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The Practice of Fiscal Federalism in Nigeria: Lessons from Some Selected Countries

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Abstract

This paper discusses the structure of revenue, expenditure, problems and prospects for revenue generation in Nigeria and 6 other countries. The major focus of this paper is on the federalism and public finance, division of functions between levels of government in the Nigerian federation in the post-independent period. The paper critically examines sources of revenues generation over time in Nigeria and how such revenue are allocated. The paper further discusses on the fiscal operations of the different tiers of government in the country. The paper finally discusses the problems and attempt to proffer solutions (prospects) for revenue generation in the Nigerian state with some remarks, and conclusion.

INTRODUCTION

In discussing the general principles governing Fiscal Federalism in a federal system of government, and examination of the history and dynamics of intergovernmental fiscal relations in Nigeria, we may want to peruse further by taking a look at the experiences of other federations in designing and sustaining a virile fiscal system. In this regard, we shall be taking a detail assessment of the experiences of Australia, India, the United States of America and New Zealand Canada; all federations with the basic attributes of the federal system of government. We might also want to know if there are any lessons Nigeria can learn from the experiences of these 'older' federations, its constituent states, but also its common citizenry. This difference is thought to create a different level of legitimacy.

In 1887, Woodrow Wilson proposed to close down “the business of manufacturing constitutions” (quoted by Ostrom, 1976). The only task left would be the management of administration. The constitution-making process would be completed, the constitution manufactured and there would be no more interest in deepening investigations. Thus, the institutional box could be closed and therefore become a black box. In this perspective, the next question would then consist in examining individual behaviors within a given constitutional framework. It is the approach adopted by public choice scholars. Of course, to recognize, as is emphasized by Frey (1990) and North (1990), that institutions do indeed matter and that no individual could boast of total emancipation from them, is necessary. Nevertheless, one should go one step beyond. Indeed, we observe the working of constitutions in practice and at the same time face constitutional moments, since there is an ongoing process of mergers and dissolution of nations (Wittman, 1991; Blum and Dudley, 1991; Alesina and Spolaore, 1997; Bolton and Roland, 1997). The reason is also to be found in the very nature of constitutions and especially in their function. Aranson insists that a constitution does not only serve a managerial but also a value function. "It does so in a particular way, involving uncertainty about the time-bound goals of the process to be managed and about what values are permissible outcomes from the process so managed" (Aranson, 1988) Since the constitutional design is never completed, it is necessary to go inside the black box and to complement the public choice analysis with a constitutional political economy perspective (Buchanan, 1990). In the latter case, the question of choice within rules is replaced by the question of the choice of the rules themselves. Constitutional political economy does not only state that economic analysis cannot but take constitutions seriously, it also affirms that constitutions are susceptible to economic analysis.

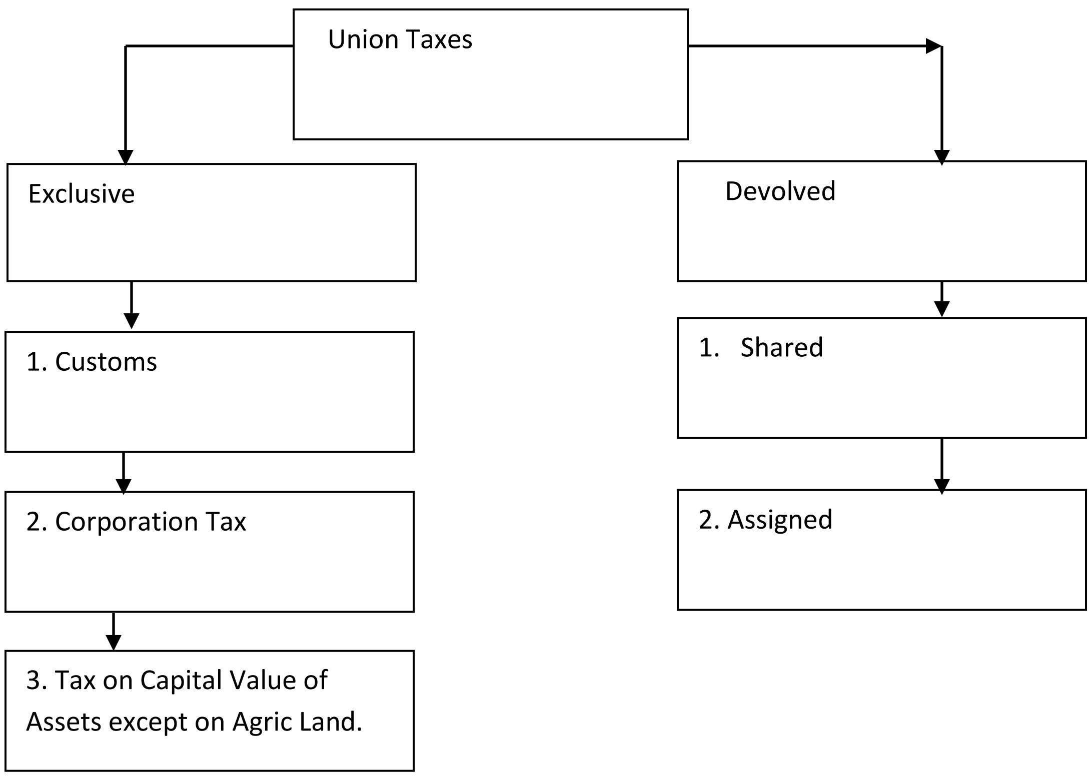
Whether unitary of federal, constitutions are charters of government. As such, they define how the collective decision-making process is organized, how and how far power has to be divided among different entities. The major difference between those two forms of organization is that a unitary constitution delegate's power to a single authority, while a federal one intends to share public prerogatives among several institutions, none of them granted with the ultimate power. Thus, the decisive question raised by federalism is how to assign responsibilities, powers, rights or prerogatives to each of the different levels of government. To put it differently, even if the word has rarely been used at least until its introduction in the semantics of the European Union, subsidiarity is the key concept to enter the world of federalism. It allows identifying a federal constitution according to the following criteria. Firstly, are responsibilities primarily assigned to the upper or to the lower level? Secondly, how do jurisdictions compete or bargain when deciding the assignment of prerogatives to a given level? Thirdly, how is the mechanism of control of the federal construction designed? Subsidiarity basically refers to the primary delegation of tasks to the smallest functional unit (Backhaus, 1999). Indeed, "in the clear case of insufficiency of a particular level, the nearest functional one needs to be found" (Backhaus, 1997). Following the intuitions of Christian Wolff (see Dreschler, 1999 for a biography), if a given level of government or province cannot adequately solve a problem, it can first turn to another province, in which case subsidiarity is lateral. If cooperation is searched with a higher level, then upwards subsidiarity prevails. Finally, downwards subsidiarity expresses that the problem is handled by communities of a lower level inside the province. This introduction did not set any agenda for investigation.

