

How Tax Bases, Expenditure and Revenues are allocated in Nigeria's Fiscal Federalism System

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Abstract

This article examines how tax bases, expenditures responsibility and revenues derive in Nigeria are being allocated amongst the three tiers of government (Federal, State, and Local Government) that make up the federation of Nigeria. This is a qualitative research that uses secondary sources of information to genre information for this article. The article shows how resources and expenditures are allocated to different tiers of government quite often known as intergovernmental relationship or popularly known as fiscal federalism. It shows that the central government (Federal government) gets the lion share of the financial resources that is pooled in the federation Account and shared amongst the tiers of government in the federation. The Federal government also receives the lion share from the Value Added Tax (VAT) Account. The allocation of tax bases and expenditure seems to be very much skewed in favour of the federal government, thereby bringing into question the functionality of the state especially the local government that is supposed to provide the necessary public good and services to the jurisdictional population. The article occasionally posits alternatives cause of action that could yield a better result than what is presently obtainable. It is very much hoped that this article would clear any misunderstanding of the operation of fiscal federalism in Nigeria that would allow a worthwhile criticism for improvement of the system.

Key Words: Federalism, Jurisdictional population, skewed, resources, intergovernmental relationship, federation, state, local.

Introduction

Nigeria as a federation and the creation of more states in Nigeria undoubtedly would affect the country's economy fiscal operations and consequently, the nature and type of relationship between central government and state governments, especially in the areas of revenues and expenditures sharing between tiers of government has to be worked out. State fiscal structures have to be developed and the fiscal functions of allocation, distribution and stabilization have to be monitored to ensure growth and development within the economy. The federal government or central government must ensure that no distortions are created at the larger economy because of the pattern of revenue and expenditure at the jurisdictional levels. However, over the years, the issues of fiscal federalism have remained dominant and contentious in Nigeria polity.

The manner in which revenue is shared amongst the tiers of government is guided by the constitution. Therefore, a meaningful discussion of fiscal federalism of Nigeria must examine the nature and character of fiscal relationship between tiers of government (Federal, state and local governments). Within this frame work, three roles are identified for the government sector. The roles of government is to correct various forms of market failure, ensuring equitable distribution of income and seeking to maintain stability in the macro-economy at full employment and stable prices (Musgrave, 1959). The government was expected to step in

where the market mechanism failed due to various types of public goods characteristics. "Government and their officials were seen as the custodians of public interest who would seek to maximize social welfare based on their benevolence or the need to ensure electoral success in democracies" (Ozo-Eson, 2005, p.1). Each tier of government is seen as seeking to maximise the social welfare of the citizen within its jurisdiction. At decentralisation levels of government, sub units governments are expected to concentrate on the provision of local public goods with the central government providing targeted grants in cases where there are jurisdictional spill-over associated with public goods.

Nigerian Fiscal federalism

Throughout the world there are only 24 of the world's 193 countries including four African countries namely Comoros, Nigeria, Ethiopia and South Africa with a clear federal constitution (Salami, 2011) Other countries that operate federal political system or considering operating it include America, Canada, Switzerland, Germany, Australia, India, Brazil, Iraq, Argentina, Belgium, Sudan, Sri- Lanka and the Democratic Republic of Congo (DRC). To reiterate what the researcher has already mentioned fiscal federalism is the inter-government fiscal relation as enshrined in a federal constitution provided for the functional responsibilities to be performed by the multi-level of government and financial resources that can be raised for provision of collective goods and services. Consequently fiscal federalism recognizes that two or three governments and not one central government must perform the role of the state in economic management, each level with different expenditure responsibilities and taxing powers.

The central system of administration is unique in that it allows both decentralized and centralized collective choice. According to many writers and researchers it places the economy at a higher level than centralized system Okigbo, (1965). Anyanwu, (1996), Okonrounmu, (1996) Devarajan,(2000) Inegbedion and Omoregie, (2006). Buettner and Wildasai, (2007) Freinkman, (2007). Two types of federalism have been identified by Tella (1999), namely the dual federalism and cooperative federalism. The constitution of the former (Dual) defines areas of responsibilities. In such a system tension and competition is inevitable. Cooperative federalism on the other hand, simply refers to making federalism work through cooperation between the various tiers of government. It emphasizes the partnership between the different levels of government in providing public goods and services to the nation. This type of federalism is practiced in the United States of America, Germany and this type of cooperative federalism was also practiced in Nigeria since the military coup in 1966 that usurped civility rule for military rule in Nigeria for almost thirty six years. In Nigeria, now civil government the central government retains the lion share of revenue in a strong central federal government approach and the state and local government the smaller share of revenue out of the federation account. However, the reverse is the case when the system is decentralized, here the federal government retains the lower share and the states/local governments get the lion shares of the revenue from the federation account (Litika, 1999). Another loose form of federalism is confederation, it allows each region to retain and utilize the revenue generated from within its jurisdiction (Okoh, 2004). It was argued by Mbanefoh (2004) that it is not possible for a segment of a federation to have enough resources it needed to carry out its functions but this Okeke (2004) said is not the cause of federalism but because of the disturbances in the equilibrium, which ordinarily would have made the undertaken developmental programs within available resources in the jurisdiction possible.

