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The Politics of Fiscal Federalism in Nigeria

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Abstract
Fiscal federation has remained a contentious issue in Nigerian politics from 1954 to date. The aim of this paper is to articulate and document how the problem of fiscal administration in Nigeria is more political than administrative. It contends that the focus on revenue sharing, as opposed to revenue generation and accountability in the utilization, is the primary cause of economic, social and political decay in the country. We posit that fiscal administration in Nigeria is heavily politicized and does not ensure amicable distribution of national resource for effective development.

Having identified the challenges of fiscal administration, the easy recommends the decentralization of fiscal administration and a re-examination of the principle of derivation.

Introduction
The eventual transformation of Nigeria into a federal state started in 1954 as a result of the 1953 Lyttleton constitutional conference. Since 1946 several enactments have been made to address the tenets of fiscal management of the economy.

Nigeria operates a federal system of government. Federalism in principles implies the construction of a system whereby consensus is reached between current demands of union and the territorial diversity within an emerging society, by the creation of a single political system within which central and provincial governments are assigned coordinated authority in a manner defining both the legal or political limits of equality or subordinate functions (Agbu, 2004). In a federal structure, adequate autonomy is given to each level of government to enable it perform its responsibility without frustration. Table 1 outlines the functions of the three tiers of government in Nigeria. This is the essence of fiscal federalism. Fiscal federalism refers to the scope and structure of the tiers of government responsibilities and functions as well as the allocation of resources among the tiers of government. Perhaps the most important issue in the fiscal federalism is revenue allocation formula, the sharing of national revenue among the various tiers of government (vertical revenue sharing), as well as the distribution of revenue among the state governments (that is, horizontal revenue allocation).

The centralization of Nigeria's fiscal federalism began with the report of the Dina Commission (1968) which argued that an appropriate revenue allocation system should result in a more equitable distribution of revenues among the states to achieve a balanced development of the federation. Revenue allocation can be described as a method of sharing the centrally generated revenue among the different tiers of government and how the amount allocated to a particular tier is shared among its components. Under the Nigerian federal system of government, federation or centrally-generated revenue is shared among the three levels of government namely: the Federal Government; the States and the Local Government. The theory of revenue sharing in a federal state is that each level of government receives an allocation of financial resources tailored to their specific requirements as defined by the mandate of legislative competence, their actual situation and the statutory indices of calculation.

Table 1: Functions and Sources of Revenue of the three tier of Government

Government	**Major Functions**	**Sources of Revenue**
1Federal Government	Exclusive list a. Accounts of the government of the federation b. Currency issue c. External affairs d. Defense and security Concurrent list a. Higher education b. Industrial development c. Agricultural development d. Road and health	1. Statutory allocation from the federal account 2. VAT 3. Independent revenue a. Personal income tax of armed forces personnel, external affairs officers, FCT residents; b. Operating surpluses of parastatals c. Dividends from investments in publicly quoted companies d. Rents on government property e. Interest on loans to states and parastatals
2. State Government	1. Provision of Social Services – Education, health care, roads, water supply 2. Agricultural development 3. Industrial development	1. Statutory allocation from the federation account 2. VAT 3. Internally – generated revenue a. Personal income taxes from persons residents in the state; b. Fees for registration and licensing of vehicles; c. Charges related to land

Government	Major Functions	Sources of Revenue
		matters
3. Local Government	1. Provision of public goods and services – primary school health care facilities, etc 2. Provision and maintenance of markets places, cemeteries, homes	1. Statutory allocation from the federation account 2. VAT 3. Internally – generated revenue a. Property taxes; b. Licensing of bicycles, trucks (other than mechanically propelled trucks), canoes wheel;

Source: Akpan and Umodong, 2003: 173

In Nigeria, decisions as to what proportion of centrally-generated revenue would be retained by the federal government, the proportion that will be shared among the state governments and the proportion that will go to the local government has always been a problem, due to the fact that there is no consensus of opinion as to what could be seen as an ideal formula. In the words of Obi (1998:262), "the issue of revenue allocation strikes the very basis of the existence of the Nigerian Federation and the rules of entry and exit from the ruling class". The struggle for the control of the nation's resources have also to some extent, been based on the regional cleavages. This, entwined with political conflict, has sometimes led to political manipulations and delineations with the aim of influencing wealth allocation. This has been especially so since 1958, when revenue from oil gained prominence as the major sources of revenue in the country. Along these lines, it has been suggested that the setting up of three commissions on revenue allocation within a short period of twelve years is a manifestation of the instability that characterized the Nigerian polity. Between 1968 and 1980, income from petroleum constituted over 80 percent of federal revenue. The importance of the federal centre therefore increased proportionately. As a consequence of this major shift in revenue generation a desperate struggle to win control of state power ensued since this control meant being all powerful and owning everything. Wantchekon, (1999) conducted an empirical study that sought to establish that natural resources dependence and rentier economies generate authoritarian governments, very slow process of political reforms and socio-political instability.

