FISCAL CENTRALIZATION AND REVENUE CONTESTATIONS IN NIGERIA; A CRITICAL APPRAISAL

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Abstract

At independence, Nigeria adopted federalism as a means of coexistence and unity. But the issue of constructing a stable and acceptable inter-governmental fiscal relation has been the subject of many commissions and committees and today, the issue still evokes virulent contestations amongst politicians and academics. Thus, on several occasions, successive governments have been revising revenue allocation formula till date. So far, an acceptable formula is yet to be arrived at; in view of the agitations here and there for an acceptable formula coupled with the extreme position of oil producing region calling for total resource control if possible, the research examined the arguments for decentralization rather than centralization of revenue and expenditure and concluded that despite the genuine arguments for centralization, revenue and expenditure decentralization presently in Nigeria is a product of the 1999 constitution where the revenue and expenditure powers were vested in the central government. Any policy change could thus require an amendment to the 1999 constitution. Recommendations are made for the revenue sharing to be based on equity, fairness and justice as enshrined in the 1999 constitution, not for political and ethnic sentiment, State Joint Allocation Committee is unconstitutional and has to be abolished and State and local government should boost their internally generated revenue rather than depending on federal government for virtually everything.

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Introduction

Federalism as a political system was adopted to cater for diversities and heterogeneity of the Nigerian society as well as address the twin issues of maintaining unity while preserving the diversity. According to Davis (1967) and Adamolekun and Kincaid (1991), it was considered as a means of preventing a single group from dominating the others as well as monopolizing the consumption of public goods. More so, it is only federalism which satisfies the desire for a national identity, retention of separate local identities and a corresponding distribution of governmental power (Nicholson, 1966).

In view of the historical commitment to federalism as a means of coexistence and unity, fiscal federalism has been an important and central feature of intergovernmental relationships in Nigeria. The construction of a stable and acceptable inter-governmental fiscal relation has been the subject of many commissions and committees since 1914 (Ezra, 1960); today, the issue still evokes virulent contestations amongst politicians and academics. While economic analysis, as encapsulated in the theory of fiscal federalism, seek to guide this division by focusing on efficiency and welfare maximization in determining optimal jurisdictional authority, it needs to be recognized that the construction of optimal jurisdictional authority in practice goes beyond purely economic consideration. Political considerations, as well as historical events and exigencies, have in practice, played major roles in shaping the inter-governmental fiscal relations in most federations.

There has been a growing movement towards greater fiscal decentralization as against centralization in recent years. Some analysts have attributed this to globalization and deepening demoralization the world over on the one hand and increasing incomes on the other (Vito Tanzi, 2000). Other specific reasons for increasing demand for decentralization are:

i. Regional and local political leaders are demanding more autonomy and want the taxation powers that go along with their expenditure responsibility.
ii. Central governments are looking to local and regional governments to assist on national economic development strategies.

iii. Central governments are increasingly findings it impossible to meet all of the competing needs of their various constituencies, and are attempting to build local capacities by delegating responsibilities to regional governments.

In the context of Nigeria, however, given the historical commitment to federalism as the basis for coexistence and unity, fiscal federalism has long been an important and central feature of inter-governmental relations. Even though the construction of a stable and acceptable inter-governmental fiscal arrangement has been the subject of various commissions, committees and other efforts since the amalgamation of Southern and Northern Nigeria in 1914, the issue remains on the front burner today, still evoking a great deal of passion and virulent contestations.

Thus, on several occasions, successive governments have been revising revenue allocation formula till date. So far, an acceptable formula is yet to be arrived at; in view of the agitations here and there for an acceptable formula coupled with the extreme position of oil producing region calling for total resource control if possible, the research is out to examine the arguments for decentralization rather than centralization of revenue and expenditure and its implication on the Nigeria economy.

1.2 Theoretical Framework

In economic theory, resource allocation is said to be efficient if premised on the principle of Pareto optimality. This is central to an understanding of modern welfare economics. Pareto optimality is defined as a state of affairs such that no one can be made better off without, at the same time, making at least one other person worse off. From the point of view of the economy, a Pareto optimal allocation of resources among use, exists if it is not possible to reallocate resources so as to improve the well-being of one person without making at least one other person worse off. A change in resource allocation is said to constitute a Pareto improvement if at least one person is made better off as a result of the change and no one is worse off. A Pareto optimum is therefore as situation in which no Pareto improvement is possible.

