The Nigerian Fiscal Federalism and its Formula for Revenue Sharing

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Abstract
This is a qualitative research based on secondary sources of information. The article examines the formula that is being used for delimitation of revenue sharing in Nigeria and sometimes criticizes some of the criteria used and sometimes posits alternative cause of action that could yield a better result than what is presently possible. The manner in which revenue is shared amongst the three tiers of government that make up the federation is guided by the Nigerian constitution; therefore a meaningful discussion of the formula used for delimitation must examine the nature and character of fiscal relationship between tiers of government. It is hoped that this article would help clear the cloudy areas of revenue sharing in Nigeria and add value to the on going debate about revenue sharing in Nigeria that has become a never ending conclusion in the country.

Introduction
In 1849, Awa (1964) the British traders established their presence in what is now called Nigeria. The encounter asserts Awa (1967) resulted in the first treaty signed between Bruce the consular and Chief Akitoye of Lagos in 1852 establishing the British firm presence in Nigeria. Nigeria according to Elias (1967) was first administered as a unitary state as supposed to federalism and had its first constitution in 1914 under Lord Lugard who was also its first governor general but the first attempt according to Ojo (1985) to introduce legislature was in 1922 and the first attempt according to Awa (1964) to introduce a federal constitution in Nigeria was in 1946 by Sir Richard, known as the Richard Constitution. This was however according to Elisa (1967) a semi federal structure designed to test the waters.

Federation was in earnest introduced in Nigeria by Lyttleton constitution of 1954, reinforced in the 1960 independence constitution and has been the norm ever since by subsequence constitutions. That the country is a federation is no doubt, with thirty-six states including a Federal Capital Territory at Abuja (Osaghae 2006). Over the years Nigeria has metamorphosed from three regions at Independence in 1960, then four in 1963, twelve in 1967 and in now 36 states including a Federal Capital Territory that has a state's status and it also has 774 local governments (salami, 2011).

Every country that practices fiscal federalism in the world has a formula for sharing the revenue derived amongst the tiers of government that make up the federation. This has quite very often been a bone for contention as there is never a perfect formula, but every attempt must be made to ensure that the formula that is being used for delimitation of revenue appears to be fair and equitable to all the stake holders in the country. The formula that is being used in Nigeria to allocate revenue to sub-region units has been a thorny ever since federalism began in Nigeria and has resulted in many different kinds of committee or commission and even Decree or Act being set up depending on the government of the day and the choice of name. What then is the formula used and how is this applied? Since 1980 when the National Revenue Mobilization, Allocation and Fiscal Commission was established, revenue allocation among states/local governments has been on the following principles: equality, population social development, internally generated revenue and land mass/terrain (Arowolo, 2011, Salami, 2011, Alm and Boex 2004) The importance attached to each of these principles is reflected in the weight given to each principle. These principles will be addressed later by the researcher in sub headings.

Nigeria's Fiscal Federalism

Fiscal federalism practice predates Nigeria's independence of 1960. It first came to the fore in Nigeria in 1946 and according to Awa (1964) it was designed to test the waters and was in earnest introduced in Nigeria under lyttletle constitution in 1954 and has been the norm ever since. The practice of fiscal federalism is synonymous to other practices in the world. In Nigeria there are three layers of government that makes up the federation of Nigeria (Federal, state, local government). The Nigeria's Constitution is very explicit and emphatic on this issue. It pronounces Nigeria a Federal republic (page 1, para 2.1 of the 1999 Nigeria's Constitution.). The longevity of federalism in Nigeria made Ademolekun and Kincaid (1991) to refer to Nigeria as Africa's most consistently federal polity.

In Nigeria, revenues are highly centralized. Nigeria's Constitution defines the manner in which resources are shared among the different levels of government.

