
HISTORICAL ANALYSIS OF THE IMPACT OF FISCAL FEDERALISM ON GOVERNANCE IN NIGERIA

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ABSTRACT – *This study investigated fiscal federalism and its impact on governance in Nigeria from the historical perspective. Fiscal federalism simply means the sharing of the wealth of the country into the various federating units. It was in the year 1946 that fiscal federalism was first introduced into the Nigerian governance structure through the splitting of the Southern province into Eastern and Western regions while the Northern region retained its status. It has metamorphosed into three tiered federal system of 36 states, one Federal Capital Territory and 774 Local Governments. The revenue sharing formula of 48.5%, 24%, 20% and 7.5% between federal, state, local government and special funds was found to be the contending issue as the local governments are placed at the mercy of the Federal and State governments thereby affecting governance in the country. This study advocated for restructuring to a true fiscal-federal structure where lower tiers of government should be allotted more funds as they are seen to be closer to the citizens, curbing funds embezzlement, strengthening of the national fiscal commission, among others.*

Key words: Fiscal Federalism, Federating units, Governance, Historical analysis, Nigeria

Background to the Study

Federalism can be defined as the breakdown of government into levels in which each is mandated with various and different responsibilities and the use of power segregation to an extent under the same emblem of government. The parastatals are not entirely separated or disbanded, but work in unity as a system in order to achieve general governmental goals and objectives and for operational efficiency.

Fiscal refers to the general treasury of a country/nation constituting of revenues and expenditures which is solely controlled by the government. According to Osisioma & Chukwuemeka (2007), fiscal federalism is the fiscal arrangement among the tiers of government in a federal structure. The various ways in which treasury is disbursed and managed among government levels is referred to as fiscal federalism. This treasury comprises of various segments can be used to achieve certain macroeconomics goals.

In Nigeria today, the need for effective decentralized system of accumulated revenues and allocated expenditures cannot be duly overemphasized. Traced back to 1966, when power was transferred to the military, Ewetan (2012) noted that fiscal arrangement has been such that while federal government received Lagos area share of export, excise taxes proceeds, regions were allotted proceeds from their various areas. Regions were also entitled to fix commodities prices and impose tax on produce of marketing boards. Which 30% went to federal tax (which was adjusted to 39% in 1957), regions were allowed to retain mining rents and royalties (Ewetan, 2012). Regions also administered and keep income tax (less than \$700 annually), while federal government bossed over corporate income tax and import duties.

These arrangements resulted to a rise in regional income from 17.7% to 41.6% between the periods 1945 through 1967 while federal government share fell by 23.9% (Obasi, 2006). However, with power transferred to the military at the time, major changes were made and fiscal arrangement readjusted. New policies were formulated, thus bringing massive rise to federal government share on hold of treasury (Okeke & Obiora, 2010).

Since the military takeover in 1966, and full handing over to civilian rule in 1999 and subsequent democratic rule, there have been various checks and balances as well as major changes in the Nigeria fiscal federalism and arrangement. Generally, Nigeria's inputs and revenue base overtime, have fluctuated and is mostly on the increase which have brought higher pressure on controlling and managing these units. According to Okeke (2004), Nigeria revenue allocation has experienced series of reviews and adjustment by various instituted committees. Despite all these reviews and adjustments, the level of fiscal federalism and policy have not met the entire need and expected outcome as seen in past years (Olugbemi, 2005). This has prompted the need to evaluate the impact fiscal federalism has on governance in Nigeria.

Fiscal Federalism in Nigeria (1946-2010)

The concept of fiscal federalism was first introduced in Nigeria in 1946 following the formation of a federation of three regions by splitting the Southern Province into the Eastern and Western Regions, while the Northern Region which was a continuation of the Northern Province remained intact. This followed the adoption of the Richards Constitution, prior to the 1914 amalgamation of Nigeria into the Southern and Northern protectorate and the Crown Colony of Lagos into a single entity. The Nigerian federal system metamorphosed thereafter from a two-tiered federal arrangement initially comprising three unequal political and

administrative regions to the current three tiered federal system of 36 states, one Federal Capital Territory and 774 Local Governments (Ijaiya, 1999).