Nigeria was incorporated in 1914 with the amalgamation of north and southern Nigeria and the concept of fiscal federalism was first practiced in 1946, when the constitution, Richard's constitution, for the first time made Nigeria a semi federal country. The South was further divided into two, West and Eastern Nigeria and thereby bringing the number of regions in Nigeria to three when Richards constitution was promulgated. Each of the three regions had their revenue base with a weak central government of a loose federation, but not of a confederation type. (Barkan et al, 2001: Vincent, 2002)

The Nigeria Federal system after independence metamorphosed from three regions at independence, to three in 1963, of unequal political and administrative regions to the current federal system of 36 states (formerly known as regions) a Federal Capital Territory and 774 local governments. Oil constitutes economic mainstay of Nigeria contributing almost 90% to its foreign earnings and up to 70% to its GDP, (Budget office of the federal Republic of Nigeria, 2010). However, oil revenues and the allocation process to each levels of government in the country has led to controversies between states, local and federal governments. If the country would leave in peace and remain one under one umbrella of federalism would very much depend on oil and method of allocation. The government in 1999 disbanded Oil and Mineral Producing Area and Development Authority and replaced it with Niger Delta Development Commission and in 2008 established Ministry of Niger delta (Salami, 2010). This measure has failed to neither resolve the agitation for more shares of national revenue by oil producing areas in the Niger Delta nor ameliorate the deplorable conditions of the area where the oil is being produced. The federal government established the Federation Account from where all revenues accruing to the nation would be disbursed to the bona fide beneficiaries (federal, state, local governments) in line with the constitution and approved revenue formula. The disbursement of the federation account funds is performed by Federation Account Allocation Committee (FAAC) and the FAAC is made up of Minister of states for finance (chair), Accountant general of the federation, Commissioners of Finance of the 36 state of the federation and representatives of other institutions meet on a monthly. There is also The Revenue Mobilization Allocation and Fiscal Commission that was established in 1989 that is constitutionally charged with the responsibility of ensuring that the disbursement exercise is accurate, fair, and transparent (RMAFC, 2003).

Tax Types and Tax Jurisdiction

The assignment of fiscal instrument has been guided by the Nigerian constitutions. The Nigeria's constitution, 1999 gave the federal government exclusive power to collect levies like customs and excise duties, company tax, education tax and mining rents, VAT. All these revenues (with the exception of education tax) are paid into the Federation Account for distribution among the three tiers of government (federal, states, and local government) as stipulated by the constitution. The states and local governments are left with the powers to collect other fees (Salami, 2011). The main types of tax revenue for the federal government and sub national governments are listed below in diagram table one below. Although the local governments have autonomy to perform their functions in line with the Nigeria's constitution but the autonomy of the local government is not absolute. They retain their functions and fiscal relations with the states and federal government.

Table 1 Nigeria's, State and Local Tax Jurisdiction and Assignment

Tax	Legal Jurisdiction	Collection	Retention
Import Duties	Federal	Federal	Federation Account

Excise Duties	Federal	Federal	Federation Account
Export Duties	Federal	Federal	Federation Account
Mining and Royalty	Federal	Federal	Federation Account
Petroleum Profits Tax	Federal	Federal	Federation Account
Capital Gains Tax	Federal	State	State
Personal Income Tax(other than listed in 8)	State	State	State
Capital Income Tax: armed and police forces, external affairs, non-residents, residents of the Federal Capital Territory	Federal	Federal	Federal
Value added tax (sales tax before 1994)	Federal	Federal/State	Federal /State
Company tax	Federal	Federal	Federation Account
Stamp duty	Federal	State	State
Gift tax	Federal	State	State
Property tax and ratings	State	State/local	State/local
Licenses and fees	Local	Local	Local
Motor park dues	Local	Local	Local
Motor vehicles	State	Local	Local
Capital transfer tax (CTT)	Federal	State	State
Pools betting and other betting taxes	State	State	State
Entertainment tax	State	State	State
Land registration and survey fees	State	State	State
Market and trading license and fees	State	Local	Local

Source: (Anyanwu, 1995) Jimoh, 2003, Federal Republic of Nigeria Constitution, 1963, 1979, 1999, Salami, 2011)

The tax types have virtually remained the same since independence but a lot of changes have occurred as to who has the right to revenues. For example before 1959, regional government (Nigeria was segmented into regions) has rights to 100% of mining rents and royalties but when oil became the order of the day and in 1959 (production and exportation of oil in 1958) the Raisman Commission in 1959 recommended, this was to be distributed as follows: mineral region (50%), federal (20%), and Distributable Pool Account (30%) and in addition sales tax to which the states (regions) previously had 100% right, was replaced by Value Added Tax (VAT) in 1994, (Jimoh, 2005). The now called Federation Account was formally called Distribution Pool Account, where all federally accrued money to be shared to lower tiers of government was paid into before it was shared.

