INTERGOVERNMENTAL FISCAL RELATIONS: THE NIGERIAN EXPERIENCE[+]

BY

AKPAN H. EKPO[++]
UNIVERSITY OF UYO
UYO, AKWA IBOM STATE
NIGERIA

[+] Paper presented at the 10th Year Anniversary of the Financial and Fiscal Commission of South Africa, Capetown International Convention Centre, Capetown, South Africa, 10 – 12 August, 2004.

[++] Author is Professor of Economics and Vice-Chancellor.
University of Uyo, Uyo, Nigeria.

Tel: 234-85-201111
Email: ahekpo@skannet.com
Web: www.AkpanHEkpo.com

1. INTRODUCTION

Federation implies the existence in one country of more than one level of government, each with different expenditure responsibilities and taxing powers. In the Nigeria context, this consists of a Federal government, 36 states, Federal Capital Territory and 774 Local Governments. Among the different levels of government, fiscal arrangements must be worked out properly to ensure fiscal balance in the context of macroeconomic stability. The fiscal arrangement among the different tiers of government in a federal structure is often referred to as fiscal federalism; in other types of political structure it is known as intergovernmental fiscal relations. Sometimes, both terms are used interchangeably.

Conceptually, fiscal operations of any economy can be viewed from two extreme forms of the public sector. On one hand, there exists a highly decentralized fiscal system in which the government at the center has no economic responsibilities. The other tiers of government performs virtually all economic functions. The other extreme is a case of total centralization where the central government takes total responsibility for all economic activities of the public sector and therefore no other tiers of government participate in the economic life of the nation. In practice, there exists some degree of decentralization in all economies.

Decentralization refers to the portion of total revenue collected and expenditures allocated to both State and Local governments. The degree of decentralization is the extent of independent decision-making by the various arms of the government in the provision of social and economic services. It connotes the degree of autonomy of State and Local governments in carrying out various economic tasks.

Nigeria's fiscal federalism has emanated from historical, economic, political, geographical, cultural and social factors. In all of these, fiscal arrangements remain a controversial issue since 1946. Therefore, there exist unresolved issues on this matter. When the country was under military rule, it was thought that type of governance exacerbated the fiscal arrangements among the three levels of government. During military rule, the federal structure was only on paper while the government was unitary.

The introduction of a democratic experiment in 1999 re-echoed the problems of intergovernmental fiscal arrangement among the different levels of government. The issues of revenue allocation and the sharing formula have generated such intense debate that led to the demand of a national conference. It was during this period that the 'resource control' phenomena rose to an unprecedented dimension such that the struggle for political power become the fight for resource control. Hence, the democratic experiment has created 'new' problems; the interference by the executive arm of government on the functions of the National Revenue Mobilization and Fiscal Commission (NRMFC) on the appropriate revenue-sharing formula among the different levels of government, the debate regarding the correct interpretation of the section of the 1999 Constitution affecting the derivation principle, among others have posed challenges for Nigeria's fiscal federalism.

The paper examines intergovernmental fiscal relations in Nigeria focusing on its evolution and challenges. Section 2 of the paper examines the evolution of intergovernmental relations in the country. Section 3 discusses the principles of fiscal federalism. In section 4, the challenges are analyzed while section 5 concludes the paper.

2. EVOLUTION OF NIGERIA'S FISCAL FEDERALISM*

The evolution of fiscal federalism in Nigeria derives from economic, political/constitutional, social and cultural developments which have influenced the nature and character of inter-governmental fiscal relations. As Nigeria progressed from a unitary to a federal type of government the form of government became more and more decentralized; there were changes in fiscal arrangements. In examining the history of the country's fiscal federalism, we divide the economy into three broad time frames:

(1) The pre-independence period;

(2) The post-independence period; and

(3) The democratic experiment period.

The evolution of Nigeria's fiscal federalism is summarized in Table A1 in the appendix.

Pre-Independence Period

Before the introduction of a republican constitution in 1963, the fiscal arrangements were influenced by political and constitutional factors. Several commissions were created to renew existing fiscal arrangements and make appropriate recommendations. For a detailed analysis of these commissions see (Ekpo and Ndebbio, 1996; Ekpo and Ubokudom, 2002; Nigerian Economic Society, 1999).

+This section draws heavily from (Ekpo and Ndebbio, 1996)

The Phillipson Commission

Under the 1946 Constitution and following the establishment of Regional Assemblies in the then Western and Eastern Regions, as well as a Northern Regional Council in the Northern Region, it was necessary to give some financial responsibilities to these new bodies. Consequently, the financial secretary to the Nigerian government, Sydney Phillipson, was appointed sole commissioner charged with the responsibility of preparing financial arrangements under the new constitution. The Phillipson commission, as it was later known, was mandated "to study comprehensively and make recommendations regarding the problems of the administrative and financial procedure to be adopted under the new constitution" (Phillipson, 1946, p.1). The commission attempted to resolve three problems, namely: (1) the criteria to be used in declaring revenue as regional revenue; (2) how to determine the size of the grants from the central revenue; and (3) the formula for allocating grants among the regions. As regards the first problem, the commission utilized two criteria: (a) the revenue in question must be derived within the region and locally collected by the regional authorities, and (b) the revenue must be free from national or significant policy questions. Direct taxes, revenue from licences, mining rents, fees of courts and offices, rent from government property, and earnings from government departments met the two criteria.

