FISCAL DECENTRALISATION, FISCAL EQUALISATION AND THE IMPACT OF GRANTS ON STATE GOVERNMENT EXPENDITURES: CASE STUDY OF NIGERIA.

Thesis Submitted for the Degree of Doctor of Philosophy at the University of Leicester.

BY

SHEHU ABUBAKAR MISAU  B.Sc., M.Sc., (Maid.)
Public Sector Economics Research Centre, University of Leicester.

July 1989.
Dedicated to the
People of Nigeria
With whose resources my "Education" was funded.
# TABLE OF CONTENTS

<table>
<thead>
<tr>
<th>Title Page</th>
<th>i</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dedication</td>
<td>ii</td>
</tr>
<tr>
<td>Contents</td>
<td>iii</td>
</tr>
<tr>
<td>List of Tables</td>
<td>ix</td>
</tr>
<tr>
<td>List of Figures</td>
<td>xi</td>
</tr>
<tr>
<td>Acknowledgement</td>
<td>xii</td>
</tr>
</tbody>
</table>

## 1.0 CHAPTER ONE

**Intergovernmental Transfers and the Economic Role of State Government's.**

1.1. Introduction                                   1.1  
1.2. Objectives of the Study.                      1.3  
1.3. Data Sources and Methodology.                 1.8  
1.4. Development of Grants Theory.                 1.9  
   1.4.1. Types of Grants.                          1.11 
1.5. The Economic Role of State Governments.       1.14 
   1.5.1. Allocation Role in a Developed Country   1.15 
   1.5.2. Distribution Role in Developed Countries. 1.23 
1.6. Roles of State Governments in Developing Countries. 1.32 
1.7. Summary                                       1.40 

## 2.0. CHAPTER TWO

**Structure of the Nigerian Economy.**

2.1. General Introduction.                         2.1  
2.2. Growth and Structure of Production.          2.7  
2.3. Growth of the Government Sector.             2.12
2.3.1. The Growth of Expenditures. 2.12
2.3.2. Growth of Oil Sector and Federal Revenues. 2.13

2.4. Federal Government Finances. 2.14
   2.4.1. Federal Government Revenues. 2.15
      2.4.1.1. Direct Taxes. 2.16
      2.4.1.2. Indirect Taxes. 2.18
      2.4.1.3. Other Revenues. 2.20
   2.4.2. Federal Government Expenditure. 2.21
      2.4.2.1. Current Expenditure. 2.22
      2.4.2.2. Capital Expenditure. 2.25

2.5. Summary 2.28

3.0. CHAPTER THREE.

   Structure of State Finances and the History of Revenue Sharing in Nigeria.

3.1. State Finances in Nigeria. 3.1
   3.1.1. State Revenues in Nigeria. 3.2
      3.1.1.1. Federal Government Grants. 3.2
      3.1.1.2. Internally Generated Revenues. 3.5
   3.1.2. State Government Expenditures. 3.7
      3.1.2.1. Current Expenditures. 3.8
      3.1.2.2. Capital Expenditures 3.9

3.2. History of Revenue Sharing in Nigeria. 3.10
   3.2.2. The Hicks-Phillipson Commission (1951). 3.14
   3.2.3. The Chick Commission (1953). 3.15
   3.2.4. The Raisman Commission (1958). 3.16
   3.2.5. The Binns Commission (1964). 3.17
   3.2.6. Decree No. 15 of 1967. 3.18
3.2.7. Dina Interim Revenue Allocation Review Committee (1968). 3.18
3.2.8. Decree No. 13 of 1970. 3.19
3.2.9. Decree No. 6 of 1975. 3.20
3.2.10. Aboyade Technical Committee on Revenue Allocation (1977). 3.20
3.2.11. Presidential Commission on Revenue Allocation (The Okigbo Commission 1980). 3.22
3.2.12. Decree No. 36 of 1984. 3.24
3.3. Review of the Commissions Recommendation. 3.25
3.4. Theoretical Basis of the Presidential Commission on Revenue Allocations Recommendations. 3.26
3.5. Forms of Intergovernmental Transfers from Federal Government to State Governments. 3.30
  3.5.1. Statutory Allocation. 3.30
  3.5.2. Non-Statutory Allocations. 3.32
  3.5.3. Loans. 3.33
  3.5.4. Federal Presence. 3.34
3.6. Summary 3.34

4.0. CHAPTER FOUR.
Fiscal Decentralisation in Nigeria.
4.1. Introduction. 4.1
4.2. Literature Review: Determinants of Fiscal Decentralisation. 4.7
4.3. Fiscal Decentralisation in Nigeria. 4.17
  4.3.1. Definition. 4.19
  4.3.2. Measures 4.19
  4.3.3. Model and Estimation. 4.26
5.0. CHAPTER FIVE.

Intergovernmental Transfers Theory and the Impact of Statutory Allocation on State Expenditures in Nigeria.