The most recent development in the struggles for the control of oil resources in Nigeria is the recent Supreme Court action instituted by the Federal Government against the oil producing states with respect to the offshore/onshore oil dichotomy. The April 2002 decision of the Supreme Court to exclude the revenue derived from offshore drilling in the calculation

of the revenue attributable to the oil producing states based on the derivation principle, has failed to resolve the controversy.

> "There arose a dispute between the Federal Government on the one hand and the eight littoral states of Akwa Ibom, Bayelsa, Cross River, Delta, Lagos Ogun, Ondo and Rivers states on the other hand as to the Southern (or seaward) boundary of each of these States. The Federal Government contents that the Southern (or seaward) boundaries of each of these States are low water mark of the land surface of such state… [or] the seaward limit of inland waters within the state, as the state so requires. The Federal Government, therefore, maintains that natural resources located within the Continental Shelf of Nigeria are not derivable from any state of the Federation. The eight littoral states do not agree with the Federal Governments' contentions. Each of the states claims that its territory extends beyond the low water mark onto the territorial water and even unto the continental shelf and the exclusive economic zone. They maintain that natural resources derived from both onshore and offshore are derivable from their respective territory and in respect thereof each is entitled to the "not less than 13 percent" allocation as provided in the provision of subsection (2) of section 162 of the Constitution" (judgement by the Supreme Court, 5 April 2002).

This persistent struggle for revenue has however wide ranging effect on the sustainability of programmes and reforms for economic transformation of the entire Nigerian economy. This paper therefore, seeks to articulate and document how the problem of fiscal administration in Nigeria is more political than administrative and to ascertain what the divergent contending issues have been. We also argue that the focus on revenue sharing, as opposed to revenue generation and accountability in the utilization, is the primary cause of economic, social and political decay in the country.

Principles of Fiscal Federalism

The principles that guide the implementation of intergovernmental fiscal relation include:

a) **The principle of diversity:** The federal system must have the ability to accommodate a large variety of diversities. Hence, the fiscal system must provide scope for variety and differences to supply national, regional and local public goods.

b) **The principle of quivalence:** Based on the geographical incidence of different public goods, allocative efficiency requires the equalization of locational advantages arising from inter-jurisdictional differences with a combination of taxes and public goods and services..

c) The Principle of Centralized Stabilization: This requires the use of fiscal instruments for achieving macroeconomic objectives of growth, stabilization and full employment at the national level.

d) **Correction of spillover effects:** This ensures that inter-jurisdictional externalities be corrected by the system. It refers to externalities (positive and negative) experienced by residents of different geo-political units; this requirement controls for what is often referred to as "central city exploitation thesis".

e) **Minimum provision of essential public goods and services:** This ensures that fiscal federalism guarantees all citizens, irrespective of where they reside, the minimum provision of certain basic public goods and services.

f) **Principle of fiscal equalization:** In order to ensure minimum level of public goods and services some degree of fiscal equalization is required. This is as a result of differences in resource endowment.

g) **The efficiency of principle:** This principle implies that efficiency must be applied in the allocation of resources. In addition, each level of government should maximize its internal revenue earning at minimum tax efforts.

h) **The principle of derivation:** The component units of a system should be able to control some of its own resources as they desire.

i) **The principle of locational neutrality:** Interregional fiscal differences tend to influence locational choices of individuals and firms. Based on different resources endowment, differences in tax capacity and effort, some decree of locational interference seems to be inevitable cost of intergovernmental fiscal relations. Therefore, policy should focus on minimizing distortions due to some interference. Hence, differential taxes which create locational distortions should be avoided as much as practicable (Agiobenebo, 1999, p.43).

j) **The principle of centralized redistribution:** This principle states that the redistribution function of fiscal policy through progressive taxation and expenditure programmes should be centralized at the federal level. This seems consistent with the principle of locational mentality. That is, if the redistributive function is decentralized, it can results in distortions in locational decision.

It should be noted that the above principles are not mutually consistent. They are difficult to apply simultaneously. Therefore, tradeoffs are necessary in order to avoid conflicts. There is no doubt that the general principles of fiscal federalism appeared to have informed Nigeria's attempt at intergovernmental

fiscal relations. The different principles have been dictated by a combination of historical experiences, political, cultural and social factors. After almost forty years in search of a workable federalism, there still exist challenges which policy makers must address.

> it is an act of self-deception for anyone to argue that there is nothing wrong with the revenue formula. We have had basically two systems of revenue allocation in Nigeria. The first system which we practiced during the First Republic allowed the North to keep the proceeds from its groundnut and cotton, the West to keep the proceeds from its cocoa, and the East to keep the proceeds from coal and oil produce. Then we changed the system so that the Federal Government got its hands on the proceeds, and yet we don't expect the minorities in the oil-producing areas to perceive that is an injustice to them. I have even heard some people turning history on its head by arguing that the country was developed on the proceeds of groundnut, cocoa and oil palm. Perhaps, [one could be correct] if you are arguing that the whole is the sum of its part. But the oil-producing minorities have a point that the rule of the revenue allocation game were changed to disfavour them (Professor Bolaji Akinyemi, COMET, June 6, 2001)." Accessed from www.nigerianbusinessinfo.com, 5th December 2005.

