The Challenge of Subnational Revenue Mobilization: The Case of Edo State in Nigeria

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▪ Introduction

Nigeria operates a decentralized system of government consisting of three tiers of government - a federal government, 36 state governments and 774 local governments. The country's fiscal structure is also decentralized; with revenue-raising and expenditure functions assigned to the different tiers of government.

The expenditure functions of these tiers derive from the roles and responsibilities that the country's Constitution assigns to each[1]. Revenue functions are also outlined in the Constitution as well as in various tax legislations. The most important revenues are collected and accumulated at the centre by the federal government[2] and formulas determined by the Fiscal Commission are applied to distribute the accrued earnings at the centre across the tiers of government on a monthly basis.

Thus, fiscal revenues at the subnational levels of government are in two main forms: federal transfers from the central government and own or internally generated revenues (IGR). Currently, all tiers of government in Nigeria are disproportionately dependent on federal transfers (which in turn, are about 80 percent natural resource (oil and gas) based) vis-à-vis own revenues. For some states in Nigeria, up to 80 percent of total revenues are from federal transfers.

Tax revenue, and in particular non-oil tax revenue mobilization, in Nigeria is quite weak[3]. There has however been the recognition – and rightly so – by both the federal and the subnational governments that the dependence on natural resource revenues is unstable, given the volatilities associated with oil prices in the global oil market. Nigeria established an oil revenue savings fund - the Excess Crude Account (ECA) in 2004 to save earnings from oil sales at prices above an annually-set benchmark price. However, the country has not always managed to run the ECA as originally envisaged.

The unstable nature of natural resource revenues became very obvious in 2008/09 during the world financial crisis when oil prices declined sharply and most recently in early 2015 when oil prices declined by over 50 percent relative to where they were in mid-2014. The monthly federally-collected revenues were lower by about 35 percent in April 2015 relative to April 2014 (the oil and gas component was lower by 53 percent) and this has adversely affected expenditure plans of all levels of government at a time that Nigeria has almost fully exhausted its fiscal buffers unlike in 2008/09 when there were relatively

[1] Strictly speaking, the Constitution does not really provide the list of functions to be executed by the Federal Government of Nigeria and the states (as it does for the Local Government Councils), but only the subjects upon which they can legislate. However, these legislative lists form the guidelines for other statutes and policy documents that lay out the specific expenditure responsibilities of the different tiers of government.

[2] This includes corporate income tax, petroleum profit tax, mining rents and royalties; customs and excise duties, education tax on companies, value added tax and personal income tax of the armed forces, police, staff of the Foreign Service and residents of the federal capital territory. Apart from taxes and levies, the federal government also has responsibility for the collection of proceeds from the sale of crude oil and gas. State governments on the other hand collect personal income taxes within their domain and capital gains tax payable by individuals, for instance. Local governments can collect a variety of taxes, including tenement rates; market and motor park fees; and marriage, birth and death registration fees.

[3] Nigeria's Tax revenue to GDP ratio is about 8 percent (average for OECD countries is 30-40 percent); while non-oil tax revenue to non-oil GDP is about 4 percent.

high levels of buffers in the ECA. Both the federal and subnational governments have therefore been seeking ways to boost domestic non-oil revenue generation and improve the share of non-oil revenues in their total revenue baskets.

Edo state is one of Nigeria's 36 states and is located in the south-south geopolitical zone of the country. It is a marginal oil producing state and thus enjoys marginal benefits from oil and gas revenue[4]. In late 2008, when the current state government regime took office, it faced the challenge of building a buoyant domestic fiscal revenue base to support its ambitious infrastructure rehabilitation program and place the state's finances on a more sustainable path given that about 85 percent of Edo's revenues were in the form of federal transfers.

The Edo government's medium term development strategy identified massive infrastructure development in roads, urban drainage, sewage systems, health and education as a priority but there were huge financing gaps. Domestic tax policy and administration reforms were urgently required if the state was going to create the necessary fiscal space. The state thus commenced a program to improve its domestic revenue generation.