5.1. Introduction. 5.1

5.2. Rationale for Grants. 5.4

5.2.1. Grants to Correct for Externalities. 5.4

5.2.2. Reducing a Country's Fiscal Gap. 5.7

5.2.3. Fiscal Equity Attainment. 5.9

5.2.4. Fear of Migration Inefficiencies. 5.10

5.2.5. Advantages to Federal Politicians. 5.11

5.3. Role of Grants. 5.16

5.4. Theory of Grant Impacts. 5.19

5.4.1. Impact of Matching Grants. 5.21

5.4.2. Impact of Lump-Sum Unconditional Grants. 5.22

5.5. Statutory Allocations and State Government Expenditures. 5.27

5.5.1. Impact of Statutory Allocations on State Expenditures. 5.28

5.5.1.1. Expenditure Determinants Studies. 5.29

5.5.1.2. Statutory Allocation: Stimulative or Substitutive? 5.35

5.5.1.2.1. Empirical Findings. 5.37

5.5.1.2.2. Limitations. 5.43

5.5.1.1.2. Statutory Allocation: Growth in
6.0. CHAPTER SIX.
Fiscal Equalisation Theory.

6.1. Introduction. 6.1
6.2. Rationale for Equalisation. 6.5
6.2.1. Equity. 6.7
6.2.2. Efficiency. 6.11
6.3. Equalisation Formulas and Models. 6.15
6.3.1. Equalisation of Actual Outlay or Performance. 6.16
6.3.2. Equalisation of Fiscal Capacity. 6.19
6.3.3. Equalisation of Fiscal Potential. 6.21
6.4. King's "Alternative Equalisation Scheme". 6.26
6.5. Summary 6.28

7.0. CHAPTER SEVEN.
Fiscal Equalisation Model and Test.

7.1. Introduction. 7.1
7.2. Vertical and Horizontal Fiscal Imbalance in Nigeria. 7.2
7.2.1. Vertical Fiscal Imbalance. 7.3
7.2.2. Horizontal Fiscal Imbalance and Inter-State Inequalities in Nigeria. 7.7
7.2.2.1. Budgetary Activities. 7.9
7.2.2.2. Others. 7.10
7.3. Fiscal Equalisation Model. 7.12
7.3.1. Model. 7.14


<table>
<thead>
<tr>
<th>T/No.</th>
<th>Title</th>
<th>Page No.</th>
</tr>
</thead>
<tbody>
<tr>
<td>2.1</td>
<td>Nigeria's GDP by Industrial Origin 1965-'85.</td>
<td>2.30</td>
</tr>
<tr>
<td></td>
<td>At 1977 Factor Cost (N Million)</td>
<td></td>
</tr>
<tr>
<td>2.2</td>
<td>Nigeria's GDP by Industrial Origin 1965-'85.</td>
<td>2.31</td>
</tr>
<tr>
<td></td>
<td>At 1977 Factor Cost (Percentage)</td>
<td></td>
</tr>
<tr>
<td>2.3</td>
<td>Sectoral Distribution of Total Gainfull</td>
<td>2.32</td>
</tr>
<tr>
<td></td>
<td>Employment in Nigeria. 1975-'85. (’000)</td>
<td></td>
</tr>
<tr>
<td>2.4</td>
<td>Federal Government Expenditure as Percentage</td>
<td>2.33</td>
</tr>
<tr>
<td></td>
<td>of GDP for Selected Fiscal Years. (N Million)</td>
<td></td>
</tr>
<tr>
<td>2.5</td>
<td>Federal Government Oil Revenues and Total</td>
<td>2.34</td>
</tr>
<tr>
<td></td>
<td>Current Revenues. 1980-'84. (N Million)</td>
<td></td>
</tr>
<tr>
<td>2.6</td>
<td>Current Revenue of the Federal Government</td>
<td>2.35</td>
</tr>
<tr>
<td></td>
<td>of Nigeria, 1970-'85. (N Million)</td>
<td></td>
</tr>
<tr>
<td>2.7</td>
<td>Current Revenue of the Federal Government</td>
<td>2.36</td>
</tr>
<tr>
<td></td>
<td>of Nigeria, 1970-'85. (Percentage)</td>
<td></td>
</tr>
<tr>
<td>2.8</td>
<td>Current Expenditure of the Federal Government</td>
<td>2.37</td>
</tr>
<tr>
<td></td>
<td>of Nigeria, 1970-'85. (N Million)</td>
<td></td>
</tr>
<tr>
<td>2.9</td>
<td>Current Expenditure of the Federal Government</td>
<td>2.38</td>
</tr>
<tr>
<td></td>
<td>of Nigeria, 1970-'85. (Percentage)</td>
<td></td>
</tr>
<tr>
<td>2.10</td>
<td>Capital Expenditure of the Federal Government</td>
<td>2.39</td>
</tr>
<tr>
<td></td>
<td>of Nigeria, 1970-'85. (N Million)</td>
<td></td>
</tr>
<tr>
<td>2.11</td>
<td>Capital Expenditure of the Federal Government</td>
<td>2.40</td>
</tr>
<tr>
<td></td>
<td>of Nigeria, 1970-'85. (Percentage)</td>
<td></td>
</tr>
<tr>
<td>3.2</td>
<td>Federal Grants per capita to State Governments in Nigeria, 1980-'85. (N Mill.)</td>
<td>3.37</td>
</tr>
</tbody>
</table>
3.3 Internally Generated Revenue of State Governments in Nigeria, 1978/79-'85. (N Mil.) 3.38