There is no doubt that Nigeria is a very rich country in terms of mineral resources, hard and human. Other areas where Nigeria generates its financial resources from are company income tax, Pay as you earn tax, (taxation) VAT, Custom and Exercise duties, External Affairs, Education. All monies arising from these sources with the exception of External Affairs and Education are paid on a first charge settlement into Federated Account, held with the Central Bank of Nigeria (Alm and Boex, 2002). The VAT proceeds are paid into the VAT Account, also held by the Central Bank of Nigeria. The money in the Federated Account and VAT Account are then shared by a formula to all the tiers level of government in the federation in form of Intergovernmental fiscal relationship or fiscal federalism (Alms and Boex, 2002) In this instance to the 36 states and the capital territory, Abuja that has a full state's status and therefore qualifies for sharing from the Federation Account and VAT account, and also the 774 local governments in the federation. Take for example in 2004, the revenue accrued to the federal government of Nigeria was N2, 478 billion, of which N1, 162billion went to the central government (federal government) states received, N590 billion, Local N454Billion, Derivation N272billion (Federal Office of Finance/Budget Office of the Federation, 2007). For 2005, 2006, 2007, 2008, 2009, 2010, please see table below.

REVENUE FRAMEWORK 2004-2010

Figure1

	2004a	**2005a**	**2006a**	**2007b**	**2008f**	**2009f**	**2010f**
FEDERAL GOVERNMENT SHARE	=N=bus	=N=bus	=N=bus	=N=bus	=N=bus	=N=bus	=N=bus
FGN Budget	1,092	1,163	1,354	1,643	1,912	2,427	2,391
FCT	24	25	29	36	42	53	52
Derivation and Ecology	27	23	27	33	42	53	52
Stabilization	11	12	14	17	19	24	24
Development of Natural Resources	37	39	46	56	65	82	81
Government	1,186	1,263	1,470	1,784	2,076	2,636	2,596
FEDERAL BUDGET SHARE							
Oil Revenue	904	979	1,134	1,364	1,577	2,032	1,916
VAT	22	26	31	36	43	51	59
CIT	63	75	108	139	169	208	256
Customs	125	105	80	104	122	136	159
SUB-TOTAL	1,114	1,185	1,354	1,643	1,912	2,427	2,391
INDEPENDENT REVENUE	59	65	33	134	120	132	145
TOTAL	1,173	1,250	1,387	1,777	2,032	2,559	2,536
Year-on-year % Growth	0.0%	6.5%	10.9%	28.1%	14.3%	25.9%	-0.9%

Source: FMC/BOF 2007

The allocation the Federal government receives from the Federation Account is in turn allocated to the Ministries, Departments and Agencies of Government (MDAs) to focusing deliverables expected of them. A survey of seven key MDAs resulted in the data below.

A Sample MDAs' Capital Budget Utilization Report, March 2009
Figure9

MDA	**FIRST QUARTER**	**FIRST QUARTER**	**PERFORMANCE**
	AMT. RELEASED (N'Bn)	AMT. UTILIZED (N'Bn)	%
	28.324		
POWER		0	0.00%
	2.801		
		0.016	0.00%
POLICE	3.179		
FORMATIONS		1.75	0.00%
	7.274		
FCTA		0.182	0.22%
	26.887		
		2.228	6.51%
HEALTH	1.54		
		20.879	11.52%
AGRIC & WATER	12.608		
RES.			17.67%
	29.129		
TRANSPORT			71.68%
EDUCATION			
WORKS			

