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Fiscal Policy in Nigeria: An Appraisal of the Increasing Role of Sub-National Governments[1]

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Abstract
The conduct of economic policy is a shared responsibility of the three tiers of government in Nigeria with federal government having the largest share especially in the area of revenue generation, hence the role of state and local governments in the fiscal policy actions in the past are often disregarded. Analysts are, however, of the view that, in recent times, particularly with the entrenchment of democratic governance, the fiscal policy feats of sub-national government put together are becoming as important as that of federal government. This study therefore assesses the trend in the fiscal policy roles of the three tiers of government in Nigeria, to determine which is dominant; federal or state and local governments put together. The findings of the study indicate that, there is still a "centripetal" bias in the assignments of revenue powers without regard to expenditure responsibilities. The expenditure trends of the sub-national governments have surpassed that of federal government without a corresponding increase in their revenue powers, thereby makes them heavily dependent on federal government for revenue. It also finds an increasing trend in the fiscal deficit of sub-national government. The study suggests further divulgence of tax base in favour of sub-national governments or increase in their share of Federation Account as well as diversification of the nation's revenue base so as to improve the revenue accruable to all tiers of government.
Keywords: Fiscal policy, government, revenue, expenditure, budget

1. Introduction

In Nigeria the conduct of economic policy is a constitutional responsibility of all tiers of government (i.e. federal, state and local governments). While monetary policy is exclusively in the federal domain under the administration of central bank, fiscal policy is a shared responsibility. However, there is increasing concentration of attention on the federal government, specifically in the areas of revenue generation, principally from oil sources and expenditure assignments, hence the role of state and local governments in the fiscal policy actions especially in the past are often unnoticed. However, in recent times, some analysts are beginning to reconsider the role of state and local governments in the fiscal policy feat. They believed that the fiscal activities of state and local governments are in aggregate becoming increasingly important.

This paper examines some of the prominent trends in federal, state and local governments' fiscal activities in order to provide a background against which have the dominant role (Federal or state and local governments put together). The paper is structured into five sections. After this brief introduction, section two reviews relevant literatures on the assignment of fiscal powers, while section three looks at country experiences on revenue sharing and expenditure assignments. Section four examines the trend in revenue and expenditure of both national and sub-national governments, while the last section gave the concluding remarks.

2.0 Literature Review

The role of government varies from nation to nation depending on the established principle of internal governance imbibe by a nation. Prominent system of internal governance practiced across the globe can be identified as: devolved, unitary, regionalized unitary and federal system of government. The latter which is the practiced in Nigeria is a situation whereby federal government shares power with semi-independent state and local governments. Most of the federations have a clear fiscal responsibilities shared among the tiers of government. Also, most except the United States of America (USA) have made several efforts to address regional fiscal disparities through a program of fiscal equalization. In the USA, there is no federal program, except that education finance at state level uses equalization principle.

There is a noticeable difference in terms of arrangements to implement revenue programs across the federating units. While countries such as Brazil, India, Nigeria, Spain, South Africa among others consider a multitude of fiscal capacity and need factors (such as revenue effort, population etc.) in determining state and local governments portion in the revenue sharing formula, Malaysia uses capitation grants. Similarly, while Russia

[1] The views expressed in this paper are solely mine and does not necessarily reflect the position of the Central Bank of Nigeria.

uses a mixture of fiscal capacity equalization program, Canada and Germany match fiscal capacity to a certain specified criteria. In Australia, the program is relatively more comprehensive and matches both the fiscal capacity with fiscal needs of the states (Rao and Singh 1998).

There are however, discontentments in some quotas regarding the yardstick for revenue sharing in most of the federations. For instance, according to Jean & Marion (2000), in Australia, the discontent with the sharing formula is the complex nature of the expenditure needs compensation as an important yardstick for revenue allocation. In Canada, it is the provincial ownership of natural resources as well as the treatment of natural resource revenues in the equalization formula. The source of disagreement in Germany is principally the application of a progressive equalization formula.

In Nigeria, a lot of controversy and crisis had ensued from different states and local governments due to dissatisfaction with the existing formula. In some quota the argument is that local councils should be allocated more funds because they are at the grassroots where more developmental activities are required. This group claims that, if half of what is been given to federal and state governments is allocate to the existing 774[1] local governments, Nigeria will be transformed in few months. Some are, however, of the opinion that more revenue should be allotted to state governments, because, local government areas are grossly underperforming and there are no adequate measures on ground to check their excesses. More so, others suggest that the third tier of government (i.e. local governments) should be scrapped. There is also what is popularly tagged as “resource control” argument. The proponents of this (i.e. the oil producing states) are of the opinion that states should be allowed the control of natural resources endowment of the state, hence they advocate for total control over oil revenue.

It is generally agreed that the mapping of benefits across jurisdictions cannot be perfect nor can there be a balance between assignment of functions and sources of finance at each governmental level, but since analysts[2] have agreed that disharmony among different levels of government has its root not only in revenue powers but also expenditure assignments[3]; there is the need for assignment of responsibility to precede the allocation of revenue powers (shah, 1994). This is because division of revenue powers will be able to take spending requirements of different levels of government into consideration. Moreover, allocation of revenue powers based on expenditure responsibilities will make sub-national governments self-sufficient enough not to depend exclusively on inter-governmental transfers to finance their expenditures.

There are, however, contrasting views in the literature with regard to which tier of government to do or get what. For instance, early “Layer cake” models of assignments of governmental functions assumed that services can be unambiguously aggregated into Musgravian tripartite categories - macroeconomic stabilization, income redistribution and resource allocation. Under this classic theory of public finance, it is suggested that the degree of responsibility of government should determine which tax assignment (revenue power) to assign to a tier of government.