Taxation and Revenue Structure in Nigeria

In the last three decades Nigeria sources of public revenues have been from the proceeds from the sales of crude oil, taxes, levies, fines, tools, penalties, and charges. Oil since independence has been the country's mainstay and the sales from oil constitutes 80-85% of public revenue (Alm and Boex, 2002, Salami 2011, Ogwumike,2012, AFDB, UNECA, and OECD, 2010). According to Salami, (2012), oil revenue averages 27% of GDP while tax

revenues average 6.4%. Unfortunately oil revenue has been volatile, and in 2009 it ranges from 35.6% to 19.6% when oil prices dropped as a result of global crises and recession. Unfortunately Nigeria relied on a single type of tax, which is from oil, unlike Kenya, South Africa, and Mauritania.

In Nigeria, the lion shares is collected and retained by the federal government. Take for example from 1980 to 2008, the federal government collected 93.9% of total Nigerian government revenues. This is not surprising because the federal government controlled and sole responsible for the collection of mining rights and royalties, petroleum profit tax (Nigeria major revenue tax) and share VAT collection with state government. What this means is that both the state and local governments are left with 6.1% in collection of the federation revenues. The bulk of the federal government revenue is from the Federation Account; about 72% of its revenue is derived from there. In fact the federal government from 2003 to 2008 own revenue generated was 6% and similarly internal generated revenue (IGR) efforts of the states between the same period was 14%. (Central Bank of Nigeria: Statistical Bulletin and Annual Report and Statement of Account, 2011) This is an indication of weak collection efforts which is not good for growth and development as the country only relied on one source of tax revenues. The structure of local government in raising taxes follows the same pattern exhibited by both federal and states government.

The weak collection of taxes exhibited by the three tiers of government is not conducive to economic growth and prosperity. The revenue collection and tax administration is performed by various bodies at the different tiers of government; Federal, state and local governments level. At Federal level, the Federal Ministry of Finance, the Federal Inner Revenue Service and the Nigeria Customs Service are responsible for the administration of tax laws and revenue collection (Salami, 2011). The Tax Joint Board is responsible for harmonising the relationship between tax authorities at the federal level and state levels. The National Revenue Mobilisation, Allocation and Fiscal Commission (NRMAFC) propose the remuneration of political and judicial office holders and also advised on the allocation of revenues among the three tiers of government. At the State level, the State Board of Internal Revenue and Ministry of Finance are responsible for tax administration, while at local level the function is by the Revenue Committee for local governments with Finance and Supply Department are responsible (Salami, 2011).

Ironically, the efficiency and effectiveness of Nigeria's tax system over the years has been marred with problems and challenges. The federal government has made concerted efforts in trying to solving the problems. Some of the problems tax revenue collection and administration are include; inadequate personnel and institutional capacity to administer taxes effectively. Compliance challenges, such as the failure of employers to keep accurate records and remit all personal income tax (PIT), Lack of reliable statistics on the major tax payers is a major hindrance for the identification and assessment of tax payers, this hinders follow up to enforce taxes. Lack of equality especially in PIT is major problem of taxation in Nigeria, for example self-employed workers are more than paid workers and earned as much as four times that of the formal sector worker, but the bulk of PIT is paid by employees whose salaries are deducted at source (Mamud, 2008). There are over 500 different taxes and levies imposed by three tiers of government instead of those approved by taxes and levies (Approved List of Collection) Act. The complexities of tax imposing and tax structure drives up the cost of doing business and destroy investor's confidence. Nigeria was ranked 132nd out of 183 countries by the World Bank Doing Business Report in 2010. This poor performance was partly due to the

ease of doing business as a result of multiple taxations in the system (AFDB, UNECA, and OECD, 2010).

The federal government is best equipped to deal with various areas of policy. But when this happens, the federal government is expected to subsumed the state functions, but at the moment the federal and states complement each other in the provision of health and education. In real sense the functions on the concurrent list lead to a wasteful duplication and inter-unit competition which hinder effective function of the federal structure (Barkan, 2001, UNDP,2009)

Expenditure Assignment

Since independence and even during colonial period all constitutions that have been promulgated by the federal republic of Nigeria allocated the functions to be performed by each level of government. The 1963 constitution allocated the functions to be assigned by the federal and regional government under, two main headings. That is, the exclusive federal and concurrent legislative list for state and local government was treated implicitly as part of the regional governments, now called states. The 1979, 1989, and 1999 constitutions identified functions of each tier of government. The functions to be performed thus:

- Exclusive list; these functions are to be performed exclusively by the central government (federal government). The functions include; external affairs, police, (issue of legal tender (issuance and printing of money) defense, etc
- Concurrent list: these are to be performed by state/regional governments. These include census, higher education, industrial development prisons, National Parks and Antiquities.
- The functions of local government are spelled out in the 1979, 1989, an1999 constitutions schedule 4. The main functions are provision public goods, cemetery, refuse disposal, public convenience, naming of roads, streets and housing numbering, licensing, regulation and control of sales of liquor, collection of rate, radio and television etc (Salami, 2011).