Total Average of all MDA's 20.68%

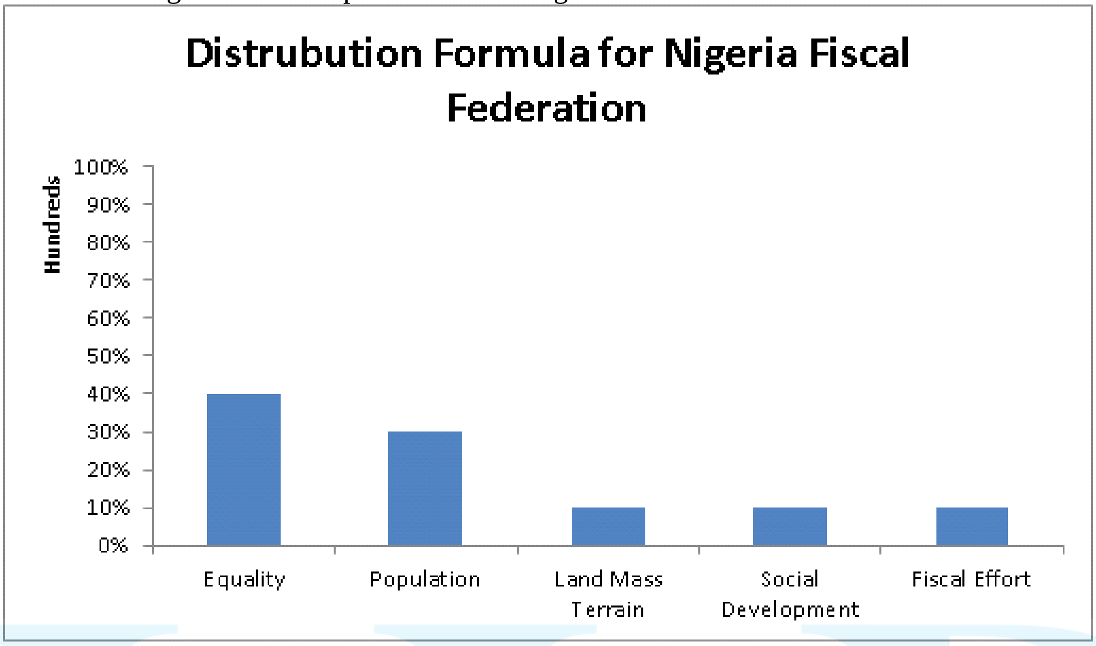
Source: The OAGF, 2009

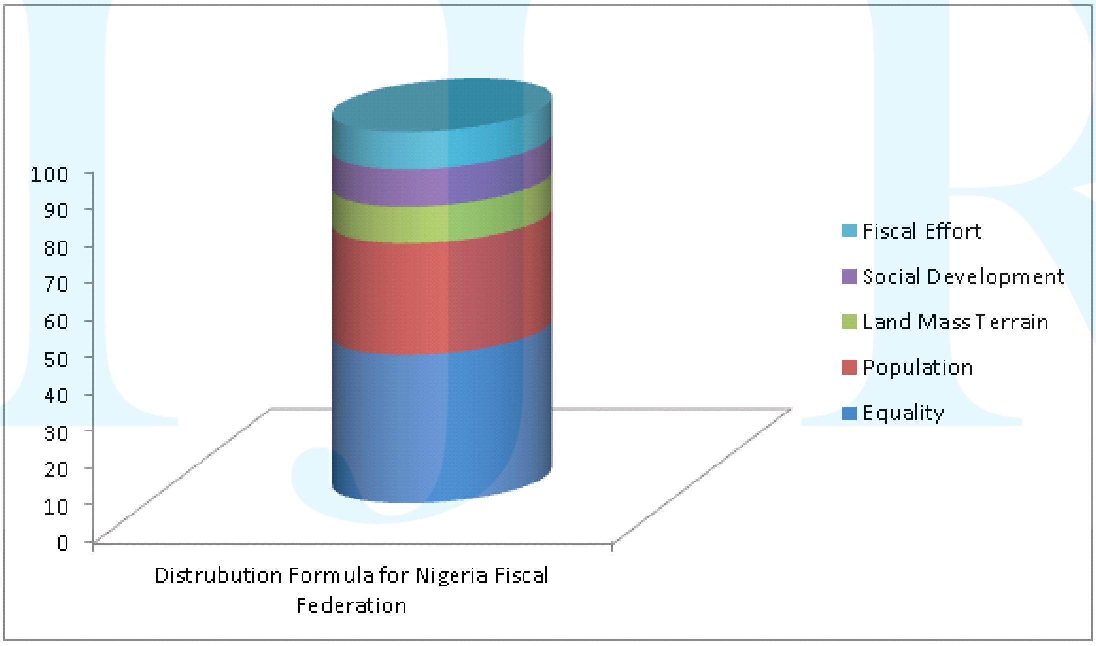
This shows a significantly low level of utilization by sampled MDAs. This is a major problem for the federal government as the money expended to MDAs is hardly put into use properly. This is seriously hampering any serious meaningful development for the country and great implications for poverty alleviation. Since 2007 to 2011, private final consumption in Nigeria has been on a downward trend. In sharing the national bounties, Nigeria uses a formula, which of course due to environmental variables may be different from other countries Formulae for delimitation of revenues to different tiers of government in the country.