INDIA

India is a large populous union, or federation, of 21 states and 6 union territories. The country's constitution of 1947 clearly demarcates the taxing jurisdiction of the two levels of government in the union the central and the states. The taxing powers between the two is organized in a such that by and large, taxes having an inter-state base have been placed under the union's jurisdiction, while those that have a dominantly local base fall under the legislative jurisdiction of the states. Like in most other federations however, the union taxes are qualitative, though qualitatively less, superior to state taxes. According to Sharma, "a cursory glance at the schedule

and the quantitative look of at the taxes falling under the union, may create an illusion--. A closer look however reveals that qualitatively superior and elastic taxes on personal and corporate incomes.....are all under central jurisdictions, leaving stagnant ones to the state taxes are quite meager in terms of quantum as compared with those of the union (Common Wealth 1936)
However, the situation is not as bad as it appears. The founding fathers of the constitution have anticipated such a problem. They thus drew a distinction between the tax revenue to be collected by the union Government and whose net proceeds are then shared to the State Governments, this constitute the shared tax revenue. Tables 1 and 2 show the structure and distribution of such tax revenue as described in the foregoing.

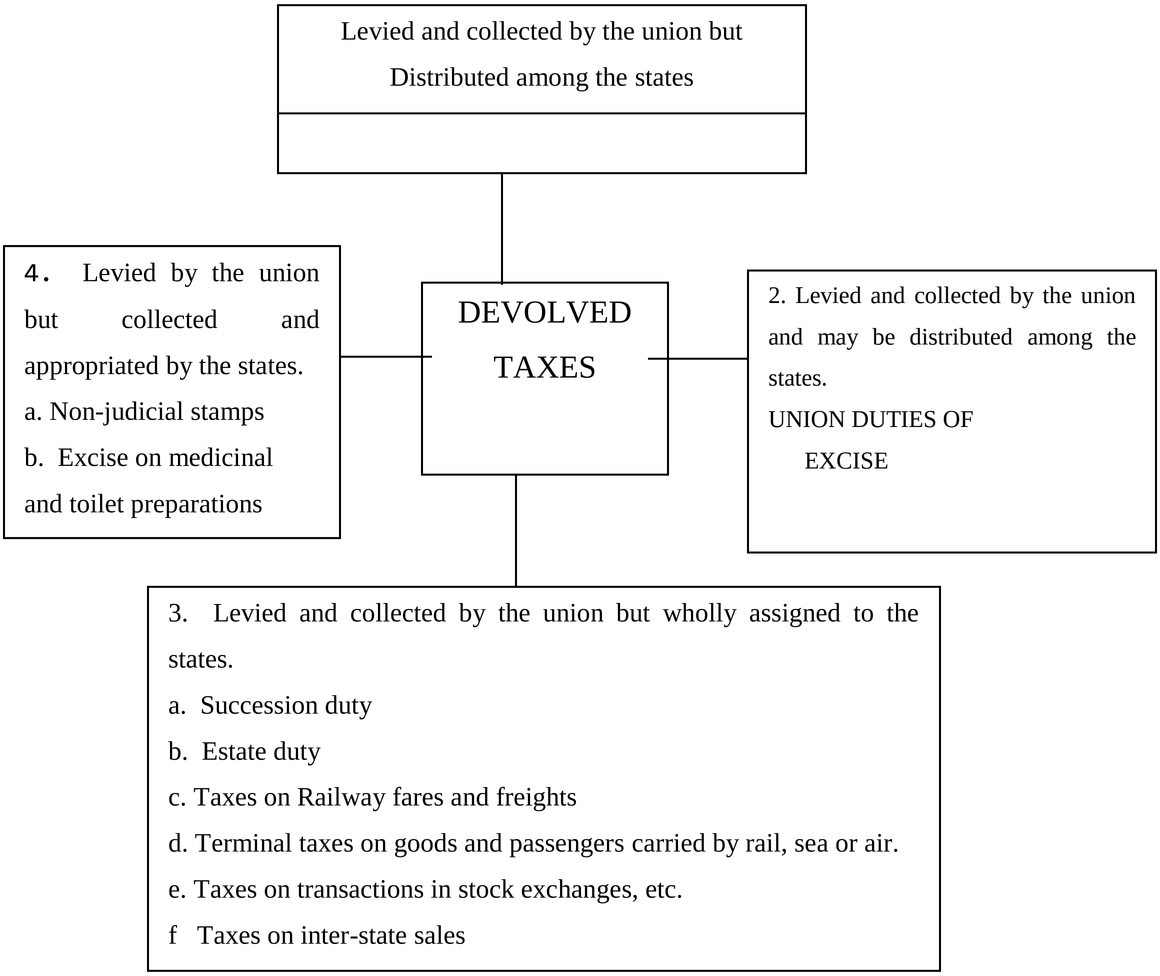
Table 1
Classification of Union Taxes.



Source: *The Union and State: A study federalism New Delhi (1974)*

Table 2

Detailed Classification of Devolved Taxes



Source: The Union and State: A Study of Federalism New Delhi (1974)
Note: While 1 and 2 are shared taxes, 3 and 4 are assigned taxes.
Cited from Abubakar 1986

Revenue Allocation in India

The sharing of devolved tax revenues is determined by the Indian Finance Commission (IFC), a semi-permanent constitutional body, appointed by the president every quinquennium (5 years) to enunciate principles for revenue sharing. Such principles are determined in the light of prevailing and envisaged economic condition of the country. Eight commissions have so far been appointed since the first one in 1946.

Central to the system of revenue sharing in India is the principle of fiscal need. Although it is argued that this principle has the inherent problem of application, it is designed in such a way that it internalizes the budgetary needs of the states, the tax effort made by each state, economy in state expenditure, the level of social services attained in each state, special obligations and broad per pages of national significance. As the eight-finance commission observed, "once

minimum requirements have been established, the natural way to ensure their continuity is conditional, non-matching close-end grants in each area, with the funding level equal to the minimum expenditure requirement (May 1969)
For Nigeria, the lesson she can learn from Indian experience in revenue allocation system is to attach heavier weight on the principle of fiscal need that is well designed to capture the budget needs of the states, the tax efforts and economy in the state expenditure. Tax efforts by states in Nigeria should also attract higher weights so as to stimulate states to generate more income from taxation.

