



KEYNOTE ADDRESS DELIVERED AT THE NATIONAL WORKSHOP ON THE REVIEW OF THE REVENUE SHARING FORMULA

PROTOCOL

I am pleased and honoured to be at this brainstorming workshop to x-ray the challenges of the current revenue sharing arrangement towards a review. Public discourse on this all-important subject is paramount at this period when the present administration is deepening the reforms for higher growth trajectory. The central importance of this subject is better appreciated especially in our federal arrangement, where the political system has been designed to respond to specific political, economic, social realities and balances. Most noteworthy also is the premium which this administration places on the promotion of understanding, dialogue, harmony, peace, good governance and fairness in the distribution of resources in the federation.

2. The practice of modern democracy began as a struggle over public revenue in England. Merchants demanded a say in how tax money was spent. The battle cry for democracy in that conflict between merchants and the monarchy was 'no taxation without representation'. This marked the beginning of concern by ordinary citizens that the peoples' representatives manage public revenue. Virtually every constitution in the world has subscribed to this fundamental principle of democracy. Our 1999 Constitution has entrenched this principle by granting the



National Assembly and the State Assemblies the exclusive power to appropriate funds and oversee their expenditure.

3. The concept of fiscal federalism was first introduced in Nigeria in 1946 following the adoption of the Richards Constitution. The period 1947-1952 marked the beginning of the recognition of sub-national governments during which financial responsibilities were devolved to the three regions- North, West and East.

Revenue Allocation Arrangement

4. In July 2002, the 'Modification Order 2002' provided for distribution as follows: FGN 54.68%, States 24.72%, LGAs 20.60% and derivation 13% (Mineral revenue only). The breakdown of the Federal Government share is as follows: FGN 48.5%, FCT 1%, FGN share of derivation and ecology 1.46%, Stabilization fund 0.72% and the development of minerals 3%.

5. This order was adjusted in January 2004 giving birth to the existing revenue allocation formula of FGN 52.68%, States 26.72%, LGAs 20.60% and derivation 13% for mineral resource only. Again, the breakdown for the Federal Government share is FGN 48.5%, FCT 1%, FGN share of derivation and ecology 1%, Stabilization fund 0.50% while development of natural resources is 1.68%.

6. The 1.46% FGN share of derivation and ecology was created following the Supreme Court ruling on the resource control case in April 2002 stating that the Ecology and derivation funds were illegal. Prior to that judgment, 2% of the total Federation Account was provided for the



amelioration of ecological problems in part of the country and 1% for the derivation. Therefore to comply with the ruling of the Supreme Court, the 2% Ecology Fund and 1% Derivation were distributed as follows: FGN 1.46%; States 0.72%; LGAs 0.60%. The shares of the States and LGAs were added to their allocations. With the adjustments in January 2004, the FGN share was reduced to 1% and it is paid into a fund administered by the Federal government but it is still being used for amelioration of derivation and ecological problems in any part of the country in accordance with such directions as may be issued in that behalf by the president from time to time.

7. In the 2002 Order, 0.72% was allocated for stabilization fund but adjusted in January 2004 to 0.50%. The allocation is added to the FGN share and held in trust for all beneficiaries for unforeseen emergencies. The 3% allocated for the development of natural resources in the 2002 Order was also adjusted in January 2004 to 1.68%. The allocation is for the exclusive management of the FGN to develop alternative sources of revenue for the nation as may be directed by the President.

8. The 26.72% allocated to the States and the 20.60% for Local Government Areas are distributed amongst the States and the Councils using the following formula; Equality 40%, population 30%, Landmass and terrain 10%, Social development factors 10% and Internal revenue generation effort 10%.

9. The Value Added Tax (VAT) was introduced in 1993 and it replaced Sales tax in the states. The formula for the



distribution when it was first introduced was 50% to FGN; 35% to the States; and 15% to LGAs. With effect from January 1999, the formula was adjusted as follows: FGN 15%, States 50% and LGAs and area councils of the FCT 35%. The share of the States and that of the local Governments is shared amongst them using the factors of Equality 50%, population 30% and derivation 20%.

10. The funding of the non-oil revenue collecting agencies, Nigeria Customs Service and the Federal Inland Revenue Service is through the Federation Account and was implemented in June 2005 with effect from January 2005. The NCS is getting 7% of its monthly collection while the FIRS gets 4% of its monthly collectible revenue. The funding is based on the provision of Section 165 of the 1999 Constitution.

11. Revenue sharing thus constitutes an important instrument of inter-governmental financial adjustments in the Nigerian federalism. The revenue collectable to the federation account is shared with the other tiers of governments as provided for in Section 162 of the 1999 constitution. To ensure the revenue sharing is done in a rational manner, the exercise has usually been guided by the recommendations of the Revenue Mobilization, Allocation and Fiscal Commission which the constitution have saddled with the primary responsibility of constant review of the bases of revenue sharing among the three levels of government.