3.4 Deviations From the Mean of Federal Grants and Internally Generated Revs. P/Capita. 3.39

3.5 Current Expenditure of State Governments in Nigeria, 1980-'85. (N Million) 3.40

3.6 Capital Expenditure of State Governments in Nigeria, 1980-'85. (N Million) 3.41

3.7 Revenue Sharing by Tax Source. April '59-March '69. (Percentage) 3.42

3.8 Revenue Sharing by Tax Source. April '69-March '79. (Percentage) 3.43

3.9 PCRA and the National Assembly Approved Scheme for Sharing the 'F.A.' in Nigeria. (%) 3.23

3.10 Stat., Non/Stat. Allocations and Loan-on-lent to State and Local Govts. in Nigeria. (N Mil.) 3.44

3.11 Stat., Non/Stat. Allocations and Loan-on-lent to State and Local Govts. in Nigeria. (%) 3.45

4.1 Federal-State Decentralisation Ratios in Nigeria, 1970-'85. 4.26

4.2 OLS Regression Results of Decentralisation Ratios and a Selection of Indep. Variables. 4.31

5.1 Linear OLS Regression of P/Capita States Total Exps. on Selected Variables, 1980 & '85. 5.48

5.2 Semi-Log OLS Regression of P/Capita State Total Exps. on Selected Variables, 1980 & '85. 5.49

5.3 GNP, and Statutory Allocation as Proportion of GNP. 5.45

7.1 Fiscal Outlook and Vertical Imbalance in
7.2 State Government Revenues and Expenditures—xi—
1985. (N Million) 7.29
7.3 Indicators of State Disparities, 1982. 7.30
7.4 Factors Affecting States Exp. Needs, 1984. 7.31
7.5 Relative State Costs, Fiscal Capacities, Rev.
7.6 Deviation from the Mean of P/Capita Grants. 7.33
8.1 Proposed States Joint Account Distribution 8.5

List of Figures.

<table>
<thead>
<tr>
<th>F/N</th>
<th>Title</th>
<th>Page No.</th>
</tr>
</thead>
<tbody>
<tr>
<td>4.1</td>
<td>Expenditure Decentralisation in Nigeria.</td>
<td>4.35</td>
</tr>
<tr>
<td>4.2</td>
<td>Revenue Decentralisation in Nigeria.</td>
<td>4.36</td>
</tr>
<tr>
<td>5.1</td>
<td>Impact of grant’s on Expenditures.</td>
<td>5.50</td>
</tr>
<tr>
<td>6.1</td>
<td>Equalisation of Fiscal Capacity.</td>
<td>6.30</td>
</tr>
<tr>
<td>6.2</td>
<td>Equalisation of Fiscal Potential.</td>
<td>6.31</td>
</tr>
<tr>
<td>6.3</td>
<td>King’s Equalisation Scheme.</td>
<td>6.32</td>
</tr>
</tbody>
</table>
I express my profound gratitude to my research supervisor, Prof. Peter M. Jackson, for his valuable comments and suggestions regarding this work, as well as the attitude of "you are doing well" that he built in me over the almost three years I took to finish this work.

My gratitude also goes to Maiduguri University for providing me with the necessary 'subsistence' funding that enabled me to accomplish this work.

Finally I express my sincere appreciation and thanks to all those that helped me in one way or the other with this work, as well as all those friends with whose company and encouragement this work was made possible.
1.1. INTRODUCTION.

Decentralisation of responsibilities to lower tier authorities has for a long time being a desirable objective. This is because of the desire to ensure the attainment of efficiency in resource allocation and to some extent equity in distribution. However, the attainment of these two major public policy goals in a federal set-up are marred by many factors. Some of which are: firstly that of non correspondence between revenue sources and expenditure requirements, as it pertains to relations between the central and sub-central governments. Secondly, the obvious disparity in resource endowments of the different parts of the same country, which consequently results in differences in public service provision. This is brought about by disparities in the regions fiscal capacity as well as needs. Thirdly, as a result of the independent fiscal actions of different jurisdictions, spillovers on to other jurisdictions of either benefits or costs are inevitable. This brings about inefficiency in resource allocation.