Trends in Fiscal Federalism in Nigeria
The issue of Fiscal Federalism has engaged various commissions and committees since the colonial days. Yet, even today, this issue continues to be in the front burner of national discourse. The calls or demands for resource control clearly demonstrate that this is still an unsettled issue. Yet, it is an issue we must find a way to resolve if we are to continue as a federation. The researcher believed we have all committed ourselves to remaining as a federation. It is important that we take a historical view of how we arrived at the present situation. Between 1948 and today, nine commissions, six military decrees, one Act of the Legislature and two Supreme Court judgments have been resorted to in defining and modifying fiscal interrelationships among the component parts of the federation (Egwaikhide and Isumonah, 2001). The inconclusive discussion of the issue at the recent Political Reform Conference is the latest attempt at engaging this issue. These attempts sought to define or redefine or interpret the framework for revenue sharing both between the Regions and the Centre (vertical sharing) and among the Regions themselves (horizontal sharing).

The Aboyade Technical Committee on Revenue Allocation (1977)
As part of its transition programme to the second Republic, the Federal Government appointed the Aboyade Committee on revenue allocation in 1977. It submitted its report to the Federal Government in 1978. This committee recommended that all federally collected revenues be included into Federation Account. By this development, it was only changes in the total amount of federally collected revenues and not in its composition that could affect how much and in what way the states obtain their statutory revenue. Since then, the division of revenue among the three levels of government has become a matter of deliberate decision and not an accidental by-product of particular taxes.

The committee recommended that each state should contribute 10percent of its total recurrent revenue to the Local Government Joint Account. It also proposed that the Federation Account was to be shared among the Federal, State and Local Governments in the descending order of 60 percent, 30 percent, and 10 percent respectively. In the committee's opinion, given the expected important role of Local Governments in social, political and economic development of the country, they should have access to the most lucrative sources of revenues. It also created a Special Grants Account into which the Federal Government would credit 3 percent of its share and administered it for the benefits of mineral-producing areas and other areas in need of rehabilitation form natural disasters. The committee further recommended that tax jurisdiction be shared among the three levels of government as follows:

a) Federal Government: Import duties, excise duties, export duties, mining and royalties, petroleum tax, capital going tax, (Legal basis only)
b) State Government: Sales of purchase taxes (except on commodities so designated by the Federal Government), football pools and other betting taxes, entertainment taxes and stated duties, gift tax, land tax (other than agricultural land), land registration fees (legal basis only

capital gains tax (administration and retention), personal income tax (administration and retention) and company tax (administration only).

c) Local Government: Property tax, market and trading licenses and fees, motor park dues, canoe park dues entertainment tax, motor vehicle tax and drivers license fees, land registration fees (administration and retention), and license fees on television, and wireless radio (administration and retention).

There is no doubt that the most controversial part of the committee's report was that concerning the criteria to be used in sharing revenue among the state Governments. The criteria or principles of revenue sharing recommended were as in Table below.

Table 3

Five-factor formula for Revenue Sharing Among States.

S/N	Principle	Recommended Weight %	Accepted Weight %
a.	Equality of access to development opportunities	0.25	0.27
b.	National Minimum Standards	0.22	0.28
c.	Absorptive capital act.	0.20	0.20
d.	Independent revenue and tax effort.	0.18	0.12
e.	Fiscal efficiency	0.15	0.13
	TOTAL	1.00	1.00

Source: *Aboyade Technical Committee on Revenue Allocation Report 1977*

The Committee attempted to ensure that the objective of equity and efficiency were not sacrificed in revenue allocation among states. Although the committee did not want to undermine the capacity of the Federal Government to manage the natural economy effectively, it wanted to ensure adequate financial flows to the state and local government. The committee's report was criticized as too technical. In fact, the constituent assembly rejected it. The reasons were not Unconnected with the difficulty envisaged in applying most of the principles at the state and Local Government levels. However, the recommendation that all federally collected revenue with minor exception be paid into the Federation Account and be shared by the three levels of government was wholly, were allocated as follows: 2 percent by derivation and 1.5 percent for the development of mental-producing areas generally.

Table 4

Okigbo's Horizontal Revenue Allocation

S/N	SECTOR	OKIGBO	GWP	1982 ACT
A	Minimum responsibilities	40.00	40.00	40.00
B	Population	40.00	40.00	40.00
C	Social Development Factors: Direct Primary School Enrolment Inverse Primary School Enrolment	 11.25 11.25	 11.25 3.75	
D	Internal Revenue Effort	5.00	5.00	5.00

Source: Revenue Allocation Act 1982

The Okigbo commission restored population as a major factor of revenue allocation. It regarded primary school enrolment as an important indicator of social development and accepted internal tax efforts on the grounds that it encouraged the states to raise and collect internal revenue as much as possible. The commission used the ratio of total internal revenue to total expenditures as an index of this principle. Having reviewed the arguments put forward by the mineral producing areas for advocating the principles of derivation, the commission recommended that mining rents should be paid directly to the state Government in the mineral producing areas of right. It also recommended that 2 percent of the Federation Account be paid into a special Fund Account to be applied exclusively for the rehabilitation of the mineral producing areas, stressing that in the application of this recommendation, no distinction should be made between off-shore and on-shore mineral producing areas.

The Okigbo commission further recommended that the amount standing to the account of the Local Government councils be shared among them on the same basis as the states shared their Joint Account. A body was to be established by the state government to administer the Local Government Joint Account. The Local Governments were to be adequately represented in this body. In addition, the state government were expected to contribute 10 percent of their total revenue to their respective Local Government Joint Account. The Okigbo report was certainly controversial as evidenced by two minority reports by two members of the commission.

Leton's Minority Report

Leton argued that the mining rents and royalties which -the" constituted about 30 percent of the Federal Account should be set aside yearly and shared fully on the basis of derivation and that there should be no distinction between off shore and on-share production. Then the remaining 70 percent should be shared as proposed by the majority report. He proposed that the 7 percent special fund be share as follows; Federal Capital Territory (2.5%) funds for Mineral-producing Areas (3.0%), other ecological problems (1.5%)

Philips Minority Report

In another minority report, Professor A.O. Philips argued that the allocation of 60 percent of the Federal Account to the Federal Government was too high and therefore, proposed the following revenue-sharing arrangements.