It is against the backdrop of the preceding assertion, delivered by a Nigeria academic and a delegate to the National Political Reform Conference, that the complicated discussion regarding the revenue allocation formula might be visualized. The South-South Zone (in the imagined or putative division of Nigeria into six geo-political zones) insists at this confabulation that in order to address past anomalies in the allocation scheme, it should be given 25 percent instead of 13 percent (or 17%) as a first step toward boosting the percentage to 50 percent In spite of the empirical evidence to support the claims of the South-South at the confab, the north, as represented by some of its oligarchs, argue against a change in the formula that would address the needs of the ethnic minorities whose territories houses the country's bread winner-crude oil. The north argues for a 17 percent derivation for the oil-producing area.

The Political Economy of Revenue Allocation in Nigeria

Welfare economics and political theory are the two strands of theory which guide revenue allocation. The main theme of the economic arguments is the bridging of inequality gap. This gap exist because of unequal endowment of natural resources which results in an imbalance in the physical development of

the communities. According to Oyediran and Olgunji (1984), higher spatial poverty in natural resource endowment increases the agitation for equality as a revenue allocation criterion. Fiscal policy is the deliberate use of revenue generating and spending machinery of the government to steer the economy in the desired direction. The major economic roles of government are resource allocation, income distribution and macroeconomic stabilization. Through fiscal activities, taxes are levied on economic activities in the regions with concentrated economic resources and some of the proceeds transferred to the scant resource region, in any way that will guarantee equitable distribution across sectors and geographical regions within a fiscal system. The centrally collected revenue should be shared such that horizontal fiscal disparities among localities and vertical imbalances among tiers of government are minimized (Akpan and Umodong, 2003:338).

Federalism provides a framework for solving the political problem of administration and the economic problem of resource distribution. In practice, sometimes, the optimization of administrative cost is an economic issue, where also the distribution of resources involves some political issues in determining the constitutional criteria for such allocation in such a way that will ensure equality and/or equity. An efficient distribution is that in which no section of the society is worse off, while making the other better off. However, Musgrave and Musgrave (1982) observe, that the problem of efficiency is beset with major measurement difficulties when the issue of redistribution is evaluated. This is because redistribution entails balancing of value with gains accruing from all parts of the society from fiscal operations. Akpan and Umodong (2003) observe that redistribution that can ensure equality in an acceptable way encompasses the use of economic and political means to induce compromise and agreement. This may involve the use of consociational approach to power balancing and the protection of rights.

The use of derivation as a criterion for revenue allocation is associated with change in social state of welfare that results from production activities and the compensation of losers by gainers in production activities. As production takes place in any society, value is created for some members of the society while some members suffer losses to externalities. A production activity is said to enhance the society's level of welfare, in pareto optimality sense, if it is possible for those who gain value (and attain higher welfare level) to compensate those who made losses (and incur reduction in welfare level) such that the latter is at least left at the level of welfare as before the production with the former group still better off after the redistribution. This principle of redistribution of gains from production in a way that guarantees the removal of welfare losses caused by externalities of production is referred to as compensation principle.

Compensation principle is the basis on which derivation as a criterion for sharing fiscal revenue is anchored. The production of oil, for instance, entails losses to the oil communities in three major ways:

- Natural resources, these include the extracted depletable crude petroleum
- The vegetative part of the land used in the mining;
- Externalities of oil production – these include environmental pollution, high costs of living, unemployment and loss of means of livelihood due to environmental degradation, and
- Social cost of production – for example, breakdown in social value system, high crime etc.

These losses by the oil producing communities due to oil production activities can be compensated for by increasing fiscal means of revenue allocation based on losses suffered by those communities.

The Evolution of Revenue Allocation Formula till 2005

The discovery of oil in some parts of Eastern Nigeria and the potential it had for growth altered the thinking about the place of minerals in the revenue allocation formulae. Up till then, royalties from minerals fully belonged to the region of origin. In 1958, however, the discovery of oil in Nigeria coincided with the need to review the existing revenue allocation schemes, which were the fallout of the 1957/58 Constitutional Conference and the imminence of political independence. The colonial government subsequently appointed Sir Jeremy Raisman and Professor Ronald Trees to review the federal fiscal structure. The Committee, in the main, recommended that the regions should have authority over produce sales tax and sales tax on motor vehicle fuel. It also recommended the establishment of a Distributable Pools Account (DPA) for the purpose of sharing federally collectible revenues. The Commission recommended that the then practice of returning mining rents and royalties to the regions should be discontinued. Such revenue was now to be shared through the DPA with the region of origins getting 50 percent, Federal Government, 20 percent and all the revenue from it at the time (1958/59) was estimated to be only 65,000 pounds. According to the Report:

