal targets that will eliminate fiscal deficit and reduce debt burden in order to restore fiscal buffer against future adverse events, increase state savings and support inflow investment,

reduce future borrowing and unlock untapped growth potentials. Supported by legislative fiscal targets are act for this fiscal expenditure strategy.

- **Expenditure ceiling:** prudent aggregate expenditure limit shall at all events not exceed 25% above the aggregate revenue estimate for that financial year.
- **Multi-year Budgeting:** To achieve an annual 60:40 ratio for capital expenditure to recurrent expenditure using a multi-year budgeting methodology based on established medium term action plan.
- **Grants and Aids:** To maintain a 60:40 ratio for all grants/aid inflows into the state, and to grow development partners support on the average by about 20 percent year-on-year, while keeping state's counterpart funding at minimal level.
- **Loans and Credits:** The total amount of loans outstanding at any particular time shall not exceed the actual total revenue of the state for the preceding two years. And government shall manage total remains consistently below 35 percent of the state GDP.
- **Reserve Fund:** Maintain the state's Reserve Fund established under the Cross River State Reserve Fund Law by providing for an assured inheritance for future generation of citizens of the state with a monthly contribution of not less than ₦50 million from the state government, and ₦1 million each from the 18 local government councils of the state for a period of fifteen years (CRS Reserve Fund Law, 2011).
- **Investment:** To efficiently manage government investment to achieve a Return on Investment (ROI) of at least 3 percent above prevailing Treasury Bill Rate (CRS FRA, 2011).
- **Contingencies:** Combined contingencies amount of any authorization should not exceed 2 percent of the total amount appropriated in the annual budget of the state for the current financial year.

### Theoretical Framework

This study is based on the Keynesian theory of public expenditure. Keynes (1936) showed that there is insufficient aggregate demand and active stabilization policy is needed to maintain good economic performance. He regarded public expenditures as an exogenous factor, a policy which can be used to maintain the economic performance. Accordingly, Keynes was of the view that increases in public spending speedily leads to a multiple rise in total output of an economy. Therefore, this theory advocate government involvement in the management of economy with the expansion of fiscal policy to influence macroeconomic performance and increase output growth. This theory went on to suggest that the efficient utilization of public expenditure can contribute positively to economic growth as well as revenue generation.

### Empirical Studies

A plethora of empirical studies have been carried out on public revenues and expenditure without given much attention to the linkage between internally generated revenues and capital votes utilization mostly at the sub-national levels. In recent times however, a few scholars have ventured into this area and their efforts have served as the stepping stone for recent studies.

Tracy & Vester (2009) investigated the interrelationship between total government expenditure and total tax revenue in Barbados applying the Granger causality on both bivariate and multivariate models. It was revealed from the empirical findings that a unidirectional causality exists from tax revenue to government expenditure.

Waziri (2010) examined the growth of public expenditure using the Adolf Wagner hypothesis and employing primary data on the aggregate expenditure of local councils in Nigeria between 1993 and 2002, and their distribution between consumption and investment spending in relation to economic growth. It was found from the study that local governments in Nigeria are mostly affected by the low level of capacity utilization and weak revenue base.

Emelogu & Uche (2010) examined the relationship between government revenue and government expenditure in Nigeria, using cointegration and causality approaches. Applying time series data from 1970 to 2007, obtained from the Central Bank of Nigeria, the study was based on four hypotheses such as revenue-spend hypothesis, the spend-revenue hypothesis, the fiscal synchronization hypothesis and the institutional separation hypothesis. It employs the Engel-Granger two-step co-integration technique, the Johansen co-integration approach and the Granger causality test within the Error Correction Modeling (ECM) framework. The findings revealed that there is a long run relationship between government revenue and government expenditure in Nigeria. Thus, the findings support the revenue-spend hypothesis for Nigeria, indicating that changes in government revenue induce changes in government expenditure at both national and sub-national levels.