The conventional wisdom in the theory of public goods and public choice is that both the redistribution and stabilization functions be performed by the central government (Oates, 1972, 1977). This, according to the proponents of this view, is true for several reasons. First, sub-national governments can hardly affect macroeconomic conditions within their limited boundaries. Any macroeconomic policy attempt by the sub-national governments will undoubtedly leak out of the state boundary. The spillover of effective demand to areas outside their jurisdiction makes stabilization effort at this level less effective. Second, sub-national governments cannot cope with the deficit financing requirements to implement expansionary fiscal policy, because, they have limited power to borrow and lack power to print money; hence cannot vary money supply. Therefore, they lack the capability to effectively carry out stabilization program. Third, due to the mobility of economic agents, any attempt by sub-national governments at income redistribution is most likely to be unsuccessful, as it could lead to massive movements of economic agents from one location to the other, hence renders the policy ineffective. It is also capable of igniting distortion in the geographical allocation of economic resources (Layard and Walters, 1978).

With respect to resource allocation function, Musgrave argues that sub-national governments should be largely responsible and that their policies should be allowed to vary to reflect the preferences of the residents, since they

[1] Total number of the constitutionally recognized local government areas in Nigeria
[2] For more on this, see Rao & Singh (1998)
[3] Expenditure burden outweigh revenue source.

have more information about residents' needs than the central government.

The Musgravian tripartite assumption of three functional branches of government is, however, impracticable in a real world situation, because the functions are inter-dependent. There is also the possibility of each tier of government playing effective and efficient redistribution and stabilization role. Tresch (1981) argued that redistribution may become a localised public good particularly when population is relatively immobile across jurisdictions such that local redistributive initiatives may yield remarkable result. Similarly, Gramlich (1987) argued that sub-national governments, although limited, can and do play effective role in stabilization policy in term of employment.

Alternatively, assignment functions can be formulated in terms of goods and services instead of functional branches of government. In this case, Rao and Singh (1998) identified three distinct approaches; namely: (a) the Breton-Olson-Oates models of efficient management of spillovers; (b) the Breton-Scott model of minimizing costs and (c) the competitive federalism model.

(a) The Breton-Olson-Oates models of Efficient Management of Spillovers

This approach was developed by Breton (1965) and later by Olson (1969) and Oates (1972). Under this approach, assignments of responsibilities are viewed as an outcome of managing spillovers from various public goods. Public services are assumed here to be of Samuelsonian type although with different benefit across the regions. Public goods are hierarchically arranged into different layers ranging from local to international public goods to minimize spillovers (Breton 1965). The bottom line of this approach is that efficient and effective design of jurisdictional boundaries or assignments of functions among different levels of government depends largely on the scheme which ensures efficient management of spillovers. In case the exogenously determined jurisdictional boundaries do not exactly agree with the benefit spans, the approach recommends internalization of spillovers through a Pigovian system of grant to be administered by the central government. The major setback of this approach is said to be that it requires an all-knowing central government to accurately estimate spillovers. Information not in anywhere available. If in the first place, the central government has precise information about spillovers, there will be no need for decentralization, hence the division of functions is unnecessary.

(b) The Breton-Scott model of Costs Minimization

This approach looks at the possibility of minimizing costs, since it is agreed that optimal assignment results from maximizing welfare gains. A function should, therefore, be decentralized if welfare gains exceed the cost due to increasing returns to scale. According to this model optimal assignments are achieved when transaction or organizational costs of providing the services are internalized into the decision making framework. The major drawback of this approach is also said to be the omniscient requirement of the decision maker (i.e. the central government) which is required to have a prior knowledge of the cost implication of carrying out specific assignments and strives to minimize them to achieve equilibrium.

(c) The Competitive Federalism Model

This approach advocates automatic determination of optimal assignment from vertical inter-governmental competition. Here, different tiers of government compete with one another in the provision of public goods. Functional assignment is then determined in accordance with the comparative advantage of different jurisdictions in providing the services. The assumption is that competition will force the governmental units to specialize in the supply of public services in which it has comparative advantage over the other, thus the division of functions is not entirely a constitutional role. Competitive advantage of different jurisdictions determines constitutional divisions instead of the reverse. Constitution is thereafter adjusted to accommodate changes required by vertical inter-governmental competition. However, it is important to mention that short-run intergovernmental relationships are determined by the existing constitutional arrangements. The transition takes place in the long-run.

The broad principles of expenditure assignments discussed above can undoubtedly be helpful in determining revenue powers (tax assignments). It is however important to observe that in practical world situation actual assignment dot not necessarily follow the theoretical ideal. There are other factors that are also critical in the determination of fiscal arrangements. Historical, political and other non-economic factors are important. For instance, property tax theoretically should be a local levy but it is a central government tax in Indonesia. Income tax should be a central government levy but in Canada and United States of America it is concurrently done by the state, provincial and central government. Similarly, custom duty which theoretically should be a central government levy is administered by local governments in Malaysia. Revenue from mineral resources in many countries is administered by the central government but in Canada oil revenue is administered by the sub-national governments[1]. These deviations from the theoretical ideal are due to some non-economic factors that are

[1] Oil revenue constitutes a significant proportion of revenue in Alberta

critical in determining assignments, due to socio-political cum historical background of the country.

2.1 Revenue Sharing Experience in Nigeria

The above discussions on economic and non-economic criteria for the assignment of expenditure and revenue powers provide the guideline for examining the Nigerian experience in revenue sharing which is the most controversial issue in the history of Nigerian nation. It has been a contentious issue since colonial period and has generated constitutional, political and legal controversy as well as violent clashes in the country[1]. The situation became worse recently with the increased violence in the Niger Delta region. The oil producing areas are protesting the inadequacy of their share in oil revenue which is derived from the region. However, some states as well as individual are of the view that all the mineral resources are owned by the federal government, hence the entire federation should benefit from it equally.

It was in view of these grievances that various ad-hoc commissions/committees (as we shall discuss later) were set-up at different times to design an equitable formula for sharing national revenue. While the reports of some of these Commissions/Committees were implemented, either fully or partially, some were kept in the archive for references (Hamman, 2003). For instance, during the pre-colonial era, particularly between 1946 and 1956, about three commissions were set-up on revenue allocation.