The second problem had a constitutional solution. Under the constitution the central government had complete authority to determine how much to provide as grants to the regions. However, the onerous task faced by the commission was how to derive a formula for distributing such grants among the regions. The commission considered two principles, (a) derivation and (b) even progress or even development. It recommended that the sharing of the grants be shared solely on the principle of derivation. The shares were as follows: East, 24%, West, 30%; and North 46%. The adoption of the principle of derivation in sharing revenue among the regions in Nigeria started with the implementation of the Phillipson Commission's recommendations. The derivation principle has since been a thorny issue in Nigeria's inter-governmental fiscal relation (Adedeji, 1969; Phillips, 1971; Teriba, 1966).

<u>The Hicks-Phillipson Commission</u>

Following the dissatisfaction with the revenue allocation system under the Phillipson Commission and the decision to transfer educational grants-in-aid from the central to the regional estimates, a new commission known as the Hicks-Phillipson Commission (HPC) was appointed in June 1950.

The terms of reference of the HPC included: (1) To carry out an expert and independent enquiry in consultation with all parties concerned, to submit proposals to the governor-in-council for division of revenue over a period of five years between the three regions and central Nigerian services in order to achieve in that time a progressively more equitable division of revenue among the three separate regions and the center. (2) To determine whether any region had been unfairly treated in past years; if this was proven, then that region would be allowed a block grant to compensate for grants lost in past years.

In allocating revenue, the commission adopted the following criteria: liberty, justice, fraternity and efficiency. It recommended four principles corresponding to these criteria. They were independent revenue, derivation, need and national interest. Regarding independent revenue, four conditions were postulated for viewing revenue as regional. The revenue must be localized within the region, stable in yield, inexpensive to administer and free from considerations of national interest and policy. Hence, independent revenues to the regions were similar to revenues viewed regional by the Phillipson Commission except that the regions were given powers to impose sales taxes on petrol and also to impose entertainment taxes and stamp duties. The HPC applied the other three principles to the allocation of non-declared revenue. It apportioned 50% of tobacco tax on the principle of derivation; based capital grants on the principle of need; and transferred to the federal budget police and education. The Native Authority Police received 50% national interest.

Furthermore, the HPC recommended that a one-time grant of ₦4 million be paid to the Northern Region as compensation for its deprivation, arguing that the North was under-capitalized as compared to other regions. Scholars have criticized the HPC for fomenting inter-regional conflicts and misunderstanding (Terriba, 1996, p.366).

The Louis-Chick Commission

As the nationalist struggle persisted, two constitutional conferences were held, the first in August 1953, and the second in January and February of 1954. The conference created the Louis-Chick Commission (LCC). Its terms of reference included: (1) to assess the cost of central services and those of the regions; (2) to recommend how best revenue should be collected and distributed having regard to the need to provide the center and the regions and adequate measure of fiscal autonomy and the importance of applying the principle of derivation to the fullest degree compatible with meeting the reasonable needs of the center and the regions; and (3) to examine the financial ramifications of the southern part of the Cameroons becoming a separate region.

The commission's report was accepted by government and became operational in October 1954. The report provided that:

1 The federal government should retain the revenue from the following: company income tax and 50% of the duties on exports, tobacco, excise, imports (except those on motor spirit and tobacco).

2 50% of import duties except those on tobacco and motor spirits should be shared thus: 40% for the West; 30% for the North; 29% for the East; and 1% for the Southern Cameroons.

3. Regions should collect and retain revenue from personal income tax, produce sales tax, license and service feeds, interest on loans and earnings on surplus funds invested, revenue from regional departments, etc.

4. Revenue from the following sources should be shared among the regions in accordance with regional consumptions: 50% of tobacco, export and excise duties; 100% of the duty on motor spirit, all mining rents and royalties; and fees from small craft licences. Personal income tax revenues collected by the federal government from Africans were returned to the regions where the Africans who paid the tax were resident.

The Raisman-Tress Commission

The revenue allocation commission of Sir Louis Chick was found wanting on three grounds: insufficient independent revenues to the regions, the utilization of the principle of derivation in revenue allocation, and the rejection of the principles of need and national interest in revenue allocation. As a result of these shortcomings, the 1957 constitutional conference inaugurated another fiscal revenue review commission in 1958 under the chairmanship of Sir Jeremy Raisman. Though details of the commission's assignment are in (Raisman Tress, 1958), we present highlights of its terms of reference.

