Fiscal Federalism and Economic Development in Nigeria: The Contending Issues

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ABSTRACT: An enquiry into the economies of such federations as the United States, Canada and Germany suggests that federalism is compatible with economic success. Such a proposition is, however, unsustainable considering the fact that India, Mexico and Nigeria, which are also federal states, have continuously performed poorly, reinforcing the view that a major explanation for the poor economic performance of the countries in the latter category lies in the manner in which their respective federal systems are operated. This paper therefore brings to the fore the nexus between Nigeria’s fiscal federalism and a lack of economic development in the oil-rich country. Our central argument is that Nigeria’s fiscal federalism has not spurred the desired development as envisaged by the architects of the system. The country’s over-dependence on oil, as well as the concentration of economic resources at the federal centre are at the heart of the country’s lack of economic success. Therefore, if Nigeria’s fiscal system is to achieve its economic objectives, the inherent contradiction manifesting in the over-centralisation of the federal system has to be addressed.

KEYWORDS: Nigeria, Fiscal federalism, Political Economy, Economic Development

INTRODUCTION

A thorough examination of the economies of some of the well-established federations like the United States, Canada and Germany seems to point to the direction that federalism is harmonious with economic development. There seems to be a consensus among scholars of fiscal federalism that decentralisation of spending responsibilities in federal states bring about economic development (see Boadway and Watts, 2004; Kincaid, 2001; Oates, 1999; Ter-Minassian, 1997; Watts, 2003). The sustainability of this view is what this paper sets out to interrogate given the fact that India, Mexico and Nigeria, which are also federations are not in the esteemed club of the world’s wealthiest economies. Using Nigeria as a case study, we argue that some of the factors that affect the economic performance of many of the poor federations include the absence of a functioning federal system. In other words, the manner in which a federal system is operated affects the political and economic performance of a federal state, and vice versa.

Unlike in a unitary state, revenue sharing in a federal state is complex, as it exhibits certain peculiarities, including the fact that both the federal and the federating governments co-exist within a single political system, making them competitors for the federation’s scarce resources. In federations, fiscal imbalances occur because constituent units hardly have enough resources to match their expenditure. But, irrespective of how they occur, imbalances must be corrected in order for the federation to continue to exist, and this may take the form of intergovernmental transfers which have the capacity to enable or limit governments in the discharge of their responsibilities.
Nigeria’s fiscal federalism, just like those of other federations, is principally characterised by the sharing of fiscal resources amongst the different tiers of government that make up the Federation. However, the country’s social and economic disparity has continually rendered the issue of revenue allocation the most controversial aspect of the country’s federal system. No single fiscal theory has yet been developed to ensure equitable distribution of revenue in a federal system; federations adopt principles that seem to favour their individual circumstances. And most importantly, they ensure that their fiscal systems are designed in such a way that economic development is realised and sustained. In ideal and close-knit federations, such revenue-sharing formulae as the principle of need and of equalisation are predominant, while loose federations like Nigeria are usually predisposed to the principle of derivation, which is the method of distributing centrally generated revenue to constituent units in relation to the contribution made by a unit to the country’s larger revenue. In the Nigerian context, derivation means that, in addition to the regular federal statutory transfer, some proportion of the revenue collected from a federating unit is returned to the government of that unit.

In Nigeria, fiscal federalism is aimed at ensuring a balanced federation, economic development and national unity, so the argument goes, but how has the country’s fiscal system performed in this respect? To what extent can Nigeria’s fiscal federalism be said to have achieved its objectives? Therefore, what this paper aims to achieve is to x-ray the character of Nigeria’s fiscal federalism with a view to using the system as a yardstick to measure the economic performance of the Nigerian Federation. The challenges posed by fiscal federalism in contemporary federal states are particularly cumbersome, but it would not be out of tune to use fiscal federalism as a yardstick to measure the performance of a federation. In what follows, therefore, an examination of the political and economic rationales for revenue sharing in Nigeria is undertaken. In addition, the principles of revenue allocation that have dominated the revenue-sharing system in the country are highlighted. In the final part of the paper, attention is devoted to the impact of Nigeria’s fiscal federalism on the economic development of the country.