Phillipson Commission was set-up in 1946 to determine the allocation of national revenue among the then regions (i.e. North, East and Western Regions) of the federation (Akpan, 2004).The recommendations of this commission was based on the principles of derivation and even development. Grants were mainly on derivation (East 24%, West 30% and South 46%). This operated between 1946 and 1951 (see also John, 2002).

Hicks Phillipson commission was set-up in 1950 to carry out independent inquiry in consultation with the existing three regions and submit proposal on revenue sharing formula as well as verify the veracity of claims of unfair treatment in some regions. The Commission proposed among others, independent revenue, derivation, need and national interest as the four principles on which the sharing of national revenue should be based (Ehtisham and Singh 2002, Akpan 2004).

Louis Chick Commission was set-up in 1954 to examine among others, the cost of running both the central and regional governments as well as recommend best method of collecting and sharing national revenue. The Commission proposed among others, that federal government should retain revenues from Company Income Tax (CIT), 50 per cent of duties on exports, tobacco, excise and imports. Regions should also collect and retain revenues from Personal Income Tax (PIT), Produce Sales Tax, license and service fees, interest on loans and earnings on surplus funds invested, revenue from regional departments. It also recommended that revenue from 50.0 per cent of tobacco, export and excise duties, 100 per cent of the duty on motor spirit, rents and royalties from mining and fees should be shared among the three regions in accordance with the level of consumption of the item in each of the region.

The Raisman-Tress Commission was set up in 1958 under the chairmanship of Sir Jeremy Raisman to examine among others, the division of power to levy taxes in the country as well as the system of allocating revenue derived by the federation. The commission adopted four criteria for sharing revenue; namely: balanced development, continuity in regional government services, maintenance of minimum responsibilities and population.

In a nutshell, therefore, the allocation of revenue in Nigeria before independence was based on three main criteria: derivation, fiscal autonomy and need. The sharing formula was basically 80.0 and 20.0 per cent to federal and regional governments, respectively. It is also clear from the above analysis that revenue allocation had been a serious political issue in Nigeria even before independence in 1960.

The post-independence period also witnessed various allocation commissions, prominent among which are:

The Binns Commission was established in 1964 to review inter-governmental fiscal relations as it relates to the formula for the allocation of funds from mineral rents and royalties and distribution of funds in the distributable pool account. The commission recommended the principles of regional financial comparability, continuity in government services and maintenance of minimum responsibilities and that 35.0 per cent of federally collected revenue from import duties, mining rents and royalties be paid into the distributable pools account and should be distributed as North 42.0 per cent, East 30.0 per cent, West 30.0 per cent and mid-west 8.0 per cent (Akpan, 2004).

Interim Revenue Allocation Review Committee also known as the Dinns commission was set-up in 1966 to look into and suggest any change in the country with regard to the existing system of revenue allocation and to explore new sources of revenue for both the federal and newly created states. It was the first of such committee that consisted mainly of Nigerians. The commission recommended among others, the criteria for revenue sharing; namely: basic need, minimum national standard, population, tax effort, financial prudence, fiscal adequacy,

[1] Even the civil war that engulfed the country in the 70's was partially attributed to revenue issue.

balanced development, independent revenue, derivation and national interest. The Committee divided revenue into independent and shared. The independent part was to be allocated between the federal government and other accounts, namely: States Joint Account, Special Grants Account and Derivation Account. Excise duty, import duty, export duty, mining and royalty (in-shore) and mining and royalty (off-shore) are to be shared as follows:

- Excise Duty: Federal 60.0 per cent, States Joint Account 30.0 per cent and Special Grants 10.0 per cent.
- Import duty: Federal 50.0 per cent and States Joint Account 50.0 per cent.
- Export duty: Federal 15.0 per cent, States Joint Account 70.0 per cent, Derivation 10.0 per cent and Special Grants 5.0 per cent.
- Mining royalty (in shore): Federal 15.0 per cent, derivation 10.0 per cent, States Joint Account 70.0 per cent and Special Grants 5.0 per cent.
- Mining rent and royalty (off shore): Federal 60.0 per cent, States Joint Account 30.0 per cent and Special Grants 10.0 per cent.

Decree No. 13 of 1970 was promulgated after the civil war. The decree allocated the bulk of the federally collected revenue to the federal government. It abrogated the principle of derivation, thus revenue allocation was based on population (need) and a lump sum transfer to cover administrative cost (Ehtisham & Singh, 2002). The Decree provided that all off-shore revenue accrued to the Federal Government should be distributed among the states on the basis of: equality of states 50.0 per cent and population 50.0 per cent, while in-shore revenue should be shared as: Distributable Pool Account 50.0 per cent, Derivation 45.0 per cent and Federal Government 5.0 per cent. This Decree was however amended in 1975.

The Aboyade Commission was set up in 1977 under the chairmanship of Professor Ojetunji Aboyade to consider the possibility of each government unit to have adequate revenue to discharge its responsibilities considering the principles of derivation, geographical peculiarities, even development and national interest. The Committee proposed that local governments should have a share in the statutory revenue of the federation. It also recommended five criteria for the horizontal revenue sharing from the State Joint Account; namely: equality of access to development opportunities (0.25), national minimum standards for national integration (0.22), absorptive capacity (0.20), independent revenue (minimum tax effort) (0.18) and fiscal efficiency (0.15). The committee recommended the following formula for vertical revenue allocation: Federal Government 57.0 per cent, State Joint Account 30.0 per cent, Local Governments 10.0 per cent and 3.0 per cent for Special Grants Account (John, 2002).

The Okigbo Commission was set-up in November 1979 under the chairmanship of Dr. Pius Okigbo. The Commission was also known as the Presidential Commission on Revenue Allocation. The Committee revised the vertical revenue allocation formula as: Federal Government 55.0 per cent, State Governments 30.0 per cent, Local Governments 8.0 per cent and Special Funds 7.0 per cent. On the horizontal revenue allocation, the Committee proposed four criteria: population 40.0 per cent, national integration 40.0 per cent, social development factor 15.0 per cent and internal revenue effort 5.0 per cent. However, the report of the commission was set aside on October 2, 1981 by the Supreme Court of Nigeria (John, 2002).