Nigeria's fiscal federalism is anchored on economic, political, constitutional, social and cultural development. As Nigeria progressed from a unitary to a federal type of government, the form of government became more and more decentralized; there were changes in fiscal arrangements (Ekpo, 2004). Before the amalgamation of Nigeria in 1914, the component units, the protectorate of Northern Nigeria, the protectorate of Southern Nigeria and the Colony of Lagos-each enjoyed complete fiscal independence. Also before the amalgamation, a unified fiscal system had already been in place while a centralized budgeting system was introduced in 1926. However with the adoption of regionalism in 1946, a decentralized fiscal structure was evolved. Before the introduction of a republican constitution in 1963, the fiscal arrangements were influenced by political and constitutional factors. Several commissions were created to renew existing fiscal arrangements and make appropriate recommendations (Ekpo and Ndebbio, 1996). These were

(i) Sir Sydney Phillipson; 1947, (ii) Hick & Phillipson; 1951, (iii) Chick Commission; 1954, (iv) Ransman Commission; 1957, (v) Binns Commission; 1964, (vi) Dina Commission; 1968, (vii) Aboyade Technical Committee; 1977, (viii) Okigbo Committee; 1981, and (ix) Danjuma Commission; 1989. New formula was also introduced in 1990 and 2000 (Dunmoye, 2002).

Each of these commissions came up with their own distinct contending criteria as to how the revenues in the country are to be shared. However, it needs to be pointed out that none of the commissions' recommendations were completely accepted by government. With the enthronement of democracy in 1999, controversies regarding the country's fiscal operations took a new turn with the Federal Government been accused by oil producing states for not honoring the derivation principles as stated in the 1999 federal constitution.

These made the Federal Government to introduce the on-off shore dichotomy implying that oil found in the sea cannot be ascribed to the adjoining state. The on-off shore controversy resulted in states in the Niger Delta calling for a greater control of their resources (Petroleum). This led to the struggle for resource control culminating in some states suing the Federal Government with the matter ending in the Supreme Court. It should be noted that the National Revenue Mobilization, Allocation and Fiscal Commission (NRMAFC) which was inaugurated in 1990 become effective during this period (Ekpo, 2009).

The NRMAFC rejected on several occasions the interference of the President and the Federal Ministry of Finance on the formula for revenue sharing. The NRMAFC insists on the proper interpretation of the constitution. For example in January, 2004, the Federal Ministry of Finance in a letter to the Commission gave the Federal Government a share of 54.68% and a grant of 2% of the states. The NRMAFC disagreed with the Ministry of its non-compliance with the provision of section 164(1) of the 1999 Constitution (Akpo, 2004). From the foregoing, it is clear that Nigeria fiscal federalism is still metamorphosing and evolving.

Fiscal Decentralization in Nigeria (1999-2020)

Fiscal Federalism recognizes two or three levels of government in which one central government must not perform the role of the other tiers of government in economic

management, thus each level of government have different expenditure responsibilities and taxing powers. In the strong central government approach, the federal government retains the larger share of revenue and the state/ local governments have smaller share out of the federation account. This is known as decentralization. Sharma (2005) clarifies that while fiscal federalism constitutes a set of guiding principles that helps in designing financial relations between the national and sub national levels of government, fiscal decentralization on the other hand is a process of applying such principles.

Likita (1999) is of the view that in the decentralized approach, the federal government retains a lower share, with states and local governments having a larger share out of the federation account. Mbanefoh (1998) argues that, it may be practically impossible to satisfactorily balance the financial resources of a segment of a federation with the functions which it is expected to perform. Okeke (2004) concluded that this imbalance should not be regarded as a result of federalism, but as a result of the disturbances of the equilibrium which ordinarily would allow the segments of the federation to carry out developmental programs that could be undertaken with the available internal resources.

For any federation to be sustained there must be fiscal decentralization and financial autonomy. Fiscal decentralization means delegating decision-making to lower levels of government instead of concentrating it at the centre. Each level of government, therefore, should be free to take decisions and allocate resources according to its own priorities in its own area of jurisdiction. In addition, the federating units should be able to act independently on matters within their own jurisdiction (Ewetan, 2011).

Ostrom (1998) argued that with reasons, policies formulated for infrastructural provision and human capital, which are sensitive to national/local requirement are likely to be effective in boosting economic development than policies which are centrally determined which do not consider geographical differences.

In support of fiscal decentralization, Bello, Imam and Agba (2004) are in favour of this stand, stating that cost of financing of local produce and services will be reduced. Akindele (2009) disputed this argument on the basis that fiscal centralism gives pride of place in the running of government businesses.

Revenue Allocation in Nigeria (1957-2020)

Revenue allocation remains one of the vital components and element of fiscal federalism. Revenue allocation refers to the revenue sharing formula to be adopted and marginalized amongst the tiers of government. The principle of revenue allocation comes in various forms and arrangement which are unbiased. These arrangements come in vertical and horizontal form. Vertical as in, in between the levels of government and horizontal as in, in between the elements of each lower level (i.e. State and Local). The history of revenue allocation in Nigeria dates as far back to 1957 when Raisman Commission established a Distributable Pool Account (DPA) for effective and proportional revenue allocation between the tiers of government in various regions. During this period (1957-1960), 40%, 31%, 24% and 5% of generated revenue were distributed to the Northern region, Eastern region, Western region and Southern Cameroon, respectively. The Southern Cameroon withdrew and was disbanded in 1961 which resulted to a new formula of 42%, 30%, 20% and 5% for North, East, West and Mid-west region in 1964 (Eze, 2001).