Table 5
Proposed Revenue Sharing arrangements

GOVERNMENT	Percentage (%)
Federal Government	50
State Government	35
Local Governments	10
Special fund	5

Source: Philips Minority Report (1980)

The 5 percent special fund was to be shared as follows: 2.5 percent for the special problems of mineral producing areas and 2.5 percent of other ecological problems. Philips also proposed that revenue should be allocated among the state and Local government as follows:

Expenditure Obligation	50%
Internal revenue effort	25%
Fiscal equalization	25%
TOTAL	**100%**

In 1981, after the Supreme Court had voided the Okigbo Inspired Revenue Allocation Formula, the National Assembly passed a new Revenue Act. It went into operation in January 1982. The Act which lasted until December 1989 and which thereby remained the longest lasting revenue formula to date, distributed federally-collected revenues as follows; Federal Government (53%), • State governments (35%) and local governments (10%). The revenue act survived for so long, not because it was equitable or just, but because the military government in power after December 1983 Ignores criticisms and agitation against it. There were obvious inconsistencies in the revenue act. For example while some states received more than their statutory allocations, others received less. Except for 1983, Lagos received more than statutory allocation during the entire period. 1986-89, Anambra State got far more than its statutory allocation while the middle belt state of Plateau received less than its share of the federation account. There is no doubt that economic, political and social scenario thus made a mockery of the revenue allocation system and the federal structure within which it subsisted.

In 1984, the federal Government amended the 1982 Act by making the following revenue sharing arrangements.

Table 6
Vertical Revenue Allocation.

	PERCENTAGE (%)
Federal Government	55.0
	35.59
Local Government	10.0
Mineral Producing Areas (Derivation)	15.0
General Ecological Problem	1.0
TOTAL	100.00

Source: The revenue Allocation Act 1982 as amended
Note: a. 2.5% of the states' share is for the development of mineral producing areas b.1.5% of the revenue accruing to the Federation Account from the mineral producing areas.

The inability to stick to the allocation guidelines and the persistent cry for equitable distribution of revenue inevitably led to the inauguration of another revenue allocation commission by the Babangida administration.

The Babangida Regime, 1985-1993.

By this regime peculiar circumstance, the revenue allocation principle it inherited, and the formats adopted or recommended for it clearly represented a classical case of a travesty of the principles of federalism. It also represented a negation of the Ideals of the Structural Adjustment Programme (SAP) which the regime introduced in 1986. One of the cardinal principles of SAP is social justice which proclaimed the equity and distributional objectives of government intervention in the economy. This objective therefore called for a whole panoply of changes in the insalubrious political, social, economic and fiscal principles prevalent within the polity. According to Nwankwo (1992) it would be recalled that prior this, Nigeria calculations were not based on the totality of the collectivity. It was this that rendered the issue of revenue allocation one of uncommon intensity.

Thus, in order to address the equity issue, the Babangida administration in line with the principles of SAP and federalism, inaugurated in 1988, the National Revenue Mobilization, Allocation and Fiscal Commission (NRMAFC) under the chairmanship of General T.Y. Danjuma (Rtd). The first report by the National Revenue Mobilization, Allocation and Fiscal Commission was slightly modified and it came to force in January 1, 1990. The Revenue Allocation regime that came out of this effort utilized what the Commission and the approval by the Armed Forces Ruling Council (AFRC) have regarded as a cumbersome, static and arbitrary yardstick to wit the tables below shows the proposals.

Table 7
Vertical Revenue Allocation

SECTOR	NRMA & FC %	AFRC %
Federal Government	47 F.A.	50
State Governments	30 F.A	30
Local Governments	15 F.A	15
Special Funds:	8 F.A	3.53
i. FCT	1% F.A	1% F.A
ii. Stabilization	10.5% F.A	10.5% F.A
iii. Savings	2.0% F.A	12.0% F.A
iv. Derivation	2.0% M.R	
v. Oil producing areas	1.5%M.R	1% F.A
vi. Non-oil producing areas	0.5% NOMR	1% F.A
vii. General ecology	0.5% F.A	1% F.A

Source: National Revenue Mobilization, Allocation and Fiscal Commission Vol.1-Main Report 1992.
Note; F.A = Federation Account
M.R = Mineral Revenue
NOMR = Non-oil Mineral Revenue
OMR = Oil Mineral Revenue.

Table 8
Horizontal Revenue Allocation

PRICIPLES	RMAFC %	AFRC %
1. Equality of States	40.0	40.0
2. Population	30.0	30.0
. Social Development		
Factor: Education		
Direct Enrolment	8.0	8.0
Indirect Enrolment	2.0	
. Land mass and Terrain	---	10.0
. Internal Revenue Effort	20.0	10.0

Source: Revenue Mobilization, Allocation and Fiscal Commission Vol.1 Main Report 1992

One important innovation by the as noted by the Commission's report (1992) was the introduction of "Stabilization Fund" as buffer against wide fluctuation in government revenue, which was noted to have destabilized the budgetary operations of the three levels of government. Besides this provision, the Commission recommended Institutionalized savings in the revenue allocation arrangements. This was because it believed that the country should save a minimum percentage of its revenue yearly and invest income-yielding assets abroad.

The government added a new dimension to revenue allocation when it gave 2 percent of the revenue from mineral exploitation in direct proportion to the value of mineral extracted from each state and another 1.5 per cent allocated to the fund to be administered by the federal government for the development of the mineral-producing areas of the country. Although this formula was supposed to be an improvement of previous formulae, a studious perusal of the formula revealed that it not only retained some of the anachronisms of the earlier ones, but also introduced obnoxious aspects of its own. First of all, the act of picking a soldier to head a revenue allocation commission at a period when the nation was trying to grapple with the negative effects of a communist structure was in bad taste. Also, whatever claims the formula may make on equitability, reasonableness and acceptability was circumscribed by its adherent to among others, the low percentage weight it assigned to derivation, and the disproportionate weight given to population, and population-related factors in relation to "equality of states". The introduction of landmass as an index of revenue allocation was also regarded as retrogressive and unfair.

The new revenue allocation also encouraged a fiscal centralization, which allowed the Federal Military Government (FMG) to perpetuate an inescapable sense of dependence among the states. In fact, the disposal of funds over statutory allocation by the F.M.G empowered it to facilitate an inequitable distribution of official patronage, and at the whim of the president. This was clearly revealed in 1992 when the minister of Finance, Alhaji Abubakar Alhaji, while reacting to Governor Segun Osoba of Ogun States in Daily Sketch; Ibadan 14 March, 1992 declared.

> *I am glad to announce to you that president Babangida has- directed me to lease some amount of money to all states of the federation on Monday. Criteria to be used will depend on the needs of each state, as the needs of the states are not the same*.

Even the so-called innovations in the formula, the derivation fund and the fund for the ecological repair of the areas affected by mineral producing, raised more delicate and sensitive issues, especially as each local authority had to make good case for allocation (Ayida 1992). On the other hand, oil-producing local government also felt that the goals of the derivation fund would remain unrealized if state governments continued to administer the funds.