Because of the commendable progress Edo state had made in implementing its development strategy and its commitment to carrying out policy reforms, the state was selected by the Bank as the second Nigerian state to benefit from Development Policy Financing (DPF) after Lagos State. A total of US$225 million was earmarked for Edo state in a three-year programmatic DPF operation starting in 2012. Building on the state's own aspirations and efforts, one of the pillars for the first DPF operation was "Ensuring Fiscal Sustainability" through (i) improving state internally-generated revenue (IGR); and (ii) ensuring expenditure control. The first operation closed in June 2014 and the second operation, approved by the Bank's Board in April 2015 retains this pillar and builds on its earlier gains. A Fiscal Sustainability Analysis conducted by the Bank in the context of the first DPF operation indicated that among the key risks to the sustainability of Edo's fiscal program over the medium term was a possible inability of the state to significantly grow its IGR as planned.

This Note discusses the path Edo state has taken (with some Bank support) in its bid to achieve fiscal sustainability through enhanced domestic fiscal revenue mobilization in the face of several constraints. It also raises the question of what lessons other subnational governments in Nigeria and elsewhere in the developing world can draw from Edo's experience in their bid to boost tax and other domestic revenue generation sources whilst being mindful of tax equity and efficiency considerations; and how the Bank can best support these sub-national efforts.

▪ The Edo State Solutions

Up till about 2009, Edo state, like most other states in Nigeria derived at least 85 percent of its revenues from federal transfers; i.e. shares from federally-collected revenues[5]. Federally-collected revenues in turn,

[4] 13 percent of oil and gas revenue is shared only to the nine oil-producing states in proportion of their oil output. This is called the "derivation principle" in Nigeria.

[5] Lagos state is the exception with over 60 percent of its revenues generated internally. Lagos is however different from all other states as it is the commercial nerve center of the country.

have usually been about 80 percent due to oil and gas revenues (sales of crude oil and gas as well as petroleum profit taxes). Whilst states are limited by the number of domestic taxes and other revenues they can collect, there is the widely-held notion that tax effort in states is quite weak and the tax gap (difference between revenue collected and what could be collected) is very wide. This has been proven by a state like Lagos that has reformed its tax policy and administration and currently records much higher tax takings than previously.

Table 1: Revenue Collection Assignment across Nigeria's three tiers of Government

Federal Government	State Governments	Local Governments
Personal Income Taxes of personnel of the armed forces, the police force and Foreign Affairs; as well as residents of the FCT (employees and self-employed persons)	Personal Income Taxes of residents of the state (employees and self-employed persons)	Marriage, birth and death registration fees
Witholding Tax on Companies, residents of the FCT and non-resident individuals	Witholding Tax on individuals	Sewage and refuse disposal fees
Capital Gains Tax - corporate entities, residents of the FCT and non-resident individuals	Capital Gains Tax - individuals	Burial ground and religious places permit fees
Stamp Duties - Corporate entities and FCT residents	Stamp Duties - individuals	Radio/Television license fees
Companies Income Tax	Property Taxes	Tenement Rates
Petroleum Profits Tax	Right of Occupancy fees in state capitals	Right of Occupancy fees outside state capitals
Education Tax	Naming of street registration fees in state capitals	Naming of street registration fees outside state capitals
Mining Rents & Royalties	Pools betting, lottery, gaming and casino taxes	Liquor license fees
Customs and Excise Taxes & Duties	Development Levies - Individuals	Slaughter slab fees
Value-added Tax (VAT)		
	Vehicle Registration Fees	Bicycle, truck, canoe, wheelbarrow and cart license fees
	Rates in State-financed markets	Market and motor park fees
	Road taxes	Shops and Kiosk Rates
	Business Premises Registration and Renewal Fees	Signboard Advertisement fees
	Miscallaneous revenues e.g. hotel consumption taxes	Cattle Taxes
		Domestic Animal License Fees

Source: The 1999 Constitution of the Federal Republic of Nigeria; Various Statutory and Policy Documents

Given the situation that the reformist government in Edo faced in 2008 as highlighted earlier, the state took, and is still taking a number of steps to boost its domestic tax revenues and some of these include

policy and institutional measures supported by a programmatic Bank Development Policy Financing (DPF) operation as well as an Investment Project Financing (IPF) operation – the State Employment and Expenditure for Results (SEEFOR).