> The allocation of the proceeds of mining royalties has presented us with a most perplexing problem. Although the revenues from columbite royalties rose rapidly at the time of the American stockpiling in 1953 – 55, royalties on tin, columbite and coal, normally yield a fairly constant annual sum. If these were the only minerals concerned, there might be no difficulty in our recommending the continuation of the present system .. The problem is oil. Test production of oil has already started in the Eastern Region and exploration is being undertaken in both the North and the West. While the yield from oil royalties is at present comparatively small, .. we cannot ignore the possibility that the figure may rise very

> markedly within the next few years. There is therefore a double obstacle in our recommending the simple continuation of the existing method of allocating mineral royalties. First, it would involve us, our revenue assessment for the next few years, in crediting the Eastern Region with a source of income which is at once too uncertain to build upon, and too sizeable to ignore. Secondly, it would rob our recommendations of any confident claim to stability for the future since oil development might take place in any one of the regions on a scale, which would quite upset the balance of national development, which is part of our task to promote .. our considered conclusion therefore is that the time for change is now. While there is still uncertainty as to which of the Regions may be the lucky benefiting or which may benefit the most.

Based on the above, the Raisman Report significantly reduced the use of derivation as a principle for sharing the DPA. In its place, it introduced four variables: continuity, minimum responsibility, population and balanced development of the federation.

Oil was not the first natural resource to be exploited in Nigeria. Prior to its discovery, tin and bauxite were being exploited in the Northern Region solely for the benefit of the North. The West could not be bothered because it was the wealthiest of the three regions, thanks to the cocoa boom. The East had very little natural or agricultural resources. Although it was unhappy with the concept of derivation, it was forced to develop other sources of income in its bid to survive.

Technical committee on allocation was then appointed, under the chairmanship of Professor Aboyade. Its propositions were to be submitted to the CDC and if adopted, made part of the new Constitution. In summary, the Committee recommended that all federally collectible revenues, without distinction, should be paid into the Federation Account. It also, for the first time, took into account, local governments in the vertical distribution of the Federation Account. It, for instance, recommended that the proceeds of the Federation Account should be shared between the Federal Government, State Governments and Local Governments in the following proportions: 60 percent, 30 percent and 10 percent respectively. From its share, the Federal Government was required to set 3 percent for the benefit of Mineral Producing Areas and areas in need of rehabilitation as a result of emergencies and disasters.

On the horizontal allocation of revenue amongst the states, the Committee jettisoned the existing principles of revenue sharing arguing that, population had been characterized by illogicality, inconsistency and inequity; derivation

had done much to “poison intergovernmental relations and hampered a sense of national unity”; need had “little if any operational relevance”; even development was analytically ambiguous… (and was) not technically feasible to measure in any meaningful way”; equality of status of states was a “consolation prize to states not favoured by the population and derivation principles”; geographically peculiarities defied any “concise definition … (and) circumstances.”. It then recommended the adoption of five new principles. These were: Equality of Access to Development Opportunities, National Minimum Standards for National Integration, Absorptive Capacity, Independent Revenue and Tax Effort and Fiscal Efficiency.

The Aboyade Report was however extensively criticized. The economic background of its prescriptions was especially attacked. Sylvester Ugoh, a member of the Constituent Assembly, for instance, questioned the wisdom behind the Reports reliance on the data based on the 1975 – 1980 National Development Plan. According to him, some sections of the report were based in the implicit assumption that the 1975-1980 Plan would be fully or largely implemented. As such, the projects which were represented by these allocations would be realized. In such a situation, what the measure would show would be the socio-economic gaps that will arise from the full implementation of the plan. But the fact is that our National Plans, and especially that of 1975-1980, were expressions of pious hopes and wide expectations. In fact, the 1975-1980 Plan has proved to be mostly a national dream. And if that is the situation, how can we use such dream – like allocations, which are unrealistic and unrealizable to measure socio-economic gaps in our development. Another member of the Constituent Assembly, Dr. Pius Okigbo, criticized the vertical distribution of revenue amongst the various tiers of government arguing that the Aboyade Report unduly favoured the Federal Government. Based on such criticisms, the constituent Assembly rejected the Aboyade Report.

In 1979, the newly elected government of President Shehu Shagari appointed a new Committee headed by Dr. Pius Okigbo to review the “formulae for revenue allocation having regard to such factors as the national interest, derivation, population, even development, equitable distribution and the equality of states”. On the sharing of revenue, among the various tiers of government (vertical allocation), the Okigbo Committee recommended the following formulae: Federal Government (53 %) state governments (30 %), local governments (10 %). While 7 percent was to be set aside as special funds for the following purposes: development of the Federal Capital Territory, 2.5 percent; special problems of Mineral Producing Areas, 2 percent; ecological problems, 1 percent; and Revenue equalization Fund, 1.5 percent. These were: minimum responsibilities of government (40 %), population (40%), social development factor/primary school enrolment (15%) and internal revenue effort (5 %).

