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TOWARDS AN OPTIMAL FORMULA FOR REVENUE ALLOCATION IN NIGERIA*

by

DON NNAEMEKA IKE **

I. INTRODUCTION

From the history of revenue allocation in Nigeria, it is evident that an objective formula with internal consistency has long eluded the state agents entrusted with the problem of searching for an acceptable solution. As the term implies, it is a continuous problem within the confines of fiscal federalism. In situations of this nature, negotiations and political considerations loom large in the determination of the final outcome. But these considerations should not overlook the underlying economic and demographic factors on which an optimal solution must be based. In Nigeria we have settled for ad hoc solutions depending on the prevailing concentration of political power. The experience is that those with repository of power would want to direct and allocate formula in their own favour. Consequently, terms like even development, derivation, equality of state, population, national interest, are manipulated to suit each area’s economic interest.

The essential features of fiscal federalism require that:

(a) Functions be allocated between the central and state Governments, with the necessity for each Government to be endowed with enough fiscal powers to be able to carry its functions.
(b) Both Central and State Governments should have fiscal autonomy which implies freedom to disburse funds.
(c) All Governments should have adequate and elastic resources to meet their needs and responsibilities.
(d) Economy and efficiency should be maximised in the process of revenue collection and disbursement. This is flouted by the Nigerian decentralised systems.
(e) The Federal authority has supervening powers of revenue re-distribution. Thus resources could be transferred from one State to the other for purposes of achieving economic stability and even development.

An efficient formula between the centre and the states should satisfy these broad principles. The Federal and State Governments have political autonomy with exclusive and concurrent powers. Thus the states should also be endowed with adequate fiscal capacity to match with their responsibilities regardless of the gap between fiscal need and available resources.

A State may generate substantially more revenue than the others. If the state is allowed to retain and disburse the entire revenue it would defeat a larger national goal of even national development and this is potentially disintegrative. Hence the need for additional powers of the federal authority for a more even distribution of the National resource endowment to make for inter-regional equity and balanced development.

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*This paper was written in 1981 immediately after the Joint Finance Committee of the National Assembly passed the Revenue Allocation Bill that was later successfully challenged in the law court.

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Nigeria was run as a unitary Government until 1946 with the coming of the Richards Constitution. As a Unitary Government there was no need for revenue allocation, since the central authority had only provincial administrators to cater for. In 1946 with the Richards Constitution and the three regional set-ups, the need arose to allocate revenue to the Regions. Phillipson Commission was appointed to study and make recommendations on the implementation of the new system.

Phillipson identified what he called "declared revenue", which was regional revenue collectible and disburseable within the regions. These revenue sources included direct taxes, receipts from licenses, mining rents, fees of courts and offices as well as receipts of rent from Government property and earnings from departments.

On the allocation of non-declared revenue to the states, Phillipson considered two criteria, derivation and the need for even development. He adopted derivation because he believed that regions should be encouraged to learn financial responsibility and restraint. They have to learn to spend only what they can contribute to the national revenue.

This was the principle of derivation which would allocate to each region a share of non-declared revenue proportionate to its contribution of such revenues.

Non-declared grants were to be paid to the regions as follows:

<table>
<thead>
<tr>
<th>Region</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>North</td>
<td>46%</td>
</tr>
<tr>
<td>West</td>
<td>30%</td>
</tr>
<tr>
<td>East</td>
<td>24%</td>
</tr>
</tbody>
</table>

The principle was not only detrimental to national integration and even development but was found unworkable. It created problems for the East and bitter wranglings in its application. Thus this principle was rejected in 1950. The Hicks-Phillipson commission discarded derivation and emphasised a weighted population measure for the non-declared revenue which accounted for 94% of the total revenue.

The importance of Hicks-Phillipson commission was that it rejected derivation as the primary principle of revenue allocation and introduced other criteria namely: independent revenue, need and national interest all designed to make for effective fiscal federalism. This however still caused disaffection among the regions and is said to be contributory to the constitutional crisis of 1953.

Other Revenue panels were Chick Commission of 1953, Raismen Commission of 1958, Binns Commission of 1964, Dina Commission of 1968 Aboyade Technical Committee of 1977, and the present Okigbo Commission of 1979. Chick Commission emphasised derivation, Raismen Commission de-emphasised this principle. Under Raismen, a newly styled distributable pool account was established. The Binns equation was not substantially different from Raismen's except for a new quantifiable principle of financial comparability in distribution of the Distributable Pool Account. The Dina Commission advocated a Special Grants Account to be operated by a fiscal and planning Commission, but this was rejected by the Federal Government. The analyses of the various recommendations are as shown by Phillips (1975), Teriba (1966), and Nwosu (1980).