The main functions are provision public goods, cemetery, refuse disposal, public convenience, naming of roads, streets and housing numbering, licensing, regulation and control of sales of liquor, collection of rate, radio and television etc. (Salami, 2011). During the time of military rule in Nigeria the functions of each tier of government were not well defined and the military used decree and edict to assign responsibilities and the function of each level of government depended on the Head of state and commander of the Armed forces.

Even to day with Nigeria under civility government local government are still subject to varying degrees of oversight and control, even though their functions are well specified in the fourth schedule of the 1999 federal constitution. The local government can only exercise their function on the enabling legislation of the state government and this makes the execution of local governments function a bit difficult and problematic. It is worth mentioning here that most of the things in the concurrent list (state function) are also applicable to federal government.

Revenue Sharing Arrangements in Nigeria

As already posited above the Nigerian fiscal system and system of financial federalism are defined and enshrined in the Constitution of 1999 (Constitution of federal Republic of Nigeria 1999 section 149 paras 1-7 and also sections 150-155.) The Constitution prescribes three tiers of governments, state governments, and country-like local governments. Thirty-six

states are defined in the constitution (1999 Nigerian Constitution), plus the Federal Capital Territory, Abuja and there are at present 774 local government councils. Alm and Boex (2002). The constitution also spells out what responsibilities the federal government is charge to execute and the state governments and local governments are supposed to execute. The federal responsible duties are spelled out in what is termed the exclusive legislative lists while that of the state government is called the concurrent legislative lists and the local governments is spelled out on schedule 4 (Nigerian Constitution, 1999) It is also spells out in the constitution that where state supposed duties transcend that of the federal government function, in case of any legal action brought over the matter the federal power should subsumed that of the states.

Revenue allocation refers to the redistribution of fiscal capacity between the various levels of government, or the disposition of fiscal responsibilities between tiers government (Salami, 2011). Revenues sharing is at two folds; one, the vertical allocation- among federal, state, and local governments- two, horizontal allocation, among the states and local government (Alm and Box, 2002). Revenue allocation is meant to achieve two things, namely equity and efficiency (Salami, 2011).

Revenue allocation, as posited above commenced under Richard constitution, when Nigeria for the first time, became a semi-federal country under the British colonizer, and there after had nine fiscal commissions, six military decrees and one act of parliament to design appropriate tax assignment and revenue allocation formula; it include, Hicks-Phillipson Commission, (1951), Chick's Commission (1953), Raisman Commission, (1958) Binns Commission (1964) Dina Commission (1968), Abayode Technical Committee (1972), Okigbo Commission (1980) and Danjuma Commission 1988 (Salami, 2007). These commissions were set up to find the best way to have equitable and balanced vertical and horizontal allocation for the country. The researcher will address these commissions soon in a sub heading.

The Constitution defines the expenditure responsibilities of each level of government while federal government provides services of national scope or importance, such as defence; important expenditure responsibilities are assigned to the sub national levels of governments. Key local government council's expenditure responsibilities include primary education and host of traditional local government functions, such as operating local markets; which state governments play a key role in providing health care, secondary and tertiary education, and physical infrastructure. Revenues are highly centralized. Nigeria fiscal arrangement has been guided by the country's constitution, for example, section 162(1) if the constitution states that the federation shall maintain a special account to be called "Federation Account" into which are paid all revenues collected by the government of the federation.

All funds standing to the credit of the Federation Account must be distributed among the federal, the state governments and local government councils on such term and manner prescribed by the National Assembly, with the exception of money coming from Personal Income Tax (PIT) of member of the Armed forces, the National Police Force, and the External Affairs Ministry and residents of the Federal Capital Territory, are few exceptions of revenues that are not paid into the federation account. The federation Account also excludes the derivation Account, it also excludes the federal government dedicated priority project funds, External service Funds, NNPC Joint Venture Payment Account, Education Tax Funds. Consequently, after the payment of all these, (less specific first charge) then the remaining revenue is then paid into the Federation Account for sharing among the federal, states, and local councils. In 2008, the revenue paid into the Federated Account was 4,552, 800 trillion

naira and it was down from 90% in 1970 to under, 60% in 2008. (Central Bank of Nigeria: Statistical and Annual Report and Statement of Account: Various Issues)

