Fiscal Federalism and the Determinants of State Internally Generated Revenue (IGR) in Nigeria

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Abstract
This study empirically examines the impact of fiscal federalism on state Internally Generated Revenue (IGR) in Nigeria over the period 1999–2024. The study evaluates how the fiscal instruments such as revenue-sharing arrangements, grants and transfers, sub-national debt levels, and vertical and horizontal revenue allocation formulas affect IGR across Nigerian states with heterogeneous economic structures. Specifically, the study seeks to: (i) assess the impact of revenue-sharing arrangements on state IGR; (ii) examine the effect of grants and transfers on

state IGR;. Adopting an ex post facto and analytical research design, the study utilizes secondary data sourced from the National Bureau of Statistics and other official publications. The Autoregressive Distributed Lag (ARDL) model is employed to estimate both short-run and long-run dynamics, with inflation rate incorporated as a moderating variable. The study applies a comprehensive set of econometric techniques, including unit root tests. The empirical findings reveal that revenue-sharing arrangements exert a statistically significant effect on IGR, leading to the acceptance of the alternative hypothesis (H_1). Similarly, grants and transfers demonstrate a statistically significant relationship with IGR, supporting the acceptance of (H_2). Sub-national debt is found to have a statistically significant negative effect on IGR, confirming. These findings underscore the critical role of fiscal structure and intergovernmental financial relations in shaping sub-national revenue performance.Based on these findings, the study recommends that state governments should reduce excessive dependence on revenue-sharing allocations, improved compliance systems, and diversification of revenue sources

Key words:*fiscal federalism, Internally Generated Revenue (IGR), sub-national debt, allocationformulas*

Introduction

1.1 Background to the Study

Finance has been the most essential ingredient in running of government; this has made contest in federalism a unique characteristic which mostly occurred in fiscal relation. Federalism has been known as centralized and decentralized levels of decision making. It means constitutional division of power between federal and constituent units. In fact, the federal structure and the composition of any society define its governance and administrative structure.

Nigeria before and in the first half of the decade after independence practiced fiscal federalism under a regional structure (Mohammed et al., 2017) and this promoted an agro economy and laid the foundation for economic progress. Agriculture was the mainstay of the economy, accounting for 65 percent of the Gross Domestic Product in 1962–1963, and 63 percent in 1966–1967, and approximately, 62 percent, 65 percent and 55 percent of the country's export earnings in 1966, 1967 and 1969, respectively (Akindele, 1986). Unfortunately, the situation changed in 1970 and by the second half of the 1970 s, crude oil production and export had become the main engine of growth of the Nigerian economy while the contribution of agriculture to export earnings declined progressively. The reversal of the economic progress in agriculture achieved by the various regions in the first decade of independence in Nigeria has also been linked to the incursion of the military into governance in 1966 with its unitary command structure which led to the abandonment of fiscal federalism (Ewetan, 2012; Ewetan et al., 2020).

In subsequent decades and till date oil exploration and production became the main driver of the Nigerian economy. Almost six decades after independence in 1960 Nigeria's Gross Domestic Product per capita was 2396.30 US dollars in 2018 equivalent to 19 percent of the world's average (Trading Economics, 2020). This showed economic performance for Nigeria that placed her among middle-income countries. For Nigeria to record rapid economic transformation, sustainable development emphasizes the need for fiscal decentralization of responsibilities to engender efficiency in public service delivery particularly in the provision of robust infrastructure (Amoo, 2018). Based on the economic progress recorded in terms of the significant contribution of agriculture to Gross Domestic Product and export earnings in the first decade of independence (Akindele, 1986) this study posits that fiscal federalism could provide a

solution to the challenges of economic development in Nigeria (Arif & Ahmad, 2018; Babajide et al., 2020; Ewetan et al., 2015; Ma & Mao, 2018; Mykola et al., 2019). There have been various reports and studies that have canvassed for the adoption of fiscal federalism with little empirical work evidence-based theory on Nigeria in recent times (Aigbokhan, 1999) to justify this recommendation. Against this background, this study, therefore, seeks to examine empirically the relationship between fiscal federalism and economic development in Nigeria.