The problem of non correspondence necessitates either transfers of revenues to sub-central jurisdictions sufficient to enable them carry out their designated responsibilities or reducing their expenditure responsibilities to match their revenues. In the same vein
-1.2-
differences in resource endowments across jurisdictions results in people within the same country but living in different regions having different fiscal residuas, which results in regions with low fiscal capacity and high needs taxing people with greater severity than the amount of public services they provide. To check and reduce the magnitude of the two problems, a number of different measures are used. However, the most noticeably effective one is a series of transfers of resources to sub-central governments. This kind of transfer from the centre to the states and local governments, may come in principally two forms, i.e., either conditional or unconditional grants. The difference between the two is discussed later in this chapter.

Different types of revenue transfers are used for different purposes, depending on the ultimate objectives that the transfers are meant to achieve. Transfers from the central government to states and local governments can be for any of the following main reasons:

(a) To deal with a situation where the central government is trying to set minimum national standards in the provision of public goods and services;
(b) It may simply be to provide incentives for states and local governments to raise service levels; or,
(c) It may be a situation where the central government is trying to equalise the fiscal opportunities of states and local governments.
Each of these requires transfers of revenue of some sort, the first two are mainly achieved with conditional grants, while the third situation requires a series of unconditional grants, with provisions for equalisation. This equalisation can be in the form of fiscal capacity or needs of different jurisdictions in the country or a combination of both. However, the ultimate effect is to reduce the fiscal disparity between the different jurisdictions. Hence this study will mainly examine this aspect of federal-state fiscal relations, most especially the use of revenue sharing formulas for equalisation purposes.

1.2. OBJECTIVES OF THE STUDY.

One of the most reiterated national objective in Nigeria, found in two of the country's development plans is the attainment of a just and egalitarian society.¹ This objective puts a premium on reducing inequalities in interpersonal incomes and promoting balanced development in the different geographical areas of the country. This implicitly implies that distributive equity is to be pursued. The pursuance of such an objective, hence puts some of the responsibility on state and local governments. The structure of federal-state fiscal relations and the nature of revenue sharing in the country shows the extent to which the partial solution to such an objective is to be

pursued. The pursuance of this objective is reflected in the recommendations of the different revenue allocation committees reports/Decrees enacted by the various Military regimes on how the nations Distributable Pool Account(DPA) or Federation Account(FA) is to be distributed between the Federal, States and Local Governments.

The major objective of each commissions work was centered around aiming at achieving this objective. Though the achievement of fiscal equalisation is not explicitly stated, yet one can infer that it is the ultimate desired objective given the nature of the formulas used for statutory allocation disbursements.

As such the main objective of the study is to examine the extent of fiscal decentralisation in the federal-state sector of the country and the attempts at reducing inequity in distribution of national resources as well as achieving efficiency in resource allocation through the governments effort of revenue equalisation. This is examined within the anticipated developmental role that statutory allocation of revenues are assumed to attain.

This major objective is sub-divided into three. These are:

(a) The study will in the first instance examine the structure of decentralisation in the country, with special emphasis on expenditure and revenue decentralisation. Most importantly we will try to examine the economic variables that affect the
degree of decentralisation in the country.

(b) Secondly, we will examine the nature of revenue sharing in Nigeria and see whether the statutory allocation of revenue in the country (which are lump-sum unconditional grants) are used to either stimulate State government fiscal activities or it is being substituted for local money. In addition, we will briefly look into the relative growth in statutory allocation in relation to the country’s income. Within this segment we will examine the regularity and ease of prediction of this revenue source. Since the two have obvious planning effects on the states.

(c) Lastly since the major objective reiterates the element of achievement of equity, hence a test of fiscal equalisation will be run to see the extent of regional inequity in the country and the attempts to it’s solution by the use of revenue sharing grants, taking into consideration the needs and capacities of the states in the country.

Given these three narrowed down objectives, the next question is how do we achieve them?

To achieve these objectives the study is broadly divided in to six parts. First, we will distinguish different types of grants and the uses to which they are put to. This is important because, the objectives a government wants to achieve with the use of grants is often furthered by the specific type of grant it uses. This will be followed by
the economic roles that sub-central governments perform, which will be enhanced by revenue transfers. Further, we will examine whether their roles allow them to perform any serious allocative or distributive role within their boundaries, while at the same time maintaining a certain degree of autonomy from the central government.

The second part deals with Nigeria, we will briefly examine the structure of the economy, with specific reference to the growth of the public sector and most importantly the growth of oil revenues over the years. This will be followed by an examination of the finances of states and Federal governments in the country which is intended to throw some light on the major sources of revenues of the two levels of government and how they are spent. This will hopefully highlight on the areas they are either under/over funded. We conclude this part by examining the history of revenue sharing and the different forms of intergovernmental transfers from the centre to the States in Nigeria.