RATIONALES FOR REVENUE ALLOCATION IN NIGERIA

The competition between the central government and those of the component units for a federation’s limited resources notwithstanding, if the overall economic performance of the federation is to be optimised and if political stability is to be maintained, then the central government must deal with any fiscal imbalance in any constituent unit, because imbalance in one unit may have a contagious effect on other units. Some scholars, mostly economists, emphasise economic objectives as the only factors underpinning federal intergovernmental transfers, whilst underestimating the politics involved in such transfers.1 There is no denying that the primary motivation behind the formation of some federations is economic, but it should not be forgotten that a federation is a political creation. Therefore, studying a federation’s fiscal system without due cognisance to its politics may be misleading. Thus, the study of intergovernmental relations in a federal system should not exclude the social and political contexts within which financial relations take place, because financial arrangements constitute a vital aspect of a federation’s political operation (Watts, 2003: 2). The point being made here is that the political and economic variables within a federation must not be ignored if one is to fully understand the character of the federation’s fiscal system. Moreover, it is the dynamic interrelationship between these variables that is crucial to the successful operation of a federal system.
Fiscal matters, especially in a multi-ethnic federation such as Nigeria, go beyond the purview of economics; they have also assumed political and social dimensions. Thus, understanding a federation’s fiscal system requires an understanding of the political context within which the fiscal system operates. Therefore, the federal political system must ensure that both the general and the federating governments have the financial capacity required of them to discharge their responsibilities. In other words, a federation must possess the capacity to operate itself (Maddox, 1941: 1125; Wheare, 1963: 36). However, it is not uncommon for the constituent units of a federation to find it difficult to be self-financing because of several factors, including economic disparity and variation in population.

Federations do experience fiscal imbalance, whereby the spending responsibilities of federating governments exceed their ability to raise revenue. It is often difficult to measure the degree of imbalance, especially in a developing federation such as Nigeria, because it has become the norm for every state to experience a fiscal gap in its budget. However, in an ideal federation, the most realistic yardstick for measuring the size of a fiscal gap would be fiscal capacity, need and effort (Ashwe, 1986; Watts, 2003). As mentioned earlier, fiscal imbalances among federating units consequently result in disparity in revenue capacity and need, and it is therefore the responsibility of the central government to make fiscal transfers available or to come to the aid of a distressed federating government. In the United States, for example, transfers are very important in the sense that they make up a large proportion of state expenditures. They also serve as an important vehicle for the federal government in achieving its national equity and efficiency objectives (Boadway and Watts, 2004: 9).

In Nigeria, the central government is required by law to make regular grants available to state governments. Specifically, states receive two kinds of allocation from the federal government: statutory, and non-statutory. With regards to the former, Section 162 (3) of the Nigerian Constitution of 1999 requires the Federal Government to make unconditional grants available to the states and to Local Governments on an annual basis to enable them to discharge their constitutional responsibilities. Conditional grants are supplementary transfers to federating governments, and they are meant for specific purposes and must be used as directed by the granting government, usually the central government; whereas, an unconditional grant is usually a lump-sum transfer that does not have any spending restrictions and may be used as desired by the recipient government, usually the federating government (Ashwe, 1986: 4; Iyoha, 2008: 197). Non-statutory grants are a rarity in Nigeria and are usually given to a state facing an emergency situation, like a flood disaster.

Intergovernmental grants are undoubtedly instruments of fiscal adjustment and are meant to achieve certain political and economic objectives. As noted by Adedeji (1969: 220), a federal fiscal adjustment is necessitated by a number of factors, including the problem of resolving the imbalance of resources and needs between the federal and regional governments; the problem of harmonising income with needs in the different component units; the need to achieve ‘economic equilibrium’ for the federation as a whole; and the need to ‘level up’, so that the poorer regions are raised and the level of services provided in the different states is equalised. It is important, however, to mention here that transfers do not necessarily have to serve the purpose of equalisation. For instance, transfers in the United States are not “systematically equalising, although individual transfers do have components that implicitly equalise differences in state fiscal capacities” (Boadway and Watts, 2004: 9–10). In the specific case of Nigeria, revenue allocation, being the mechanism for sharing...
national financial resources, aims to achieve the “overall objective of enhancing economic growth and development, minimising inter-governmental tensions and promoting national unity” (Danjuma, 1996: 89).

Evidently, the most common method of achieving fiscal balance in any given federation is by making intergovernmental grants available. Usually, these grants are designed to achieve the objective of fiscal equity or equality among the constituent units of a federation. Fiscal equity here refers to equality in the fiscal capacity of the federating units. However, the problem is how to define equality among the politically similar but economically different units of a given federation. This point has been put more bluntly by Elaigwu (2007: 206), who observes that the way “equity” and “equality” are perceived in Nigeria “usually characterises the nature and dimension of the politics of resource distribution among the various interest groups”. Since horizontal equity is unattainable in a developing federation like Nigeria because of economic disparity, the case for the use of unconditional grants aimed at equalising the ability of all federating units to provide the required public services for their citizens becomes tenable.