The Government White Paper adopted the Okigbo recommendations only with slight modifications. This culminated in the promulgation of the Revenue Allocation Act Number 1 of 1981. In summary, the Act provided that the Federation Account shall be shared amongst the various tiers of Government as follows: Federal Government, 58.5 percent; State Governments, 31.5 percent: Local Governments 10 percent. and 26.5 percent of the state allocation shall be allocated to all states, while the remaining 5 percent shall be allocated on the basis of derivation. Two-fifths of the 5 percent of this derivation fund shall be paid out to the states in direct proportion to the value of minerals extracted from their areas, while the remaining three-fifths shall be paid into a special fund to be administered by the Federal Government for the development of the Minerals Producing Areas. The 26.5 percent outstanding to the credit of all states shall be distributed amongst them using the following criteria: equality of states (50 percent), population (40 %) and land area (10%). Finally, the 58.5 percent allocated to the federal government shall be subdivided as follows: Federal Capital Territory (2.5%) and ecological problems (1%). This Act was however widely criticized mainly on the grounds that it allocated too much revenue to the federal government to the detriment of the state and local governments. The result was that the federal government could afford to waste valuable resources in the financing of unprofitable white elephant projects while the states and local governments were starved of funds. According to an Editorial by the *Daily Sketch* at the time: On the vertical distribution of revenue amongst the various tiers of government, for instance, the federal government modified the Okigbo recommendations as follows: Federal Government, 55 percent; state Government, 3o percent; Local Government, 8 percent; and special Funds, 7 percent; State Government, 30 percent; Local Government, 8 percent; and Special Funds, 7 percent (Government Views on Okigbo Report, 1980:13). To expect an allocation which gives the Federal Government 55 percent and the 19 states only 30 percent to achieve the contrary will be like in a world of fantasy.

Table 2: Revenue Allocation Formula, 1946 - 1996

Commission/Decree	**Criteria**
Phillipson, 1946	Derivation and even development
Hick-Phillipson, 1951	Derivation, need, national interest, fiscal autonomy of regions, special grants to regions for education, the Police and Capitation
Chick Commission, 1953	Derivation, Fiscal autonomy. Most of the Country's revenue derived from exports went to the regions on the basis of derivation and consumption
Raisman Commission, 1958	Need, even or balanced development, derivation and fiscal autonomy, set up a distributable pool account (DPA) for the regions, - North 40%, West 31%, East 24% and Southern Cameroun 5%; First

Commission/Decree	Criteria
	to introduce an objective formula for horizontal revenue allocation model among the regions
Binns Commission, 1964	Same principles as Raisman, but North 42%, East 30%, West 20%, Mid West 8%
Decree No. 15 of 1967	Population was added to Raisman formula. Each of the six Northern states was to receive 7%; the remaining 58% was to be shared among the six states in the south according to population.
Dina Commission, 1968	Upheld principles of derivation, need, even development, special grants and added minimum responsibility of government or Equality of states. It also introduced special grants account and recommended the establishment of a permanent revenue planning and fiscal commission
Decree No. 13 of 1970, No. 9 of 1971, No. 6 of 1975	Population and equality of states with each criterion receiving 50% of the share of the DPA- 50% (Population), 50% (Equality); following post war reconstruction, rehabilitation, and reconciliation, it increased the share of the federal government because of increased responsibility. Decree No. 9 of 1971 & No. 6 of 1975 reduced mining rents and royalties from 45% to only 20%, gave more functions to federal government, particularly in education and all erstwhile regional universities became federal and federal also undertook Universal free primary education.
Aboyade Commission, 1977	Five point criteria rejected, recommended federation account into which all federally collected revenue (excluding personal income tax of the ministry, residents and non residents of the Federal Capital Territory) would be paid and share among the three levels of government, vertical allocation formula recommended was 57% federal, 30% state governments, 10% local and 3% special grants account; Horizontal formula – 1) Equality and access to development opportunities 25% 2) Minimum standard for national integration – 22% 3) Absorptive capacity – 20% 4) Independence revenue and minimum tax effort – 18% 5) Fiscal Efficiency – 15% Vertical formula recommendation was accepted, but horizontal formula was dubbed 'too technical' and rejected.
Okigbo Commission, 1980	Revised the revenue allocation formula as follows – 55% federal, 30% state, 8% local government, and

Commission/Decree	Criteria
	7% special funds; on horizontal revenue allocation, Population (40%), national minimum standard for national integration (40%) social development factor (15%), and internal revenue effort (5%). Supreme Court declared it null and void.
1981 Revenue Act	Revised the revenue allocation formula of Okigbo Commission as follows – 55% federal, 30.5% for states, 10% local government, and 4.5% special funds
Decree No. 36 of 1984	Military regime revised the revenue allocation formula as follows – 55% federal, 32.5% states, 10% local government, and 2.5% special funds
National Revenue Mobilization, Allocation and Fiscal Commission, (NRMAFC) 1989	Revised the vertical revenue allocation formula of as follows – 47% federal, 30% for states, 15% local government, and 8% special funds. Government approved 50% federal, 30% for states, 15% local government, and 5% special funds; on (30%), Internal revenue effort (20%), social development factor (10%), Government approved this but added 10% for land mass and terrain.
Armed Forces Ruling Council (AFRC)	Revised the revenue allocation formula as follows: – 48% federal, 24% for states, 20% local government, and 7.5% special funds; Equality of states (40%), Population (30%), Internal revenue effort (10%), Social development factor (10%), Land mass and terrain (10%).