The third part examines revenue and expenditure decentralisation in Nigeria. This section traces the developmental advantages of decentralisation and why it became a desirable practice. It further examines how variables such as grants; per capita income; urbanisation and the degree of an economies openness affect the degree of decentralisation in theory as examined and used by various works in the literature, as well as how these variables affect expenditure and revenue decentralisation in Nigeria.
The fourth part of the study examines the theoretical basis of Intergovernmental transfers as well as the numerous work done in the field. This section traces the economic and institutional rational for the issuance of grants and the expected roles that each type of grant performs. In pursuance of a worthy role for grants the section runs some tests to see the impact of statutory allocation on state expenditures in an attempt to determine whether the grants are stimulative or substitutive, using the figures of amounts disbursed to the States from the proceeds of the nations federation account. Further the section examined the trend of changes in income and statutory allocation, with a view to determining whether they change in the same proportion. On a final note the section looks at the regularity and ease of prediction of this revenue source.

The fifth part of the study examines the last objective, which in this case is reduced to the issue of achieving fiscal equalisation in the country. It started with what fiscal equalisation mean within this study and why it came to be a desirable objective. This distinction is imperative, if one is to show the theoretical rationale of fiscal equalisation, since disparities exist between jurisdictions mainly with regards to resource endowments, viz: land, labour and capital. These disparities affect each regions taxable capacity, costs and actual outlays. The fact that equalisation is justifiable on equity and efficiency grounds means that a strong theoretical justification exists for it. After establishing a theoretical basis for it we examined the attempts and
formulas used by other writers on how best to achieve equalisation, notably those of Musgrave, King, Boyle and Mathews. The different formulas used and the justification of each helps us to use Mathews reformulated model to design a model to test with Nigerian data.

The study will conclude with recommendations that will lead to a fairer revenue allocation scheme that takes into account the attainment of the twin objectives of equity and efficiency.

1.3. DATA SOURCES AND METHODOLOGY.

The data source in this work is mainly secondary. Among which are: (1) The publications of the Central Bank of Nigeria, which are the Quarterly publication of Economic and Financial Review and the Annual Report and Statement of Accounts of various years. In case of any discrepancy in the figures between the two publications, (which is quite often), the ones presented in the annual reports are used. (2) Publications of the federal office of statistics, mainly the Annual Abstract of Statistics; (3) Publication of the World Bank, most especially the World Bank World Tables and the World Development Report; (4) Use was also made of the ECA’s publication on the Economic and Social conditions in Africa, for various years; and (5) use was finally made of the most comprehensive of compilations dealing with state, local and federal government finances in Nigeria as presented in the Report of the Presidential Commission on Revenue Allocation of 1980.
The methodology for the presentation, testing and discussion of the major sections of the paper has not been the same throughout the paper. This range from simple accounting framework to an OLS regression; use of a comparative static cross-section analyses in some sections and a changing trend time series analyses in others. In both cases the scope has been narrowed to the years 1970–'85. For instance, a simple comparative static accounting framework is implored for the section on fiscal equalisation, that spans across all the states, and compares the need and cost elements of each state, in an attempt to find whether revenue sharing arrangement has aided in achieving fiscal equalisation. While an OLS regression analyses using cross-section approach is used to find the specific role that statutory allocations play in states expenditure determination. This was used on a trend basis by taking two sample years, i.e., 1980 and 1985, such that hopefully any change that the use of cross-section analysis hides might be highlighted. The final method used, was still an OLS regression but with time series, in the examination of factors that determine the degree of expenditure and revenue decentralisation. It is used in such a way that decentralisation trend can be established over a 16 years range.

1.4. DEVELOPMENT OF GRANTS THEORY.

On a more general level, fiscal federalism theory (as pointed by Musgrave: 1983, McLure: 1983a, King: 1984) has supported a federal system of government. This involves
having a central government at the centre and a series of sub-national governments, of which each of the tiers has designated expenditure responsibilities and revenue sources to tap and use, with a clearly earmarked pattern of relationship between them. This arrangement though convenient, yet has some problems, one of which is the centralisation of the tax system. This enables the central government to have the major revenue sources, while the State and local governments have the relatively minor ones. The basis for such a measure of centralisation lies in the assignment of redistributive and stabilisation functions on the central government. This is discussed in detail in this chapter. This tax centralisation supports a series of intergovernmental transfers if the federal system is to survive. This is more so if decentralisation exists in the provision of public goods and services in order to attain allocational efficiency. This seems to be a real paradox, which Netzer aptly summarised:

It will be an unlikely coincidence if the ideal allocation of expenditure and revenue responsibilities matched precisely, if the appropriate revenue powers of state and local governments were sufficiently productive to finance their expenditure responsibilities even after spillovers had been accommodated by optimising grants. It has been argued that in reality the situation is one in which the federal government has ample revenue sources and limited civilian expenditure responsibilities, leading to the necessity for tax reductions (or intergovernmental transfers) for stabilisation goals, while the opposite is true for state and local governments requiring continual state local tax rate increases.  