In 1977, Aboyade Technical Committee was established and thus, according to its recommendations, all federally collected revenue were paid directly to the federation account of which further sharing formula was 60:30:10 between federal, state and local government. Okigbo Commission in 1980, intuited a new sharing formula of all federally collected revenue at the tune of 53:30:10:7 between federal, state, local government and special funds. This recommendation was overlooked by the Supreme Court (Chukwuemeka, 2008).

The revenue sharing formula have varied and fluctuated in the past years and settled at 48.5%, 24%, 20% and 7.5% between federal, state, local government and special funds in 2010 (Okeke and Obiora, 2010).

Importance of Fiscal Federalism to Governance and National Development

- a) It leads to improved spending on social service which is helpful to the society at large.
- b) Efficient and equitable services are rendered through assistance of local understanding.
- c) There is efficient resource mobilization and purposeful spending.
- d) Through lower tiers, government can meet with the grassroots needs and aspirations of the local people (Shan 1990).
- e) Quality services are improved through guaranteed minimum standard across all tiers of government.

Problems Facing Nigeria's Fiscal Federalism

The major challenge of fiscal federalism is to ensure equitable distribution of resources to all groups that make up the nation and at the same time, guarantee that the geese that lay the golden eggs are adequately rewarded. There are several challenges tormenting intergovernmental fiscal relations in Nigeria which according to Ekpo, (2009) include:

- i. Non-correspondence problem;
- ii. fiscal Autonomy and Independence;
- iii. federation account and the derivation fund;
- iv. oil-producing areas and the derivation principle and intergovernmental fiscal relations and the economy.

Furthermore, Dorcas (2015) noted that the following are major problems facing true fiscal federalism in Nigeria;

- a) Problem of allocation of functions and tax raising power.
- b) The problem of acceptable sharing formula
- c) Funds Diversion and embezzlements.

A critical foray into the oil-producing areas and the derivation principle brings to bare the fact that crude oil production has been the most important economic activity on the Nigerian economy since the early "1970s". Its impact is not limited to its contributions almost 90% of Nigeria's total foreign exchange earnings but also to the fact that the national budgets are predicated on the expected annual production and price of crude oil. This crude oil is the

primary engine for national economic growth and development. It is therefore, quite reasonable to expect that the areas producing the nation's crude oil would be very highly developed as compensation for what is taken away as well as for the devastation on the land engendered by the exploration process. There should have been development of physical and social infrastructures, human capital creation and economic empowerment of the general citizenry in those areas. The Niger Delta area suffers near total neglect by both the federal government which claims ownership of the oil and multinational companies which actually exploit the oil reserves. The intervention of the federal government through the Niger Delta Development Commission (NNDC) seems to be a welcome development.

However, the missing "factor" seems to be the proper treatment of the derivation principle in a way that would enable the State and local governments of the oil producing areas to handle their developmental problems according to their own felt needs and priorities. The minimization of the derivation factor over the years from the earlier 50% to 1% and now 13% only as it affects crude oil is unjust and unfair (Ekpo, 2004). The challenge will be to re-examine the issue of derivation particularly in line with the new democratic experiment.

Typically, the challenges of fiscal federalism in Nigeria hinge on the equity of the expenditure assignment and revenue-raising functions amongst the three tiers of government. The revenue sharing and expenditure assignment formula has been generally inadequate in addressing the needs and resource gaps in the three tiers of government. The strategy and institutional arrangement for redressing the mismatch have been approached incrementally over the years. Beginning with the era whereby a committee was appointed every five years to make recommendations regarding fiscal responsibilities among the tiers of government, the 1999 constitution of the Federal Republic of Nigeria, under the third schedule, provide for the establishment of a body known as the Revenue Mobilization Allocation and Fiscal Commission.

While there is an apparent disconnect arising from expenditure and revenue responsibilities, this has not been as visible and controversial as the system of transfers or sharing of the national revenue. The sharing formula is based on arcane principles such as equality of states and landmass. Why should the States be equal in consumption and unequal in production? And why should a huge landmass of unfertile and unproductive soil be rewarded more than a small landmass of fertile and productive soil? Considering these foregoing arguments, the major challenge of fiscal federalism is to ensure equitable distribution of resources to all groups that make up the nation and, at the same time guarantee that the geese that lay the golden eggs are adequately rewarded.