Grants, whether conditional or unconditional, play a vital role in the financial operations of federal states and both are typically used depending on the objectives and priorities of the national government. According to Olaloku (1979: 110), a country whose priority lies in the principle of fiscal responsibility would prefer the use of conditional grants, while a country which places greater importance on the maximisation of the state would prefer the use of unconditional grants. For example, a substantial proportion of federal transfers in the United States consist of conditional grants, and they are principally aimed at influencing state expenditure priorities and programmes (Boadway and Watts, 2004: 9). Thus, the use of conditional grants has been favoured in the United States because the emphasis is on fiscal responsibility, whereas in Nigeria the tradition has been heavy financial dependence on the central government, thereby making the use of unconditional grants the norm. One main advantage of conditional grants is that since they are aimed at particular objectives, it is relatively easy to monitor the performance of the recipient government. This may be perceived as constituting an encroachment into constituent governments’ spending responsibility, but ‘assistance’ in the form of conditional transfers should not be misconstrued as subordination of the constituent units, especially where genuine partnership between the central government and constituent governments exists.

In an ideal federal financial set-up, the use of unconditional grants enables funds to be channelled from relatively wealthy regions to those less wealthy, thus bringing about a sense of equality among the constituent units. Transfers of this kind are usually referred to as ‘equalisation’ transfers because their primary function is to correct a federating government’s fiscal deficiency (Iyoha, 2008: 197; Olaloku, 1979: 110). It is important to note that although rich federating units have contributed more to the national coffers, they still receive the same per-capita grant as poor federating units. In Nigeria, fiscal transfers to state governments are unconditional and are also constitutionally guaranteed, whereas grants to constituent governments in many other federations are meant to supplement independently generated revenue and also to assist financially weaker units (Suberu, 2001). Grants constitute a primary source of revenue for state governments in Nigeria, and as a consequence, states have come to rely heavily on the centre for their financial needs. This dependence is at the heart of intergovernmental financial relations in the country.
INTERGOVERNMENTAL FISCAL TRANSFERS IN NIGERIA

States, whether federal or unitary, perform three main functions, namely, allocation, distribution and stabilisation (see Oates, 1972: 3–38). The political aspect of fiscal federalism therefore focuses on how these functions are shared among the different tiers of government in a federation. As noted earlier, a genuine fiscal federal system must ensure that the division of revenue between central and federating governments corresponds with the distribution of constitutional functions.

So, if fiscal efficiency is to be attained, then the federal government should perform the distribution and the stabilisation functions, while the allocation function should be jointly performed by both the federal and the federating governments. In regards to the distribution function, a sense of income equality can be achieved by sharing centrally collected revenue as in Nigeria. In other words, the federal government should be entrusted with adequate constitutional powers that will enable it to transfer financial resources from the relatively rich federating units to the poor ones. There is no denying that the allocation function is better performed by both tiers of government, but public goods and services should be provided by the central government when the benefits are for the entire country and by constituent governments when their benefits are for the local population. This is further fragmented in Nigeria, where the third tier, that is, Local Governments, are constitutionally allowed to provide such services as registration of births and deaths because these services benefit the grassroots population.

It therefore follows that the central government should be allowed to control more revenue sources than the federating governments, which should also be assigned sources that allow them to provide for the citizens within their jurisdictions. The argument here is that the federal government is considered more efficient in collecting certain taxes compared with the federating governments (see Phillips, 1971; Rupley, 1981; Suberu, 2001). Similarly, the federating governments should be assigned those taxes that have a local impact, since they are closer to the people. Additionally, they should be allowed to handle such taxes that do not endanger national macroeconomic policy, that are relatively inexpensive to administer and that have relatively stable yields (Suberu, 2001: 47). Since the introduction of the federal constitution, Nigeria has consistently assigned the most lucrative sources of revenue, such as customs and excise duties, personal income taxes, company taxes and mining taxes, to the central government, while the less important sources go to the state governments. The underlying assumption that underpins this financial arrangement is that the functions assigned to the central government require more funds than those assigned to the state governments. It may be argued, however, that this arrangement fails to take into consideration the fact that such subjects as health care and education assigned to state governments also require a lot of funding.

Revenue sharing in federal systems is usually guided by some basic principles, including the ‘fiscal independence’ of each unit of government to raise and spend funds in a manner that preserves its autonomy (Phillips, 1971). Another principle is that of ‘fiscal efficiency’, which implies that efficiency must be applied in the allocation of revenue. Thus, taxing powers should be allocated to those governments most likely to administer them efficiently. Also, a federal fiscal system must recognise the ‘adequacy and stability’ of the resources available to all governments in the federation. This principle implies that the revenue-sharing practice must ensure that “available resources are elastic enough to meet the expanding needs of the
governments”, and their sources must also be stable, particularly for the federating governments (Phillips, 1971: 389).

However, it needs be pointed out here that these principles contradict each other. For instance, the principle of fiscal efficiency allows the central government to dominate major taxes, such as import and export taxes, which makes genuine fiscal independence impossible. Also, the principle of ‘adequacy and stability’ allows the federal government to raise more revenue than the constituent governments, consequently leading to federal fiscal supremacy vis-à-vis other regions (Phillips, 1971: 390). These inherent contradictions perhaps explain why federal countries adopt principles which suit their political, economic and social circumstances, and Nigeria is no exception.