Formula Use

Every country of the world that practices fiscal federalism has a formula, which the revenues so transfer, are based. Whether the formula used meets the general objective of decentralization, which is to promote an efficient allocation of resources via a responsive and accountable government sector assuring an equitable provision of services to citizen in different jurisdictions and stimulating economic growth while preserving macroeconomic stability is another matter. However the objectives provide the guidance for the sound assignment of expenditure responsibilities among different levels of government. In Nigeria, there are five components of the state distribution formula for the Federation Account. These are: Equality, Population, Land mass and Terrain,Social Development and Fiscal effort, Ekpo, (1994) Alm and Boex (2002). Each measure attracts different percentage allocation, in calculating the amount that is transferred: Equality of states 40%, population 30%, land mass 10%, social development 10% and fiscal effort 10% (Salami 2011)

Below is a diagrammatical representative of Nigeriam revenue distribution formula till date





There is no mention of equalisation in the formula, but the federal government uses it to genre fiscal balance among the states in the federation. Derivation is a constitutional matter and it is only paid to the nine oil producing states (Abia, AkwuaIbom, Bayelsa, Cross rivers, Delta, Edo, Ondo, Imo, Rivers, of the federation at 13% off shore oil (Salami, 2011). This has raised a lot of agitation and discord for the country as other resources do not attract derivation. According to Salami (2011) there is stil no acceptable formula by all the states in the federation and during the past years different committees and commission have been set up to look into the affairs of the formula and percentage allocation of revenue from the Federation Account to the tiers of government. Various commissions and committees have been set up to look into the best way to achieve fair and equitable formula for Nigeria that would be universally acceptable by all the stake holders in the country, led to different commissions or committees being set up in the past years: Phillipson Commission 1946-1953, Hick-Phillipson Commission, 1950. 54, Lious Chicks Commission 1954-1958, Raisom –Tess Commission, 1958-1960. After independence, there were, Binns 1964, Interim Revenue Allocation Commission (Diana Commission 1967), The 1977 Techmical Committee Allocation (Adebayo Commission), The

1979 Okigbo Commission (Presidential Commission on Revenue Allocation),Revenue Act1981, The Danjuma Commission 1982-1998 (The National Revenue Allocation and Financial Commission) (Ekpo, 1994).

2.51 Democracy era (post-1999) /Formula use till date

In May 1999 Nigeria returns yet to democracy. As would be expected the new lease of life often associated with democracy, meant that the controversies surrounding the fiscal formula came intensively to the fore. The oil producing area accused the Federal government for not honouring the derivation principles stated in the 1979 constitution. The federal government introduced the offshore inshore dichotomy, implying that the oil found in the sea cannot be assigned to the adjoining state. The oil producing states intensified their protest and took the federal government to court. The matter ended in the Supreme Court. During this time the National Revenue Mobilization Allocation and Financial Commission (NRMAFC) was inaugurated.