The Value Added Tax (VAT) also is shared by formula among government units at all levels of governments. The main sources of revenue for the federation Account are petroleum taxes; several non-oil revenue sources also contribute to the Federation Account, notably companies income tax, as well as custom and excise duties. The state and local governments' share of the Federation Account are distributed using allocation formula, thus assuming the character of intergovernmental transfers: Jointly the Federal Account disbursement plus the VAT apportionment are referred to as the "Federal Allocations." Alm and Boex (2002 p.3). Oil revenues play a dominant role in intergovernmental fiscal relations in Nigeria. nine states have the concentration of oil, Edo, Ondo, Rivers, Bayelsa, Imo, Abia, Delta, Akwa Ibom and Cross Rivers (N.N.P.C.2008, Salami 2007)

The oil revenue to Nigeria now constitutes almost 90% of the foreign currency earnings and is federally collected but is shared between the Federal Account and oil producing states on derivation basis. The National Revenue Mobilization Allocation and Fiscal Commission administer the federal allocation. The make-up of the commission is constitutionally defined, comprising the Federal Minister of Finance and representative from each of the states, typically the state Finance Commissioner and State Accountant- General. The members meet at Abuja on a monthly basis to allocate the previous monthly tax receipts among the recipient governments.

The local governments are not represented in the commission and their allocation does not pass through the state (horizontal transfer) because according to Osaghae (1996) state governments do not have the financial control to disburse funds to local governments. Mered (1976) enthuses that a few other intergovernmental transfer exist, therefore less substantial and are discretionary and non-statutory in nature. However below are how revenue has been allocated vertically since 1960 and the percentage allocation of revenue vertically or horizontally has not changed since 2002.

Vertical Allocation and fiscal balance

The distribution of public resources between different tiers of government according to Alms and Boex (2002) is what is known as "vertical fiscal balance"(p.19) In Nigeria the federal government retains some of the federally collected revenue as its independent revenues and the balance of the collected revenues is then paid into the Federation Account to be distributed in fiscal sharing among all the tiers of government in accordance to an agreed formula.(Salami,2011) The share of the federal government since independence has always been more` than what the other tiers get in allocation but before independence the share of the regions (states) was more than the central government. Table 3, below shows the historical and current distribution of the federation Account and the VAT Pool. At the moment states receive 26.72% of the Federation Account and 40% of VAT revenues (Jimoh 2003, RMAFC database, 2003, Salami 2911, Alm and Boex, 2002).

The sharing formula in 1958 as recommended by Raisman Commission was 40.60 in favour of region. (See Raisman Commission,1958). However the share of the federal government has been falling. In 1992 vertical allocation was changed from 48.5%, 24% and 20% for federal, state and local governments respectively. The current allocation from 2002 till date is 52.68%, 26.72%, and 20.60% for federal, state, and local government councils respectively (Salami, 2011). The federal government of Nigeria is often being accused by the state's governments of having a fiscal regime that is too centralized. They have called for more decentralization in their dispensation of resources but Anderson (2007) reckons that at less

than 53% of total government spending (after all transfers to the states), Nigeria is more decentralized than Brazil, Malaysia and Venezuela. On the other hand some federations are still more decentralized than Nigeria like Belgium, Canada, Germany and Switzerland, where federal government accounts for between 30% and 40% of direct government pending (Anderson, 2007). Before 1958, money paid into derivation account was 50% but presently derivation account is 13% of the revenues obtained from oil produced off-shore, that is on the land areas of each of the nine oil producing states, namely: Abia, AkwaIbom, Bayelsa, Cross, Delta, Edo, Rivers, Imo, Ondo. (Arowolo, 2011, Salami, 2011)

Derivation principle is where the heated arguments are particularly strong in Nigeria. The oil producing states have argued that revenue for derivation purpose is not enough and that derivation use to attract 50% or more but why now. But Nigeria is perhaps the only country that still applies derivation principle in its allocation of revenues. Countries like the United State of America, Mexico, Brazil, and Australia have no derivation principle (Anderson, 2007). India and Russia for example make minor special transfers to the producing states. It also excludes that various federal government dedicated account that has first charge AFEM Surplus Account, Petroleum Trust Funds, National Priority Project Funds, NNPC Joint Ventures Project Funds, Education Tax Funds, The first charge has to be settled first and also the derivation account, then the balance of the total federally collected revenues would be paid into the Federated Account. In 2008, the balance of the totally collected federal revenues paid into the federation account after all deduction, was 4,552,800 million Naira, less than 60% of the total collected revenues and down from 90% in 1970. VAT that was introduced in 1994 that replaces the Sale Tax also has a first charge to federally collected revenues and is paid into a special fund called the VAT Pool Account. This is also shared by an agreed formula by the states and local councils in the federation. The lion share of the VAT allocation formula goes to the federal government. Currently, the federal government is allocated 40%, state governments 35% and local governments 25%. (CBN: Statistical bulletin and Annual Report and Statement of Account, various issues, also cited in Salami, 2011). Table 3 shows the percentage of revenues paid into the federation Account against total revenues actually collected by the federal government while table 4 highlights the vertical allocation in Nigeria from 1960 till date.