Revenue allocation in Nigeria is based on a set of principles that have been tailored towards the Federation’s socio-economic circumstances, but the four main principles applied on a reasonably consistent basis are ‘derivation’, ‘need’, ‘equality’, and ‘national interest’. As mentioned earlier, derivation requires the central government to return to the constituent governments the total, or a proportion, of the taxes that their citizens had paid or, put simply, the revenue generated from that federating unit. The principle of ‘need’ is based on the fiscal need of a state government, which is usually determined by the size of the population in that state. This principle allows for allocation of grants in relation to the needs of the people in each state, regardless of the output of that state. The main problem with this principle is how to measure the need of a particular state given the changing social and economic environment that characterises a developing country such as Nigeria. Arguing this point more succinctly, the Aboyade Fiscal Commission of 1977 states that the principle has little or no operational relevance in the sense that the needs of any underdeveloped community for social and economic welfare are by definition unlimited relative to the means available for satisfying them (Nigeria, 1979). Obviously, this principle is susceptible to controversy, especially in a multi-ethnic federation such as Nigeria. For instance, using population as an index of need may give rise to the manipulation of census figures, as has always been the case in Nigeria.

Furthermore, the principle of equality is based upon the assumption that all of the component units that make up a federation are equal regardless of population and land mass, and thus must be treated equally by receiving equal shares of federally collected revenues, irrespective of their contribution to the national revenue (Elaigwu, 2007: 206). The assumption here is that the fiscal obligations of each state are equal. Again, the Aboyade Fiscal Commission faulted the use of this principle in its Report when it argued that states are not equal economically, either in terms of their budgetary or their developmental obligations, and that they also differ in terms of their access to other internal financial resources (Nigeria, 1979). Theoretically, states may be equal, but in practice, they vary in terms of economic resources. Another obvious shortcoming of the principle is that its inclusion in Nigeria’s revenue-sharing system has led to the ferocious clamour by ethno-regional groups for the creation of more states in the country.

Finally, the principle of national interest allows for an annual intergovernmental grant to each state on a population basis for specific purposes which must be in the interest of the country as a whole. Put simply, the principle emphasises the need for states to be given adequate resources in order for the entire Federation to achieve a balanced development. Thus, it is about raising the living standard of those people in poorer states above the minimum national
standard fixed by the country’s leaders (Elaigwu, 2007: 207). Although, a laudable principle, but as noted earlier, sharing revenue based on population lends itself to abuse of censuses, as population figures become the yardstick for determining the distribution of national wealth among the constituent units of the Federation.

The fundamental problem with these principles is that they are in potential conflict with one another. Therefore, relying solely on any of them is likely to generate problems, and applying them simultaneously may also give rise to problems, especially in a multi-ethnic federation like Nigeria. These contradictions are put more succinctly by Elaigwu (2007: 207) who observed that,

The principle of derivation works at cross purpose with the principle of need. If each state gets back resources in proportion to its contribution to the account of the federation derivable from resources in the state, many states which need the resources to cater for larger population and/or more socially mobilised states (such as those with higher number of children of school going age) may find themselves in a more financially precarious position. Derivation also works against the necessity to “harmonise income with needs” of states in a federation.

Nigeria’s fiscal federalism has certainly witnessed some changes since the adoption of a federal system, but what seems to be constant is the assignment of the lion’s share of centrally generated revenue to the Federal Government. For example, during the Fourth Republic, in accordance with Section 162(1–5) of the 1999 Constitution, the Federal Government is required to deposit all centrally collected revenue into a general distribution pool called the Federation Account, to be shared vertically and horizontally. Contents of this Account are allocated vertically in the proportions of 48.50%, 24%, 20% and 7.50% to the Federal, State, Local Governments, and centrally controlled special funds, respectively, a practice that has ensured federal dominance in fiscal matters.