The Raisman-Tress Commission (RTC) was required to examine the division of power to levy taxes in the Federation of Nigeeria and the system of allocation of the revenue thereby derived in the light of: (1) experience of the system to date; (2) the allocation of functions between the governments in the federation as agreed at the conference; (3) the desirability of ensuring that the maximum possible proportion of the income of regional governments should be within the exclusive power of those governments to levy and collect, taking into account consideration of national and inteer-regional policy; (4) as regards item 3, the special problems in the are of indirect taxation given the position of Lagos as a federal territory; (5) in so far as the independent revenues that can be secured for the various governments are insufficient to provide not only for their immediate needs but also for a reasonable degree of expansion, and bearing in mind the federal government's own further needs, the desirability of allocating further federal revenue in accordance with such arrangements as will best serve the overall interest of the federation as a whole.

It is noteworthy that the commission introduced taxes on partnerships, clubs, trusts and other unincorporated associations to accrue to regional government jurisdictions. It contended that the federal government should be financially strong in order for it to avoid insolvency, and be able to provide grants to needy regions and services of national interest. The commission adopted four criteria in allocating revenue in a distributable pool account, which it created. These criteria were: balanced development, continuity in regional government services, maintenance of minimum responsibilities and population.

The RTC divided each type of revenue into three parts to be paid to states of origin, federal government and the distributable pool account. These included: under state of origin, 50% of mining rents and royalties and imports duties; for the distributable account, 30% of mining rents, royalties as well as 40% of import duties.

The distribution of the distributable pool account was based on 40% for the North; 31% for the West; 24% for the East; and 5% for the Southern Cameroons. It is interesting to note that the distributable pool account was used after independence to share some federally-collected revenue among the regions of the federation. In addition, the commission recommended the formation of a fiscal commission to review periodically the revenue from mining rents and royalties as well as the size, composition and distribution of the distributable pool account. The fiscal commission was required to consult with the regional governments. This recommendation seemed to have survived given the frequent review of revenue allocation within the economy.

From the above discussion, it appears clear that each commission was concerned with the efficient provision of public goods, and the distribution of available revenue. New fiscal commissions were appointed on the basis of constitutional changes. Though not explicit, there was some evidence of power struggle between the regions – each attempting to secure benefits for having important natural resource. This phenomenon is implicit in the debate over the derivation principle.

2.2 <u>The Post-Independence Period</u>

1) This period experienced significant economic, social and political changes, including an almost three-year civil war (1967-1970) which affected government expenditures and revenue patterns. 2) The form of government was further decentralized in 1967 by the creation of 12 states out of the erstwhile four regions. 3) In 1976, 19 states were created and local governments became officially known as the third tier of government. 4) Two new states (Akwa Ibom and Katsina) were created in 1987, thereby bringing the number of states to 21 excluding the Federal Capital Territory (Abuja), which received full status and thus was entitled to the allocation of federal funds. The number increased to 36 states in 1996. 5) Of significance during the period was the frequency and duration of military rule. The military took over the

reigns of power and held them for almost 13 years before a civilian administration was installed in October, 1979. 6) In 1984, the military once again seized power from the civilians and three military regimes have existed since then: the Buhari regime, the Babangida regime and the Abacha regime. 7) The military rule was characterized by the promulgation of decrees affecting the country's fiscal operations.

A major economic feature of the period was the ascendancy of the petroleum sector as the major foreign exchange earner. The windfall profit from petroleum beginning in 1974 and the dependence of the economy on oil revenues had implications on fiscal variables. For example, as a result of the huge foreign exchange earnings, government embarked on various non-viable projects and became actively involved in virtually all sectors of the economy.

Almost throughout the post-independence period Nigeria has been in a situation of economic crisis. Beginning in 1979/80, the economy entered a recessionary phase. The prolonged high rates of inflation and unemployment coupled with declining productivity confirmed the existence of stagflation in the economy. Consequently, various stabilization and adjustment packages aimed at reversing the crisis were introduced from 1984. The economy finally had to settle for a full-blown IMF type of structural adjustment in 1986. These stabilization and adjustment packages have implications for the country's fiscal operations. More concretely, the issues highlighted above influenced – positively or negatively – the evolution of fiscal federalism during the post-independence period in Nigeria.

The Binns Commission of 1964

Following the introduction of a republican constitution in 1963, the Binns Revenue Commission was appointed in 1964 to review inter-government fiscal relations. Its terms of reference included an examination of the appropriateness, in the prevailing circumstances of Nigeria, of: (a) the formula for the allocation of the proceeds of mining rents and royalties laid down in section 140 of the constitution of the federation; and (b) the formula for the distribution of funds in the distributable pool account laid down in section 141 of the constitution of the federation (Binn, 1964, pp. 5-6).

The commission rejected the distribution of funds based on principles of derivation and need, and utilized the principles of regional financial comparability, continuity in government services and maintenance of minimum responsibilities. The commission recommended that 35% of federally collected revenue from import duties, mining rents and royalties be paid into the distributable pools account and distributed among the regions on the basis of North, 42%, East, 30%; 20%; and Mid-West, 8%. After the military intervention in 1966, and the creation of 12 states in 1967, the shares of the Northern Region were divided among the six northern states on the basis of population and equality of states. The military government carried out the changes by promulgating, as an interim measure, Decree No. 15 of 1967. The decree stipulated how the funds in the distributable pool amount were to be shared among the 12 states. It took cognizance of the regional blocks and segmented the funds in the account that had accrued to those regions among the new states. The principle adopted in dividing a region's share among the states emanating thereof was **ad hoc** and unsatisfactory. As a result, the military government appointed an Interim Revenue Allocation Review Committee in 1966, chaired by Chief I.O. Dina.