1.2 Statement ofthe Problem

It is imperative to emphasize that whatever may be the origin of a federation, whether aggregation or devolution, its establishment at once raises three salient problems: how to allocate functions rationally; how to allocate taxing powers; and how to share revenue between the governments of that federation‖ Ojo (2010). Meanwhile, it is imperative to note that Nigeria‘s revenue sharing debates have revolved basically around three issues namely: (i) the relative proportions of federally collected revenues in the federation account that should be assigned to the center, the states, the localities and the so-called Special Funds‘ (vertical revenue sharing), (ii) the appropriate formulae for the distribution of centrally devolved revenues among the states and among the localities i.e. local governments (horizontal revenue sharing) and

The problem becomes even more acute due to the political dimension the issue has assumed; with tempers flaring along geo-political lines over perceived injustices in the way the country's resources are being controlled. The issue of resource control has however created a gulf of suspicion between the various geo-political zones in Nigeria, hence, the continuous search for the best and acceptable formula for controlling resources in our federation Ifesinachi (2015). The 13% derivation fund notwithstanding, there exists a wide gap between the fund available to the oil producing states and their general level of socio-economic development, while oil derivation funds is on a steady increase, infrastructural facilities are on a steady decline, revealing challenges in the utilization of the fund.The structural weaknesses of the Nigerian federalism have become an Achilles heel predisposing the political system to various shocks championed and sustained by ethnic nationalism. These non-nationalistic and negatively decentralizing tendencies have left cracks on the Nigerian state and the resolution of the numerous challenges generated by the Nigerian federal structure has therefore, become an onerous task and a storm every administration would deploy ingenuity in contending with least the political system will be rocked. The structural challenges that have attracted the attention of the federating units are located basically at the political and economic spheres as these have the capacity to impact on all others including infrastructure. In view of the foregoing, the following basic questions are asked.

1.3 Objectives of the Study

The primary objective of this research is to examine the impact of structured fiscal federalism on the state internally generated revenue in Nigeria. Specific objectives are to:

(i) Assess the impact of revenue-sharing arrangements on state internally generated revenue in Nigeria.

(ii) Examine the impact of grants and transfers on state internally generated revenue in Nigeria.

1.4 Research Questions

Based on the specific objective stated above, the following research questions were formulated:

(i) To what extent do revenue-sharing arrangements impact state internally generated

revenue in Nigeria?

(ii) How do grants and transfers impact state internally generated revenue in Nigeria?

1.5 Research Hypotheses

To accomplish the objectives of this study the following hypotheses were stated in null form.

(i) Revenue-sharing arrangements have no significant impact on state internally generated revenue in Nigeria.

(ii) Grants and transfers have no significant effect on state internally generated revenue in Nigeria.

1.6 The Scope of the Study

The study focused on the impact of structured fiscal federalism on the state internally generated revenue in Nigeria (1999 to 2023). The base year, 1999 is a landmark year for Nigeria in terms of fiscal federalism because it marks the start of the Fourth Republic with the adoption of the 1999 Constitution. This constitution provided the foundation for the current fiscal federalism framework, shaping the distribution of fiscal powers and resources among Nigeria's federal, state, and local governments, and influencing the country's economic development and governance.The study concluded in 2023 due to data constraints. The study included some fiscal federalism variables in the model.

2. Review of Related Literature

2.1 Conceptual Review

2.1.1 Structured Fiscal Federalism

Structured fiscal federalism denotes a systematic and rules-based framework for the allocation of fiscal authorities and obligations among various tiers of government within a federal framework. In contrast to ad hoc or discretionary mechanisms, structured fiscal federalism encompasses established regulations and formulas that govern the processes of revenue-sharing, expenditure obligations, and intergovernmental transfers. This framework aspires to bolster transparency, accountability, and efficiency in the allocation of financial resources, thereby contributing to the mitigation of inter-jurisdictional inequalities and the promotion of equitable economic growth (Boadway & Shah, 2009).

2.1.2 State Internally Generated Revenue

Internally Generated Revenue (IGR) constitutes the financial resources that a governmental entity independently accrues within its jurisdiction, distinct from allocations or grants provided by the central government or extrinsic organizations. For sub-national governance structures, such as states, IGR signifies an essential revenue stream, particularly in federal systems, where regional fiscal autonomy enhances both fiscal decentralization and institutional accountability. The notion of revenue generation, as articulated by Ahmed (2010), encompasses the total financial inflow received by a governmental entity from external origins, particularly those generated beyond the scope of governmental net funds, including proceeds from investment sales, insurance payouts, debt repayments, transactions involving agencies or private trusts, and intergovernmental fiscal transfers. Obichinna (2010) corroborated that all financial inflows of the government comprise the majority of its revenue, which is associated with funds mobilized or produced within the economy.