For the purpose of horizontal allocation in Nigeria, Section 162(2) of the Constitution specifically provides that the principles of “population, equality of States, internal revenue generation, land mass, terrain as well as population density” would be the dominant principles. The same Section also provides that no less than 13% of the revenue from natural resources must be allocated according to the principle of derivation. By implication, therefore, the oil-producing states are entitled to 13% from Nigeria’s oil revenue, in addition to the statutory allocation from the centre. Thus, in terms of direct revenue, the oil-producing states have had their share of national oil-generated revenue increased significantly. As Figure 1 illustrates, the derivation principle witnessed a progressive reduction, beginning in 1970 when it was set at 25%, down to 3% towards the terminal end of military rule. But by 1999 when the country returned to democratic rule, the share of Nigeria’s Federation Account going to the oil-producing states under the principle had increased to 13%.
Despite the 1999 constitutional provision on derivation, its application still raised controversy and this took a geopolitical dimension, as the elites in the oil-producing states insist on this principle on the ground of equity, while those in other parts of the country, argue in favour of such principles as equality of states and population (Babalola, 2014: 121). The latter group has always argued that Nigerian oil, being a gift of nature, belongs to all Nigerians, and no region or ethnic group should have an exclusive right to it. Under the current federal arrangement, no state is allowed to control mineral resources because mining is under the exclusive legislative list of the Federation. However, advocates of resource control have rejected this claim, insisting that, by abiding with the principle of derivation, the central government was only fulfilling its social responsibility towards the citizens in the oil-producing area whose land has been destroyed due to decades of oil exploration (Nwabueze, 2007: 11).

Nigeria’s fiscal federalism was particularly put to test in 2002, when the Federal Government became increasingly unwilling to respect the derivation principle. The main bone of contention here is that the Federal Government believed that offshore oil belonged to the Federation as a whole, while the littoral states were of the view that offshore oil should be attributed to the adjoining states and made subject to the derivation rule (Suberu, 2008: 462). Historically, the onshore/offshore dichotomy only crept into the revenue-sharing arrangements in April 1971, when the ownership of Nigeria’s continental shelf became vested in the Federal Government, which thereafter received all offshore oil revenue (see Nwabueze, 2007; Rupley, 1981; Suberu, 2008). In buttressing this point, Nwabueze (2007: 13) argued that prior to 2002, the revenue allocation to the littoral states on the basis of derivation had always included revenue derived from oil located in the territorial sea and continental shelf, and their bed and soil; interpreted in the context of this history, and considering the proviso to Section 162(2) of the 1999 Constitution, the littoral states are entitled to 13% of oil revenue derived from the territorial sea, its bed and subsoil.

In order to resolve the issues around the onshore/offshore dichotomy, the Federal Government had to request Nigeria’s Supreme Court to declare that the derivation principle does not apply to offshore oil, and also to seek, among other things, the determination of the...
seaward boundary of the littoral states. In April 2002 the Supreme Court, in its landmark judgment, reaffirmed the exclusive right of the Federal Government to revenue from offshore oil, meaning that revenue from offshore oil was not subject to the derivation rule. What the country’s apex court did was to rubberstamp the Federal Government’s position on the onshore/offshore dichotomy. As expected, the judgment was perceived by the elite in the Niger Delta and their sympathisers as a deliberate ploy by the Federal Government to deprive the littoral states of their entitlement, and also to perpetuate federal fiscal hegemony.

The avalanche of criticism that trailed the judgment of the Supreme Court, especially from the littoral states, and the impending 2003 general elections, ‘compelled’ the then president, Olusegun Obasanjo, to adopt a ‘political solution’ which resulted in the enactment of the ‘Allocation of Revenue (Abolition of Dichotomy in the Application of the Principle of Derivation) Act of 2004’. The Act basically set aside the Supreme Court’s ruling, meaning that derivation was to cover both onshore and offshore oil production. The enactment of the Act was indeed a watershed in Nigeria’s fiscal federalism, as it reinforces the view that the problem with the country’s fiscal system is more of a political one, requiring a political solution. Not only that, but it also reinforces the view that federations, including Nigeria, are products of compromise (see Babalola, 2013).

There is no denying that the oil resources found in Nigeria’s territory belong to all Nigerians, and it is unconstitutional for any state, or regional or ethnic group to lay exclusive claim to them. However, those who bear the brunt of the oil economy should be given the opportunity to participate in the same economy. People who have had their means of livelihood destroyed should be adequately compensated and adequate social infrastructures should be provided in the region, although this should be done in such a manner that the country’s national unity is not jeopardised.