The Aboyade Technical Committee went ahead to separate revenue jurisdiction of state and Federal Governments and to identify a State's Joint Account to be shared amongst the States and Federal Government according to the following principles: Equality of access to development opportunities, National minimum standard for national integration, Absorptive capacity, Independent revenue and minimum tax effort, and Fiscal efficiency. The National Constituent Assembly of 1978
rejected the criteria used on the basis of its dubious statistical foundations and measurement problems. The criteria were not amenable to objective quantification, and depending on assumptions made could lead to entirely different results. Subsequently the Federal Government rejected the formula and set up the Okigbo Review Panel in 1979.

2. **PRINCIPLES TO BE CONSIDERED**

An optimal revenue allocation formula should answer to the broad objectives of inter-regional equity and balanced national development. It must not look askance at the essential features of fiscal federalism as itemised above which involved autonomy, adequacy, centrality, efficiency, and redistributitional capacity of the federal authority.

The recurring principles: running through the above-analysis and in the other referenced articles are the following:

1. Derivation.
2. Population.
3. Even National Development
4. Need
5. Absorptive capacity
6. Fiscal Efficiency
7. National Interest
8. Equality of States

Derivation recognises the need to retain incomes in States that produce such incomes. It is argued that in order to inculcate financial responsibility, and fiscal prudence in revenue management, states should learn to spend only what they contribute to the national purse. Under this system thus, poorly endowed states would remain poor and well endowed ones would grow richer, all in the same country. This would negate the need for even national development, and this would be potentially disruptive in the context of national economic integration.

But the apologists of derivation could have a case. They have pointed to the deleterious effect of mineral exploitation on environment, destroying ecological zones for agriculture and life. Such destruction goes beyond the actual monetary compensation paid out to the real land owners. Additionally there is need to transform areas of mineral potential to industrial zones as agriculture is inhibited by exploitation creating quasi-technological unemployment. Areas of oil and mineral potential would consequently require more revenue for the transformation that may be required to ensure equilibrium in the relevant micro-economy.

Thus, although a de-emphasis of derivation is recommended, it should not be completely scrapped especially in dealing with oil royalties and rent.

Population could be used as a relevant index for need with the assumption of equal per-caput minimum need; population would approximate the economic needs of each State. Since maximization of peoples welfare is a relevant state objective, population and; or percapita income must be seen as an important co-State variable.

Phillipsen in 1945 considered population as the best available measure of human needs and very simple to understand. Phillipsen, however did not pursue the implication of this conclusion and thus
left out population from his formula. Since the Hicks-Phillipson review of 1950, population has been recognised as an important variable, until the Aboyade review which sought for objective criteria that could not be manipulated by public officials.

The problem with population in the Nigerian situation is the inaccuracy of the existing population data. It is argued by some that any emphasis on population would lead to large scale population inflation by States who would want to use this process to increase their allocation. It is necessary to state that revenue allocation is not the only incentive for states to seek to inflate their population. The desire for enhanced political representation in the centre and inter-regional struggles for hegemony are other strong inducements for rigging the population count. As a result, we should not throw away the baby with the bathwater. Thus efforts should be made to hand over to the present and future generations of Nigerians accurate population data. This would guarantee a fair, simple and equitable distribution of revenue with population as an important variable. I would add parenthetically that in advanced capitalist countries, U.S.A. for instance, population is the most important criterion for revenue distribution accounting for about 90% of the shared revenue.

Even national development is not a quantifiable criterion. One of the broad objectives of revenue allocation is the achievement of even national development, since states have widely differing resource endowment. Hence the added responsibility of the superior Federal authority to re-distribute resources from the rich to the poor states. Thus, the use of criterion other than derivation is aimed at achieving even and balanced national development.

Need is amorphous and nebulous. Needs are limitless while resources to satisfy them are constrained by the fact of scarcity (Nwosu, 1980). Consequently in the context of a state structure, need cannot be totally quantified or specified except by reference to population. Population should supersede any further reference to need in an appropriate revenue calculus.

Absorptive capacity, fiscal efficiency and national interest are not easily quantifiable. Proxies could be used to approximate the influence of these variable, but these proxies cannot be made objective and acceptable to all states as they are likely to have differential effects. There is evidence that all States have very high absorptive capacity and as such this criterion should be ruled irrelevant in the present Nigerian situation. States with high fiscal efficiency should be able to collect and disburse efficiently revenue sources within their exclusive jurisdiction. National interest is not objective and has high political undertones; if incorporated into our revenue framework, it is likely to follow the distribution of political power and as such would be a source of political disputations. A Special Grant’s Account, of negligible fiscal magnitude, could be created within the discretionary powers of the Nation’s Chief Executive on the advise of a Fiscal and/or Planning Commission for use to attend to national emergencies, disasters and ecological depredations. The author did recommend this in his 1977 memorandum (Ike 1977) to the Aboyade Technical Committee.