Any judgment on whether a change improves society's economic welfare involves making interpersonal comparison between gainers and losers in any change in resource allocation. This interpersonal comparison would involve value judgment, and this is an important problem for welfare economists. Rather than making interpersonal comparison, economists have attempted to extend the use of the Pareto principle to such circumstances in a variety of ways. According to Broadway (1979), one of such ways is to judge a move not according to whether a potential improvement is attained but according to whether a potential Pareto improvement occurs. The concept of economic efficiency is derived directly from the Pareto principle. An efficient allocation is defined as a Pareto optimal one. In the same way, a gain in economic efficiency is equivalent to Pareto improvement. Under perfectly competitive conditions, allocation of resources, resulting from competitive markets under laissez faire will be Pareto optimal. In real life however, conditions of perfect competition will not always be satisfied which leads to market failure and provides the rationale for government involvement in resource allocation.

Market failure may derive from the presence of public goods, externalities, increasing returns to scale as well as risk and uncertainty. The oil revenue is more akin to a public good with its property of non-rivalry in consumption and non-excludable consumption. Since the market mechanism fails to allocate public goods efficiently to various uses, resource is made to the political process to perform this function.

Economists have proposed some theoretical justification which a democratic political class could adopt for transfer of resources from one level of government to another. One of such criteria is the inter-jurisdictional spillover theory which argues that more resource be allocated to regions to undertake expenditure which benefit residents of such regions.

A second criterion is the difference in taxing powers. The proponents argue that efficiency in revenue sharing will be achieved by taking into consideration the needs of various recipients. The third criterion is that of equity. The federal government must consider the taxing powers of state before determining their allocation. Of these criteria, equity rationale seems to be the most appealing and more appropriate for Nigeria.

1.3 Conceptual Framework

There are a variety of definitions about the concept of federalism. Musgrave (1959) and Oats (1972) originally defined federalism as the division of government political and financial powers among different tiers of government. Some writers on federalism stress that governments within federal system have not been independent of each other but have in practice been interdependent and interacted with each other in a relationship of both cooperation and rivalry (Duchacck, 1970, Akinyemi et al 1979).

Jinadu (1982) view federalism as a form of governmental and institutional structure, deliberately designed by political architects to cope with the twin but difficult task of maintaining unity while also preserving diversity. According to Wheare (1963), federalism is a method of dividing powers so that general and regional governments are each within a sphere, coordinate and independent. He sees federal government as a constitutional arrangement, which divide law-making powers and functions between two or more levels of government.

Livingstone (1952) is another scholar who has clarified the federal principle. He opines that federal structure comes about as a result of socio-economic, cultural and political interaction. While noting that the documentary constitution may be a poor guide as to whether a political system is federal or otherwise, he explains that the essential nature of federalism is to be sought for not in the shading of legal and constitutional terminology, but in the forces of economic, socio – political and cultural that have made their outward forms of federalism necessary.

Etzioni (1965) sees federalism as an attempt to cope with the problem of power. On this premise, conflict is endemic to the unification process and such sociological variables as ethnicity, religion will feature prominently in the conflict.

In attempting to define the scope of fiscal federalism in Nigeria, it is pertinent to note that government plays a very important role in the economy. This fact is even more crucial in developing countries like Nigeria. Through various polices, government is able to guide and influence development direction of the economy and the general wellbeing of the state (Diamond et al, 1998).

1.4 Origin of Fiscal Centralization in Nigeria

The Constitution of the Federal Republic of Nigeria 1999 (as amended) prescribed the revenue and expenditure powers of the federating units under the Second Schedule; Part I, II and III into the exclusive, concurrent and residual list. By this provision, the central government was vested with more powers of taxing and spending federally collected revenue. This simply implies that any meaningful agitation for revenue allocation must first target the constitutional amendment.

Another feature of the 1999 constitution was the provision under Section 162, which established some principles to be applied by both the Revenue Mobilization Allocation and Fiscal Commission and the National Assembly on the subject of revenue allocation.

Sub-section 2 of Section 162 of the 1999 Constitution stipulates, that the President upon receipt of advice from the RMAFC, 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, the allocation principles especially those of population, equality of states, internal revenue generation, land mass, terrain as well as population density. This sub-section further stipulated that the principles of derivation shall be constantly reflected in any approved formula as being not less than thirteen percent of the revenue accruing to the federal account from any natural resources.

Section 162 sub-sections 3 -8 further provide for revenue allocation between the federal, state and local government and also between states and local governments.

1.5 Tax Type and Tax Jurisdiction in Nigeria

The Constitution of the Federal Republic of Nigeria 1999 (as amended) gave the federal government the exclusive power to collect levies like customs and excise duties, company tax, education tax and mining tax, VAT etc (see appendix 1). All these revenue are the major revenue sources and are paid into the federation account for distribution among the tiers of government. The states and local governments were left with the powers to collect other fees.

The tax types have remained virtually unchanged since independence, a number of changes had occurred with respect to who has right to revenues. Eg. Sales tax, to which states hitherto had 100% right, was replaced by VAT in 1994 (Jimoh, 2003).