2.1.3 Revenue-Sharing

Revenue-sharing constitutes a fiscal framework whereby the revenue accrued at one governmental tier is apportioned among various other tiers or jurisdictions within a nation. This principle is prevalently applied in federal and decentralized political systems, wherein the central authority allocates segments of its revenue to state, provincial, or local administrations to augment their financial capabilities, facilitate local development, and foster equitable regional advancement (Bird & Smart, 2002). The mechanism of revenue-sharing is pivotal in mitigating fiscal imbalances, advancing a fair allocation of national resources, and empowering sub-national authorities to fulfill their responsibilities in delivering public goods and services.

Formula-Based Sharing: In the context of formula-based revenue-sharing, financial resources are allocated according to a pre-established formula that accounts for variables such as demographic size, income distribution, geographical area, or fiscal capacity. This methodology fosters a transparent and systematic distribution framework that enables sub-national governments to forecast and strategize effectively. Nations such as Nigeria and India implement formula-based revenue-sharing structures to distribute resources based on a variety of criteria (Ehtisham & Botman, 2013).

2.1.4 Grants and Transfers

Grants and transfers serve as pivotal fiscal instruments within the framework of intergovernmental relations, especially in contexts characterized by federalism and decentralization. These mechanisms facilitate the allocation of financial resources from higher tiers of government typically the national or central authority to subordinate levels, including states, provinces, or municipal governments. The significance of grants and transfers is underscored by their ability to mitigate fiscal inequalities, foster equitable service delivery, and underpin local initiatives that resonate with overarching national objectives (Bird & Smart, 2002).

2.4 Theoretical Review

In order to investigate the effects of organized fiscal federalism on state internally generated revenue (IGR) in Nigeria, a variety of fiscal federalism theories can elucidate the complexities of fiscal interactions between the central and state administrations, along with the manner in which these interactions affect the states' ability to generate revenue.

2.4.1 Fiscal Federalism Theory

The concept of fiscal federalism serves as a pivotal theoretical framework for analyzing the intergovernmental dynamics within a federal structure. According to Oates (1972), the principles of fiscal federalism posit that the distribution of fiscal authority, encompassing taxation and expenditure responsibilities, between central and sub-national entities ought to be meticulously structured to facilitate the efficient and equitable provision of public goods and services. This theoretical perspective contends that decentralization, often referred to as structured fiscal federalism, and has the potential to optimize resource allocation by customizing public policies to align with local preferences, thereby augmenting the revenue-generating capabilities at the state level.Within the Nigerian context, the phenomenon of fiscal decentralization endows states with a degree of autonomy to generate revenue through various means such as taxes, levies, and alternative sources. The theoretical framework posits that such autonomy, when strategically

designed, could bolster a state's Internally Generated Revenue (IGR), as states are enabled to leverage local resources and economic activities to finance public goods.

2.5 Empirical Review

Abada, Omeh, Ovaga, and Ugwuanyi (2022) studied Nigeria's fiscal federalism and the difficulties of national development. The study found that efforts to restructure and design revenue allocation parameters are ongoing struggles. It was observed that one issue is the power of the central government to decide what counts as revenue allocations and how it would be distributed among the federating units. The study used a systematic documentary methodology, and data were created from secondary sources and then examined in-depth. The power theory served as the foundation for the study's analytical approach. The study's conclusions showed that the type and character of the federal and fiscal deficits have caused a wide range of developmental issues to affect components and federating units. The study suggests that Nigeria's tiers of government ought to adopt a culture of self-reliance and clearly defined statutory roles.More precisely, Evalsam and Ecoma (2020) studied fiscal federalism and good governance in Nigeria since independence. They asserted that the process of fiscal federalism had become corroded by mutual suspicion and lack of confidence in the existing institutions and processes of fiscal federalism. They observed that in 2007, the Revenue Mobilization, Allocation and Fiscal Commission took the then President Obasanjo-led federal government to court for illegally withdrawing 2.071 Trillion Naira from the federal account. In addition, the Excess Crude Account had been an issue of conflict between the federal and state governments as it relates to its basis and usage.Fiscal federalism and effective governance in Nigeria since independence were studied by Ecoma and Ecoma (2018). The purpose of the article was to examine the significance of fiscal federalism for effective government in Nigeria. It was noted that a truly federating form of government can only survive and continue to exist if the principles of fiscal autonomy and fiscal integrity are upheld. The analysis thus shows that the competing problems and difficulties of fiscal federalism may take the form of an imbalance between the funding sources and purposes of the various levels of government. According to the study's findings, the prospect of a stable federation can only be supported by arrangements grounded in equity, fairness, and justice. Additionally, the distribution of revenue should motivate each State and Local Government to increase internal revenue generation and devolve fiscal authority and responsibility to component units.In order to support or disprove the accusations of flaws in the current status quo, Onwioduokit and Esu (2018) investigated the fiscal federalism in Nigeria: Implication for growth. Time series data were used, and they came from several secondary sources. Fiscal decentralization could actually promote economic growth, but this growth may have been hampered by corruption, ineffective leadership, an unfavorable macroeconomic environment, as well as other upheavals. The designed models were estimated using the Autoregressive Distributed Lag (ARDL) technique. The elasticities of the estimated equations showed this. According to the study's recommendations, Nigeria should consciously draft and enact laws that support fiscal federalism that is efficient, equitable, and inclusive; it should also strengthen and enact laws that are very hostile to corruption and other unethical behavior in order to foster the conditions necessary for the development of a federal state.