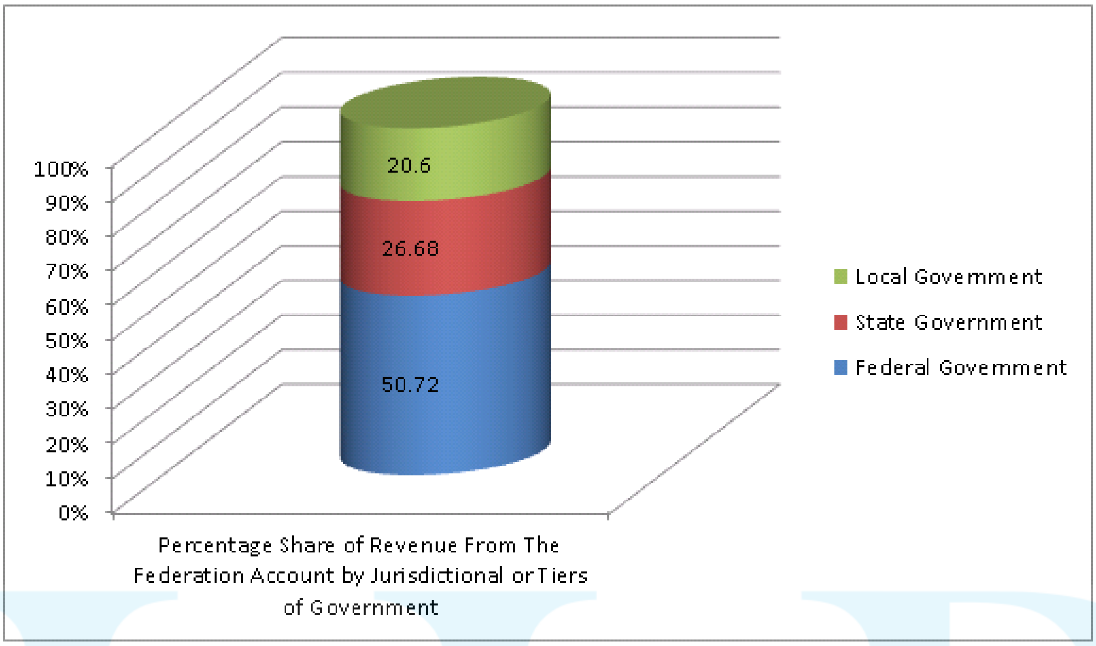
The NRMAFCN rejected on several occasions the interference of the president and the Federal Minister of Finance on the formula of the revenue sharing in the country adjudging that the due process of the constitutionality must be adhered. For example in 2004 the federal ministry of finance in a letter to the commission gave the federal government 54.68%, and grant of 24.72% to the state. The Nation Revenue Mobilization Allocation and Financial Commission disagreed with the ministry on the ground of not compliance with the provision of section 164(1) of the 1999 Constitution. The table below summarizes the changes the recommendations in the vertical formula from May 1999 to the present, 2014. It is important to stress here that the earlier modification order was the Act of National Assembly by virtue of s.315 and therefore any amendment must follow due legislative process.