Interim Revenue Allocation Review Committee

This committee was the first such body consisting only of Nigerians. In the light of the creation of 12 states, charged with the functions formerly exercised by the regional governments, the committee was mandated to look into and suggest any change in the existing system of revenue allocation as a whole. This included all forms of revenue going to each government besides and including the distributable pool account. The committee was also to suggest new revenue sources for both the federal and state governments.

In carrying out its mandate the committee proposed possible principles that could serve as criteria for revenue allocation, including four of those used in earlier allocation systems. The principles were basic need, minimum national standard, population, tax effort, financial prudence, fiscal adequacy, balanced development, independent revenue, derivation and national interest. The allocation of revenue between the federal and the state governments was divided into independent revenue and shared revenue. The independent revenue to the federal government comprised principally company (including oil companies) income tax, while that of the state governments consisted of personal income tax, licenses, fees etc. The shared revenue consisted of revenue from excise duty, import duty, export duty, mining rent and royalties from off-shore operations, and royalties from in-shore operations in respect of oil and solid minerals.

In addition, the committee recommended that the shared revenue should be allocated among the federal government and three accounts namely: the states joint account to replace the distributable pool account, the special grants account and the derivation account. The committee also worked out the details for sharing the states joint account.

Table 1: Allocation of shared revenues (in %)

Account	ED[1]	IM[2]	ED[3]	MRI[4]	MRRO[5]
Federal	60	50	15	15	60
State deriv.	-	-	10	10	-
State joint	30	50	70	70	30
Special grants	10	-	5	5	10
Total	100	100	100	1001	100

Source: The Report on the Interim Revenue Allocation Comm. (1969, p.77).
Notes: 1. excise duty, 2. import duty; 3. export duty; 4. mining royalty (in-shore); 5. mining rent and royalty (offshore).

In terms of derivation, the committee argued that the rent from inshore oil exploration should be assigned in full to the state from which the oil was extracted, while 10% of the royalties should be shared on derivation. The formula for the allocation of shared revenue is given below:

It must be noted that this first indigenous revenue allocation committee addressed vital fiscal issues in its recommendations. For example, it called for the centralization of certain functions, overhauling the tax administration throughout the country as well as uniformity in personal income taxes, measures that would increase tax revenue to federal and state governments, and the intensification of federal government spending on public goods that have the characteristics of spillovers in their consumption. However, the military government rejected the report of Chief Dina's committee and enacted Decree 13 of 1970. This decree modified the distribution of the distributable pool account, and the revenue paid into the account was distributed among the states on the basis of 50% on equality of states and 50% on population. Furthermore, an off-shore oil revenues decree was promulgated in 1971 – it amended Section 140(6) of the constitution, which provided that the continental shelf of a state is part of that state.

The 1971 amendment stated that (a) the ownership of and title to the territorial waters and the continental shelf shall vest in the federal military government; and (b) all royalties, rents and other revenues derived from or relating to the exploration, prospecting or searching for or the mining or working of petroleum (as defined in the Petroleum Decree of 1969) in the territorial waters and the continental shelf shall accrue to the federal military government.

The implication of the off-shore was that all the revenues from off-shore operations accrued to the federal government, while those from in-shore operations were allocated as per the existing formula: 45% on derivation; 50% to the distributable pool account; and 5% to the federal government.

In 1975, further changes were effected in the revenue allocation system. The distributable pool account was enlarged and revenues credited o the account included 35% of import duties other than motor fuels, tobacco, wine, potable spirits and beer; 100% of the import duty on motor fuels and tobacco; 50% of excise duty on any commodity; 100% of the export duty (if levied) on produce, hides and skins; 80% of mining rents and royalties from inshore operations; and 100% of mining rents and royalties from off-shore operations. The creation of 19 states in 1976 and the demand by the constitution drafting committee for a new revenue allocation formula inclusion in the proposed new constitution led to the establishment of The Technical Committee on Revenue Allocation in 1977 under the chairmanship of Professor Ojetunji Aboyade.

The 1977 Technical Committee on Revenue Allocation

The terms of reference of the committee were to take into consideration the need to ensure that each government of the federation had adequate revenue to enable it to discharge its responsibilities, with regard to population, equality of status among the states, derivation, geographical peculiarities, even development, the national interest and any other factor bearing on the problem. The committee was to analyze the existing revenue allocation formula with a view to determining its adequacy in the factors mentioned above and representations from the federal government and the state governments and other interested parties. Based on those findings, the committee was charged with recommending new proposals as necessary for the allocation of revenue among federal, state as well as the local governments, and also among state, and the local governments and making whatever recommendations were deemed necessary for the effective collection and distribution of federal and state revenues.