There is sufficient evidence to prove that the ugly phenomenon of growth development arises from the spending of too much money on a few growth industries to the neglect of people-development oriented projects. Yet do we have to build giant industries and make our people sub-human? Tens of millions of our people are wallowing in abject poverty. States and local governments whose Pre-eminent job is to see their welfare are helpless. They are starved of funds while the federal government soaked in billions of Naira, fritter away much needed money on fruitless and worthless grandiose projects. How human is it to give Abuja 2.5 percent while even the most populous state cannot get 2 percent? The average is less than 1.6 percent for millions of people. This 1981 Act was however, technically declared null and void by the Supreme Court of Nigeria. It was subsequently replaced with the Allocation of Revenue (Federation Account) Act Number 1 of 1982. Essentially, this increased the share of the states in the vertical revenue allocation from 31.5 to 35 percent. The FCT was however now classified as a state. Furthermore, the funding for the 1 percent ecological funds was also transferred from the Federal Government to the states. Finally, the fund for the

development of Mineral Producing areas was reduced from 3 percent to 1.5 percent. The net effect of this was that the Federal Government's share of the Federation Account remained unaltered. On the horizontal sharing of revenue amongst the states, the Decree adopted the following criteria: minimum responsibility of government, 40 percent; population, 40 percent; social development factor, 15 percent; and internal revenue effort, 5 percent.

Shortly after the promulgation of this Act, the military in December 1983 overthrew the government of Alhaji Shehu Shagari and Major General Mohammadu Buhari became the new Head of state. His government subsequently promulgated the Allocation of Revenue Federal Account) Amendment Decree Number 36 of 1984. This, in the main, only altered the existing formulae for revenue allocation marginally. It reserved 55 percent of the Federation Account exclusively for the Federal Government and maintained the Local Governments' share at 10 percent. The 1 percent and 1.5 percent for the development of mineral producing areas were also retained. The share of the state governments' in the Federation Account was 32.5 percent. Out of this, 2 percent was to be paid directly to the Mineral Producing States in direct proportion to the value of minerals extracted from such states. Finally, the Decree retained the Shagari regime basis for the horizontal sharing of revenue amongst the state.

Table 3: Brief Historical Outline of Revenue Allocation Formulas in Nigeria, 2002 – 2005

Item	Date	Federal Govt. %	State Govt. %	Local Govt. %	Special Funds %	Total %
Pre-Supreme Court – Legal Decrees/Law	Pre-April 2002	48.50	24.00	20.00	7.50	100.00
Pre-Supreme Court RFMAC Proposal	August 2001	41.23	31.00	16.00	11.70	100.00
Supreme Court Ruling	April 2002				Current Allocation Ruled Unconstitutional	
Post-Supreme Court Executive Order # 1	May 2002	56.00	24.00	20.00	0.00	100.00
Post-Supreme Court Executive # 2	July 2002	54.68	24.72	20.60	0.00	100.00
Post-Supreme Court RMFAC	Submitted	47.19	31.10	15.21	National Priority	100.00

Item	Date	Federal Govt. %	State Govt. %	Local Govt. %	Special Funds %	Total %
Proposal	President September 20, 2004				Services Funds*: Ecology – 1.50 Mineral Devt. 1.75 Agric Devt. – 1.75 reserve Fund – 1.50 ……………….…. Total – 6.50 {joint Fed/State/LG Management	
Presidential Proposal	Submitted to NASS January 25, 2005	47.19	31.10	15.21	Ditto + Horizontal Formulas** + State Derivation Funds Boards to Manage 13% derivation**	100.00

*General Ecological Fund (1.50 percent); Solid Minerals Development Fund (1.75 percent); National Agricultural Development Fund (1.75 percent) and National Reserve Fund (1.50 percent)

In 1989, the military government then head by General Ibrahim Babangida, appointed a permanent revenue allocation committee: National Revenue Mobilization and Fiscal Commission (NRMAFC). The committee prescribed the following formulae for the horizontal allocation of revenue amongst the states: equality of states, 40 percent; population, 30 percent; internal revenue effort, 20 percent; and social development factor, 10 percent. The committee also vested the powers to determine the vertical allocation formulae on the National Assembly. The second part of the Committee's recommendations was later adopted and inculcated in the 1989 constitution. Although some partial democracy took place at the time, it did not last as full military government was restored in 1994 under the leadership of General Sani Abacha. The new government immediately set up a constitutional conference. Expectedly, the issue of revenue allocation was one of the contentious issues. It has, for instance, been asserted that in 1994, the mineral producing states at the so-called constitutional conference, convened by the Federal Military Government requested that the allocation of revenues derived from their areas

be restored to what it was in 1957, namely, 65 percent thereof. Despite numerous discussions at several committee meetings and at plenary sessions, no agreement was reached. Eventually, it transpired that he had agreed to allocate 13 percent of the revenues derived from their areas proposed the new constitution that was promulgated in May 1999.