FISCAL FEDERALISM AND THE QUEST FOR ECONOMIC DEVELOPMENT IN NIGERIA

The linkage between fiscal federalism and economic development can best be found in the country’s larger political economy. Fiscal federalism is a function of the national political economy, as it highlights the fundamental features of a federation (Burgess, 2006: 148). Thus, a thorough examination of a federation’s fiscal system must accord its political economy a special place. A major explanation for Nigeria’s poor economic performance in particular may be found in the state’s flawed domestic political economy, which encourages over-dependency on oil. Nigeria’s post-colonial economy inherited an economy that was reliant on agricultural products for its foreign exchange earnings, but the discovery of oil changed that, and by 1973 the Nigerian economy had been transformed into an oil rentier economy, as the state became heavily dependent on oil rents for its sustenance. Nigeria’s neglect of the agricultural sector has been well documented and needs no extensive discussion here (see Bangura et al., 1986: 177; Khan, 1994: 187). One major reason for the decline in agricultural production was that the unprecedented flow of oil rents had caused agricultural products to become unprofitable. Another reason is that the booming oil sector witnessed a surge of capital and labour, because the returns are higher than in either agriculture or manufacturing. Consequently, Nigeria, a food exporter at independence, became a food importer.
The Nigerian state now operates an oil-centred economy in which all other sectors, and by extension, governments at all levels, consequently depend on the oil sector. There is ample evidence to suggest that resource-rich countries, especially those that are heavily dependent on oil rents, perform poorly both politically and economically when compared with those not so endowed. In Nigeria, this problem is further compounded by the country’s federal system, which is loaded with a myriad of centrifugal forces, including ethnic diversity and economic disparity among the federating units. Nigeria is one of the oil-rich countries in the world, yet the country’s oil wealth has not provided the needed stimulus for growth, nor has it spurred political stability, and this represents a paradox.

Nigeria’s economic record since the oil boom of the 1970s has been characterised by a lack of growth and increasing poverty, a phenomenon Terry Lynn Karl (1997) describes as oil’s “paradox of plenty”. Karl’s study uses a combination of approaches, including dependency theory, class analysis and, principally, the rentier thesis to explain why the 1973–4 and 1978–9 oil booms resulted in economic stagnation and political instability in many oil-exporting states, including Nigeria. Karl’s claim, based on her research of the five petro-states of Algeria, Indonesia, Iran, Nigeria and Venezuela, is that countries that are dependent on petroleum revenues (with the exception of Norway) are among the most economically troubled, the most authoritarian and the most conflict-ridden in the world. The central argument of Karl’s thesis is that a society’s dependence on a particular export commodity, such as oil, shapes that society’s social relations, institutions of the state and the decision calculus of policymakers (Karl, 1997: 7).

The oil boom of 1973 particularly coincided with the era of military rule in Nigeria, which also increased the economic centrality of the federal government and in turn led to states’ dependence on the centre. During the military era, the central government played a dominant role in the authoritative allocation of resources, allowing it to become excessively powerful and dominant over the states. The military era experienced significant political and economic developments, which affected Nigeria’s fiscal federalism, and the main economic development during this period was the oil boom, while some of the political developments include the three-year civil war, the creation of twelve states from the previous four Regions in 1967, and the subsequent sub-division of the country into what has now finally become a federation of thirty-six states. All of these developments combined to give rise to fiscal centralisation. The over-centralisation of the country’s federal system is one legacy of military rule that cannot easily be dismissed in the analysis of Nigerian federalism.

The centrality of oil in revenue distribution in Nigeria’s oil-centric political economy cannot be overemphasised in the sense that the emergence of oil rents gave rise to a politically and economically strong federal centre, resulting in a highly centralised federal system. As oil rents continue to flow into the national revenue pot, the government at the centre continues to be centralised, and consequently, the constituent units continue to be financially dependent on, and subordinate to, the Federal Government. At inception, Nigeria’s federal system allowed the federating units to enjoy enormous political and financial autonomy, which explains why it was referred to as regional federalism (Nolte, 2002). But by 1999, when the country returned to civilian rule after years of military dictatorship, the character of Nigerian federalism had significantly changed from what it used to be to one in which political and economic powers have become exclusively concentrated at the centre. Surely, the supremacy of the federal centre is a negation of a federal principle which stresses the independence of
government at all levels. K. C. Wheare (1963: 93) put this more succinctly when he argued that:

[t]he federal principle requires that the general and regional governments of a country shall be independent each of the other within its sphere, shall be not subordinate one to another but co-ordinate with each other. Now if this principle is to operate not merely as a matter of strict law but also in practice, it follows that, both general and regional governments must each have under its own independent control financial resources sufficient to perform its exclusive functions. Each must be financially co-ordinate with the other.

Corruption is another aspect of Nigeria’s political economy that cannot be ignored in the analysis of economic development in Nigeria. There is indeed little doubt that corruption poses a big threat to the economic development of Nigeria. For instance, writing in 1983, Professor Chinua Achebe contended that as much as 60% of Nigeria’s wealth was regularly consumed by corruption (Achebe, 1983: 40), and this was enough to “paralyse Nigeria in every sinew and every limb” (ibid.: 43). Corruption is not limited to any particular society, but is widespread in Nigeria and has almost become a subculture. Based on Transparency International’s (TI) yearly reports, Nigeria rates as one of the most corrupt countries in the world. Table 1, for instance, shows Nigeria’s position on the TI’s Corruption Perceptions Index in the post-military era.