Table.3 Federation Account as a percentage of federally- collected Revenue

	Total federally collected revenue N million	Federation Account N million	Federation Account as percentage of federally collected revenue
1970	634	582	92
1975	5,515	5,294	96
1980	15,324	14,742	97
1985	15,050	13,750	91
1990	98,102	68,064	96
1995	459,987	170,523	38
2000	1,906,159	1,262,468	66
2005	5,597,500	3,203,300	57
2006	6,061,000	3,315,100	55
2007	5,715,600	3,878,500	68
2008	7,866,600	4,552,800	58

Sources: CBN: Statistical Bulletin and Annual Report and Statement of Account (Various Issues)

Table 4. Vertical Allocation of the Federation Account, 1981-Till Date	1960 - 1962	1963 - 1966	1981 Act	1984 Jan	1990	Jan 1992	June 1992	June	2002 till Date
Recipients									
• Statutory Allocation									
(1) Federal Government	70	65	55%	55%	50%	50%	48.5 %	48.5 %	52.68 %
(11) State Government	30	35	30.5 %	32.5 %	30%	25%	24%	24%	26.72 %
(111) Local Government			10%	10%	15%	20%	20%	20%	20.60 %
(1v) Special Funds			4.5%	2.5%	5%	5%	7.5%	7.5%	-
(a) Federal Capital Territory					1%	1%	1%	1%	-
(b) Stabilization					0.5%	0.5%	0.5%	0.5%	-
(c) Savings					0%	0%	0%	0%	-
(d) Derivation			2%	2%b	1%	1%	1%	1%	-
(e) Derivation of oil mineral producing areas			1.5%	1.5%	1.5%	1.5%	3%	3%	-
(f) General Cology			1%	1%	1%	1%	2%	2%	-
Total			100%	100%	100 %	100 %	100%	100%	100%
2. Value Added Tax									
Federal								80	40
State								20	35
Local								0	25

- Without the special funds

Source: (Anyanwu, 1995; Jimoh, 2003; RMAFC database)

As said earlier, the vertical fiscal allocation is a thorny political issue in Nigeria and the guiding principle used by economists is whether the distribution of resources reflects the expenditure responsibilities in each level of government and this is a difficult conundrum to solve. There are many ways in which fiscal imbalance can be noted: revenue trends, which shows trends in revenues, expenditures, and budgetary deficits (surpluses) as a percentage of Gross Domestic Product (GDP) for the federal government, consolidated state governments and consolidated local governments, Fiscal balance, which is the budget balance of each level of government. (Alm and Boex, 2002)

The relative budgetary position of each government will be a reflection of fiscal vertical imbalance if each government is equally efficient in allocating resources to achieve its responsibilities. In Nigeria there are no institutional constraints on governments at each level to incur budget deficits. The federal government of Nigeria very much often runs budget deficits while there is the demand at the sub national levels for government to balance their

books. Therefore, comparing the fiscal surplus or deficit of each level of government in Nigeria does not provide a valid measure of vertical imbalance because of the requirement that subnational governments need to balance their budgets, the third way fiscal imbalance can be noted is by the proportion of capital expenditures.

On the same vein, vertical imbalance would be to look at the relative spending on capital expenditures at each level of government. Alm and Boex (2002) report that in Nigeria governments at all levels first allocate resources towards recurrent expenditures items, and then use any recurrent budget surplus for the purpose of funding capital expenditures. Consequently, the share of the budget spent on capital expenditures could thus be a measure of fiscal pressure. By this measure, the fiscal structure could be skewed in favour of the federal government: The federal government of Nigeria posit Alm and Boex (2002) spends two-thirds of its resources on capital expenditure, compare to state and local governments with one-third of expenditures.

Alm and Boex (2002) analysis shows that there is no consistent economic argument to support the political argument that a major vertical imbalance exists in Nigeria intergovernmental relations. They however contend that it would be necessary to explore at political level if expenditure of almost half of the federal government budget on capital projects is an efficient allocation of public resources! They argue that instead of state governments asking for increase in share they should raise the lack of revenue autonomy, for instance instead of asking for increased share of the Federation Account and VAT resources, sub national governments could seek fruitfully increased revenue autonomy by demanding increase discretion over taxes rates of certain federally regulated taxes. Instead of relying on handouts could be allowed to increase income tax rates within a certain limit from the federal government.

This would definitely allow the government to make the difficult decision of trade-off between increase in public expenditure and increasing the tax burden. In Nigeria, as already mentioned Federation Allocations (ie Federation Account and VAT sharing) is the dominant funding mechanism for subnational governments and it does not provide a very stable source of funding for subnational governments overtime. Also the federal allocations fluctuate greatly and are dependable on the price of oil on the international market. But state and local governments need a stable stream of revenues because they provide many of the most basic services, such as primary education and primary health care. To counter this problem, Nigeria government introduced a “Stabilization Account” in order to stabilize the revenue flow, but this is not meeting its objective as payments into and withdrawing from the Stabilization Account are often based on adhoc basis and also politically motivated. For example in 2000, during the oil price boom, payment ought to be made into the Account instead the National Revenue Mobilization Allocation and Financial Commission wanted to withdraw money from the Account.