Despite this constitutional provision, the elected government of Chief Olusegun Obasanjo refused to implement it. Instead it appointed a committee to review the 1999 Constitution. On the issue of revenue allocation, the Committee recommended that the derivation formulae be increased substantially beyond the 13 percent minimum recommended in the 1999 constitution. The government again refused to accept this recommendation. Rather, the government asked the Supreme Court to declare that the derivation principle does not apply to offshore oil. The Supreme Court, in its landmark judgment on April 2002 agreed with the position of the Federal Government. The uproar, especially from some of the affected oil producing states, and the imminence of the April 2003 general elections, made the federal government to cede some grounds to the states. The legitimacy of such concessions, however, remains in doubt. This is especially so given the fact that the Supreme Court has already interpreted the constitutional provisions on the matter. It could therefore be argued that only a constitutional amendment can effect a change to the existing position. The revenue allocation debate is therefore likely to continue unless a new system is enthroned which will change the nation's focus from revenue sharing to revenue generation.

Challenges

There are several challenges and contending issues confronting intergovernmental fiscal relations in Nigeria:

I) Non-correspondence problem

Ideally, each level of government should be given adequate resources to allow it discharge its responsibilities. Because this is not possible, there is usually a lack of correspondence between the spending responsibilities and the tax power/revenue sources assigned to different levels of government. It is this incongruence that is often referred to as the non-correspondence problem. In Nigeria, most of the major sources of revenue come under the jurisdiction of the Federal Government yet lower levels of government are supposed to generate internal revenue. There is, therefore, the need to resolve the imbalance between assigned functions and tax powers.

Tables 4: New Horizontal Formulae for Distributing Revenue

S /N	**Item**	**To state (Col. 1)**	**To LGA's (Col. 2)**	**Could have Been for States (Col. 3)**	**Should have been for LGA's (col. 4)**
1	Equali	45.23	0.00	0.00	0.00

	ty				
2	Population	25.60	30.83	46.74	25.00
3	Population Density	1.45	6.45	2.64	5.00
4	Internal Revenue generation Effort	8.31	13.31	15.17	20.00
5	Land Mass	5.35	10.35	9.77	5.00
6	Terrain	5.35	10.35	9.77	5.00
7	Rural Roads & Inland Waterways	1.21	6.21	2.21	10.00
8	Potable Water	1.50	6.50	2.74	10.00
9	Education	3.00	8.00	5.48	10.00
10	Health	3.00	8.00	5.48	10.00
Total	31.10	100.00	100.00	100.00	100.00
% From FG	31.10	15.21	15.21	15.21	15.21

Note: [(Col. 2) = (Col. 1) + 5] except Equality (=0) and Population [= (Col.1) + 5.23]
Note: Except for Equality: (Col.3) = (Col.1) * [1+45.23/(100-45.23)] = 100*(Col.1)/54.77. Since 45.23 percent should have been re-distributed in proportion to original ratios (minus equality)

II) Fiscal Autonomy and Independence

The issue of relative fiscal autonomy and independence of the state and Local Governments in a true federal structure goes with the corollary issue of the correspondence of governmental functions and revenue sources. Since the creation of the twelve states structure in 1967, states and local government have been excessively dependent on the Federation Account. This dependence must be reduced if the federating units are to be free to pursue their own developmental goals without being hampered by the unpredictable fluctuations in their shares of the Federation Account. It is important that revenue sources should be re-allocated and made compatible with the fluctuations stated for each tier of government to enhance steady and proper funding of administrative and developmental activities instead of the often experienced unexpected financial constrictions at the two lower tiers of government.

III) Federation Account and the Derivation Fund

It is important to define what constitutes the Federation Account – to which the various vertical revenue allocation formulae have been applied and what should be directly financed from it. Up to 1990, the amount accruing yearly to the Federation Account was still over 96 percent of totally federally collected revenue; but since 1991, when it first dropped to about 75 percent and nose-dived to around 35 percent by 1997, it showed no sign of recovery (Olowononi, 1999). It is therefore clear, that in such a situation, whatever the vertical formula applicable, there must still be a serious fiscal imbalance between the federal government and the two lower tiers of government. It is crucial to redress this revenue imbalance in the spirit of balances true federalism. What appears to account for this imbalance is the assertion of the self-claimed right by federal government to finance various first-line charges from the Federation Account before the application of the formula. These first-line charges include funding for external debt service, National Priority Projects, NNPC Priority Special reserve account and excess proceeds of crude oil sales account, and in addition, the joint venture cash calls account. These deductions are made from the proceeds of crude oil sales before the derivation fund in the Federation Account is arrived at, and after which further deductions for special funds and the funding of the Federal Capital Territory are made. It will seem more logical, with the exception of joint venture cash call that these various charges which are federal government obligations be financed solely from the federal government's revenue proper, that is, from its share of the Federation Account or from its revenue from other sources. Therefore, in order to determine what constitutes the derivation fund, resolving the issue of the Federation Account is crucial. Therefore, the derivation formula to be utilized can be arrived at.