1999 Constitution and Revenue Allocation

The allocation of revenue between the federal, state and local governments is clearly enshrined in the 1999 constitution of the Federal Republic of Nigeria. Section 162 (1) of the constitution states that: *"The Federation shall maintain a special account to be called "the Federation Account" into which shall be paid all revenues collected by the Government of the Federation, except the proceeds from the personal income tax of the personnel of the armed forces of the Federation, the Nigeria Police Force, the Ministry or Department of government charged with responsibility for foreign affairs and the residents of the Federal Capital Territory, Abuja"*.

However, despite this clear provision, the constitution further recognizes the roles of National Assembly as well as National Revenue Mobilization Allocation and Fiscal Commission (NRMAFC) in the sharing process. Section 162(2) of the constitution stipulates that: *"The President, upon the receipt of advice from the Revenue Mobilization Allocation and Fiscal Commission, shall table before the National Assembly proposals for revenue allocation from the Federation Account, and in determining the formula, the National Assembly shall take into account, the allocation principles especially those of population, equality of States, internal revenue generation, land mass, terrain as well as population density"*

Similarly, section 162 (5, 6, 7 and 8) of the constitution provides for how the shares of local government allocations are to be handled by their respective states: *"The amount standing to the credit of Local Government Councils in the Federation Account shall also be allocated to the States for the benefit of their Local Government Councils on such terms and in such manner as may be prescribed by the National Assembly. Each state shall maintain a special account to be called "State Joint Local Governments Account" into which shall be paid all allocations to the Local Government Councils of the State from the Federation Account and from the Government of the State. Each State shall pay to Local Government Councils in its area of jurisdiction such proportion of its total revenue on such terms and in such manner as may be prescribed by the National Assembly.*

The amount standing to the credit of Local Government Councils of a State shall be distributed among the Local Government Councils of that State on such terms and in such manner as may be prescribed by the House of Assembly of the State".

National Revenue Mobilization, Allocation and Fiscal Commission

The National Revenue Mobilization, Allocation and Fiscal Commission (NRMAFC) were established in 1989 under the chairmanship of General T. Danjuma. The Commission recommended the following vertical revenue allocation formula: Federal Government 47.0 per cent, State Governments 30.0 per cent, Local Governments 15.0 per cent and Special Funds 8.0 per cent (Akpan, 2004). The Commission also prescribed the following formula for the horizontal allocation of revenue amongst the states: equality of states 40.0 per cent; population 30.0 per cent; internal revenue effort 20.0 per cent and social development factor 10.0 per cent.

The Commission became effective with the entrenchment of democratic system in 1999. The commission was empowered by the third schedule of the 1999 constitution to *"monitor the accruals to and disbursement of revenue from the Federation Account, as well as reviewing, from time-to-time, the revenue allocation formula and principles in operation to ensure conformity with changing realities …advice the federal and state governments on fiscal efficiency and methods by which their revenue can be increased".*

The Commission in August 2001 submitted a proposal to the national Assembly through the president. The proposal allocated to federal government 41.3 per cent, states 31.0 per cent, local governments 16.0 per cent and special fund 11.7 per cent. The special fund was sub-divided into: FCT 1.2 per cent, Ecology 1.0 per cent, National Reserve Fund 1.0 per cent, Agric/Solid Minerals Fund 1.5 per cent and Basic Education and Skill Acquisition (BESA) 7.0 per cent. This proposal was however rendered ineffective as a result of the nullification of Special Fund in the existing formula by the Supreme Court in April 2002.

However, with the executive order of the federal government to take over the items on special fund to manage on behalf of the federation, the share of federal government from May 2002 became 56.0 per cent, while state and local governments were 24.0 and 20.0 per cent, respectively. The federal government in July 2002 further gave up 1.32 per cent from its allocation, thus increased the state and local governments share to 24.72 and 20.60 per cent, respectively (Table 1). The proceeds from Value Added Tax (VAT) are also shared among the three tiers of government. While federal government got 15.0 per cent, state and local governments get 50.0 and 35.0 per cent, respectively (Table 2).

Table 1: Nigeria's Statutory Revenue Allocation Formula (percentage)

	1960	1963-67	1980	1982	1987	1990	1993	1995-98	FMOF Allocation Formula
Fed. Gov't	70	65	55	55	55	50	48.5	48.5	52.68**
State Gov't	30	35	34.5	34.5	32.5	30	24	24	26.72
Local Gov't	0	0	8	10	10	20	20	20	20.6
Others*	0	0	2.5	0.5	2.5	0	7.5	7.5	-

Source: *Approved Budget of the Government of the Federal Republic of Nigeria.*
Note: **includes Special Fund: FCT, Ecology, Statutory Stabilization & Natural Resources.*
*** Includes 7.5 per cent Special Funds: FCT, Ecology, Statutory Stabilization & Natural Resources.*

Transfers from Federation Account to state and local governments are shared in accordance with a formula which uses ten indicators (horizontal formula), namely: population 30.0 per cent, geographical area 10.0 per cent, revenue effort 2.5 per cent, primary school enrolment 2.4 per cent, secondary school enrolment 0.8 per cent, number of hospital beds 3.0 per cent, access to clean water 1.5 per cent and quantity of rainfall 1.5 per cent. However, most of the transfers are made at lump sum covering about 47.5 per cent of the total allocation (Ehtisham & Singh, 2002).

3.0 Country Experiences on Oil Revenue Sharing

There are varying types of revenue sharing arrangements for oil producing countries. While some use the same formula for sharing both oil and non-oil revenue, some others apply different rule or formula. As stated earlier countries such as Brazil, India, Nigeria, Spain, South Africa etc. consider a multitude of fiscal capacity and need factors (such as revenue effort, population etc.) in determining equitable sub-national governments allocation in the revenue sharing formula, some others such as Malaysia uses capitation grants. Russia uses a mixture of fiscal capacity equalization program, Canada and Germany match fiscal capacity to a certain criteria. In Australia fiscal capacity is match with fiscal needs of the states.