Edo's underlying strategy was initially geared solely towards raising more revenue for the state. Subsequently, the goal of stimulating growth and job creation in the state through increased investment was added as part of the strategy underlying the state's tax policy. In addition, inequality issues are also being taken into account when designing additional tax instruments. However, the state faced, and still faces a lot of challenges in its domestic revenue mobilization effort, some of which include the very limited tax base, high levels of informality (making it difficult to capture and reach potential taxpayers), weak tax administration capacity, potential for corruption on the part of personnel of the state internal revenue service, as well as determined resistance from some segments of the populace to the introduction of new tax handles.

Nonetheless, the government of Edo has embarked on the following tax policy and administrative measures:

Tax Policy

1. Expansion of the tax base by bringing more activities into the tax net:
   a. In this regard, the state in 2011, introduced a Hotels and Events Centers Occupancy and Restaurants Consumption Law which enables the collection of a 5% consumption tax on hospitality industry goods and services.
   b. Also, a Land Use Tax Law (incorporating the Property Tax, Ground Rent and Tenement Tax in one charge) was enacted in 2012 which has strengthened the framework for collection of property levies.
   c. The state has also issued new regulations and guidelines for the conduct of lottery, pools betting, casino and gaming activities and the drafting of regulations and guidelines for online lottery, pools betting, casino and gaming activities is almost completed.
   d. A review of the Entertainment Taw Law in also in progress.
   e. Plans at an advanced stage to significantly expand the base for Capital Gains Tax (CGT) and Stamp duties. This is to be accomplished through a land registration "amnesty" program which is expected to bring in more land transactions into the formal system. In parallel, a planned reduction in CGT and stamp duty rates (from 5% to 3% and 5% to 2%, respectively) is expected to enable more formalized land transfer transactions. These policy actions are supported by the second and third DPL operations.

Tax Administration

2. Taxpayer Enumeration Survey: In order to capture the bulk of potential taxpayers in the state, especially many who reside in the rural areas, plans are underway to undertake a state-wide taxpayer enumeration survey. The first phase of this project, covering the six largest local government areas of the state, is to be implemented by a firm of independent consultants and is being funded by the Bank's SEEFOR project. The motive is to capture and electronically register new taxpayers who would not voluntarily go to register.

3. A new coding system for pay-as-you-earn taxes was completed in 2011 and this is updated annually. This was a prior action for the first DPL operation.

4. Specialized taxpayer service units have been established in all tax offices to support taxpayers.

5. Tax Audits: the state embarked on an aggressive tax arrears drive from 2009. Vigorous tax audits were conducted mainly with regard to corporate entities and this led to huge collections of employee tax arrears.

6. Aggressive public enlightenment campaigns: In the early stages of Edo's tax reform program, the state incorporated vigorous public awareness campaigns into its tax strategy. These sometimes sought to boost citizens' tax morale and at other times, cautioned strongly about the consequences of tax evasion.

7. Organizational and Business Process Reform: The Edo state Internal Revenue Service (EIRS) has embarked on major organizational restructuring and business process re-engineering since 2012; including automation of processes as well as human resource (HR) capacity development to position itself and its staff for more effective service delivery. A new Revenue Administration Law was enacted in 2012; establishing the EIRS as an autonomous revenue service to be anchored on strict professionalism, transparency, integrity and results. The EIRS is now self-funded - by 4 percent of its collections.

8. ICT deployment to improve revenue collection efficiency: Edo state deployed point-of-sale (POS) terminals at all tax offices in the state which are linked to the IGR accounts to minimize cash transaction with a stronger potential for fraud. The state also introduced an e-filing system; launched a new website that will support online tax payment; has hooked up with the national Unique Taxpayer Identification Number (UTIN) program which seeks to ensure that all taxpayers are biometrically registered[6]. Edo state has now deployed UTIN registration kits at all its 32 tax offices state-wide for this purpose. This was a prior action for the second Bank DPL operation. Online UTIN registration is also being made possible. The UTIN is making it easier to track taxpayers. The state intends to subsequently deploy an electronic database management system (EDBMS) for managing taxpayer data and this is a trigger for the third DPL operation.