On the horizontal revenue allocation, the commission recommended that equality of states be given a very high weight of 40 percent. The Social Development Factor (SDF) was broadened to include a number of a state hospital beds, secondary/commercial school enrolment, rainfall and the territorial spread of the state. The share of the SDF was however reduced from 15 to 10 percent and distributed as follows:

i. Direct primary/ Commercial school enrolment	-	2.4%
ii. Direct primary/commercial school enrolment	-	0.8%
iii. Inverse secondary/commercial school enrolment	-	0.8%
iv. Direct number of State hospital beds	-	1.5%
v. Indirect number of state hospital beds	-	1.5%
vi Direct territorial spread of rainfall	-	1.5%
vii. Inverse proportion of mean annual rainfall	-	1.5%
Total	**-**	**10.0%**

Landmass and Terrain had a share of 10 percent. Half of it was shared in direct proportion while the remaining half was shared in inverse proportion. Internal revenue effort also had a share of 10 percent. The previous commissions had used the ratio of internal revenue to recurrent expenditure as an indicator of this effort. The Danjuma Commission believed that the tax effort of each state should have been related to its taxable capacity-but realizing that the potential taxable capacity of a state government is difficult to measure, the commission recommended the percentage increase in internally generated revenue in a given period over the proceeding period as a good measure of tax effort. Both the Richard the poor states protested over the use of this method, especially those states which felt that they had reached the upper limit of their taxable capacity and that there was no room for substantial increase in their internal revenue. Since only revenue items that could be influenced by state or local governments efforts were involved, transfer earnings were excluded. The Danjuma's commission modified, as we have already seen, the Okigbo's proxy of tax efforts and increased it's weight from 5 to 20 percent but the federal government accepted only 10 percent. Consequently the problem and debate on the appropriate measure of not only tax efforts but other principles continued.

The Fiscal Regime 1994-1997.

The Sani Abacha administration, which came into power on 17 November 1993, promised an end to many of the problems confronting the nation. It there after inaugurated a constitutional conference to find solutions to the country's endemic problems of power sharing and transfer. (News Watch 1997) to demonstrate its seriousness in its programme of equity and fair play, the government set up among others the Transitional Cqmmittee on Devolution of powers, and the Revenue Mobilization and Fiscal Commission(Vangard,1996) most of the recommendations of these bodies may however not be implemented until the promulgation of the draft constitution in 1998. As an interim measure, the government adopted an ad-hoc revenue allocation formula, which is more or less a continuation of the previous regime. The adoption of this formula was, however, accompanies by strident calls by different tiers of government and even the central Bank of Nigeria, for a review of the indices that determine allocation of revenue in the country.

As a result of continued agitations, the Federal Military Government (FMG) gave its approval to the National Revenue Mobilization and Fiscal Commission, to carry out the review in view of the creation of six new states and 183 Local councils in October 1996, and currently 774 local councils exists.

The paradox of the whole situation was that the attempt to find solutions to the intractable problem of revenue allocation went hand in hand with the subversion of the same process. The Akwa Ibom state administrator, Navy Captain Joseph Adeusi, in (Post Express, Lagos, September, 1996) succinctly put the most basic problem manifested under the Abacha administration so far. In inspect to the member of the committee on the Devolution of powers, he affirmed that:

> *The current practice of military federalism had tended to raise fears on an over centralized federal structure which denied states the autonomy to decide their constitutional responsibilities to the people as a result of close supervision and control.*

Further testimonies reveal that the Federal Government (FG) has been guilty of the rapacious accumulation of power and the nation's wealth to the detriment of the federating units which had been further Balkanized from nineteen in 1976 to twenty one in 1989, thirty in 1991 and thirty-six in 1996. The octopoidal tendencies of the FG have been intensified with the promulgation of decrees strengthening its position in relation to the other tiers of government. According to Alex Ekweme (1997), the massive increase in revenue accruing to the FG and the unilateral decreeing as to how it would be shared between it and the states avoided the financial autonomy of states and enabled the federal government to venture into areas exclusive to, or shared concurrently with the state. The value Added Tax (VAT), the Autonomous Foreign Exchange Market (AFEM) and the petroleum Trust Fund (PTF) were public policy trusts of the nation's resources without respect for the revenue allocation formula. The VAT as a proxy for sales tax, should accrue largely to the states, which initially were to receive eighty percent for itself, with twenty percent accruing to the F.G as cost of administration and collection. But the F.G inverted this to be eighty percent collection. But the F.G inverted this to be eighty percent for itself and twenty percent for the states. It took a clamour by the states for the formula to be reviewed to 33-35-30 for the Federal, State and Local Government. The AFEM gains on the other hand were regarded as the joint property of the three tiers of government. This sector yielded a profit of #78 billion in 1995 and #286 billion in 1996. But without consultation and in disregard of the wishes of the other tiers of government, the F.G. unilaterally invested the profits allegedly "in the productive sector of the economy.30 such infraction by the F.G no doubt, are well replicated in other spheres of national life.

Thus, by the time six new states and 183 local governments were created in October 1996, the depredations of the F.G. had all but wiped out the other tiers of government as tools for catalyzing development. The onus rests on the proposed 1998 constitution to restore the balance of power and functions between the three tiers, of government and thereby enthrone a genuine and equitable federal polity.

Case for Federalism and Division of Responsibilities.

The case for federalism is identical with that of partial decentralization of government. Put differently, it is identical with the case of more than one level of government. The question then is: why is it desirable to have more than one level of government, as is the case in Austria, Nigeria and the USA? The argument for multilevel government or a stratified system is relatively straightforward. At the theoretical level, the central government, and others best perform some economic functions by sub-national governments. There are also a number of practical advantages that accrue from decentralization. A substantial part of the argument is based on the theory of public goods and public choice theories of political process.

As indicated in the preceding section, the government had three major economic functions to perform, namely, allocation, distribution and stabilization. Discussion of the allocation function is predicated on the assumption the division of responsibilities between the private and public sector has been settled, implying that we have a well-defined set of publicly provided goods. Also publicly provided goods can be of three major types depending on the degree to which the free market system falls in their provision. These are private goods, impure public goods and pure public goods. Private goods are those whose consumption is both enjoyed individually and made contingent upon payment, e.g electricity, water and milk. Impure public goods are those whose consumption are both collective and made contingent upon payment, e.g. highways with toll imposed. Finally, pure public goods are those whose consumption is collective but not contingent upon payment e.g. fresh air.