The committee rejected the former principles used in previous allocation systems. On the other hand, it recommended the following five criteria in allocating funds in the states joint account: equality of access to development opportunities, national minimum standards for national integration, absorptive capacity, independent revenue, and minimum tax effort and fiscal efficiency. The following weights were assigned to each of the above criteria respectively: 0.25, 0.22, 0.20, 0.18 and 0.15. The committee maintained that the allocation criteria should be applied to the incremental changes in the state joint account and not to the total absolute amount so as to ensure that each state government would be able to maintain minimum continuity of services in carrying out its duties. The same formula was suggested for local governments.

The allocation formula recommended by the committee was: 57% for the federal government; 30% for states joint account; 10% for local government; and 3% for special grants account. The federal government in accepting the committee's recommendations modified the formula to read thus: 60% for the federal government; no change in state and local government shares, and no allocation for the special grants account.

The other significant recommendations of the committee, accepted by government, included: (1) the concurrent subjects in the new constitution would be similar to those of the 1963 constitution; (2) the local governments would be entrenched in the new constitution as the third tier of government; (3) all mineral rights would be vested in public ownership; (4) the tiers of government would be allocated tax powers and functions; and (5) all revenue collected by the federal government (apart from personal income tax form the armed forces, external affairs officers and the new federal capital territory) would be shared among the federal, states and local governments.

The committee's report came under severe criticism especially as regards the weights attached to the five criteria and the recommendation that state governments should administer company income tax. It was feared that the latter would introduce complications while the former (weights) were arbitrary. An excellent appraisal and critique of the various fiscal commission reports is in Uduebo (1982).

The Okigbo Commission

Consequently, a new revenue allocation commission was established in November 1979, under the chairmanship of Dr. Pius Okigbo. This commission, otherwise known as the Presidential Commission on Revenue Allocation or the Okigbo Commission was set in motion two months after a new civilian administration assumed power. Despite the minority views expressed by some members of the commission, government modified and accepted its report.

However, on 2 October 1981 the Supreme Court of Nigeria declared the recommendations of the Okigbo Commission as invalid, null and void, and of no effect whatsoever.

The 1981 Revenue Act

In 1981, a new revenue act was passed by Parliament. It became operational from January 1982. Under the new act, federally collected revenues were distributed as follows:

Federal government	-	55%
State government	-	35%
Local government	-	10%

The 35% statutory share of the state governments was to be distributed thus:

(1) 30.5% to be shared among the states on the basis of:

(a) Minimum responsibility of government (equality of states) - 40%
(b) Population - 40%
(c) Social development as indicated by primary school enrolment, of which 11.5% is based

on direct primary school enrolment; and 3.75% on inverse enrolment) - 15%

(d) Internal revenue effort measured as the ratio of total internal revenue to total recurrent expenditure - 5%

(2) 3.5% for the benefit of the mineral producing states to be shared on the basis of derivation, of which 2% will be shared directly on derivation and 1.5% will be administered by the federal government for the development of the mineral producing areas.

(3) 1% will be allocated the federal fund for ecological problems.

The 1981 Revenue Act remained in force until December 1989. The act was the longest-standing revenue formula in the history of Nigeria's fiscal federalism. Even the two military governments, after the civilian rule, ignored the several criticisms levied against the act. However, in 1988, The National Revenue Mobilization, Allocation and Fiscal Commission was inaugurated under the chairmanship of General T. Danjuma. In December 1989, government modified and accepted the recommendations of the Danjuma Commission.

The Danjuma Commission

Among other things, it is noteworthy that government agreed with the commission that there should be no dichotomy between on-shore and off-shore oil production for the purpose of revenue sharing and for the development of mineral producing areas. The important aspects of the revenue allocation formula of the Danjuma Commission accepted by government are summarized below:

	Commission's Recommendation	Government's approved
Vertical allocation:		
Federal government	47%	50%
State governments	30%	30%
Local governments	15%	15%
Special funds	8%	5%
	100%	100%
Special Funds:		
Federal territory	1.0% FA	1.0%
Stabilization	0.5% FA	0.5%
Savings	2.0% FA	-
Derivation	2.0% MR	1.0%
Development of oil MPA	1.5% OMR	1.5%
Development of non-oil MPA	0.5% NOMR	-
General ecology	0.5%	1.0%
	8.0%	5.0%
Horizontal Allocation:		
Equality of states	**40%**	**40%**
Population	**30%**	**30%**
Social dev. factor*	**10%**	**10%**
Land mass and terrain	**-**	**10%**
Internal rev. effort	**20%**	**10%**
	100%	**100%**

Notes:
FA = Federal account
MA = Mineral Areas
OMR = Oil mineral producing areas
NOMR = Non-oil mineral producing areas
***includes education (direct enrolment 8%); inverse enrolment (2%)**
The above revenue allocation formula except that of land mass and terrain took effect from December 1989.

2.3 THE DEMOCRATIC EXPERIMENT PERIOD

In May 1999, the country replaced the military regime with a democratic government through the ballot box. During this period, there exist controversies regarding the country's fiscal operations. The Federal Government was accused by oil producing states for not honouring the derivation principle as stated in the 1999 Federal Constitution. The Federal Government introduced the on-off shore dichotomy implying that oil found in the sea cannot be ascribed to the adjoining state.