In another dimension, while some revenue sharing arrangements allocate large amounts of revenue to sub-national governments relatively to the federal government, others do the reverse. Colombia, Nigeria, Russia and Venezuela belong to the first category while countries such as Ecuador, Indonesia and Mexico fall in the second category. There is however, the system of assigning specific oil revenue bases to the sub-national governments. A good example of countries practicing this method is United State, Canada and UAE.

Table 2: Allocation of Value-Added Tax (percentage)

	1994	1995	1996	1997	1998	1999	2004	FMOF Allocation Formula
Fed. Gov't	20	50	35	35	25	15	15	15
State Gov't	30	30	40	40	45	50	50	50
Local Gov't	50	20	25	25	30	35	35	35

Source: *Approved Budget of the Government of the Federal Republic of Nigeria.*

Note: FMOF = Federal Ministry of Finance

Russia

Oil revenue in Russia consists of about 50.0 per cent of the country's total revenue. Most of the taxes are collected by the federal government and shared with the sub-national governments according to an agreed principle or in some cases fixed rate. However, unlike Nigeria, taxes on natural resources are collected by the sub-national governments and constitute a major source of their revenue for the oil producing regions. Due to high concentration of oil in few regions, this system created large disparities in the revenue profile of oil resource regions. For instance, oil resource regions constitute the five richest regions with only 5.5 per cent of the country's total population but more than 53.0 per cent of all the sub-national governments' revenues. This notwithstanding, the oil rich regions with high per capita oil revenue still argue for greater autonomy and in some cases for absolute control over revenue from oil resources.

Venezuela

Oil revenue in Venezuela accounts for between 47.0 and 50.0 per cent of central government revenue and about 9.0 per cent of the country's GDP. Like Nigeria, the sub-national governments are dependent on central government as their revenue comes from revenue-sharing arrangements and transfers. Also, like Nigeria sub-national governments enjoy between 15 – 20 per cent of revenue from VAT. It is also important to note here that like Nigeria more than half of the sub-national governments' revenue comes from oil. Similarly, sub-national government plays a very important role in the fiscal operations of the country, especially in terms of expenditure assignments, as their expenditure represents about one-third of the national government expenditure. In the same way as in Nigeria and other jurisdictions, revenue allocations are continuous source of political and fiscal dispute. The central government considers revenue to sub-national government as excessive and that there is no machinery for expenditure control. However, sub-national governments on the other hand, want their revenue share increased.

Mexico

Oil revenue in Mexico constitutes about 35.0 per cent of the total public revenue. Like Nigeria, there is no direct link between oil production and sub-national governments. Most of the country's oil revenue accrue to the central government but shared with sub-national governments according to an agreed formula established by the law of fiscal coordination. Under the law, lower governments receive 20.0 per cent of ordinary oil extraction rights and 3.17 per cent of the additional oil extraction rights. Like Nigeria's 13.0 per cent derivation, there is a special provision for municipalities that are in the regions where oil is produced or lifted abroad, in order to compensate for environmental damage caused by the exploration activities. Since oil revenue is small, the sharing has really not been an issue of serious political contention but sometimes the component transferred to the municipalities involve in oil production and export generates some controversy. However, sub-national governments have sizeable expenditure, mostly the provision of education, health, care services, social services, basic social infrastructure, security and utilities.

United Arab Emirates

Oil and gas revenue accounted for over 50.0 per cent of the total emirate revenue. In UAE, unlike Nigeria, each emirate has high degree of economic and political autonomy with full control over its oil resources. Oil revenue in Abu Dhabi which is the largest emirate constitutes over 60.0 per cent of the emirate revenue. The central government depends largely on upward revenue sharing arrangement for sustenance. In this case, the oil producing emirates give contribution to the central government either in cash or kind. The amount of contribution from each emirate to the central government is negotiated every year taking into consideration the price of the commodity.

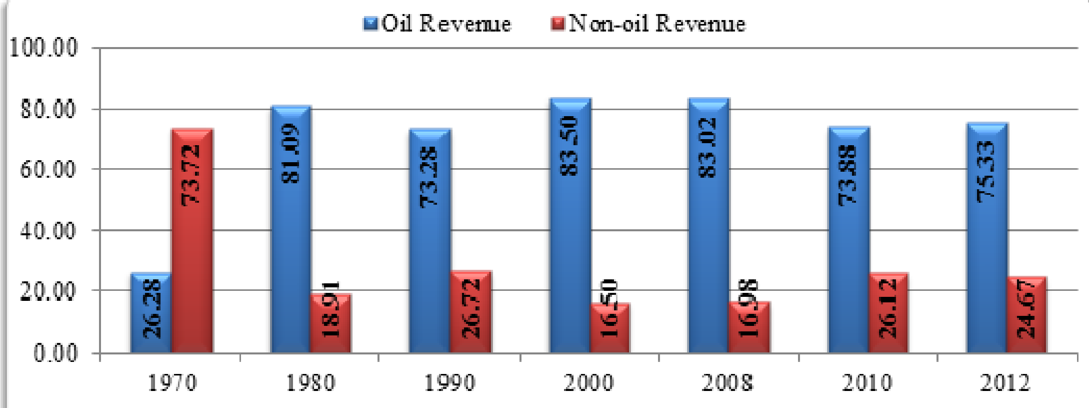

Figure 1: Oil & Non-Oil Revenues as percentage of Total

4.0 Trend in Revenue and Expenditure Profile of the three Tiers of Government in Nigeria

4.1 Revenue Profile

In 1970, total revenue generated by Federal Government of Nigeria (FGN) totaled ₦634.0 million (about 12.0 per cent of GDP). Of this amount 73.7 per cent constituted non-oil revenue. This trend changed in less than a decade. Out of ₦15,233.5 million (30.7 per cent of GDP) generated in 1980 over 81 per cent come from oil sources. Oil portion amounted to about 73.3 and 83.5 per cent in 1990 and 2000, respectively. In 2010 oil revenue stood at 73.9 per cent of the total revenue and increased slightly to 75.4 per cent in 2012 (Figure 1).