Ogbonna (2010) who studied the effect of government revenue on capital spending in Nigeria made use of primary data through structure questionnaire. The areas covered by the study include tax payers constraints, tax administration, principles of taxation, as well as its purposes, uses, classifications and effects in revenue generating capacity. The results of the study was in consonance with the stark reality that characterized the Nigerian tax system such as poor infrastructure, use of unqualified tax personnel, public resistance to tax payment, unconventional means of tax administration, greed and sharp practices on the part of tax officials, which undermine internally generated revenues at the sub-national components of government.

Olusola (2011) using Ordinary Least Squares found that revenue sources such as rates, fines, fees, licenses and rent are factors that significantly influence the generation of revenue internally in Ogun state.

Saeed & Somaye (2012) examined the causality and the long run relationship between government expenditure and government revenue. Using oil revenue as proxy for total revenue, their findings revealed a positive unidirectional long-run causality between oil revenue and government expenditure.

Nwosu & Okafor (2014) studied the disaggregated analysis of government revenue and expenditure in Nigeria, using time series data from 1970 to 2011. Utilizing the co-integration techniques and Vector Auto-Regression (VAR) models it was revealed that a long run equilibrium dynamic relationship exist between government revenue and expenditure.

Nwanne (2015) investigated the effects of tax policy on the expenditure of local government councils in Imo State. The objective of the study was to evaluate the effect of the Nigerian tax policy on the ability of local governments to raise and spend money in discharge of their

statutory responsibilities. The study was occasioned by the fact that sub-national governments seems to be carried away by the euphoria of the periodic statutory allocations from the Federation Account to the extent of neglecting internally generated revenues to finance both recurrent and capital expenditures. A descriptive approach was adopted and the Ordinary Least Squares regression was used. Applying the chow test of structural stability it was revealed that tax policy on internally generated revenue has significant positive on the public expenditure of sub-national levels in Imo State.

However, despite the numerous empirical studies (e.g. Tracy & Kester, 2009; Waziri, 2010; Ogbonna, 2010; Nwosu & Okafor, 2014; Saeed & Somaye, 2012; Emelogu & Uche, 210 and Nwanne, 2015) conducted to link revenue and expenditure, yet less attention has been paid on the nexus between internally generated revenue and capital expenditure mostly at the sub-national levels of government in Nigeria. Hence, this study is to fill the gap with particular reference to Cross River State, Nigeria.

## METHODOLOGY

Data analysis is undertaken using descriptive method. A major segment of the information collected during the study was descriptive in nature. Descriptive statistics such as charts, percentages and graphs etc were employed in most of the analysis in summarizing trends, changes and comparison across certain characteristics. Final presentation took the form of description, tabulation and illustrations. The major source of data is secondary as the data used were sourced from the Cross River State Internal Revenue Service, Budget Department and Ministry of Finance.