The free market system tends to break down totally in the case of pure public goods, partially in the case of impure public good and probably partially in the case of private goods. (Musgrave and Musgrave 1989). The argument for federalism based on the allocation function is usually illustrated with pure public goods as such goods constitute the limiting case of market failure. This is equivalent to the assumption that all publicly provided goods are pure public goods.

In terms of the spatial incidence of the benefits enjoyed, pure public goods (hereafter referred to as public goods) are two major types. First, we have national public goods whose spatial incidence covers the entire nation, e.g. defense, international affairs, space exploration and the benefits of research and development. Second, there are local goods whose spatial incidence is limited to particular geographical areas, e.g. regional transportation systems, street lighting and local fire engines. For analytical purpose and with reference to federalism, this distinction is fundamental. The theoretical case for fiscal federalism can now be couched a little more specifically as follows; is it optional for one level of government to provide for national and local public goods and at the same time, be responsible for the distribution and stabilization functions of government?

At the theoretical level, it has been argued that the central government would be in a better position to perform the distribution and stabilization functions as well as provide national public goods (Oates 1972; Musgrave an Musgrave 1989 Cremeretal 1994). All of these functions will be inefficiently performed at the local government level for two interrelated reasons difficultly in appropriating the full social benefits of the programmes undertaken at that level, and the tendency towards the free rider problems with respect to the former, the local government tends to take into consideration only its own marginal cost and benefits conferred on other local governments. Consequently, the locality, insofar as it confers benefits on other localities will tend to operate at a level, which is lower than the nationality desired level. This problem unlikely to arise if the decision is taken by the central government, as all the associate cost and benefits taken into consideration. The same argument prevails if it is external cost that is imposed on the other localities. However, in this case, the localities level of operation will be more, rather than less, than what is nationally acceptable. Another related problem is the free rider problem which occurs when an individual or group of individuals have the incentive to benefit from the provision made by other (Lanyard and Welfare 1978).

Now considering provision of national public goods such as defense. For ease of comparison two basic assumptions are made. It is assumed ex ante that one is indeed indifferent about whether the provision of the public goods is centralized or decentralized, and that cost of providing each good is the same for a locality and the central government. Now let us assume that there is only one national public good and that it is provided by one locality. Since the good is a national public good, other localities will certainly benefit from its provision. The question now is: With the optimum level output will be provided? Under this arrangement, the efficient level of output will be provided. If and only if, there is an agreement between all the localities to share the cost of providing the service. However, such a sharing arrangement will be hard to come by. The reason is that since the other localities cannot be excluded from enjoying the service provided the tendency to seek free ride will arise.

The locality that is responsible for providing the national public goods has the option of consuming with the provision of the goods: and if this is done, giving the fact that we are dealing with a public good, the localities level of operations will be sub optional it will be at such a level where the marginal cost is equally sum of the marginal values placed on the additional unit of the goods by local residents. The benefits that are conferred on the other localities will be ignored on the decision-making process since such benefits cannot be appropriate. The desire for efficiency then compels one to turn to the central government which is in a suitable position to appropriate all social benefits.

Tax and Revenue Sharing Arrangement

As a starting point, one may ask, should revenue generation be centralized or decentralized? For convenience, let us assume that all revenue is generated from taxes. There are three distinct options here, namely; to collect all taxes centrally to allow sub-national government to collect taxes; or to assign taxing powers to each and every tier of government (Tanzi 1995:310-311). Central collection of taxes tends to be consistent with the pursuit of the distribution and stabilization functions of government, and also the provision of national public goods, all of which have been assigned to the central government. This system is also likely to generate economies of scale in tax administration and prevent revenue loss due to the mobility of taxpayers from one locality to another if such taxes were collected locally. The system is also desirable when considerable weight is attached to tax uniformity across jurisdictions. On the other hand, a decentralized system of tax collection would be more likely to make spending decision of the grassroots level more comparable with available resources. It could, therefore promote accountability and responsibility as well as the efficient provision of local public goods. This system can also encourage fiscal autonomy and tax competition among localities. Neither of these alternative systems is capable of reaping both sets advantages. Consequently, like the allocation of government functions to the various tiers of government, revenue or tax collection should be shared between all tiers of government. Put differently decentralization of function should be matched by decentralization of revenue collection.

There are different aspects to a given tax. They include the legislative or legal power to impose tax, the tax base, the tax rate, the administration of the tax, and the right to revenue (Mclure, 1995:318-319). It is hardly the case that all of these aspects are treated the same way in terms of the degree of decentralization. For example, in Nigeria, it is the federal government that legislates on personal income tax, while the state governments are largely responsible for its administration and collection. Exceptions are foreign embassy staff, resident of the Federal Capital Territory and members of the armed forces, whose personal income taxes are paid to the federal government.

It is also important to ask: given the collection system, which sources of fund should be shared and how is the sharing supposed to be done? The choice here is largely between tax base sharing and revenue sharing. Let us consider first the issue of tax sharing. Which tax bases should be shared to sub-national government? A good tax should have certain qualities like efficiency, equity and revenue adequacy, low administration cost and be able to promote economic stability (World Bank 1988:79-104). However, at the grass root level where attention is focused on the provision of local goods, only three of these attributes are really important. They are efficiency, revenue adequacy and administration cost. Virtually all taxes are based on either the ability to-pay principle. A meaningful comparison of these principles would require that we hold the tax yield or revenue constant. Since the ability to pay principle is geared toward equity issue and the benefits principle towards efficiency issues, it appears that the benefits principle has an edge over an above the ability to pay principle in the provision of local goods. Charges that are based on the benefits principle can take the form of benefits taxes or user charges. The former would be more appropriate for the prevision of public goods, and the latter for the provision of publicity provided private goods. Such taxes and user charges exist; tax sharing has the advantage of enhancing the efficient allocation of resources in a locality.

Theory of Public Finance

Wheare (1994), one of the earliest authorities on federalism, defines the concept as “the method of dividing power so that the general and regional governments are each, within a sphere co-ordinate and independent.” Different forms of federalism can be distinguished by the scope of functions performed by the central and state governments. In other words, distinctions can be based on the scope of geographical areas over which different levels of government in a federation have jurisdictions. By connection, the central government has a jurisdiction, which covers defense, currency and central banking, citizenship, etc. Regional/state/provincial government exercise power over non-overlapping subsections of the country in such matters as law and order, social services, commence and local governments, among other things. Local government have authorities over non-overlapping areas within a state or province such as control of pets, tenement rating, primary education, dispensaries, orphanages, markets, motor parks and so on. Economic theory suggests that the provision of pure public goods, such as defense should be assigned to a single unit of government with jurisdiction over the entire country. This is because the service does not taper off with area covered and additional persons can be supplied at no extra cost. Per capital cost of such goods is reduced to the barest minimum when it is supplied by the central government. In other words, the central government provision of pure public goods enables a country to reap fully the benefits of economics of scale.