The on-off shore controversy resulted in states in the Niger Delta calling for a greater control of their resources (petroleum); this led to the struggle for resource control culminating in some states suing the Federal Government. The matter ended in the Supreme Court.

It should be noted that the National Revenue Mobilization, Allocation and Fiscal Commission (NRMAFC) which was inaugurated in 1990 became effective during this period. The NRMAFC rejected on several occasions the interference of the President and the Federal Ministry of Finance on the formula for revenue-sharing. The NRMAFC insists on the proper interpretation of the Constitution. For example, in January 2004, the Federal Ministry of Finance in a letter to the Commission gave the Federal Government a share of 54.68% and a grant of 2% to the States. The NRMAFC disagreed with the Ministry of its non-compliance with the Provision of Section 164(1) of the 1999 Constitution. To table below summarizes the changes and recommendations in the vertical allocation formula from May 1999 to January 2004.

Changes and Recommendations in the Vertical Allocation Formula: 1999 – 2004

	*1 Revenue allocation of Order 2002 beginning May 1999	*2 Revenue Allocation July Order 2002	*3 Ministry of Finance Allocation Formula January 2004
1. Federal Government	** (i) 56%	** (i) 54.68%	** (i) 52.68?%
Federal government	48.5%	48.5%	
General Ecology	2.0%	-	
Fed. Cap. Territory	1.0%	1.0%	
Stabilization Account	1.5%	.725%	
Dev. of Natural Resources	3.0%	3.05%	
Deirivation (Ecology)	-	1.46%	
2. State Governments	(ii) 24.0%	(ii) 24.72%	(ii) 26.72%
3 Local Governments	(iii) 20.0%	(iii) 20.60%	20.60%
Total	100%	100%	100%

Source: NRM AFC, Abuja.

Notes:

* 1 Consequent upon the decision of the Court in the 'Resource Control Suit' the President invoked the provision of Section 315 to bring the provision of Cap. 16 into conformity with the provisions of the constitution.

** The Federal Govenmment allocated 48.5% for itself and distributed the balance of 7.5% on General Ecology and FCT.

*2 Proposal Re-Modification Order by the President which the NRMAFC disagreed with on the ground that the earlier modification Order was the Act of the National Assembly by virtue of S.315 and therefore any amendment to it must follow due legislative process.

** The Federal Government allocated 48.5% to itself. The 2% for General Ecological problems is to be shared by all three tiers of government on the basis of the existing formula.

*3 Modification of the sharing formula through a letter of 15th January, 2004 from the Honourable Minister of Finance, authorizing 2% Grant to the states which the NRMAFC disagreed because of its non-compliance with the provision of section 164(1) of the 1999 Constitution.

It is clear from the above that Nigeria's fiscal federalism is still metamorphosing; the NRMAFC was unable to disagree with previous military governments.

3. PRINCIPLES OF FISCAL FEDERALISM

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

(i) 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.

(ii) The Principle of Equivalence: Based on the geographical incidence of different public goods, allocative efficiency requires the equalization of locational advantages arising from interjurisdictional differences with a combination of taxes and public goods and services.

(iii) <u>The Principle of Centralized Stabilization</u>: This requires the use of fiscal instruments for achieving macroeconomic objectives of growth, stabilization and full employment at the national level.

(iv) <u>Correction of Spillover Effects</u>: This ensures that interjurisdictional 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".

(v) <u>Minimum Provision of Essential Public Goods and Services</u>: This ensures that fiscal federalism guarantees all citizens, irrespective of where they reside, the minimum provision of certain basic public goods and services.

(vi) Principle of Fiscal Equalization: In order to ensure minimum level of public goods and services same degree of fiscal equalization is required. This is as a result of differences in resource endowment.

(vii) <u>The Efficiency Principle</u>: This principle implies that efficiency must be applied in the allocation of resources. In addition, each level of government should maximize its internal revenue earnings at minimum tax efforts.

(viii) The Principle of Derivation: The component units of a system should be able to control some of its own resources as they desire.

(ix) The Principle of Locational Neutrality: Interregional fiscal differences tend to influence locational choices of individuals and firms. Based on different resource endowments, differences in tax capacity and effort, some decree of locational interference seems to be an 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)

(X) 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 result in distortions in locational decision.

It should be noted that the above principles are not mutually consistent. They are difficult to apply simultaneously. Therefore, trade-offs 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 (see Table A-1 in the appendix).

After almost forty years in search of a workable fiscal federalism, there still exist challenges which policy-makers must address.

4. CHALLENGES

There are several challenges tormenting intergovernmental fiscal relations in Nigeria:

4.1 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 powers/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 suppose to generate internal revenue. There is, therefore, the need to resolve the imbalance between assigned functions and tax powers.

4.2 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 – state structure in 1967, States and Local Governments 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.

4.3 **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% of totally federally collected revenue; but since 1991, when it first dropped to about 75% and nose-dived to around 35% 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 balanced 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 vertical formula. These first-line charges include funding for external debt service, national priority projects, NNPC priority projects, 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 calls, that these various charges which are federal government obligations be financed solely from he 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. Thereafter, the derivation formula to be utilized can be arrived at.