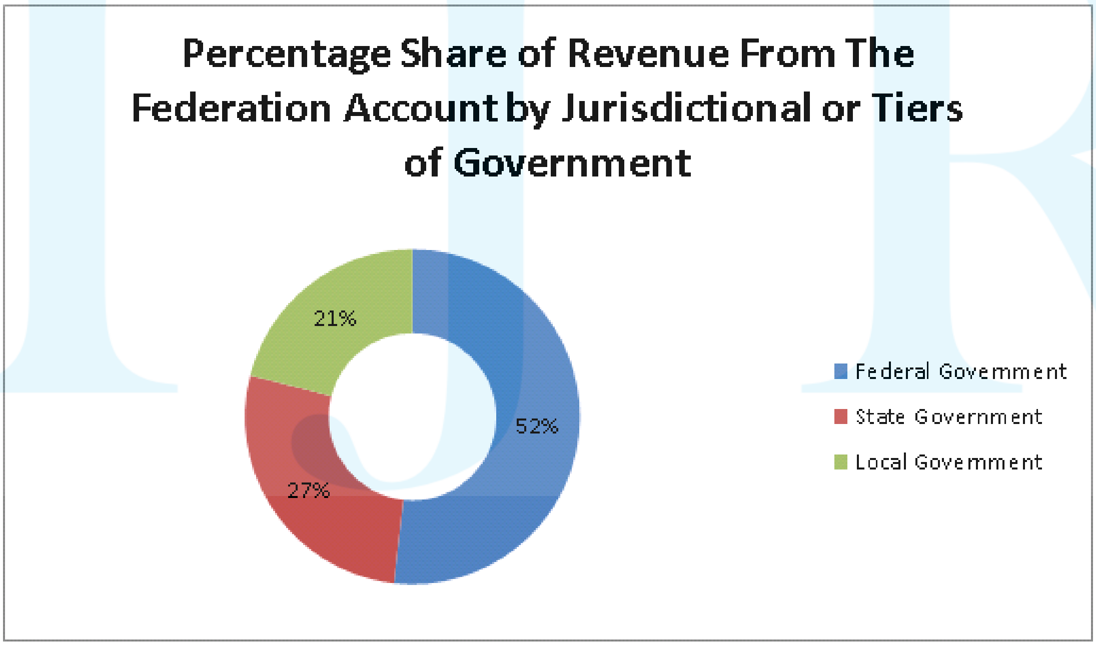
Changes and recommendations in the vertical Allocation formula: 1999-2004

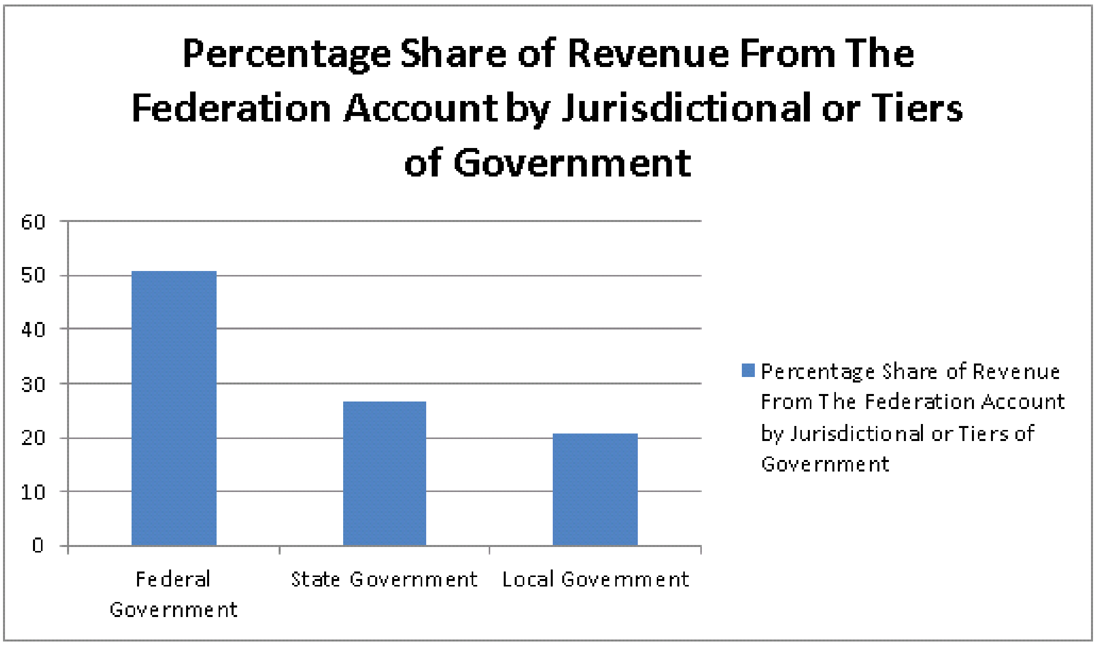
	Revenue allocation of Order 2002 beginning May 1999	Revenue Allocation July Order 2002	Ministry of finance Allocation formula January 2004
1. FederaGovt	** (1) 56%	** (1)56.68%	**(1)52.68%
Federal govt	48.5%	48.5%	
Gen ecology	2.0%		
Fed,CapTer	1.0%		
Stabilization Acct	1.5%		
Resources			
Ecology	-	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, 2004