Nigerian fiscal federalism, sub-national uprisings, and internal colonialism were all studied by Egobueze, Ojirika, and Ikuinyi (2021). They came to the conclusion that the excessive concentration of power and resources in the top tier of government has compromised the other levels' ability to carry out the primary function for which they were established. Federalism's

underlying premise of the independence and coordination of the many levels of government has significantly deteriorated, aggravating a variety of uprisings. This essay examines internal colonialism, fiscal federalism, and sub-national political uprising in Nigeria. Its methodology made use of content analysis and secondary data. The paper pinpointed the structural imbalance in Nigeria's federal system caused, among other things, by colonial experience as the source of sub-national upheavals and offers restructuring Nigeria as the country's best chance of preserving federalism. Udefuna, Asogwa and Uzodinma (2019) also considered maintaining a federal character in Nigeria adopting a qualitative research design. They discovered that the mode of emergence of Nigeria federalism constitutes an albatross on its effective workability as an instrument of good governance. Thus, they recommended that review of responsibilities among the three tiers of government should be done and also to reduce the possibility of duplicating functions.

2.8 Research Gap

While most scholars in this context investigated the correlation between structured fiscal federalism and Internally Generated Revenue (IGR) within Nigerian states, it predominantly neglects the short-term and long-term ramifications of fiscal federalism components on IGR across states characterized by disparate economic capacities. Employing the Autoregressive Distributed Lag (ARDL) model to evaluate both immediate and equilibrium consequences of fiscal structures may elucidate distinctive insights into the manner in which policy modifications regarding revenue allocation, fiscal autonomy, and federal transfers influence the sustainability of IGR. This dynamic methodology would address a significant lacuna by equipping policymakers with sophisticated, temporally-sensitive data regarding the implications of fiscal federalism reforms across states with varied economic profiles.

3. Chapter Three
Methodology

3.1 Research Design

The methodological framework utilized in this investigation is predicated upon ex post facto and analytical research designs, as it primarily concentrates on evaluating the influence of structured fiscal federalism on the internally generated revenue of Nigerian states from 1999 to 2023. Given that the data is pre-existing, the analysis commences subsequent to the occurrence of the events under scrutiny. An ex post facto research design, frequently referred to as causal-comparative research, signifies a non-experimental approach whereby researchers examine potential causal relationships by analyzing a pre-existing condition or outcome and tracing it back to its preceding factors.

3.2 Nature and Source of Data

The data used for the study is secondary data. The data were retrieved from secondary sources. Secondary data being already processed and pooled, are easily found in National Bureau of Statistics (NBS), Nigeria and Central Bank of Nigeria (CBN), thus, the data gathering is based on documentation technique and the required information from online downloaded materials.

3.3 Population of the Study

The population of this study comprises all the thirty-six (36) states of Nigeria and the Federal Capital Territory (FCT), which together constitute the sub-national governments within the

Nigerian federal structure. These states and the FCT are the primary recipients and administrators of revenue from the Federation Account, grants, and other intergovernmental fiscal transfers, and they are directly affected by the nation's revenue-sharing arrangements, vertical and horizontal allocation formulas, and debt profiles.

3.3.1 Sample size

The sample size for this study consists of eight (8) states purposively selected based on their consistent ranking among the top performers in Internally Generated Revenue (IGR) over the historical period 1999–2023. Using publicly available IGR data published annually by the National Bureau of Statistics (NBS). The states that met this criterion are Kano, Lagos, Katsina, Kaduna, Bauchi, Oyo, Rivers, and Jigawa.

3.3.2 Sampling Technique

The selection process involved computing the 25-year average IGR for each state and identifying those with the highest sustained revenue performance. These states were chosen because their high IGR performance reflects significant fiscal activity and revenue mobilization capacity, making them particularly relevant for examining the effects of structured fiscal federalism on sub-national revenue generation in Nigeria.