12. Although, no system of fiscal federalism can be adequate and suitable for all times, revenue allocation in



Nigeria has been challenged by; lack of correspondence between revenue availability and expenditure responsibilities of the different levels of government, political interference and lack of consensus on the criteria. There is need therefore to resolve these problems if the country is to derive maximum benefits in its fiscal federalism arrangements.

13. The success of fiscal federalism is hinged on local autonomy, liberal democracy, administrative capacity and revenue mobilisation.

Provisions of the 1999 Constitution on the roles of the Tiers of Government

14. On the federal exclusive list are the functions over which authority has to be centralized because of their implications for security, political stability and macroeconomic performance of the country. Such functions include the provision of public goods, which cover the entire country or have significant amount of externalities and effects that spill over the boundaries of the States and local governments.

15. The functions of the States in the federal system are those specified on the concurrent legislative list, which include provision of public services whose consumption could be confined to the areas within their jurisdiction, secondary education, health, industry and agriculture. The local government, which is the third tier, has the responsibilities that can best be discharged at the grassroots level. These include refuse disposal, provision and



maintenance of primary education, motor parks, market stalls etc.

16. The adoption of federalism in Nigeria lies mainly in the plurality and heterogeneity of the society, the regional differences and the diversity of functions which a modern government is expected to perform. The allocation of functions to these different tiers of government has fiscal implications. This is due to the fact that the discharge of the assigned functions involves expenditure and revenue. Consequently, a federal system has to deal with counterpart issue of intergovernmental fiscal relation.

17. The Federal Government of Nigeria has assumed so much responsibilities overstretching the resource availability. For example, all prisoners in the country are the responsibility of the Federal Government even though the offence committed was against the laws of a state government. The advantages of true fiscal federalism are best appreciated when one considers the persistent pressure towards greater political centralization.



Politics of Centralization of power

18. We acknowledge that the ideal of democracy is that power should be dispersed but there is always a tendency in democracies for its centralization because centripetal forces dominate centrifugal forces. A fundamental flaw in our present arrangement is the temptation by States to free ride on other States' contributions to the federal government. We should be competing on wealth creation rather revenue formula and sharing.

19. It is argued that centralization of power is necessary for efficient performance of government because as problems become increasingly complicated, people become increasingly mobile and more services are demanded of government to generate benefits that extend beyond the boundaries. State and local governments will fund services like education, public health and poverty relief below levels that maybe efficient since they recognize that their contribution would be insignificant and they can conveniently free ride on the contribution of others.

20. The efficiency-enhancing explanation for government centralization would be credible if government decision makers at all levels are sufficiently informed and motivated to determine and promote some common vision of the public interest. In this era of private-interest model of government, political outcomes emerge out the interaction of diverse and competing interest groups. There is no presumption of efficiency in the private-interest model of government. Efficient outcomes may or may not



emerge; depending on how well the political process matches up those who realize benefits from government and those who pay for those services.

21. The more central the collection of revenue, the more the political process rewards organized interest groups, and State and local governments, for demanding projects that are 3rd class with 1st class cost, and the less it will reward them for implementing such projects efficiently. But regardless of the inefficiencies, it is in the interest of each organized group to demand more spending on its programs and to push for the political centralization that amplifies that demand.

Making Sub-national Governance Competitive

22. Competition among States is necessary to provide the information and motivation for efficiency in political activity, as in market activity. Most people see competition as a constraint on government's ability to promote the public interest. But by rejecting competition among governments they have implicitly bought into the view of government as a benevolent promoter of inefficiency.

23. Government responsibilities will be assigned appropriately only in response to the pressures of a competitive process that gives those who are paying for government services more power to determine which services are provided and which government jurisdictions provide them. Fiscal responsibility at these levels of governance would go a long way in creating such a competitive process.



24. The competitive pressures on the tiers of government would improve the connection between those who pay for government services and those who benefit from them. Many government expenditures would be rendered a lot less essential than they are under the current arrangements where many States and local governments are free riders.

25. Imposing accountability on spending decisions always risks passing up some desirable spending, but this is a reasonable price to pay for reducing the level of inefficiency that characterizes so much current government spending at States and local levels. Also, worthwhile government services are not provided, or provided poorly, because they are crowded out by an avalanche of special-interest spending, or provided in the absence of competitive pressures.

Conclusion

26. The case for downsizing the federal government maybe strong, focusing its attention on truly national and international concerns, with government responsibility for the most domestic concerns being shifted to the states and local levels. The popularity of such a shift is reflected in the ubiquitous campaign promises to return government to the people. But the political process, as currently instituted, is more responsive to narrowly focused groups than to the general public. Fiscal discipline and prudent procurement process at the sub-national levels maybe a way out of the myriad of macroeconomic problems that beseech our polity.



27. The above submission should not be misconstrued as belonging to the group of optimists who believe that fiscal responsibility is the only solution to the myriad of problems of governance at the sub-national level rather I would conclude that if accountability is an important political objective for our country and we can establish the institutional framework to make Sub-national governments work with a reasonable degree of efficiency, then making states compete through fiscal responsibility is a good policy.

REMI BABALOLA

Honourable Minister of State for Finance