In order to ensure stability in the share of subnational government from the Federation Account many authorities of fiscal federalism, for example Alms and Boex (2002), Anderson (2007) have advocated that, the share from the Federation Account could be based on nominal share as a percentage of Gross Domestic Product (GDP) as opposed to specifying the state and local governments share as a percentage of revenue collection. This will ensure that any shortcoming or fluctuation in the Federation Account would have to be absorbed by the federal government, while completely shedding the state and local governments from fluctuation in resources. Secondly the mechanism of federal allocations could be modified so that subnational governments would rely less on oil revenue, which presumably are more

variable than other revenue sources. For example subnational governments could be given an increase share in the VAT revenue (a more stable source of revenue) but a smaller share of oil revenue, which is subject to external shocks, alternatively Nigeria could have a legislative fixed revenue sharing formula for a fixed multiple – period of year, thus providing a greater fiscal stability for states and local governments...

Horizontal Fiscal balance

Although it is the vertical fiscal balance that usually draws a lot of political heated debate regarding the insufficiency of the transfer of revenues to state from the Federation Account, the horizontal fiscal imbalance, which according to Alm and Boex (2002) is the distribution of federal allocation between states and between local governments is not entirely free from problems. Horizontal allocation in Nigeria favours states with large land areas, large number of councils, high population, and some instances derivation purpose. (Salami, 2011) Before 1964 derivation was given the largest weight (50%) in horizontal revenue allocation, while the balance was shared among the region based on principle of equality of state (50%) and population (50%) (Salami, 2011). There was no derivation principle between 1964- 1967, instead attention was given to equality of states which still attracted (50%). However between 1977 to 1981 equal opportunity has a weight of 25%, national minimum standard 22%, absorptive capacity 20%, independent revenue efforts 18% and fiscal efficiency 15% (Salami, 2011).

From 1982 up till 1998, equality of states has a weight of 40%, independent revenue efforts 10%, population 30% social development 10% and land mass and terrain 10% Equality of states had the highest weight under horizontal allocation among the states. The balance was shared among the others respectively. As for VAT distribution of proceeds among the states and local councils, the share was derivation (20%) equality (50%), and population (30%). Since 1981, horizontal formula has remained stable, with exception of derivation principle that has been increased to 13% for mineral nine producing states in the country. As a result for the past eight years Rivers, AkwaIbom, Delta, Bayelsa and Ondo, all oil producing states, have received the highest amount from the federation Account. Consequently, Anderson (2007) observes that just four states in Nigeria are receiving almost a third of all federally allocated revenue. Although oil producing states tend to get more revenue from the federated account the revenue received v by these states have been a serious point for discord. They argued that the increase in derivation do not cover the negative effect caused by externalities to their environments let alone grant them access to equal opportunities for development with other states in Nigeria. Vincent, (2002) and Jimoh, (3003) blame for the persistent restiveness in the oil producing regions in Nigeria.

In Nigeria's context and to understand how resources are allocated using the Federation Account and the VAT sharing mechanism explained above, Alm and Boex (2002) use regression analysis to ascertain the variations in per capita federal allocations to state governments. Based on the factors that are included in the distribution formula, the allocation mechanism in Nigeria seems to be designed to do four things: allocation of revenues on derivation basis, particularly for oil revenue and VAT collections; provide general purpose funding; provide additional funding for needier regions; and stimulate fiscal effort. Alm and Boex (2002) noticed that a common objective, namely equalizing fiscal capacity in many grant formula is surprisingly missing.

Their findings was that these measures of fiscal capacity and fiscal need only explained 4 percentage of variations in per capita federal allocations, and non of the variables had a statistically significant impact. Therefore they modified the regression equation in one

important way; since large share of the Federation Account and VAT collections are shared based on “equality” (i.e., each state gets an equal share, or 1/36 of the pool). They contend that it is likely that when they consider per capita allocations that smaller state will receive higher per capita federal allocations. Secondly, in their second regression they included population in the regression equation, and that improves the ability of the regression to explain per capita federal allocations, which moves from 4 per cent in the first equation to 63 per cent in this equation. Second, as expected, population has a strong negative impact on per capita federal allocations and for every one million increase in population the per capital transfer decreases by almost N300. Third, the regression results actually indicate that higher income states actually receive greater federal allocations, meaning federal allocations appear to be counter equalizing, and as a whole they favour wealthier states. This result largely reflects the fact that a portion of the Federation Account and VAT collections are allocated on derivation basis. Alm and Boex (2002) also added fiscal effort as an explanatory variable. It indicates that fiscal effort does not have a statistically significant impact on federal allocations. In fact the parameter estimate on fiscal effort was negative (Although not statistically significant) suggesting that states with greater fiscal effort receive fewer federal allocations.