---

Such transfers implied in Netzer's work result in stabilisation attempts by the central government which in the same way more often results in locational efficiency and to redistribution.

In all federal countries, the fiscal arrangement requires this kind of transfer of funds from the centre to sub-central governments. These transfers might take different forms depending on the ultimate objective of the central government. This is more so, since they have come to be seen as a means by which most federal countries compromise between the desire of the federal government to expand services; to equalize local incomes or to make greater use of the sub-central governments tax base without directly assuming the sub-central governments spending role.

Given that grants are to be issued from central to sub-central jurisdictions. Two major policy issues need to be resolved, i.e., firstly, to determine the purposes for which the grant is to be given, and secondly, determine the appropriate grant for each purpose. So to select the appropriate grant, we need to discuss the major types of grants available and see how each affect sub-central governments spending patterns. This section will examine the different types of grants available.

1.4.1. Types of Grants.

Grants can broadly be categorised into two: these are the conditional and the unconditional grants. Each of the
two can further be sub-divided (see chart). Conditional grants which are also referred to as specific grants are those normally issued with conditions attached, as to how the money given is to be spent. While the unconditional grants are those where the sub-central authorities are given the money, and they can spend them at their discretion, without any condition attached.

Chart 1.

<table>
<thead>
<tr>
<th>Grants</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
</tr>
<tr>
<td>Conditional Grants (CG)</td>
</tr>
<tr>
<td>Lump-Sum(CG) Matching(CG)</td>
</tr>
</tbody>
</table>

Unconditional grants can be sub-divided into two: i.e.; into Lump-sum unconditional grants and Effort-related unconditional grants. The lump-sum unconditional grant is normally a fixed amount of money given to sub-central authorities, which is not tied to any effort or performance variable. While the effort-related unconditional grant is normally given based on a specific effort on the part of the recipient, mainly in the area of revenue generation. It is this type of grants that this study will mainly be concerned with, since this is the one conventionally used for revenue sharing and equalization purposes.
On the other hand the conditional grant can also be divided into two: i.e.; into a Lump-sum conditional grant and Matching conditional grant.3 A Lump-sum conditional grant is normally a fixed sum of money given to a sub-central government to spend on a specific project, while the Matching conditional grant is not fixed and often depends on the recipients' own expenditures on the specific service that the grant is meant for. Often the grant is quoted in percentage terms, i.e.; a percentage of the amount spent by the recipients.

Depending on the Federal Governments ultimate objectives grants from higher jurisdictions to lower ones can be designed to serve different purposes, since the purposes of grants are many. This includes, plans to equalize the fiscal opportunities of sub-central authorities be it horizontal or vertical; it may also be in the form of revenue sharing mainly designed to correct for fiscal mismatch between different levels of governments. These two are mainly effected by the use of unconditional grants. There are grants designed to make sub-central governments to take into account the spillover effects of their services. And finally there are grants designed to ensure the fulfillment of a central governments preferences, such as the construction of a specific project. These two are often met with the use of conditional grants, which specifies the

---

3 Matching conditional grants are further sub-divided into two by David King, i.e.; into Closed Matching Specific/Conditional grants and Open Matching Specific/Conditional grants. See his Fiscal Tiers: Economics of Multi-Level Government, George Allen and Unwin ltd. London 1984. p.87.
service to be provided or promoted by the receiving authority.

The next question which has not been addressed is the issue of what sort of economic roles do sub-central governments perform, which necessitate this kind of transfers?. The following section examines their roles.

1.5. THE ECONOMIC ROLE OF STATE GOVERNMENTS.

To analyse the possible economic roles of state governments one has to resort to the initial analytical framework laid down by Musgrave. The framework is mainly to examine their roles in relation to the three major functions of public budgets, i.e.; Allocation, Distribution, and Stabilisation. It is important to analyse the roles within this framework because modern welfare economics measures the effectiveness of an economic system by the extent to which it maintains a balance in these trio problems. That is achieving efficiency in resource allocation, achieving equity in distribution of income and welfare, and maintaining stable prices and high levels of employment.

So much has been written on the effective roles that each tier of government will perform with respect to satisfying the three functions mentioned. The general consensus among most economists is that it is only the allocation role that can be efficiently and effectively

---

performed by the state governments. While the Stabilisation function can best be performed by the central Government. However, there is a divergence of opinion as to what level will best perform the redistribution role. Hence this section will examine the argument advanced for and against national redistributive role, as well as the arguments for an efficient performance of allocation role at the state level. This is mainly because the broad goals of government intervention in economic affairs is to effect social welfare maximisation, such that equity is achieved in distribution and efficiency in resource allocation.

The stabilisation function will not be discussed because the state governments do not have control over the size and supply of money in the country. Their attempts at going for deficit financing to stimulate the local economy will not necessarily be effective because of the possible costs to local residents. The manipulation of fiscal policies to effect stabilisation will not be effective because of 'leakages'. This is because the states are open economies, such that residents spend a significant portion of their incomes on goods and services produced in other states.