Below are diagramatical representations of the Percentage of Revenue Sharing Allocation from the Federation Account to Tiers of Government in Nigeria till date(2014)







Note
1. Consequent upon the decision of the Supreme Court (cannot go through it here) in the resource Central Suit' the President (then Obasanjo) invoked the provision of sec 315 to bring the provision of cap.16 into conformity with the provisions of the constitution.
The federal government allocated 48.5% for itself and distributed the balance of 7.5% to general ecology and Federal Capital Territory.
2 Proposal Re-Modification Order by the *President* which the NRMAFC disagreed on the ground that the earlier court Order was the Act of National Assembly by virtue of s.315 and therefore any amendment to it must follow due legislative process. The federal government allocated 48% to itself and 2% was allocated to ecological problems and it was to be shared by all three tiers of governments on the basis of the existing formula.
3 The consequence of the court action means that there was a modification to the sharing formula of grant to the states. This followed the NRMARC rejection of the letter by the honourable minister of finance allocating 2% of grant to the states that the National Revenue Allocation (NRMARC) rejected on the ground that the honourable of finance had failed to comply with the provision of sec 164(1). Therefore the present percentage allocation of revenue since 2002 stands at: Federal 52.72, State 26.68, Local government 20.60%.
4. In 2013 the federal government asked a new formula to be worked out under the chairmanship of Mr Mba. The debate was thrown to the public domain for suggestion and debate. The new formula which is yet to be assented to by both houses of parliament would be 40% Federal government, 35% states, and 22% Local government.

Summary

Federalism dictates that the different constituent parts of the nation must survive the economic reality of the time, this usually takes the form of economic decentralization or fiscal federalism and this is dependent on the fiscal arrangement among the different tiers of government in a federal structure. Ekpo (2004) refers to this arrangement as fiscal federalism or intergovernmental fiscal relations, both terms are used interchangeably. Abati (2009) and Babawale (2000) conclude that Federalism act as a compromise solution in a multinational state whereby the component units desire a super national framework of government that guarantees security for all the nation states, and at the same recognizing and upholding the individualities of the component units, all of who seek to retain their individual identities.

In any intergovernmental relationship or a situation that calls for revenue sharing between tiers of government there must be a formula that lays down how revenue to be shared would be determined. This is where problem in fiscal federalism very often emanates because to find a suitable formula that will be viewed as fair and equitable in the eyes' of the people concerned is always not easy. This has resulted for example, Nigeria, in incessant setting up of different commissions and Committees to look into ways of making the formula more acceptable than is currently the case.

Conclusion

The subgovernments are usually allocated with expenditure assignments and in doing so they must also be allowed to raise revenues in form of taxes to match their expected obligation to their local populace in the provision of public goods and services. In addition to what is raised through taxes and levies subgovernments also receive in fiscal allocation from the central government. The allocation to the state takes the form of vertical transfers and the one to local government is called horizontal allocation (Smart and Bird (2006). The purpose is ensuring that public goods and services are evenly provided throughout the country. It is hoped that fiscal federalism would lead to expansion of the economy, hence reduction in unemployment and improve in welfare. But empirical researches show the opposite, fiscal federalism in developing countries of the world has failed, with poverty rising in developing countries practising fiscal federalism (Wibbels (2000) Sagay (2008).

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