4.1.1 Revenue Allocation in Nigeria

Table 3 indicates that in 1993 out of the total revenue[1] of ₦192.8 billion shared[2] among the three tiers of government in Nigeria, ₦126.1 billion was retained by the federal government while ₦50.6 billion was shared among states and local governments. The federal government share which includes the independent revenue of federal government was ₦75.5 billion or 59.9 per cent higher than the share of sub-national governments. However, if the internally generated revenue of sub-national governments is added the difference narrowed to ₦68.7 billion or 54.5 per cent. This shows that federal government share was nearly one and a half fold more than the share of sub-national governments. This centripetal bias in the sharing of federally collected revenue continued up to year 2001 but peaked in 1997 when federal government share was over 72.0 per cent larger than the share of sub-national governments. In the year 2000 after the entrenchment of democratic rule in 1999 the margin of the federal government share of the federally collected revenue narrowed to ₦133.20 billion or 22.3 Per cent from ₦472.01 billion or 71.2 per cent in 1999. The pattern however changed completely in 2002 when the federal government in July gave up 1.32 per cent of its share to state and local governments. This is in addition to 85.0 per cent from VAT (i.e. state 50.0 per cent and local governments 35.0 per cent). In 2002, therefore, sub-national governments got ₦740.3 billion as against ₦716.7 billion accrued to the federal government. With the IGR of sub-national governments they enjoyed a ₦123.5 billion income more than the federal government. This trend continues till date but peaked in 2011 when a total of ₦4,463.3 billion was allocated to sub-national government as against the ₦3,553.5 billion allocated to federal government.

[1] Comprehensive data on local governments expenditure is available from 1993 when CBN started local governments survey, hence the decision to start the analysis from 1993 for the purpose of uniformity.
[2] Excess revenue over budgetary provision are saved in the excess crude account

Table 3: Fedral Government Retained Revenue vs. Allocation to Sub-National Governments (NBillion)

	Allocation				Actual Difference		Percentage Difference	
Year	Total Revenue (Gross) /1	FG Retained Revenue /2	Allocation to Sub-National Gov'ts /3	Total Revenue of Sub-National Gov'ts /4	Sub-National Gov'ts /3	Total Revenue of Sub-National Gov'ts /4	Sub-National Gov'ts /3	Total Revenue of Sub-National Gov'ts /4
1993	192.77	126.07	50.60	57.36	75.47	68.71	59.86	54.50
1994	201.91	90.62	56.13	68.26	34.50	22.36	38.07	24.67
1995	459.99	249.77	74.33	93.43	175.44	156.34	70.24	62.59
1996	523.60	325.14	90.96	112.63	234.19	212.51	72.03	65.36
1997	582.81	351.26	97.76	127.64	253.50	223.62	72.17	63.66
1998	463.61	353.72	154.85	187.40	198.87	166.32	56.22	47.02
1999	949.19	662.59	190.58	229.37	472.01	433.21	71.24	65.38
2000	1,906.16	597.28	464.08	509.03	133.20	88.26	22.30	14.78
2001	2,231.60	796.98	678.04	743.47	118.94	53.50	14.92	6.71
2002	1,731.84	716.75	740.27	840.30	(23.51)	(123.54)	(3.28)	(17.24)
2003	2,575.10	1,023.24	1,084.12	1,223.05	(60.88)	(199.81)	(5.95)	(19.53)
2004	3,920.50	1,253.60	1,422.01	1,578.61	(168.41)	(325.01)	(13.43)	(25.93)
2005	5,547.50	1,660.70	1,866.83	2,013.61	(206.13)	(352.91)	(12.41)	(21.25)
2006	5,965.10	1,836.61	2,066.14	2,214.59	(229.53)	(377.99)	(12.50)	(20.58)
2007	5,715.60	2,333.66	2,567.70	2,894.71	(234.04)	(561.05)	(10.03)	(24.04)
2008	7,866.59	3,193.44	3,842.72	4,306.98	(649.28)	(1,113.54)	(20.33)	(34.87)
2009	4,844.59	2,642.98	3,153.01	3,640.30	(510.03)	(997.32)	(19.30)	(37.73)
2010	7,303.67	3,089.18	3,718.25	4,503.35	(629.07)	(1,414.17)	(20.36)	(45.78)
2011	11,116.90	3,553.54	4,463.31	4,999.90	(909.77)	(1,446.36)	(25.60)	(40.70)
2012	10,654.72	3,629.60	4,457.01	5,031.74	(827.41)	(1,402.15)	(22.80)	(38.63)

Source: *CBN Statisticsl Bulletin and Authors calculation*
Note:
/1 Includes deductions (memorandum items): JVC cash call, excess crude proceeds/PPT/Royalty and others
/2 Includes independent revenue of federal government
/3 Includes VAT, grants receipts from stabilization funds, ecology, budget augmentation and share of excess reserves
/4 Includes internally generated revenue of state and local governments

4.1.2 Internally Generated Revenue of Sub-National Governments

State and Local Governments have three sources of revenue; share from Federation Account, share from VAT Pool Account and internally generated revenue (IGR). Besides, local governments are entitle to 10.0 per cent of states internally generated revenue. The federal government has the responsibility of collecting taxes whose bases are mobile and large, constituting perhaps more than 80.0 per cent of the total tax base in the economy. While state and local governments are saddled with the responsibility of collecting revenues that are related to the services they rendered. Some of them includes: Personal Income Tax (PIT), stamp duties, road taxes, business registration fees and lease fees of state lands (Table 5).