Despite taxing powers, oil revenues are the main source of public revenue, accounting for about 80% to 55% of the total (UNECA & OECD, 2010). In the period 2001 – 2009, oil revenue averaged 27% of GDP while tax revenue averaged 6.4%. In Nigeria like Algeria, Angola, Equatorial Guinea and Libya rely almost entirely or a singly type of tax unlike Kenya, South Africa which shows a relatively balanced mix of different types of taxes (OECD, 2010).

The federal government has been granted the constitutional right to collect major tax and other revenues for the country hence she retains the lion share when it comes to sharing the revenue

1.6 Revenue Allocation in Nigeria

The history of revenue allocation formula and commission all in an attempt to arrive at an acceptable sharing formula for Nigeria occurred long before independence. The first set of commissions was ad-hoc in nature. The first commission ever set up by the colonial masters was in 1946. Since then, there have been several revenue allocation commissions and military decrees in Nigeria up to 1999 when the Revenue Mobilization Allocation and Fiscal Commission was established.

Since then to date, there are two levels of revenue allocation in Nigeria: one, the vertical allocation among federal, state and local councils, two, horizontal allocation among the states and local government, as contained in appendix II and III respectively.

Vertical allocation: Based on the principle, the share of federal government declined from 55% since 1990 to 48.5% in 1992 (see Appendix II). This further declined favoured the lower tiers of government with 24% and 20% for state and local government respectively.

The current vertical with effect from 2002 is 52.65% 26.72% and 20.60% for federal, state and local government respectively. Anderson (2007) observed that at less than 53% of total government spending, 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 the federal government accounts for between 30 and 40% of direct public expenditure.

The derivation account phased out by the military regime was re-established in 1999. This account was as high as 5% in 1958 presently account for 13% of revenues obtained to nine oil producing states. India and Russia for example make minor allocations to oil producing states, while countries like Mexico, Brazil, Australia and USA have no derivation principle

(Anderson, 2007). The lion share of the VAT allocation also goes to the federal government with 40% leaving 35% and 25% to state and local government respectively.

Horizontal Allocation: Allocation among states and local government councils in Nigeria favoured state with large land areas, number of councils, high population density and in some instance, derivation principle. Between 1964 and 1976, there was no principle of derivation; it was equality of states and population were given weights of 50% in the allocation of revenues among the states. Between 1977 and 1981, equal access to development opportunities, equality of states and population were given prominence.

Since 1999 to date, equality of states, population and internal revenue efforts are given prominence with 40%, 30 and 30% respectively.

1.7 Revenue Contestations in Nigeria

The nature of fiscal federalism in Nigeria places the federal government on vantage position and to the control of the economy. Fiscal laws as seen above have given more powers to the federal government than the other sub-federal units combined. In fact, there is an increased dependence of the sub-federal units on the federal government particularly for their finances. As a result, there are discontentment, conflicts and agitations by the other two tiers against the federal government for self reliance. It is argued that, for any federation to be sustained there must be fiscal decentralization and financial autonomy. However, in the case of Nigeria, there is fiscal centralization.

A number of factors accounting for this according to Jimoh (2003) include the growing importance of crude oil, the civil war, military incursion into politics, the centralizing tendencies of the military state creation exercises. But the factor that is of immediate concern here is the importance of crude oil and proliferation of states which, since 1967 has reduced the size and capacity of the states and made them inherently weak and excessively dependent on statutory allocation.

Also, one striking feature of the recommendations of various revenue allocation commissions in Nigeria with respect to the revenue allocation formula adopted from the 1970s is a phenomenon tagged the “centralization process” in Nigeria’s fiscal federalism (Mbanefoh and

Egwakihide 1998:22). This refers to situation whereby there is a gradual reduction of state government accounts and this is further exacerbated with the establishment of special account by the Federal Government (Mbanefoh and Egwakihide 1998). This is because it was used to favour a few selected states/local councils more often than not; it provoked inter-state hostility and rivalry, thereby undermining the stability and corporate existence of the country.

The recommendations of the Revenue Mobilization Allocation and Fiscal Commission established to “review from time to time” an existing revenue allocation formula were rejected by most states especially the southern states. This dissatisfaction has to do with what they observed as “over-centralization” of federal revenues in the federal government. These states also felt that if they have substantial control over resources found in their areas of jurisdiction, as it was the practice in First Republic, more revenues would and should be available to them for developmental purposes.

In the economic realm, the oil producing areas have remained the most underdeveloped, lacking in modern infrastructure, such as roads, education, medical facilities, electricity, etc. But in view of the current over centralization, it has paved the way for an unprecedented and embarrassing looting of the national treasury by officials at the highest level of state and national government. The perennial haggling over revenue allocation is indicative of how the country has deviated from the original idea of federalism (Jinadu, 1982), which was adopted by the founding fathers of the nation. Indeed, over centralization of power has stifled local initiative. It has promoted inefficiency and fostered a sense of over dependence on the federal government.