- **What could be lessons for other sub-nationals elsewhere in Nigeria and the Developing World and for Bank Operations supporting them?**

Edo's tax reforms are still very much work in progress. Implementation of most of the new tax policy and administrative measures commenced quite recently. They are largely internally-driven; and some have been supported by the Bank's operations. Largely due to the aggressive tax audits and consequent collection of arrears since 2009, the state has been able to record a growth in the share of internally generated revenue in total state revenues from 11 percent in 2008 to 22 percent in 2014. The state is also on track to diversify its tax sources – the share of personal income taxes in its total tax basket is projected to decline from 85 percent in 2014 to about 75 percent by 2017 as other tax sources being targeted become relatively important.

[6] UTIN registration has now been made a prerequisite for opening corporate bank accounts in Nigeria.

Table 2: Composition of Edo State's Revenue (2005 – 2017)

(% of Total)	**2005-2008**	**2009-2011**	**2012-2014**	**2015-2017 (projected)**
Federal Transfers	**84.0**	**78.7**	**78.7**	**64.9**
State IGR	**9.6**	**19.7**	**21.0**	**28.1**
Tax IGR	6.3	13.6	14.1	20.8
Non-Tax IGR	3.3	6.1	6.9	7.3
Grants & Others	**6.3**	**1.6**	**0.4**	**7.0**

Source: Edo state government authorities

The experience of Edo state in its bid to boost local revenues potentially holds applicable lessons for sub national domestic revenue mobilization in domains with similar circumstances and especially where the Bank supports through DPFs and IPFs. Key aspects in this regard include:

Identification of new tax instruments (especially luxury-type taxes) within the ambit of the country's tax policy framework: As with the case of Edo's new hotels and events centers consumption tax, it is usually possible that there are activities that could be taxed to raise additional revenues. For income redistribution purposes, it would make more sense for any such taxes to be levied on consumption or possession of luxury items. Bank operations can support the thinking on new tax handles by bringing knowledge of the experiences of sub-nationals in other countries.

Strengthening the policy framework for existing subnational taxes: Sometimes, even when the base of certain tax handles are not very large, strengthening the policy framework can clarify the rules, guidelines and modus operandi for the administration of these taxes which in turn can revitalize and optimize revenue generation from such taxes. This has been the case with the lottery, pools betting, casino and gaming tax in Edo state which is now being better collected.

The criticality of a comprehensive taxpayer database/register: Because many subnational government areas in similar domains consist of rural populations with non-formal structures, it is relatively easy to evade local taxes. Government authorities could prioritize taxpayer registration and as is being done in Edo and elsewhere in Nigeria, taxpayer registration could be made compulsory for certain important transactions e.g. opening bank accounts or taking bank loans or even cooperative loans – Bank projects could support the deployment of biometric systems for registration of taxpayers in some of these domains, where possible.

Better funding and professionalization of local Tax Authorities: Better funding of the EIRS has contributed immensely to enhanced capacity of the agency to better administer taxes. This is still very much work-in-progress but the ability to attract and retain well-qualified, trained and remunerated staff in the Revenue Service has proved to be quite instrumental. The Bank has ample experience in supporting capacity needs assessments in these type of institutions and could bring this to bear in its support of subnational revenue mobilization to be followed by appropriate capacity development.

Use of ICT, where possible: While many subnational governments in developing countries may be very limited in their ability to deploy ICT for tax administration either due to limited funding or the sheer impracticality thereof given the rural nature of some of these domains, the case of Edo shows that even simple ICT measures can make a difference e.g. the use of electronic payment methods rather than cash payment is helping to curb collection leakages and this is very important for sub-national governments that administer taxes for which takings are low and thus, every penny counts. Bank operations could support the deployment of simple ICT solutions for tax administration in these settings.

The importance of Public Enlightenment: In domains where tax mobilization has traditionally been very low, it will be important to carry citizens along when embarking on new or stronger measures to mobilize local revenues. Otherwise, such measures could instigate massive resistance. As highlighted earlier, a very critical factor in running a successful public enlightenment campaign however is improved delivery of public services. Bank operations could finance and provide technical support for the development of appropriate communications strategies for local tax authorities.

The importance of improved service delivery in order to boost tax morale: While it is not proven that the improved social service delivery (especially roads, drainage and educational facilities) recorded in the state since 2008/09 has contributed to improved tax compliance, it has been a tool for communications in Edo's tax public enlightenment campaigns which obviously has added credibility to Edo's campaigns for tax compliance.