3.4 Specification of Model variables

Nigerian fiscal federalism, sub-national uprisings, and internal colonialism were all studied by Egobueze, Ojirika, and Ikuinyi (2021). We substitute the content analysis with ARDL model and other variables such as revenue-sharing arrangements, state internally generated revenue, grants and transfers, for the purpose of evaluating the influence of structured fiscal federalism on the internally generated revenue of Nigerian states from 1999 to 2023.The study used inflation rate as the moderating variable.

The ARDL model will be applied for the test of all the hypotheses.

The model is specified as:

Model One: $IGR_{t-1} = \beta_0+\beta_1 RSA_{t-1}+\beta_2 INF_{t-1}+\mu$ ……..…..(i)

Model Two : $IGR_{t-1} = \beta_0+\beta_1 GT_{t-1}+\beta_5 INF_{t-1}+\mu$ ……..…..(ii)

Where:

IGR = Internally Generated Fund

RSA = Revenue Sharing Arrangement

GT = Grant and Transfers

INF = Inflation rate

3.5 Techniques of Data Analysis:

To examine the influence of structured fiscal federalism on the internally generated revenue of Nigerian states from 1999 to 2023, a descriptive statistical analysis will be conducted, taking into consideration all relevant factors. Various preliminary examinations were carried out, such as residual-based assessments like multi-collinearity and, along with parametric evaluations like unit root and parameter stability tests (cusum tests). The ARDL models outlined in sections one and two which hold significance, will be employed to assess the research hypotheses.

4.Data Presentation and Analysis

4.1 Result Presentation and Analysis

This section presents the results obtained from the data analysis, beginning with the descriptive statistics of the variables, followed by the other diagnostic tests.

4.2 Panel Unit Root Test

Table 4.2 Panel unit root Table

Variable	Statistic	Prob	Cross sec	Ord of Dif	Method
Lnigr	-9.73210	0.0000	8	1(1)	Levin, Lin &Chu t*
Lnsub_nat_d	-10.6181	0.0000	8	1(0)	Levin, Lin &Chu t*
lnrsa	-2.12437	0.0168	8	1(1)	Levin, Lin &Chu t*
Lng_and Transf	-7.7774	0.0000	8	1(1)	Levin, Lin &Chu t*

Source: Researchers computation

The panel unit root results in table 4.2 , obtained using the Levin, Lin and Chu (LLC) t-statistic, provide important insights into the stationary properties of the variables across the eight cross-sectional units. The LLC test, which assumes a common unit root process, is appropriate for balanced panel data and enables a consistent assessment of the stochastic characteristics of the series. The reported probability values indicate that all variables are statistically significant at the 5 percent level, leading to the rejection of the null hypothesis of a unit root in each case, either at level or after differencing.

A closer examination of the order of integration reveals a mixed pattern among the variables. Internally Generated Revenue (Lnigr) is non-stationary at level but becomes stationary after first differencing, indicating that it is integrated of order one, I(1). Similarly, Lnrsa, Lng_and_transf (Grants and Transfers), Lnvraf (Vertical Revenue Allocation), The panel unit root results confirm that the dataset comprises both I(0) and I(1) variables. thereby necessitating the use of an estimation technique that accommodates such mixed integration properties. The panel ARDL model, implemented through the bounds testing approach, is therefore the most appropriate method for examining the existence of a long-run relationship among the variables and for capturing both short-run and long-run dynamics in a robust and consistent manner.

4.3 Test for Co-integration (ARDL BOUNDS TEST)

Table 4.3Long Run Equation **Short Run Equation**

Variable	**Coefficient**	**t-statistic**	**prob**	**Variable**	**Coefficient**	**t-statistic**	**prob**
Lnrsa	4493.12	0.160724	0.8725	cointEQ01	-0.002651	-2.360229	0.0196
Lng_andt	-2702961	-0.162436	0.8712	D(lnrsa)	63.06810	1.384684	0.1682
Lnsub_na	7252.063	0.162629	0.8710	D(lng_and t	61.16672	2.093629	0.0380

Source: Researchers computation

In table 4.3, the Autoregressive Distributed Lag (ARDL) estimation results, with D(IGR) as the dependent variable, provide both long-run and short-run dynamics of the relationship between internally generated revenue and its determinants over the period 2000–2024.