When we come to the concept of semi-public goods, there is a justification for the involvement of state and local governments in their provision. Semi public goods can be supplied to only a limited area at any given time at minimal cost. A high quality of services can be supplied to additional households and cover a wider area up to a given limit without extra cost beyond this limited area, the benefit taper off suddenly to zero in such a case the semi-public goods must be provided by a number of state governments. Where a certain level of government's responsible for the provision of pure or public goods, which have the characteristics of joint supply and no-exclusion, and another level of government is responsible for semi-public goods, some degree of decentralization is required. There are other services such as primary education, registration of births and deaths and marriages that are local public goods requiring a relatively very large number of local governments to provide. Further fiscal decentralization is, therefore, required.

The extent to which fiscal powers should be assigned to state or local government is function of the possible advantages to be realized in terms of the citizens' preference which may be quite important in a diverse and heterogeneous-country. In this case, the objective of having a decentralized fiscal system is to satisfy the differing preference of different states and localities. Where preferences are homogeneous in a country, the state government may simply be asked to administer the decisions of the central governments. Issues in fiscal federalism arise, therefore, mainly from the federal set-up of the country and the zero sum of sharing a given amount of resources. The problem boils down to what formula to use in sharing resources to ensure on optimization of the various interests. While maintaining a high rate of economic growth. Two of the most important yardsticks which revenue evaluates allocation are equity and efficiency. By equity; we mean the normative concept of fairness white efficiency refers to the extent to which revenue allocation distorts efficient economic decision-making (Ameches an Ulbrich 1986). Because equity is a normative concept, the answer to the question of what is a fair revenue allocation formula is bound to be answered differently by different people.

Fiscal federalism may be viewed as a set of fiscal activities, relations and interactions, rights and demands by and among the various governments in a federation. The set defines the rights to revenue among government units, revenue allocation then defining the functions and sources of revenue of each level of government. Usually, the roles, responsibilities and rights of each government are constitutionally determined and the fiscal arrangement follows automatically. It has been difficult, however, to match responsibilities with resources at every level of government. Continuous adjustment is being made to the revenue allocation in order to meet changing economic and political circumstances. Revenue allocation is a mechanism used to address the fiscal imbalances, which emerge in the process of economic development.

It should be noted also that efficiency is the basis for tax Jurisdiction and assignment of responsibilities. Where the distribution of function does not rest on and in fact does not guarantee on adequate and independent revenue base, then the action of fiscal federalism is bastardized and is in jeopardy. Ideally therefore, tax jurisdiction should guarantee this fiscal autonomy of each level of government. However, efficiency requires that the taxing powers be vested in that level of government most likely to administer the taxes at the least cost. For this reason, taxing power on sources which cut across states an which are major sources of revenue are vested in the central government while those sources that cut across local government boundaries within a state are vested in the state government. It used to be though that fiscal centralization was an inevitable requirement for development.

The traditional approach of western macroeconomic development was within the context of unitary government consequently Keynesian theory was based on the centralization and integration of fiscal and monetary policies. His work shows that fiscal central/nation is inevitable for an economy to fight depression, combat inflation and achieve rapid growth rate of industrialization. It was in this regard that Hanson and Perloff (1965) argue that: The taxing, borrowing and spending activities of the state and local governments collectively have typically run counter to the economically sound fiscal policy (and since) states and localities have, infact, follow the swing of the cycle and have intensified the evidence of economic fluctuations unless their fiscal system are planned in relation to the federal stabilization programme, they are likely to nullify in large measure the national counter-cyclic activities.

Perhaps, fiscal centralization is generally intended to reduce to the minimum the distorting effects of autonomous taxing, borrowing and spending powers of states and local governments. However, federalism believes that growth rate would be accelerating by the diffusion, rather than the centralization of fiscal activities. Therefore, the demands of federalism and fiscal centralization are incompatible. There are few generally acceptable variables, factors and weight for distributing revenues among the states. There is a disagreement between those who favour equalization principles, which promote balanced derivation principle, which is not only one of the pillars of fiscal federalism but a source of lopsided development. Fiscal relations in a federal system require resolving these conflicting issues. Scott (1964) emphasizes, however, that a federal system demands more than economic efficiency in the allocation of resources. The primary goal of federalism is to sustain political stability and contentment of the component units of the federation against the argument that federalism inhibits economic of scale in public administration, he emphasizes that it should be noted that economies scale are not infinite but subject to the law of diminishing returns. It could, in fact be said that federalism is a political device of spreading the risk involved in government, especially in a large and heterogeneous countries. (i.e. in multiethnic, multicultural, multilingual and multi-religious countries with each group wanting to preserve its identity). Since a high degree of political autonomy is essential for the preservation of group identify, federalism is justified beyond what pure economic consideration may support.

Besides, economic growth would be accelerated by the devolution, rather than the consideration of governmental powers for the system to work well; however, there must be adequate institutions that would coordinate the various socio economic policies of the different levels of government. The component unit must also be willing to co-corporate in the task of harmonalizing government policies. Therefore the goal of federalism are to reduce, prevent and manage ethnic conflict by granting the respective states and local government maximum financial autonomy. The basic foundations for the initial theory of Fiscal Federalism were laid by Kenneth Arrow, Richard Musgrave and Paul Sadweh Samuelson's two important papers 1954, 1955) on the theory of public goods, Arrow's discourse (1970) on the roles of the public and private sectors and Musgrave's book (1959) on public `of the state in the economy. Within is framework, three roles were identified for the government sector. These were the roles of government in correcting for various forms of market failure, ensuring an equitable distribution of income and seeking to maintain stability in the macro economy at full employment and stable prices. The theoretical framework in question was basically a Keynesian one which canvassed for an activist role of the state in economic affairs. Thus the government was expected to step in where the market mechanism failed due to various types of public goods characteristics.

Economics teaches us that public goods will be underprovided if left to private market mechanisms since the private provider would under invest in their provision because the benefits accruable to her or him would be far lower than the total benefit to society. Governments and their officials were seen as the custodians of public interest who would seek to maximise social welfare based on their benevolence or the need to ensure electoral success in democracies.