### Analysis and Discussion of Results

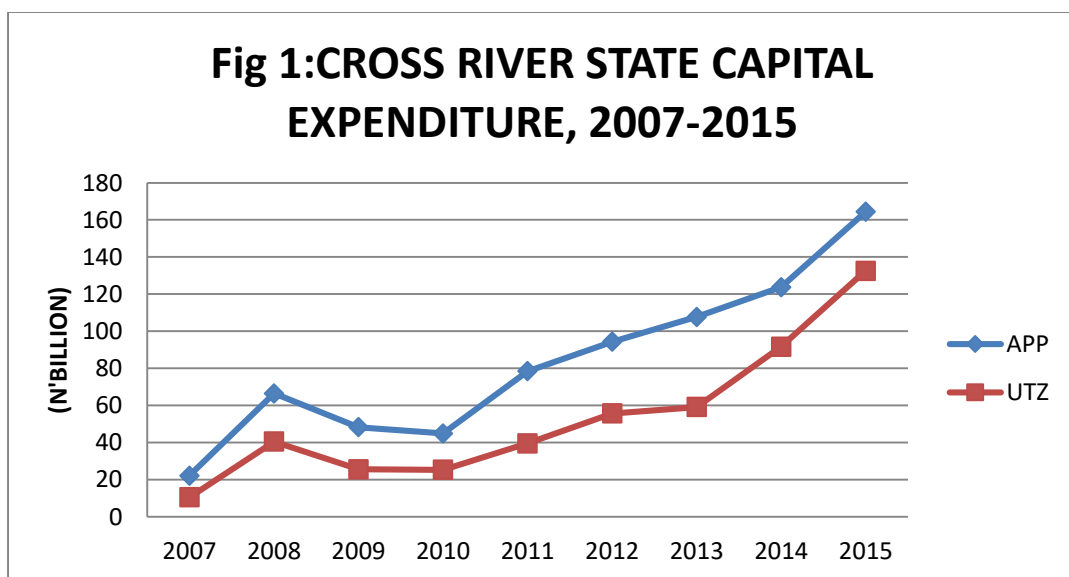
**Table 1: Capital Expenditure and Internally Generated Revenue in Cross River State, 2007-2015.**

Year	Capital Expenditure		FAAC (₦Billion)	Budget (₦ Billion)	IGR (₦ Billion)
	Approved (₦Billion)	Utilized (₦Billion)			
2007	22.098	10.423	34.779	39.85	3.34
2008	66.444	40.487	45.683	106.65	6.45
2009	48.197	25.519	24.188	85.22	7.12
2010	44.887	25.327	27.601	111.77	7.87
2011	78.388	39.484	49.574	119.00	9.16
2012	94.304	55.633	45.232	144.03	12.73
2013	107.648	59.142	44.246	151.37	12.00
2014	123.678	91.66	41.789	176.31	15.74
2015	164.358	132.54	39.673	127.85	13.54

**Sources:** CRS Ministry of Finance, 2010  
 CRS Budget Department, 2013.  
 Cross River State Internal Revenue  
 Service, 2015  
 CRS Medium Term Fiscal Strategy  
 Paper (2013-2016)