Fiscal Federalism and Governance: A Review of Empirical Studies

There have been several works that centered on fiscal federalism and its implications on Nigeria. One of such works is Maximus (2015) who investigated fiscal federalism in Nigeria: the confusion and realities using survey research method. The study found out that the recommendations proffered by the commission set up by the government did not make much impact on the economy. Similarly, Aigbepue & Ainabor (2011) carried a research on issues and challenges of Nigeria fiscal federalism. They asserted that Nigeria operate a fiscal arrangement that covers the needs of the federating units. They also concluded by arguing that there is a prospect of a stable federation if fiscal federation is equal, fair and just.

In the same vein, Olabanji et al (2020) evaluated fiscal federalism and economic development in Nigeria using the auto-regressive distributed lag approach. The study further concludes

that fiscal federalism will encourage economic development in Nigeria. Dorcas & Stanley (2015) researched on fiscal federalism and development in Nigeria. They employed the system approach using historical method and compilation in analyzing components in its theoretical framework. The study concluded that the revenue formula from 1946 to 1999 gave way for equity and fairness in the distribution mode.

Ewetan (2012) in his study on fiscal federalism in Nigeria, used the descriptive and analytical methods relying solely on secondary data accumulation. The study concluded that Nigeria has not operated as a true federalism, thereby centralizing fiscal responsibilities and taxing powers. This in turn has caused lapse and deviations over the years as there continue to exist severe challenges and unfavourable factor to climb through. Ogbole & Ejeh (2014) investigated fiscal federalism in Nigeria: an analysis of issues and challenges. From their study, it was deduced that due to unfair revenue sharing formulas and ratio, there is need to practice high level of fiscal decentralization.

More precisely, Evalsam and Ecoma (2020) studied fiscal federalism and good governance in Nigeria since independence. They asserted that the process of fiscal federalism had become corroded by mutual suspicion and lack of confidence in the existing institutions and processes of fiscal federalism. They observed that in 2007, the Revenue Mobilisation, Allocation and Fiscal Commission took the then President Obasanjo-led federal government to court for illegally withdrawing 2.071 Trillion Naira from the federal account. In addition, the Excess Crude Account had been an issue of conflict between the federal and state governments as it relates to its basis and usage. However in 2010, efforts were being made to replace the account with the National Sovereign Wealth Fund (NSWF). Their study held strongly that the character of fiscal federalism in Nigeria since independence has created an imbalance in the fiscal powers of the federal and the lower tiers of government. The expansion in the political structure has created a high degree of concentration of powers in the federal government to the detriment of the other tiers of government. This makes the federal government to change at will, its fiscal powers and responsibilities vis-à-vis the lower levels of government. The state and local governments have limited sources of internally generated revenue at their disposal; this makes them financially weak and excessively dependent on the federal account allocations for funds to discharge their functions.

Fiscal Federalism in Nigeria: The Way Forward

Empirical evidence abound which attests to the fact that Nigeria's fiscal federalism has been very controversial in the past years. Restructuring, according to Uddin (2021) appears to be the solution to the myriad of political, social and economic problems afflicting Nigeria. He went further to assert that the current constitution of the Federal Republic of Nigeria is fatally flawed to the extent that it hands too much power to the government at the centre and not enough to its constituent parts. One consequence of this is that the centre proceeds to issue a "one-size-fit-all" prescriptions from the top to the bottom.

Accordingly, Uddin (2021) observed that the recent ruling by the federal high court, which favored the state as the level of government that should collect value added tax (VAT) reinforces the notion of "subsidiarity" which places subsidiary function to the federal government i.e. the federal government performing those tasks which cannot be performed at the local levels thus avoiding the top-down arrangement currently being practiced.

Historical antecedents have favored the federal government and this has not augured well for fiscal federalism in Nigeria. Governance appears to be on the brink of collapse as various

agitations for true federalism have been viewed as agitations from detractors. Nigeria has to look inwards going into the future and see to the fact that governance is made very accessible to the grass root level by way of ensuring that control lies more with the third tier of government (local government).

Conclusion/Recommendations

There has been no optimal dynamic decentralized policy for fiscal responsibilities in recent years as there have been occurrences of lapses and inefficiency in public funds/goods management which can be traced to the incessant corrupt practices and public funds embezzlement (Adegboruwa, 2021). For Nigeria to effectively learn from the historical antecedents pertaining to fiscal federalism, the following need to be considered:

- 1) Lower tiers of government should be allotted more funds as they are seen to be closer to the citizens and are met with the major objective of social welfare maximization.
- 2) Effective measures should be taken to curb funds embezzlement to achieve fiscal federalism /responsibility goals. This can be achieved by strengthening the anti-corruption agencies.
- 3) There should be annual review and evaluation of government level functions to correct deviations and ensure accountability.
- 4) The national fiscal commission should be strengthened and empowered to enhance effective communication & working system between the various levels of government.

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