IV) Oil-Producing Areas and the Derivation Principle

That crude oil production has been the most important economic activity in the Nigerian economy since the early 1970s is not subject to debate. Its impact is not limited to its contributing almost 90% of Nigeria's total foreign exchange earnings but also fact that the national budgets are predicated on the expected annual production and price of crude oil. Thus, crude oil is the primary engine for national economic growth and development. It is, therefore, quite reasonable to expect that the areas producing the nation's crude oil would be very highly developed as compensation for what is taken away as well as for the devastation on the land engendered by the exploration process. There should have been development of physical and social infrastructures, human capital creation, and economic empowerment of the general citizenry in those areas.

The Niger Delta area suffers near total neglect by both the Federal government, which claims ownership of the oil, and the multinational companies, which actually exploit the oil reserves. It is a picture of wanton

environmental degradation of all types – land (despoliation of farmlands), water (destruction of fishing areas and sources of drinking water), and air (release of many pollutants causing diseases in humans, animals and plants). The people in the Niger Delta state who hitherto were able to cater for their needs are now being confronted with poverty through loss of their means of livelihood. The intervention of the federal government through the Niger Delta Development Commission (NDDC) seems to be a welcome development. However, the missing factor seems to be the proper treatment of the derivation principle in a way that would enable the state and local governments of the oil-producing areas to handle their developmental problems according to their own felt needs and priorities. The minimisation of the derivation factor over the years – from the earlier 50 percent to 1% and now 13 percent , only as it affects crude oil – is unjust and unfair when one considers the Igbeti Marble attract 55 percent derivation and the Value Added Tax (VAT) still attracts 20 percent derivation. The challenge will be to re-examine the issue of derivation particularly in line with the now democratic experiment.

Table 5: Sharing 13% Derivation Fund (to be managed by States Derivation Fund Boards)

Item	**13% Derivation: percentage shared**	**Basis of Sharing Among entities**
To States	60.00	Relative to Quantum of Production
To Local Government	30.00	50% quantum; 20% equality 20% population; 10% self-help projects
To Community	10.00	To be specified according to relevant Assembly (House or National)
Total	100.00	

Source: Aluko, M. E. (2005) "The Latest Revenue Allocation Formula in Nigeria – A quick Inspection", www.nigeriavillagesquare.com

V) Intergovernmental Fiscal Relations and the Economy

It is expected that fiscal decentralisation would stimulate growth and development. There is the need to ascertain whether this has been taken place in the country particularly as large amount of resources have been transferred from the centre to both State and Local Governments.

The latest of several official and unofficial constitutional reform initiatives, the NPRC was charged with forging a national consensus on new constitutional blueprint for 'reinforcing the unity, cohesion, stability, security, progress development and performance of the Nigerian federation' (Obasana 2005, 72). Yet, halfway into its proposed four-month tenure, the NPRC was already embroiled in the contradictions and divisions often associated with the

politics of mega-constitutional change in deeply divided societies. Especially palpable is the increasing polarization of the Conference along a broad geo-political fault-line that it puts putative southern Nigerian constitutional reformers against more pragmatic northern conservatives.

Conclusion

It can be seen from the analogy above that the problem of fiscal administration in Nigeria is more political than administrative. All the arguments on revision of the revenue formula or systems for financial management had never bothered on the practicality or incremental revision to an existing formula following practical experiences and identified gaps. Rather it is political considerations hat determined and structured the stance of every demand. All stakeholders are engineered by variables delving from ethnic considerations or demand patterns fashioned after very peculiar considerations. The clamour for political offices becomes very fierce since it determines what share of the national revenue that accrues to you. It is very clear that those who determine public affairs are largely concerned with revenue sharing as opposed to revenue generation. Every regime is so concerned about who gets what resources, when and how. Little concern is shown on how such revenue could be generated.

There is therefore total negligence on methods and ways of effectively generating revenue in Nigeria. The dangers associated with this orientation are that it can politically, economically and socially destroy a polity. Fiscal administration in Nigeria is enclosed in politics, which does not address amicable distribution of resources for effective national development. This trend has remained so because of the absence of fiscal autonomy, shady derivation principle and the problem with the federation account among others. These problems could be resolved. And the starting point is the decentralization of fiscal relationship between the federal state and local government establishing autonomy, as well as increases the derivation from 13 percent to about 25 percent.

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