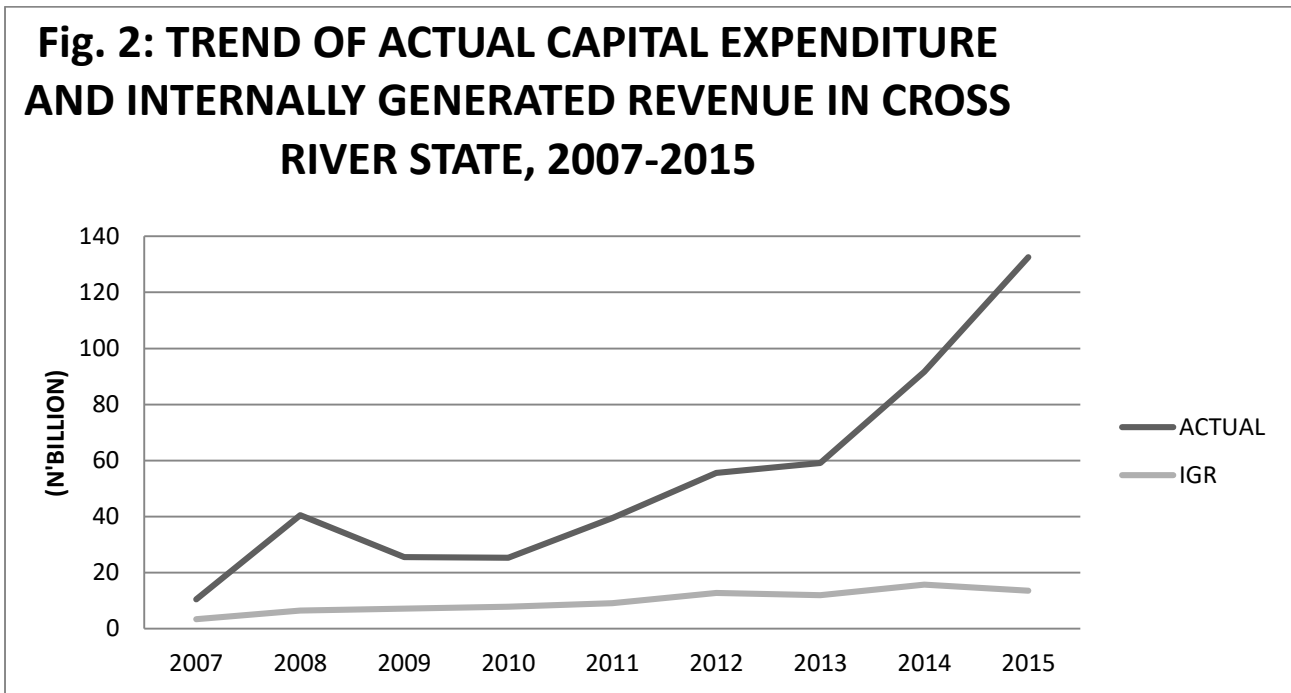
In table 1 above, it is observed that the budgeted capital expenditure grossly fall short of the actual capital spending utilized within the period under review. In 2007, 22.098 billion was earmarked but the actual capital expenditure incurred was only 10.42 billion. The difference of 11.678 billion was not utilized as a result of the shortfall either from federal allocations or internally generated revenues of the state. The approved capital votes of 66.44billion, 48.197 billion, 44.89billion, 78.39billion and 94.30billion between 2008 and 2012, were equally mismatched with actual utilization of 40.49billion, 25.52billion, 25.33billion, 39.48billion and 55.63billion, respectively. This wide variation continued unabated as the budgeted capital expenditures were not fully utilized with a shortfall of 49.51billion, 32.018billion and 31.818billion between 2013 and 2015, respectively.

The total internally generated revenue increased steadily between 2007 and 2015. The internally generated revenue increased from ₦3.3billion in 2007 to ₦6.4billion in 2008. It further increased to ₦7.1billion in 2009, 7.8billion in 2010, ₦9.2billion in 2011, ₦12.7billion in 2012 but dropped to ₦12.0billion in 2013 and increased to ₦15.7billion in 2014 but further plummeted to ₦13.54billion in 2015. The state budget cannot sustain the budgeted capital expenditure over the period as 39.85billion was budgeted in 2007. 106.65billion, 85.22billion, 111.77billion, 119.00billion and 144.03billion, 151.37billion, 176.31billion and 127.85billion were earmarked between 2008 and 2015, respectively. The dwindling revenue profile from the federation accounts occasioned by the fall in the prices of oil in the international market and the shrinking pattern of internally generated revenue are the major causes of the mismatched between the budgeted and actual capital expenditures in the state.