1.8 Conclusion

The current revenue allocation formula allocates more funds to the federal government. This has therefore, discouraged most states of internal revenue generation efforts as they wait for federal allocation for their developmental projects to be executed. Furthermore, the allocation to the LGA are reallocated in most states by a committee namely, State Joint Allocation Committee. The fiscal system in Nigeria grants minimal fiscal autonomy to the sub-national governments in terms of revenue assignment as the major taxes are assigned to the federal government.

The current revenue allocation formula in place came into force since 1999. The subsequent proposal by RMAFC and the NCC committee on revenue allocation have not been approved.

1.9 Recommendations

i. Revenue sharing should be based on equity, fairness and justice as enshrined in the 1999 constitution, not for political and ethnic sentiments.
ii. The State Joint Allocation Committee is unconstitutional and has to be abolished.
iii. State and local government should boost their internally generated revenue rather than depending on federal government for virtually everything.
iv. Effective utilization of resources is important not just availability that is the issue. It appears that the little that is so far given is not properly used by the tiers of government in Nigeria.
v. There is need to monitor the current thirteen percent derivation fund through a special body before further arguments on derivation may be sustained.

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APPENDIX I

NIGERIA'S MAJOR TAXES, JURISDICTION AND RIGHT TO REVENUE (1999)

Types of Tax	Law	Administration & collection	Right to revenue
1. Import duties	Federal	Federal	Federation A/C
2. Excise duties	Federal	Federal	Federation A/C
3. Impart duties	Federal	Federal	Federation A/C
4. Mining rents & royalties	Federal	Federal	Federation A/C
5. Petroleum profit tax	Federal	Federal	Federation A/C
6. Companies income tax	Federal	Federal	Federation A/C
7. Capital gains tax	Federal	Federal /states	State
8. Personal income tax (other than those in 9)	Federal	State	State
9. Personal income tax (and forces, police, extend affairs etc)	Federal	Federal	Federal
10. License fee of TV and radio			
11. Stamp duties	Federal	Local	Local
12. Capital transfer tax	Federal	Federal/states	States
13. value added tax	Federal	State	State
14. pool betting	Federal	Federal/states	State
15. Motor vehicle and direr license	States	State	Federation/Local
16. Entertainment tax	State	State	State
17. Land reg. & survey			
18. Property taxes & Rating	State	State	State
19. Market and trading license and fees	State	State	State/local
	State	Local	Local
	State	Local	Local

Source: Anyanwu et al (1997), Federal Republic of Nigeria Constitution 1999.

APPENDIX II: VERTICAL ALLOCATION OF THE FEDERATION ACCOUNT, 1960 – DATE

Recipients	1960 – 1962	1963 – 1966	1981 Act	1984 Jan	1990	Jan 1992	June 1992	June 1994	2000 to Date
1.Statutory Allocation									
i. Federal Government	70	65	55	55	50	50	48.5	48.5	52.68
ii. State Government	30	35	30.5	32.5	30	25	24	24	26.72
iii. Local Government	-	-	10	10	15	20	20	20	20.64
iv. Special funds	-	-	4.5	2.5	5	5	7.5	7.5	-
(a) FCT	-	-	-	-	1	1	1	1	-
(b) Stabilization	-	-	-	-	0.5	0.5	0.5	0.5	-
(c) Savings		-	-	-	0	0	0	0	-
(d) Derivation	-	-	2	2	1	1	1	1	-
(e) Devt. Of Min Producing areas	-	-	1.5	1.5	1.5	1.5	3	3	-
(f) General ecology	-	-	1	1	1	1	2	2	-
Total	100	100	100	100	100	100	100	100	100
2. **VALUE ADDED TAX**									
Federal government								80	40
State government								20	35
Local government								0	25

APPENDIX III

HORIZONTAL REVENUE ALLOCATION (AMONG STATES) IN NIGERIA (1960-DATE)

Criteria	1969 – 76	1876 – 1981	1982	Jan 1900	1999 to date
i. Minimum responsibility of government (equality of states)	50	48	40	40	40
ii. Population	50	-	40	30	30
Equal access to development opportunities	-	25	-	-	-
National integration	-	22	-	-	-
Fiscal efficiency	-	15	-	-	-
iii. Social development factors	-	-	15	1-	10
(a) Primary school enrolment inverse enrolment	-	-	12.5	-	-
(b) Education	-	-	-	4	4
(c) Health	-	-	-	3	3
(d) Water	-	-	-	3	3
iv. Land mass and terrain				10	-
v. Internal revenue effort				10	20
Total	100	100	100	100	

Source: Anyanwu et al 1997, Jimoh, 2003, RMAFC data base.