Equality of states is a straightforward democratic principle. Although in actuality states are not equal as they have differing size, population and resource endowment; but since states have the same administrative framework (namely Governors and state’s executives, houses of legislature, civil service and judicial systems) of largely equal size, the states are likely to incur similar administrative costs. Thus the equality principle with respect to states could have more than fictional and political implications (Nwosu, 1980). The principle should be accorded a place in an appropriate revenue distribution calculus as a result of its consequential economic possibilities. The weight given to this principle should
be kept as small as possible to reduce the demand for mushroom states which has gripped the nation. 

Education has been accepted to have great inter-regional externalities. A State investing highly in education would benefit the nation with enlightened and educated work force available for the larger economy. Consequently to encourage states to invest in education from primary to University level, total school enrolment should be used for revenue allocation. Furthermore, as Anderson et. al., (1963) pointed out, 40% of primary enrolment is a threshold for economic development. As a result, an inducement to States to emphasise school enrolment through a revenue framework could also lead the states into achieving larger national objectives.

Additionally, total school enrolment could be used as an index of human absorptive capacity, with states having high school enrolment being able to absorb further investment in other sectors of their economy in response to the economic force of factor complementarity.

3. AN OPTIMAL REVENUE FORMULA

The States and local governments should have certain jurisdictions exclusive to them in order to create some measure of fiscal autonomy for these States. Thus the main source of state generated revenue should be personal income tax. Other sources of state revenue should be sales or purchase taxes, football pools and other betting taxes, capital gains tax, stamp duties, motor vehicle taxes and licence fees. Local Governments should have jurisdiction for property tax, market and trading licences, motor parks dues, and land registration fees.

All federally collected revenue which should include import duties excise duties, export duties, mining rents and royalties, petroleum profit tax, companies income tax should be consolidated into one account to be shared by the Federal, State and Local Governments. The Federal Government should retain personal income taxes from external affairs officers and the Federal Capital territory. The others should be shared 50% to the Federal Government, 40% to the state Governments jointly, 8% to the Local Governments jointly and 2% special Grants Account, within the discretionary jurisdiction of the nation's Chief Executive to be disbursed on the advice of a Fiscal or Planning Commission, especially for use to attend to national emergencies, disasters and ecological deprivations.

The States account should be shared according to the following principles: population, derivation, equality of states and total school enrolment. Fifty five percent should be shared according to population, 5 per cent according to derivation, 10 per cent according to equality of states and 30% according to the raw figures of total enrolment. Thus the criteria and their associated weights are as follows:

1. Population .55 55%
2. Derivation .5 5%
3. Equality of States .10 10%
4. Total School enrolment .30 30%
5. Total 1.0 100%

There may not be much that is scientific about the above pattern of distribution, but it reflects the author's qualitative ordering of the relative weights of the principles as elucidated in the above
analysis. The formula would do for now and for the future, and it reflects the synthesis of the prioritised (antecedent) facts of our checkered fiscal evolution.

CONCLUSIONS:

The Okigbo Commission recommended a formula not substantially different from the above formula, except in the relative weights assigned. This Okigbo recommendation went through the Federal Executive Council and the National Assembly. The Federal Government White Paper on Okigbo’s recommendations reflected the Committee’s ordering and the relative weights with minor modifications, but in the National Assembly new criteria were introduced that deviated from the optimality characteristics analysed above. For instance land mass was injected into the revenue allocation calculus which to the author is a retrograde step in our historical fiscal evolution. Revenue should be meant for people and not for land. Land itself is an asset, and a state with abundant land mass already has greater resource endowment. To give more money to states with more land area is tantamount to “Carrying coal to Newcastle”.

In future the rational principles of population and school enrolment should be given enhanced status if we are interested in economic development under conditions of political stability. For instance, in the U.S.A., revenue is distributed only on the basis of population. In the 200 years of U.S. history, there has been no demand for division of states into unviable units for the purpose of deriving enhanced fiscal capacity from the common pool. It is an advantage for states to be large. If states remain large, Nigeria as a nation is more likely to benefit from economies of scale in the costs of administration and other technological indivisibilities in capital investments. Thus a formula in the line advocated would not only conduce to political stability but also accelerate economic growth and development.

REFERENCES