Once we allow for a multi-level government setting, this role of the state in maximising social welfare then provides the basic ingredients for the theory of fiscal federalism. Each tier of government is then seen as seeking to maximise the social welfare of the citizens within its jurisdiction. This multi layered quest becomes very important where public goods exist, the consumption of which is not national in character, but localised. In such circumstances, local outputs targeted at local demands by respective local jurisdictions clearly provide higher social welfare than central provision. This principle, which Oats (1972) has formalised into the "Decentralisation Theorem" constitutes the basic foundation for what may be referred to as the first generation theory of fiscal decentralisation (Oats, 2004). The theory focussed on situations where different levels of government provided efficient levels of outputs of public goods "for those goods whose special patterns of benefits were encompassed by the geographical scope of their jurisdictions" (Oats, 2004). Such situation came to be known as "perfect mapping" or "fiscal equivalence" (Olson 1969).

Nevertheless, it was also recognised that, given the multiplicity of local public goods with varying geographical patterns of consumption, there was hardly any level of government that could produce a perfect mapping for all public goods. Thus, it was recognised that there would be local public goods with inter-jurisdictional spill-over. For example, a road may confer public goods characteristics, the benefits of which are enjoyed beyond the local jurisdiction. The local authority may then under-provide for such a good. To avoid this, the theory then resorts to traditional Pigouvian subsidies, requiring the central government to provide matching grants to the lower level government so that it can internalise the full benefits. Based on the following, the role of government in maximising social welfare through public goods provision came to be assigned to the lower tiers of government. The other two roles of income distribution and stabilisation were, however, regarded as suitable for the central government.

To understand the rationale for the assignment of the redistribution function to the central government, we need to examine what the implications of assigning this responsibility to the lower tier would imply. Given that citizens are freely mobile across local or regional jurisdictions, a lower level jurisdiction that embarks on a programme of redistribution from the rich to the poor would be faced with the out-migration of the rich to non-redistributing jurisdictions and in-migration of the poor from such jurisdictions to the redistributing one. If on the other hand, the powers to redistribute were vested in the central government, a redistribution policy would apply equally to citizens resident in all jurisdictions. There would therefore be no induced migration.

The assignment of the stabilisation function also follows from the chaos that would ensue if sub-central governments were assigned the responsibility. Beggar-thy-neighbour policies will lead to sub-optimal policies from the point of view of national welfare. Moreover, given the openness that characterises the relationship between the regional governments, they are grossly constrained in carrying out effective stabilisation policies. This is because these lower tiers of government have very limited capacity to influence local employment levels and inflation. From the foregoing, we can summarise the role assignment which flows from the basic theory of fiscal federalism. The central government is expected to ensure equitable distribution of income, maintain macroeconomic stability and provide public goods that are national in character. Decentralised levels of government on the other hand are expected to concentrate on the provision of local public goods with the central government providing targeted grants in cases where there are jurisdictional spill-overs associated with local public goods.

Once the assignment of roles had been carried out, the e next step in the theoretical framework was to determine the appropriate taxing framework. In addressing this tax assignment problem, attention was paid to the need to avoid distortions resulting from decentralised taxation of mobile tax bases. Gordon (1983) emphasised that the extensive application of non-benefit taxes on mobile factors at decentralised levels of government could result in distortions in the location of economic activity. Following from the assignment of functions, taxes that matched more effectively the assigned functions were also assigned to the relevant tier or level of government. For example, progressive income tax is suited to the functions of income redistribution and macro-economic stabilisation and is therefore assigned to the central government. On the other hand, property taxes and user fees were deemed more appropriate for the local governments. Benefit taxes are also prescribed for decentralized governments based on the conclusion that such taxes promote economic efficiency when dealing with mobile economic units, be they individuals or firms.

The final element of this basic theory that we wish to note is the need for fiscal equalisation. This is in the form of lump sum transfers from the central government to decentralised governments. The arguments for equalization were mainly two. The first which is on efficiency grounds saw equalization as a way of correcting for distorted migration patterns. The second is to provide assistance to poorer regions or jurisdictions. Equalization has been important in a number of federations. For example, Canada has an elaborate equalization scheme built into her inter-governmental fiscal arrangements. It should be pointed out however, that recent literature emphasises the importance of reliance on own revenues for financing local budgets. A number of authors (Weingast, 1995; McKinon, 1997) have drawn attention to the dangers of decentralised levels of government relying too heavily on intergovernmental transfers for financing their budgets. It is on the foregoing that theory of Fiscal Federalism is adopted for this study.

SUMMARY AND CONCLUSION OF THE STUDY

This study has shown that the structure of Fiscal Federalism has had a great impact on the nature of Nigerian federalism. Although it was federalism which created the need for fiscal federalism, the stability and smooth running of a federal set up depend to a large extent on how well it is able to deal with problem of the financial relations among the component units. A major problem of this research work is political instability which has often led to military intervention in the political government. Once the military takes over the reins of power, the constitution is usually suspended and strict observance of norms and legalities of the tenets of fiscal federalism become impossible. The continues agitation for upward review of revenue allocation formula in favour of state and local governments, increased derivation revenue and quest for resource control is a major problem of the study.

Allocation and Fiscal Commission, attempt was also made at exploring ways of de-emphasizing revenue sharing while encouraging revenue mobilization and generation among state and local government thereby reducing total dependence on revenue generated from oil exploration. A federal political system is essentially, a contractual non-centralized devolution of the ordinary powers of sovereignty among different centres of government, each coordinate with, and independent of the others. It is not necessarily a hierarchy, not a pyramid of governments in which powers are allocated by "levels' but a structured dispersion of powers typical of matrix of the federating units.

In these regards, Nigeria can hardly be called federalism. Many years of colonial administration and worse still, more years of military dictatorship seem to be institutionalizing and amalgam of the federal and unitary systems in Nigeria. To preserve our federal heritage, it is therefore necessary to reduce the economic and political clout of the centre, to allow a relaxed and harmonious relationship between the constituent units of the federation.

If the federal government must ensure effective fiscal federalism and attain sustainable socio-economic stability, there must be a review of the division of the taxing and expenditure functions so that an optimal structure of functions would emerge. There may be the need to provide specific grants from the Federation Accounts to other tiers of government taking more responsibilities that could be best performed by the state and local governments and demand revenue for its provision.

Historical evidence indicates that there was no striking disparity in the statutory revenue allocation among the states of the federation, a significant departure from what was obtained prior to the 1980s. This was attributed to the weights attached to the principles used in the horizontal revenue sharing arrangements. Despite this trend, it was noted that the pattern exhibited may not have reflected the needs of the various states. For Nigeria, the lesson she can learn from Indian experience in revenue allocation system is to attach heavier weight on the principle of fiscal need that is well designed to capture the budget needs of the states, the tax efforts and economy in the state expenditure. Tax efforts by states in Nigeria should also attract higher weights so as to stimulate states to generate more income from taxation.

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