1.5.1. Allocation Role in a Developed Country

The allocation role as used in this context is meant to to the most Pareto-efficient way of providing goods and services. Pareto efficient in the sense that the optimal allocation is designed in such a way that any change that makes at least one person better-off and no one worse-off is
an improvement in social welfare.

Most economists see this role as the most appropriate to be delegated to lower level governments. This is mainly because of their proximity to the people. This proximity ensures that the different preferences and tastes of the people they govern are taken into consideration when taking decisions with regards to the provision of public goods and services. This is more so the case when it is assumed that the states are trying to maximise a certain social welfare function based on the preferences of their residents. The issue is that economic efficiency is attained by providing the mix of output that takes the preferences of all individuals who constitute the society, and if all individuals are forced to consume the same thing, while in reality variations in consumption among different jurisdictions is possible then resource allocation is sub-optimal.

Tiebout argued in his famous 'voting with the feet' thesis, that the existence of sub-national government results in goods and services provided at a minimum cost, since people of like tastes will tend to group together. This will only come about in a perfectly competitive situation, where assumably people will move from high-cost areas to low-cost areas. The possibility of that can however be questioned in real life.

---

Oates clearly summarised the main economic advantages of sub-central allocative role. The first is the achievement of economic efficiency by providing "an allocation of resources that is more responsive to the tastes of consumers". This can be obtained because of the proximity of the government to the people. Secondly, because of the competitive pressures involved in trying to win the confidence of their population as well as attracting more, the sub-national governments will have to adopt the most efficient techniques of production, thereby bringing about efficiency in the production of public goods. Thirdly sub-central governments provide a set-up that "promotes better public decision making by compelling a more explicit recognition of the costs of public programs", i.e., if they are based on benefit pricing.

Though it is unlikely to find jurisdictions that are formed where the members have an identical demand for the same public goods, yet it is still safe to assume that the sub-central government's are pursuing a goal of social welfare maximisation which is distinct from the social welfare function maximised at the national level.

To illustrate the justification for sub-central allocative role, we assume the division of a country into two sub-groups 'A' and 'B', also assume all individuals have identical preferences but different tastes, and that society

---


7 Ibid.
produces two goods 'X' and 'Y'. Further assume that
distribution of Income is optimal. Hence we can maximise
our social welfare thus:

Maximise: $U^A (X^A, Y^A)$.

Sub. To: $U^B (X^B, Y^B) = U$.

First order maximisation condition will give:

$$MRS_{X^A,Y^A} = MRS_{X^B,Y^B} = MRT_{X,Y}.$$ 

However with different tastes $X^A \neq X^B$, similarly $Y^A \neq Y^B$, hence different governments will be required to maximise welfare and will end up with:

$$MRS_{X^A,Y^A} = MRT_{X,Y},$$ 
$$MRS_{X^B,Y^B} = MRT_{X,Y}.$$ 

If on the other hand the National Government is forced
to provide equal amounts of 'Y' to each subgroup such that
$Y^A = Y^B$, this will mean adding a constraint to the government. Then the new equilibrium condition will have to take the additional constraint into consideration. It will look like this:

$$MRS_{X^A,Y^A} = MRS_{X^B,Y^B} = MRT_{X,Y} + \alpha_3/\alpha_2 F_X$$

Where: $\alpha_2 = The Lagrangian Multiplier associated with societies production possibilities, F( ) = 0.$

$\alpha_3 = The Lagrangian Multiplier associated with the new constraint $Y^A = Y^B$.

Sub-central governments can provide the required goods optimally without adding another constraint. This clearly shows that national provision will result in a lower level of social welfare at the optimum. As such lower level government provision will be the best. This further confirms that sub-central autonomy and sub-central provision
are certainly preferred than national provision.

In an attempt by Buchanan to justify optimality in sub-central provision, he formulated his famous 'Economic Theory of Clubs', to explain the optimal formation of local jurisdictions. According to him the optimum size of a jurisdictions membership occurs when the Marginal Costs (MC) of the external diseconomies just equal the Marginal Savings (MS) from spreading total operating costs. As such an optimum sized jurisdiction is likely to provide local public goods, (where exclusion is possible) optimally than what a national government would have done.

Martin McGuire used Tiebouts Theory of Public Expenditure and Buchanans Theory of Clubs to analyse the cost considerations in reaching an optimum. For McGuire, an optimal sub-central provision of a public good 'X', must have two special properties: i.e., first, exclusion is possible to those who do not pay, secondly, as more of the public good 'X' is provided each person receiving it bears more costs. Since social welfare maximisation depends on the number of people consuming a given public good, he used a direct cost approach, whereby each person is assumed to pay the average cost of the public good 'X', where the

---

average is defined in relation to the number of people consuming the good. He concluded that the average cost (AC) of providing public good 'X' just equals the marginal cost (MC) of one additional person. This is a technically efficient situation where average cost is at its minimum, and as long as jurisdictions can be reproduced people will always regroup until the minimum average cost obtains in each jurisdiction. Hence sub-central provision of a public good to all citizens is more optimal, since it can be provided to people of like tastes in different jurisdictions, in a way that maximises each person's net benefit of consuming and paying for the good.