Long-Run Relationship: The long-run coefficients reveal that none of the explanatory variables exerts a statistically significant influence on internally generated revenue in the long run. Specifically, LNRSA has a positive coefficient (4493.168) but is statistically insignificant (p = 0.8725), indicating that revenue-sharing allocation does not have a meaningful long-run effect on IGR. Similarly, LNG_AND_TRANSF (grants and transfers) carries a negative coefficient (-

2702.961) with a high probability value (p = 0.8712), suggesting no significant long-run relationship.In the same vein, LNSUB_NAT_DEBT_BN_ (sub-national debt) shows a positive but insignificant coefficient (7252.063; p = 0.8710), implying that debt accumulation does not significantly drive internally generated revenue over time. Both LNVRAF (vertical revenue allocation) and LNHRAF (horizontal revenue allocation) also exhibit negative and statistically insignificant coefficients, with p-values of 0.8722 and 0.8709 respectively.The non-significance of all long-run coefficients suggests the absence of a stable and economically meaningful long-run equilibrium relationship between internally generated revenue and the selected fiscal variables. This may reflect structural inefficiencies, weak fiscal transmission mechanisms, or institutional constraints in revenue generation at the sub-national level.

Short-Run Dynamics and Error Correction Mechanism

The short-run results provide more nuanced insights. The most critical component is the error correction term (COINTEQ01), which has a coefficient of -0.002651 and is statistically significant at the 5 percent level (p = 0.0196). The negative sign confirms the existence of a long-run equilibrium relationship among the variables, despite the insignificance of individual long-run coefficients. This aligns with the theoretical expectation that deviations from equilibrium are corrected over time.However, the magnitude of the coefficient is extremely small, implying a very slow speed of adjustment. Specifically, only about 0.27 percent of disequilibrium is corrected in each period, suggesting that the system takes a long time to return to equilibrium after a shock. This sluggish adjustment process may be attributed to rigid fiscal structures, policy delays, or administrative inefficiencies in revenue mobilization.

With respect to the short-run coefficients: D(LNRSA) is positive (63.06810) but statistically insignificant (p = 0.1682), indicating that changes in revenue-sharing allocation do not significantly influence IGR in the short run. D(LNG_AND_TRANSF) has a positive and statistically significant coefficient (61.16672; p = 0.0380), suggesting that increases in grants and transfers positively affect internally generated revenue in the short run. This may reflect complementary fiscal effects, where intergovernmental transfers enhance revenue-generating capacity. D(LNSUB_NAT_DEBT_BN_) is positive but insignificant (p = 0.4492), indicating that short-run changes in sub-national debt do not significantly affect IGR. D(LNVRAF) is negative and statistically significant (-81.36948; p = 0.0422), implying that increases in vertical revenue allocation reduce internally generated revenue in the short run. This supports the fiscal laziness hypothesis, where higher federal allocations discourage local revenue mobilization efforts. D(LNHRAF) is negative but statistically insignificant (p = 0.5654), suggesting no meaningful short-run effect of horizontal allocation on IGR. The constant term is also insignificant, indicating no autonomous short-run adjustment independent of the included variables. The findings present a mixed outcome. While the error correction term confirms the existence of co-integration (i.e., a long-run relationship among the variables), the individual long-run coefficients are not statistically significant, indicating weak long-run fiscal linkages. In contrast, some short-run dynamics particularly grants and transfers and vertical revenue allocation are statistically significant, highlighting that fiscal variables exert more immediate than persistent effects on internally generated revenue. The negative and significant effect of vertical allocation in the short run provides empirical support for the disincentive effect of federal transfers on local revenue effort, a common feature in decentralized fiscal systems. Conversely, the positive impact of grants and transfers suggests that certain forms of intergovernmental support may enhance revenue capacity.The ARDL results indicate that

although a long-run equilibrium relationship exists, the adjustment process is weak and slow, and the dominant effects are observed in the short run rather than the long run. This underscores the need for structural reforms aimed at strengthening fiscal autonomy, improving revenue administration, and reducing overdependence on statutory allocations.