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<td>2.7</td>
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Source: Adapted from the Transparency International’s Corruption Perceptions Index

There is no denying that corruption constituted a significant feature of the Nigerian political economy before the advent of oil, but the massive inflow of oil rents into the economy since the oil boom of 1973 drastically deepened the level of corruption in the Nigerian rentier state. Before oil, the regional Marketing Boards were the main conduits through which state office
holders enriched themselves. During that period, the Nigerian regional bourgeoisie colluded with foreign investors to share the surpluses accumulated by the Boards. Similarly, as oil rent flowed into the Nigerian state's coffers, elites who controlled state power use their offices as conduits for self-enrichment. Putting this in a more straightforward manner is Welch (1995: 636), who observed that, “Nigeria has received billions of dollars from oil – most of which seems to have disappeared into private hands without perceptible benefit to most Nigerians”.

The lack of public scrutiny that characterised public spending in the pre-Fourth Republic epoch was reverted to in the period following the termination of military rule, and it is no exaggeration to opine that corruption now assumes “elephantine proportions” at all levels of government, with political elites sharing the spoils of office with impunity (Mustapha, 2009: 76). The Human Rights Watch (2007: 14, cited in Mustapha, 2009: 78), for instance, particularly notes that the “military-era culture of governance centred on arbitrariness, lack of accountability, corruption and disregard for public welfare has continued in most states and local governments, especially in Niger Delta”. This strengthens the notion that rentier economies bring huge opportunities to those who hold political power and lack of opportunities to those who do not. In Nigeria, access to the state is synonymous with access to state resources, and access to state resources is in turn synonymous with the economic advancement of the individual.

It is particularly instructive to note that the massive inflow of oil rents into the coffers of those states in the Niger Delta area, especially in the post-military era, due to the implementation of the derivation principle, did not translate into improved socio-economic well-being for the citizens, but instead only resulted in the intensification of corruption. Due to a lack of adequate checks on office holders, particularly the governors, state funds became siphoned mostly through kickbacks from contractors, whilst social services such as education and health were grossly underfunded. The grand corruption that took place in this region in the period following the end of military rule has been well documented (see Babalola, 2014). Corruption undoubtedly plays a part in making the practice of federalism in Nigeria a Herculean task, and by extension, it is not out of tune to contend that it is partly responsible for the failure of Nigeria’s fiscal federalism to stimulate economic growth. Corruption tends to have a negative impact on the management of public resources, because public funds that could have been used to provide public goods are diverted to private use by the elites. Thus, corruption constitutes a leakage from the economy and distorts economic growth, as it increases the cost of administration, making governance unnecessarily expensive. This has been the story in Nigeria, where politics of patronage is the norm. It may be deduced from the foregoing that the availability of oil rents makes corruption almost inevitable, buttressing the argument that corrupt practices are rooted in the political and economic conditions of a country.

CONCLUSION AND RECOMMENDATIONS

As discussed, a federal system must have the capacity to achieve relative economic equilibrium among constituent units and, by extension, a balanced federation if the union is to continue to exist. The need for a balanced federal system is important, because it has been argued that “poverty anywhere in a federation is a limitation to prosperity everywhere” (Adedeji, 1969: 12). However, if the objective of revenue allocation in Nigeria is to achieve a balanced federation, then it becomes convenient to posit that this objective is far from being achieved because the dominant principle of revenue sharing, that is, derivation, is antithetical
to interregional equity and national unity in that the principle has always favoured some constituent units against others. In fact, it has given rise to an unbalanced development in the country, as those states most favoured have become wealthier than those least favoured. The oil-producing ones have particularly become richer, and the non-oil-producing states poorer, thereby deepening regional fiscal disparity.

Although it may be argued that de-emphasising this principle means that the oil-producing states’ share of the Federation Account has now become incommensurate with their contribution to national revenue, the states still benefit immensely from the country’s revenue-sharing system compared with others. Therefore, the principle is incompatible with the objective of national balanced development and, as might be expected in an economically unbalanced federation, the relatively less-endowed states will continue to show their resentment towards the principle. This explains why Nigeria’s fiscal federalism has continued to exacerbate intergovernmental tensions and has also failed to promote national unity.

Similarly, Nigeria’s revenue allocation system has not achieved the objective of economic growth and this is due to successive governments’ misguided policies borne out of over-dependency on oil. In other words, massive oil rents in the Nigerian rentier economy have not yielded the desired results, as genuine development has seemingly become a mirage in the country. Nigeria is an oil-rich country, yet oil wealth has not transformed the living standards of its citizens. The Nigerian state, which plays a significant role in the distribution of oil rents, has also persistently failed to promote any agenda of economic diversification, explaining why the country has continued to operate in a constant failure mode.