Fiscal capacity, fiscal effort and Fiscal Need

In Nigeria there are variations in fiscal capacity effort and fiscal need of the different tiers of government in the country. The question to ask and answer then is what determines the variations in own source revenue collections at state level? According to Alm and Boax (2002) two explanations may be responsible for this. First it could be that a state is not as wealthy as other state (fiscal capacity) second a state may not try as hard enough as other state to collect taxes and a state may have lower level of fiscal capacity than the other states. Alm and Boex (2002) enthuse that a state with a greater need to provide public goods and services would assert more fiscal efforts than the one with less demand on public services and good and the same could be said a wealthier state could assert more fiscal capacity than one that is poor. As reported by Alm and Boex (2002) “a government’s ability to raise revenues is referred to as fiscal capacity” (p.9)

It is not easy to qualify a state measure of fiscal capacity and the obvious intuitive measures is the level of revenues collected in a region and this however is not a good measure since income collections are not only a function of fiscal capacity but also a state’s fiscal effort. It is difficult to come out with a single number that represents the potential ability of a state to raise money (fiscal effort). The data in Nigeria is either scanty or not even available. However, around the world a variety of methods are used to measure a state or region’s fiscal capacity. As espoused by Martinez- Vazquez and Boex (1997) state’s level of own source of revenue collections, 2nd per capita personal income, this has extensively been used around the globe as a proxy for fiscal capacity including the USA, 3rd the level of economic activity in a state, that is, Gross State Product (GSP) state equivalent of Gross Domestic Product of a nation or state Value Added can also be used as a measure of capacity, 4th other complex measures that find their roots in the representative of tax system. As information on economic production at state level is weak or virtually non-existence, Alm and Boex (2002) used two measures to estimate fiscal capacity of a state in Nigeria. They applied household income data, which provides them with a comparable measure of state fiscal capacity and 2nd Value Added Tax (VAT) collection data.

The correlation between the two measures of fiscal capacity was 0.4, suggesting there are substantial differences in the variation between the two measures. Alm and Boex, have

reservation about using either measures, but they nevertheless favoured the VAT collections as a more credence measure of fiscal capacity. The per capita income of household data is either incomplete or outdated. Regarding fiscal effort the variations in economic conditions do not only affect a state's ability to collect revenues, but variation in regional economic conditions also would make different state to have different "fiscal needs" that is, a state with a higher number of children will have to spend more on education and a state with greater poverty will spend more on When all is in equilibrium, a state with more fiscal needs will have fewer resources to spend on discretionary projects such as capital development. It is important to stress here that many of the variables used to measure fiscal need have the same statistical problem as the measures of fiscal capacity.

State and Local Internal Generated Revenue (IGR)

As already mentioned, the key revenue sources in Nigeria are petroleum revenues, corporate income taxes, and Value Added Tax (VAT). The federal government collects these and it is disbursed by formula by the federal government to all government subunits (State and Local governments) as part of what is called government allocation. As with the federated Account to which all money raised go into before it is shared to all level of governments, the VAT is also shared between the three tiers of Nigeria's government, that is, federal state and local government. Some VAT is shared on derivation and in addition to this, state and local governments have their own revenue sources or what is called internal generated Revenue (IGR) The current assignment of revenue sources was laid down under the military, by decree 21 issued in 1998; (Taxes and levies, Approved list for collection, September 30, 1998) State level taxes include a variety of personal income tax, (e.g., pay as you earn tax, the self-assessment tax, the withholding tax, capital gain tax on individuals) development levies, a number of minor business taxes and several other miscellaneous fees and levies and capital gain tax on individual (Alm and Boex, 2002. P.8)

Summary

This article shows an imbalance in revenue expenditure and revenue derivation in the country. The federal government gets the lion share from the federation Account and also from the Value Added Account (VAT). Revenue or tax base is also allocated in favour of the federal government, whilst the local government that is supposed to be the enigma of the country because it is supposed to be closer to the jurisdictional people is allocated with virtually unproductive resources control. It also receives smallest allocation of revenue from the Federation Account. Public goods provision is a very sumptuous undertaking and is perhaps beyond private enterprise to contemplate. In providing goods and services to the populace, the profit that private enterprises would realize if it were to be left to them to provide will be too marginal that no private individuals would comprehend doing it apart from the benevolent government that would like to appease the electorate for election purposes.

Therefore, sub governments are in better position to provide the public goods for their jurisdictions because they are in best position than the central government to know the needs and preferences of their jurisdictional population (Oates 1999). 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. The author submits that the federal government should reconsider its policy, reconstituting the constitution to relinquish some of its tax bases control and also to reduce the amount it receives from the Federation Account couple with its expenditure responsibility. In particular local government should be released from its present bondage, by removing the enabling law that seems to make them answerable in perpetuity to state government so that they can become more effective in discharging their duties to their jurisdictional populace unhindered.

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