4.4 Test for Parameter Stability : Figure 1; CUSUM Test graph

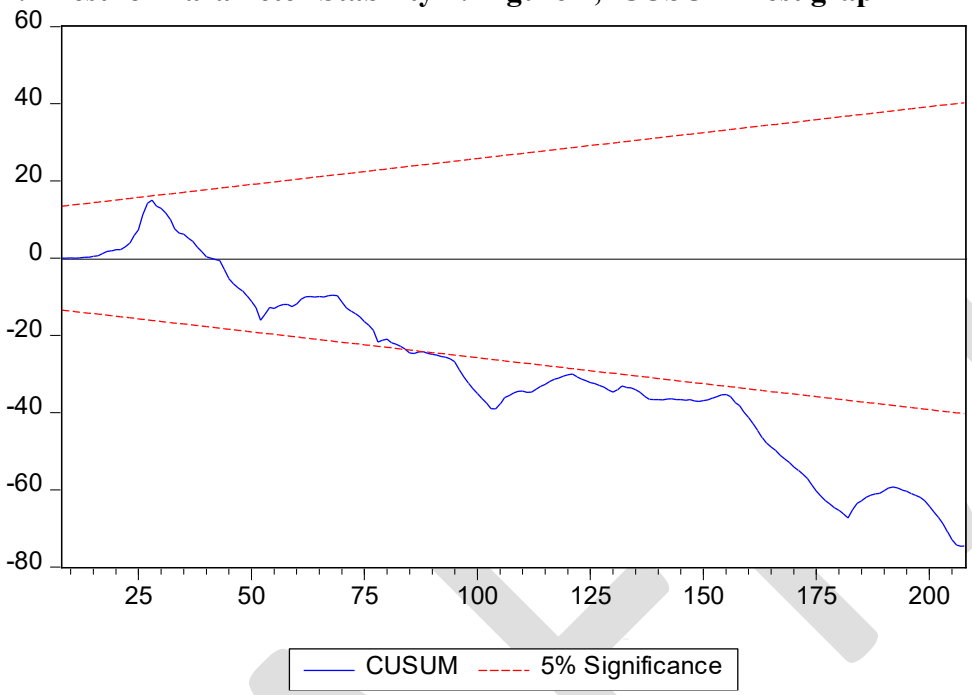


Figure 1

From the plotted result, the blue CUSUM line initially fluctuates within the 5% significance bounds (represented by the red dashed lines), suggesting that the model parameters are stable in the early part of the sample period. However, as the sample progresses, the CUSUM line begins to exhibit a persistent downward movement, eventually crossing the lower critical bound.This crossing of the 5% significance boundary is a clear indication of structural instability in the model. In econometric terms, it implies that the estimated coefficients are not stable over time and that there may be structural breaks or regime shifts affecting the relationship among the variables. The deviation becomes particularly pronounced in the latter part of the sample, where the CUSUM line diverges substantially from the confidence band, reinforcing the evidence of instability.The implication of this result is that the underlying economic relationships captured by the model may have changed during the study period. Such instability could arise from policy changes, macroeconomic shocks, institutional reforms, or other exogenous disturbances affecting fiscal variables and internally generated revenue dynamics.The CUSUM test result demonstrates that while the model exhibits short-term stability, it fails to maintain parameter constancy over the full sample period, thereby indicating the presence of significant structural instability that must be accounted for in further analysis.

4.5Test of Hypotheses

Table 4.6 ARDL Results Table

ARDL Model	coefficients	t-statistic	Prob-value	R-Squared	Prob(f-stst)	DW-stat
IGR(dependent v)						
Igr =f(rsa(-1), inf)	-1.326545	-10.30122	0.0000	0.79	0.0000	2.047379
Igr=f(Grant & Trans(-1)	-0.280012	-7.149507	0.0000	0.71	0.0000	2.098781

Source: Researchers computation

Discussion of ARDL Table

Table 4.6 presents the results of the Autoregressive Distributed Lag (ARDL) estimations examining the relationship between Internally Generated Revenue (IGR) and selected fiscal variables.

4.5.1 Effect of Revenue Sharing Allocation (RSA) on IGR

The ARDL result for RSA lagged by one period indicates a coefficient of -1.326545 with a t-statistic of -10.30122 and a probability value of 0.0000. Since the p-value is less than 0.05, the null hypothesis is rejected. This implies that Revenue Sharing Allocation has a statistically significant effect on IGR.The negative coefficient suggests an inverse relationship between RSA and IGR. Specifically, an increase in federally allocated revenue reduces the incentive for states to mobilize internal revenue. This finding is consistent with the fiscal dependency hypothesis, which posits that reliance on external allocations discourages domestic revenue effort.

The model exhibits a strong explanatory power with an R-squared value of 0.79, indicating that approximately 79% of the variation in IGR is explained by RSA. The F-statistic probability (0.0000) confirms the overall model significance, while the Durbin-Watson statistic (2.047379) suggests the absence of autocorrelation.