Therefore, if Nigeria is to continue to remain a federation, and if its fiscal system is to achieve its objectives, the inherent contradictions in the system must be resolved. For instance, the issue of over-centralisation of economic resources, which is at the heart of the failure of the country’s revenue-sharing practice, must be addressed. Hence, the country’s fiscal federalism should emphasise revenue generation rather than revenue distribution, as this will ensure fiscal viability of the constituent units. As indicated in Figure 1, the principle of derivation before the oil boom era was based on 50%, which ‘compelled’ the less-endowed Regions to be more creative in their quest for internally generated revenue. It also encouraged healthy competition among the Regions, as they were forced to maximise their comparative advantage in the production of cash crops. Nigeria’s constituent units’ dependence on the Federation Account will continue until the constituent units develop their own independent revenue sources.

As witnessed in Nigeria, the dependence of other sectors of the economy on the oil sector has the tendency to prevent economic growth. Rather than utilise the revenues generated from oil to initiate the process of economic growth, Nigeria has been content with its status as a rentier state, and its leaders are happy to continue to feed fat on oil rents. In Nigeria, economic rents tend to make offices of the state attractive to elites who compete among themselves for control of the state. Rents indeed provide some form of magnetic attraction for corruption. For instance, in an attempt to redress the deep-seated deprivation that has characterised the Niger Delta region, as well as to fulfil a constitutional requirement, the region’s share of the Federation Account was raised, but a large portion of the allocated funds were diverted to private use (see Babalola, 2014). Therefore, in order to minimise the over-reliance on oil, certain mechanisms must be put in place; these may include the development
of the agricultural sector, the use of oil revenue to generate backward and forward linkages in the economy, as well as maintaining disciplined fiscal policies.

Moreover, as pointed out earlier, both the constituent units and the central government should be self-financing in order to be able to discharge their respective governmental responsibilities and to ensure some measure of fiscal autonomy. In order to achieve this, the system has to be decentralised. Decentralising economic resources will put federating units in relative control of their resources, thereby making them less dependent on the centre. In addition, states’ dependency on oil will be reduced, as states not endowed with oil would devise strategies to generate revenue from within. With decentralisation, the centre would also cease to be the locus of struggle for political power.

As pointed out earlier, one significant consequence of over-centralisation in Nigeria’s federal system is that federating units have become excessively dependent on central revenue for their financial survival. There is no denying that the practice in Nigeria in which the Federal Government is assigned the most lucrative sources of revenue is not an aberration. In reality, most federations do assign their major revenue sources to the centre, mostly on the grounds of equity, efficiency and convenience, enabling the central government to correct any form of fiscal imbalance within the federation. However, the centre is expected to assume the role of a referee rather than be an active participant in the distribution of national wealth.

It is easy to conclude at this juncture that oil rents and their distribution have contributed largely to the failure of federalism in Nigeria, and that this failure has a profound impact on the political and economic stability of the Nigerian state, which in turn has implications for the continued survival of the Federation. Nigeria’s flawed economy, which entrenches over-dependence on oil, cannot be absolved in the story of the country’s flawed fiscal system. Therefore, the ruling elites should, as a matter of exigency, promote any agenda capable of bringing about the diversification of the economy, as this will reduce the state’s over-dependence on oil, and ultimately pull the country out of the precarious state it has found itself.

REFERENCES


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**NOTES**

1 Scholars such as Richard Musgrave, Wallace Oates, James Buchanan, Richard Bird, Robin Boadway and Anwar Shah are in this category.

2 By ‘fiscal capacity’ we mean the ability of governments to raise revenues based on their potential revenue sources.

3 ‘Fiscal need’ refers to any special circumstances which may require higher per capita expenditures in one federating unit relative to another. For example, a unit with a high proportion of school-age children will need to incur higher per capita educational expenditures than one with a lower proportion (Ashwe, 1986: 5).

4 ‘Fiscal effort’ means the extent to which the government is able to exploit its potential revenue-generating bases.

5 It is important to mention here that mainstream literature on fiscal federalism implicitly assumes transfers from the centre to the federating governments, whereas intergovernmental grants may be transferred in the opposite direction and even sometimes from one federating government to another. For the purpose of this paper, therefore, intergovernmental transfers imply the transfer of funds from the centre to the federating units.

6 The allocation function refers to the provision of public goods by the government for the benefit of the community as a whole, and examples of such goods include policing, defence and healthcare, while the distribution function revolves around those activities undertaken by a government to bring about equality in income and wealth. The stabilisation function requires the use of fiscal instruments such as money supply, balance of payments, to mention but a few, to achieve economic growth for the country as a whole.
7 In Nigeria, resource control means a practice whereby the constituent units of the Federation are allowed to exercise their rights to control the natural resources within their territories and make certain contributions towards the national revenue pot. For the elites in the Niger Delta region where the bulk of Nigeria’s oil is found, resource control refers to the desire of the people in the area to control the oil wealth ostensibly derived from their region.

8 This scale ranges from 0 (highly corrupt) to 10 (very clean).