4.4 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 to the 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 exploits 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 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 (NNDC) 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 minimization of the derivation factor over the years – from the earlier 50% to 1% and now 13%, only as it affects crude oil – is unjust and unfair when one considers that Igbeti Marble attract 55% derivation and the Value Added Tax (VAT) still attracts 20% derivation.

The challenge will be to re-examine the issue of derivation particularly in line with the now democratic experiment.

4.5 Intergovernmental Fiscal Relations and the Economy

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

5. CONCLUSION

We have examined the evolution of intergovernmental fiscal relations in Nigeria. It seems clear that political, social, and economic factors influenced the decentralization process. An analysis of the recommendations of the various fiscal Commissions did indicate the problems of addressing revenue allocation in Nigeria. We highlighted some of the challenges facing intergovernmental fiscal relations in the country; these included fiscal autonomy and independence, the Federation Account, the Derivation Fund and Problems of the Oil-Producing Areas. A robust treatment of these issues by policy-makers will result in a fair and just resolution of the problems confronting the different tiers of government.

There is no doubt that the principles of fiscal federalism implicitly or explicitly have guided the formulation and implementation of fiscal relationships among the different tiers of government. Intergovernmental fiscal relation is not a smooth process; all stakeholders must be committed to fine-tuning the process in the overall interest of the country.

REFERENCES

Agiobenebo, T. J. (1999) "Assignment, Criteria and the Fiscal Constitution: An Excursion into Theory of Rational Fiscal Federalism" in Fiscal Federalism And Nigeria's Economic Development, Nigerian Economic Society (NES), Ibadan.

Amnuwo, K. et al (1998) Federalism and Political Restructuring in Nigeria, Ibadan: Spectrum Books.

Ekpo, Akpan H. (1994) "Fiscal Federalism; Nigeria's Post-Independence Experience, 1960-90, World Development, Vol.22, No.8

Ekpo, Akpan H. (1995) "Intergovernmental Fiscal Relations in Nigeria: Issues and Experience" Workshop, Johannesburg, South Africa, May 3-5, 1995.

Ekpo, Akpan H. (1999)"Fiscal Federalism and Local Government Finances in Nigeeria" in NES, Ibid.

Ekpo, Akpan H. and John Ndebbio (1996) Fiscal Operations in a Depressed Economy: Nigeria, 1960-90. Research Paper No. 44, AERC, Nairobi, Kenya.

Ekpo, Akpan H. (1999) "Public Expenditure and Economic Growth in a Petroleum-Based Economy: Nigeria, 1960-62" South African Journal of Economic and Management Sciences, September, Vol. 2, No. pp.374-389.

Ekpo, Akpan H. and Enamidem Ubok-Udom (2003). Issues in Fiscal Federalism and Revenue Allocation in Nigeria. Future Publishing Ibadan, for University of Uyo.

Emenuga, Chidozie (1993) "Nigeria: In Search of Acceptable Revenue Allocation Formula" The National Question and Economic Development in Nigeria, Nigerian Economic Society (NES), Ibadan.

Kayode, M. O. (1993) "The National Question and Revenue Allocation: An Articulation of Some of the Problems and Issues" in NES, 1993, ibid.

Mbanefoh, G.E. (1993) "Unsettled Issues in Nigerian Fiscal Federalism and the National Question" in NES, ibid.

Prud'homme, R. (1995). "The dangers of Decentralization" The World Research Observer, Vol.10, No.2, August. Pp.201-220.

Ter-Minassian, T. (1997) Fiscal Federalism in Theory and Practice, Washington, D.C. IMF.

Uduebo, M. A. (1992) "Fiscal Federalism in Nigeria: Experience since 1967 and Proposals for the Future" Ph.D Thesis, Development of Economics, University of Lagos.

World Bank (1995) Annual World Bank Conference on Development Economics, Washington D.C., World Bank

APPENDIX

Table A – 1: Summary of the evolution of revenue commissions and allocation formula in Nigeria:

Year/Commission	Principles/Criteria and Allocation Formulas
1946 Phillipson	Based on derivation and equal progress or equal development. Grants were solely on derivation. East 24%, West 30% and the 46%
1950 Hicks-Phillipson	Based on independent revenue, derivation need and national interest. Same formula as in 1946 except regions were empowered to impose sales taxes on petrol, entertainment taxes and stamp duties.
1954 Louis-Chick	Federal government to retain revenue from company income tax; and sales on the export, tobacco, excise; 50% of import duties (except on tobacco and motor spirits) to be shared thus: West 40%, North 30%; East 29% and Southern Cameroons 1%. Regions to collect and retain revenues from personal income tax. 50% of tobacco export and excise duties and 100% of the duty on petrol to be shared among the regions in accordance with regional consumption.
1958 Raiseman-Trees	Criteria: balanced development, community in regional government services, maintenance of minimum responsibilities and population. Divided each revenue into three parts: (a) states of origin, (b) federal government, (c) distributable pool account. For (a) 50% of mining rents and royalties and import duties; for (b) 30% of mining rates, royalties and import duties; for (c) 20% of mining rents and royalties and 40% of import duties. Allocation from the pool account: North 40%; West 31%; East 24%; and Southern Cameroons 5%.
1964 Binns	35% of federally collected revenue from import duties, mining rents and royalties to be paid into the distributable pool account and shared among states as follows: North 42%; East 30%; West 30% and Midwest 8%.
1966 Dina	Principles: basic needs, minimum national standards, population, tax effort, financial prudence, fiscal adequacy, balanced development, independent revenue, derivation and national interest. Segmented revenue into independent and shared; the latter to be allocated between the federal government and other accounts, viz., states joint account, special grants account, and derivation account. Excise duty: 60% federal; 30% states joint account; 10% special grants. Import duty: federal 50%; states joint account 50%. Export duty: 15% federal; 10%derivation; 70% states joint account; 5% special grants. Mining royalty (in shore): 15% federal; 10% derivation; 70% states joint account; 5% special grants. Mining rent and royalty (off shore); 60% federal; 30% states

	joint account and 10% special grants.
1970 Decree 13	Rejected Dina report. Revenue distributed among the states on the basis of 50% equality of states; 50% on population. All off-shore revenue accrued to the federal government. In-shore revenue shard as follows: 45% on derivation; 50% to the distributable pool account and 5% to the federal government.
1975	Amendment to Decree 13 of 1970 of import duties except on motor fuels, tobacco, wine, potable spirits and beer to the distributable pool account; 100% of the import on motor fuels and tobacco; 50% of the excise duty on any commodity; 100% of the export duty (if levied) on produce, hides and skins; 80% of mining rents and royalties from in-shore operations and 100% of mining rents and royalties from off-shore operations, All of the above were to accrue to the distributable pool account.
1977 Aboyade	Criteria for state joint account: equality of access to development opportunities, minimum standards for national integration, absorptive capacity, independent revenue, minimum tax, and fiscal efficiency. 50% for the federal government; 10% for local governments; 3% for special grants account. Later to 60% and abolished the special grants account.
1979 Okigbo	Recommendations declared null and void by the Supreme Court of Nigeria.
Revenue Act of 1981	Revenues to be allocated thus: federal government 55%; state governments 35%; local government 10%. 35% statutory share of states to be allocated as follows: 40% as equality of states or minimum responsibility of government; 40% on population; social development 15%, of which 11.5% is based on direct primary school enrolment and 3.5% on inverse enrolment; 5% for internal revenue effort; 3.5% for mineral producing states, of which 2% on the basis of derivation and 21.5% administered by he federal government for the development of the mineral producing areas, 1% to the federal fund for ecological problems.
1989 Danjuma	Vertical allocation: federal 50%; state governments 30%; local governments 15%; special funds 5%. Horizontal allocation : 40% for equality of states; 30% for population; 10% for social development factor, 8% direct enrolment and 2% for inverse enrolment; land mass and terrain 10% and internal revenue effort 10%. These were approved by the government.
1999 FMG	Vertical allocation: Federal 48.5%; State governments 24%; Local governments 20%; FCT 1%; General ecology 2%, stabilization 0.5; Derivation (MR) 1%; OMPADEC 3%.

<u>Table A - 2</u>

<u>Powers and Functions of the National Revenue Mobilization, Allocation</u> and Fiscal Commission.

a. Systematic design, and effective mobilization of all sources of public sector revenues;

b. Periodic review of the revenue allocation principles and formulae such that would minimize short-term political pressure;

c. Prescription and application of revenue allocation formulae after due approval by the Federal Government for the purpose of sharing the Federation Account between the federal, State and Local governments;

d. Monitoring the accruals and disbursement of revenue from the Federal Account, the States Joint Account, the Local Government Joint Account, the various Special Purposes Accounts and such accounts that may from time to time be established or designated by the commission with the approval of the Federal Government.

e. Ensuring full compliance with established revenue sharing arrangements as well as full public accountability for all funds so allocated to various governments and/or agencies involved in the disposition of the Federation Account;

f. Liaison with the National Planning Commission and similar statutory bodies in the orderly fiscal development of each tier of government;

g. Collaboration with all layers of government as well as their ministries, departments, agencies, and extra-ministerial units in the prompt, regular and faithful production of public financial statistics;

h. Determination of the remuneration which it may deem appropriate for political office holders such as members of the executive and legislative branches of government outside the consolidated account;

i. Commissioning, undertaking or sponsoring studies, analysis and deliberations on subject which may bear directly or impinge significantly on the policy and operation domains of the federal fiscal system and inter-governmental financial relations;

j. Making whatsoever general or specific recommendations as the commission may consider necessary for more effective mobilization, collection, allocation and distribution of federal, state and local government revenues, as well as providing guidelines for their efficient implementation; and

k. Submitting regular and timely annual reports to the Federal Government on its general activities over and beyond its specific recommendations, or ad hoc submissions on particular subjects, with such annual reports also incorporating the commission's audited accounts.