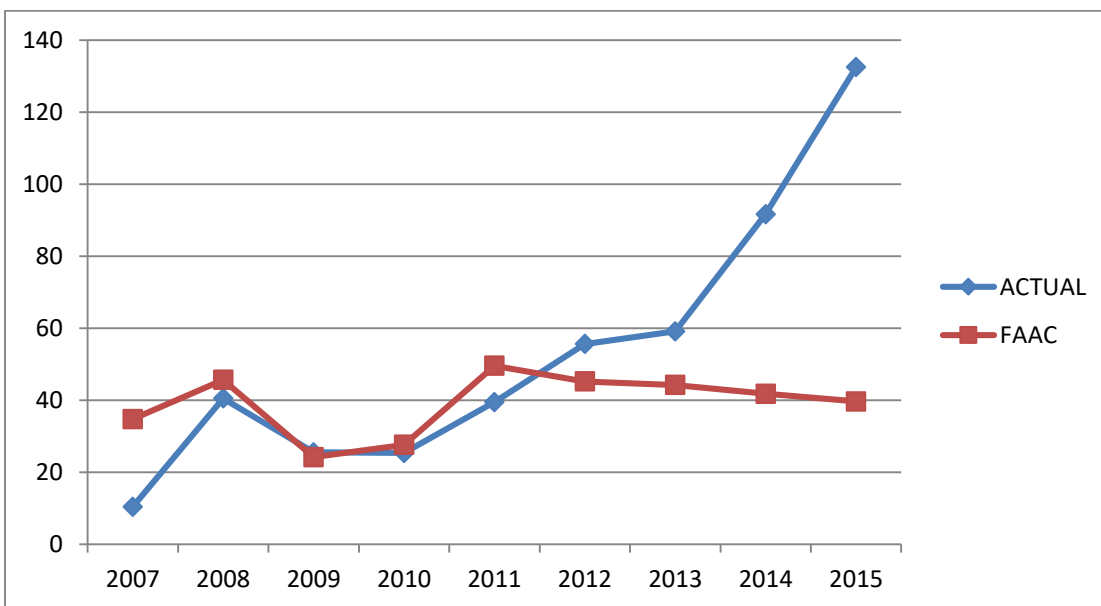
From figure 1 above, it can be observed that budgeted and actual capital expenditures trended positively within the period under review.

**Fig. 2: TREND OF ACTUAL CAPITAL EXPENDITURE AND INTERNALLY GENERATED REVENUE IN CROSS RIVER STATE, 2007-2015**



From figure 2 above, the state IGR caters for less than 10% of government annual capital expenditure. Hence, there is an enormous resource gap between available IGR and the amount required to meet the developmental aspirations of the state. Within the period, the rate of IGR increase is less than the increase in capital expenditure. This disparity is what prompted this work.

**Fig. 3: TREND OF ACTUAL CAPITAL EXPENDITURE AND FEDERAL ALLOCATION IN CROSS RIVER STATE, 2007-2015**



From figure 3 above, the state actual capital expenditure and federal allocation increased between 2007 and 2008 but plummeted steadily between 2009 and 2010. The actual capital spending outran federal allocation from 2011 through 2015, indicating that the federation



allocations have not been enough to cater for capital expenditure in the state. This prompted the state to expand its internal revenue base to undertake some capital expenditures that will enhance economic growth and development.

## CONCLUSION, POLICY IMPLICATION AND RECOMMENDATIONS

Taxation has the fiscal potency for macroeconomic stabilization as it is the main key to aggregate demand. Public expenditure is an exogenous factor which can be used to maintain economic growth and development. Increase in public spending speedily leads to a multiple rise in total output of an economy. The policy implication derivable from this study is that the increase in government expenditure without corresponding revenue will widen the budget deficit. Thus, government will be left with an option to borrow which could increase the state indebtedness. This could further widen the budget deficit and the provisions for debt servicing commitment of the state government. It is recommended from the findings that; the government should increase the size of its internally generated revenue in order to accommodate the capital expenditure of the state. The state government should diversify its economy and explore especially the non oil minerals sector of the state economy so as to correct the disparity between revenue and expenditure and reduce the attendant budget deficit. Expenditure reforms analysis should be considered vis-à-vis taxes and all other revenues sources. This will help set targets for revenue mobilization and utilization as well as expenditure spreading over the entire state economy. The Cross River State government in order to be sustainable in its development strive must develop the internally generated revenue base, promote fiscal prudence in the management of its resources, enhance infrastructures, eschew corruption and unsustainable spending as well as sustain it capital votes. The Cross River State government should continue to increase its aggregate revenue mostly from internally generated revenue base, since only revenue from internal sources can boost the state income given the dwindling allocations from the federation account. The government should go a step further in intensifying efforts at developing other sources of revenue in order to insulate the economy from the volatility associated with the oil revenues.

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