However, it is important to note that most of these taxes though collected by states, the rates are determined by the federal government. Similarly, on the surface, one would assume that tax distribution is optimal, but a closer look at it reveals that the chunk of the taxes that generate huge revenue goes to the federal government leaving the state and local governments with taxes whose bases are small and very difficult and expensive to collect. This resulted in an insignificant level of IGR for state and local governments when compared with their total revenue including allocations from the Federation Account (Figure 2).

Besides, the weak internal revenue base, sub-national governments do not make frantic effort at improving their tax revenue. Figure 3 shows the growth rate of IGR visa-a-viz allocation from the federation account. While the share of states and local governments from the federation account increased considerably over time that of IGR in some cases experienced negative growth.

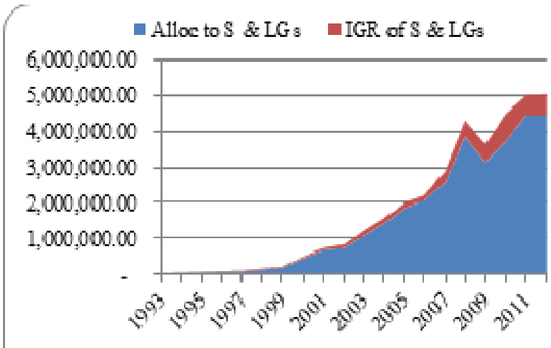

Figure 2: Total Revenue of Sub-national Governments (₦ Billion)

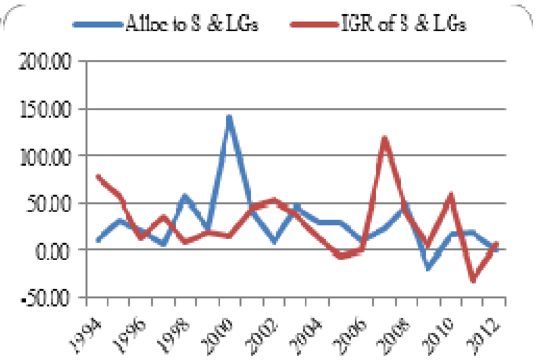

Figure 3: Growth Rate of Allocation to Sub-National Governments & IGR

Source: *CBN Statistical Bulletin, 2012 & Authors calculation*

4.2 Expenditure Profile

Spending assignments in Nigeria are in line with the pattern in some modern federations as well as agreed with literatures explore in section 2. The federal government takes care of defense, foreign affairs, railways, post and communications, some trunk roads, air and sea travel and law and public order. The states are responsible for the provision of education, health, public works etc. while Local governments are to act as agents of their respective state governments or in some cases provide menial services such as water, sanitation, waste collection as well as education and health care services. In a nutshell, matters of national interest are handle by the federal government only while those issues that are local in nature are assigned to the local governments.

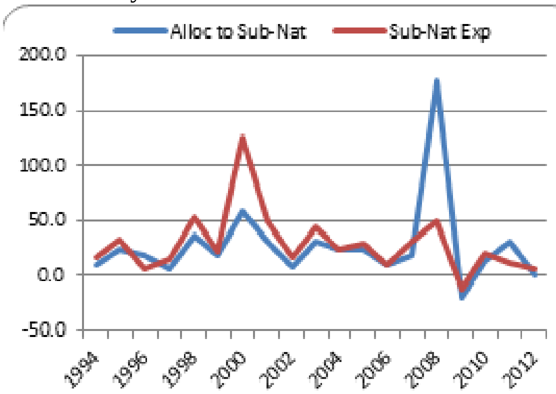

Figure 4: Growth Rate of Sub-Nat Gov'ts' Rev. Alloc. & Expenditure

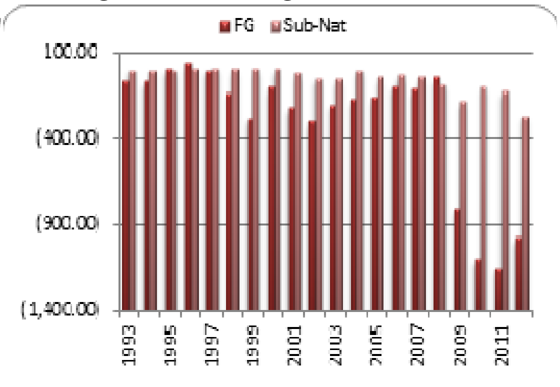

Figure 5: Budget Deficit of Fed. & Sub-Nat Gov'ts (₦Billion)

Source: *CBN Statistical Bulletin, 2012 & author's calculation*

The trend of national government expenditure as presented in Table 4 shows that federal government played a major role in the expenditure profile of the national government up to early 2000s. Expenditure profile of Nigerian governments follows the same trend with revenue. For instance, 1n 1993, out of the ₦254.9 billion aggregate expenditure of the national government, about 75.0 per cent were that of the federal government alone, leaving 25.0 per cent for the entire sub-national governments. This trend continues and climaxed at 80.6 per cent in 1999 probably due to transition to democratic rule which requires colossal expenditure. This trend was however altered in 2003 when federal government total expenditure fell to 48.9 per cent of national expenditure. In 2012 sub-national governments expended a total of ₦4,403.6 representing 57.0 per cent of the national expenditure. The sub-national government spent a total of ₦5,491.7 billion in 2012 constituting about 54.4 per cent of national expenditure.

The pattern of growth exhibited in the National expenditure presented in figure 4 shows the same characteristics with revenue indicating that expenditure of sub-national governments is determined largely by their revenue from the centre.