4.5.2 Effect of Grants and Transfers on IGR

The coefficient of Grants and Transfers lagged by one period is -0.280012, with a t-statistic of -7.149507 and a p-value of 0.0000. Given that the p-value is less than 0.05, the null hypothesis is rejected, indicating a statistically significant relationship.The negative sign implies that increased grants and transfers reduce IGR generation. This outcome aligns with the "aid dependency" argument, where sub-national governments may reduce internal revenue efforts when external funds are readily available.The R-squared value of 0.71 indicates that 71% of the variation in IGR is explained by this variable. The model is statistically significant as indicated by the F-statistical probability of 0.0000, and the Durbin-Watson statistic (2.098781) confirms no evidence of serial correlation.

4.6 Discussion of Findings

4.6.1 HypothesisOne: The ARDL result indicating that Revenue Sharing Allocation (RSA) lagged by one period has a negative and statistically significant effect on Internally Generated Revenue (IGR) aligns strongly with established theoretical propositions in fiscal federalism and public finance. The coefficient (-1.326545) and associated probability value (0.0000) imply that increased reliance on federally allocated revenue significantly reduces sub-national revenue mobilization efforts.This finding is consistent with the Fiscal Federalism Theory, particularly the first-generation theory advanced by Richard Musgrave (1959) and Wallace Oates (1972). These

scholars emphasize that intergovernmental transfer, while designed to correct vertical and horizontal imbalances, may create unintended disincentives for local revenue generation when sub-national governments become overly dependent on central allocations.Furthermore, the result supports the "Flypaper Effect", a well-documented empirical anomaly in public finance, which posits that funds transferred from higher levels of government tend to "stick where they hit" rather than stimulating local fiscal effort. As noted by James Hines and Richard Thaler (1995), intergovernmental transfers often lead to increased public spending rather than tax effort, thereby weakening internally generated revenue mechanisms.

4.6.2 HypothesisTwo: The ARDL result reveals that Grants and Transfers lagged by one period exert a negative and statistically significant effect on Internally Generated Revenue (IGR), as evidenced by the coefficient (-0.280012), t-statistic (-7.149507), and probability value (0.0000). Given that the p-value is less than the 5% significance level, the null hypothesis is rejected, confirming that grants and transfers significantly influence IGR. The negative coefficient indicates that increases in external financial inflows reduce the capacity or willingness of sub-national governments to mobilize internal revenue.

From a theoretical standpoint, this finding is consistent with the propositions of Fiscal Federalism Theory as advanced by Richard Musgrave (1959) and Wallace Oates (1972), which acknowledge that intergovernmental transfers, although designed to address fiscal imbalances, may generate disincentive effects on local revenue effort. When sub-national governments receive substantial grants and transfers, they may rely less on internally generated sources such as taxation, thereby weakening fiscal responsibility and autonomy.The result further aligns with the Flypaper Effect, as articulated by James Hines and Richard Thaler (1995), which posits that external funds tend to increase public expenditure rather than stimulate local revenue generation. In this context, grants and transfers "stick" at the point of receipt, encouraging spending behavior without a corresponding increase in revenue mobilization efforts.

5. Conclusion

The findings of the study are stated as follows:

(i)The study accepts the alternative hypothesis (H_1). This implies that revenue sharing allocation has a statistically significant effect on IGR.

(ii)The study accepts the alternative hypothesis (H_2). This indicates that grant and transfers had a statistically significant relationship

5.2 Recommendations

The recommendations presented in this study are derived from the empirical findings:

(i) State governments should reduce excessive dependence on revenue sharing allocations by strengthening internal revenue mechanisms through tax reforms, improved compliance systems, and diversification of revenue sources. Fiscal authorities should also review allocation structures to create incentives for states to enhance their IGR performance.

(ii) Governments should ensure that grants and transfers are effectively utilized for productive investments that stimulate economic activities and expand the tax base. Transparent monitoring and accountability frameworks should be established to ensure that such funds contribute positively to revenue generation.

5.4 Contribution to knowledge

The study extends the literature on fiscal federalism by shifting the analytical focus from descriptive assessments of revenue allocation to an empirical evaluation of its functional impact on internally generated revenue (IGR). While prior studies largely emphasized the structure and distribution of federally allocated revenues, this research examines how such fiscal arrangements influence the revenue-generating capacity of sub-national governments, thereby providing a more outcome-oriented perspective.The study introduces a comprehensive empirical framework that integrates key fiscal federalism variables revenue sharing allocation, grants and transfers, this approach bridges the gap between fiscal federalism theory and practical revenue outcomes, offering a more robust methodological basis for evaluating intergovernmental fiscal relations.

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