Table 4: Total Expenditure of National Government (NBillion)

	Total Expenditure			Percentage of Total		Growth Rate	
Year	FG	Sub-National	Total	FG	Sub-National	FG	Sub-National
1993	191.23	63.66	254.89	75.03	24.97		
1994	160.89	74.88	235.78	68.24	31.76	(15.86)	17.64
1995	248.77	100.34	349.11	71.26	28.74	54.62	33.99
1996	337.22	106.65	443.87	75.97	24.03	35.56	6.29
1997	428.22	122.63	550.84	77.74	22.26	26.98	14.98
1998	487.11	187.23	674.34	72.24	27.76	13.75	52.68
1999	947.69	228.34	1,176.03	80.58	19.42	94.55	21.96
2000	701.06	513.54	1,214.59	57.72	42.28	(26.02)	124.90
2001	1,018.03	768.33	1,786.36	56.99	43.01	45.21	49.62
2002	1,018.16	894.36	1,912.51	53.24	46.76	0.01	16.40
2003	1,225.97	1,282.87	2,508.84	48.87	51.13	20.41	43.44
2004	1,426.20	1,586.11	3,012.31	47.35	52.65	16.33	23.64
2005	1,822.10	2,066.56	3,888.66	46.86	53.14	27.76	30.29
2006	1,938.00	2,252.63	4,190.64	46.25	53.75	6.36	9.00
2007	2,450.90	2,943.54	5,394.44	45.43	54.57	26.47	30.67
2008	3,240.82	4,403.57	7,644.39	42.39	57.61	32.23	49.60
2009	3,452.99	3,844.53	7,297.52	47.32	52.68	6.55	(12.70)
2010	4,194.58	4,644.58	8,839.16	47.45	52.55	21.48	20.81
2011	4,712.06	5,143.20	9,855.26	47.81	52.19	12.34	10.74
2012	4,605.32	5,491.68	10,097.00	45.61	54.39	(2.27)	6.78

Source: *CBN Statisticsl Bulletin and Authors calculation*

4.3 Fiscal Balance

Federal governments' fiscal position has been characterized since 1993 by large budget deficits except in 1995 and 1996 when it recorded a budget surplus of ₦1.0 and ₦32.1 billion, respectively and 1997 when the deficit reached an all-time low of ₦5.0 billion. The deficit rose sharply to ₦133.4 billion in 1998, while that of sub-national governments was just ₦0.9 billion. The federal government deficit stood at a whooping ₦1.2 trillion in 2011 as against ₦274.9 billion for sub-national governments.

The budget balance of sub-national governments began to deteriorate with the entrenchment of democratic governance in 1999 and coincidentally both (federal and states) move in the same direction from 2000. While the deficit of the FGN reached its peak in 2010 that of sub-national governments was at its highest in 2012.

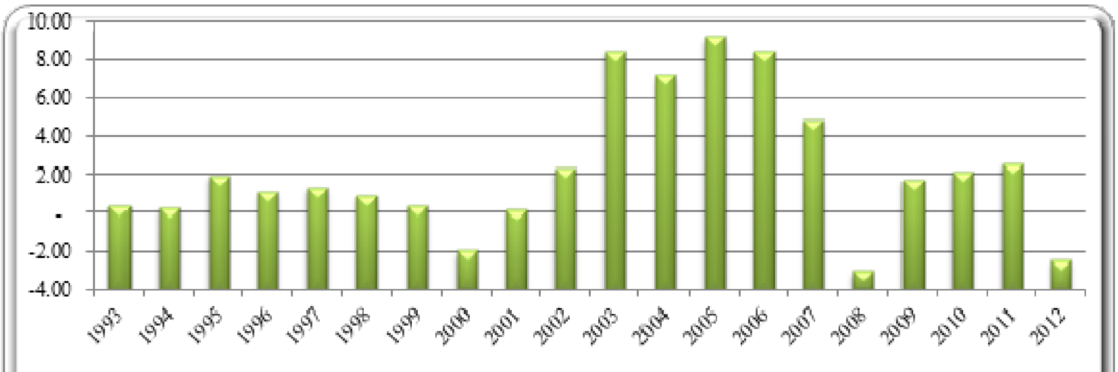

Figure 6: Fiscal Balance of Local Governments (₦Million)

However, it is important to note that a cursory look at fiscal balance of local governments separately reveals that unlike federal and state governments, the fiscal balance of local governments as presented in figure 6 has been in surplus since 1993 except for the year 2000, 2008 and 2012 when they had a deficit of ₦1.9, ₦3.0 and ₦2.5 billion, respectively. It is therefore evident from the fiscal balance that local governments have been more cautious than the states which are in-turn more careful than Federal Government to balance their budget. The major reason that the local governments were more able than the states and federal governments to control their deficit over the years is probably due largely to their limited sources of financing deficit unlike the states and federal governments.

However, the semi-independence status of state and local governments enable them to source for funds from both money and capital markets to close the funding gaps arising from the shortage of funds to finance their developmental activities. State and local governments, therefore, from time-to-time resort to the Deposit Money

Banks (DMBs) for funds. Few have also raised money from capital market[1]. This however, pauses a serious challenge to the central bank monetary policy actions. Thus, the central bank took a measure to minimize lending to state and local governments by putting a ceiling of 50.0 per cent of DMBs credit to the public sector (Biodun, 2004).

5.0 Concluding Remarks

There is a centripetal bias in the assignments of revenue powers among the three tiers of government in Nigeria in favour of federal government. This makes sub-national governments heavily dependent on federal government for revenue. However, the expenditure profiles of sub-national governments put together have surpassed that of federal government since 2003. The study also finds, amongst others, that fiscal balance of sub-national governments is also growing fast relatively to that of federal government and is likely to exceed it in the near future, if the current trend is sustained.

Although, there seems to be a consensus amongst analysts that the mapping of benefits across jurisdictions cannot be perfect, but wide disparity between revenue powers and expenditure assignments can create fiscal disharmony resulting to political tensions. There is no doubt that the problems of fiscal imbalances and disharmony in Nigeria are end result of unevenness in the allocation of revenue powers and expenditure assignments, hence requires review. There is the need for further divulgence of tax powers in favour of sub-national governments or increase their share of Federal Account. Frantic effort is also required to diversify the revenue base of the nation, not only to improve the revenue accruable to all tiers of government but also to reduce the on-going agitation for "resource control".

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[1] Some state and local governments have floated bonds in Nigeria

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