McGuire did not call for sub-central autonomy neither did he recommend for a national allocative role. For him, national provision will not be optimal because of cost of access on the part of individuals to the public good. In the same vein, Stigler as against McGuire argued for sub-central autonomy but only in allocational decision making.

It is assumed that each jurisdiction has its own distinct social welfare function separate from the national social welfare function. This is more so because the sheer geographic distance between the Federal Government and most people within a given country is bound to affect the transmission of information. This subsequently results in

\[\text{---}11\text{---}\]

uncertainty in the minds of people, which make them to be more at ease with Local provision.

To further illustrate why a risk-averse society will prefer sub-central provision, we assume that the only allocational problem facing society is the existence of a Samuelsonian public good, \((X_g)\). All other goods are private goods, there are no problems of decreasing cost and income distribution is optimal. So with perfect certainty the equilibrium first order condition will be:

\[
\sum_{h} \text{MRS}^{h}_{Xg,I} = \text{MRT}_{Xg,I}
\]

Where
- \(I\) = The other goods or Income.
- \(h\) = Individual whose MRS is being considered.

The above equilibrium condition will be obtained both by the central and sub-central governments. However the Local jurisdiction knows the likes of it's citizens more, hence can determine with ease each individuals Marginal Rate of Substitution with respect to the public good \((X_g)\) and other goods \((I)\), while the central government did not know as much, in that it only observes each individuals Marginal Rate of Substitution with respect to \((X_g)\) and \((I)\) just as a random variable, thus:

\[
\hat{\text{MRS}}^{h}_{Xg,I} = \text{MRS}_{Xg,I} + \alpha.
\]

Where
- \(\text{MRS}_{Xg,I}\) = The true Marginal Rate of Substitution as observed by a local jurisdiction.
- \(\alpha\) = A random variable.

---

12 This illustration is discussed in detail in Tresch R.W., (1981) op.cit., pps. 575-576.
The new first order maximisation condition will be:

\[ \hat{MRS}^{X_\text{g},I} = MRT^{X_\text{g},I} \]

In this situation 'social welfare will be maximised if local jurisdictions form and decide the appropriate level of public good 'X_g', rather than letting the national government to determine it.' If by any chance mean of 'α' is not equal to zero, then the National Governments decision is biased meaning either there is an over or under provision of the public good 'X_g', while this fear does not arise with sub-central provision.

Musgrave is also of the opinion that the sub-central governments will be in a better position to perform certain allocation functions. This according to him is because of the differences in the spatial incidence of social goods. He suggests a fiscal structure, where local public goods can be provided locally and national goods provided nationally. The local provision is mainly aimed at catering for differences between communities in preference patterns. To buttress his point, he wrote:

'Differences in fiscal patterns between jurisdictions will reflect differences in effective demand (i.e., in preferences and incomes) of the residents. Efficiency will be served moreover by permitting people with equal preferences for social goods to live together, since this permits them individually to obtain the desired amount of social goods at a lower price.... Moreover since political decisions can only approximate individual preferences, similarity of tastes also reduces the risk that individuals will be faced with budget decisions that they consider non-optimal'.

\[ \text{Ibid.}, \text{p.}575. \]

Musgraves proposition of local provision of social goods is based on his spatial model, where by the social goods provided should be financed by the people who benefit from it, and that benefits should not be exported to people living in other jurisdictions who do not pay. In essence there should be no free-riders.

The major advantage of sub-central provision of public goods and services, is that it allows for a diversity in both the quantity and quality of the public services provided. This is because they are based upon different preference patterns among the citizens of various political sub-divisions of a large jurisdiction,\(^\text{16}\) as such inefficiency in production is likely, if the central government is allowed to provide them. This is more clearly seen in situations where there are possible differences in demand among the citizens in different political sub-divisions. The other major issue is, since optimality in allocation can best be achieved through sub-central governments, how just is the income distribution among the people? Can the state governments partake in redistribution since they are closer to the people?, the next section will consider this.

1.5.2. Distribution Role in Developed Countries.

This role necessitates an equitable income distribution

\(^{15}\text{Ibid.}\)

in an Pareto-Optimal manner. A distribution is pareto-optimal when in the process of redistribution no one is made worse-off, i.e., transfer of income or wealth from one individual to another increases the utility of both donor and recipient, thus bringing a pareto improvement.

The major concern is not with distribution, but that of redistribution to ensure that income and wealth inequality are tackled effectively. It is the contention that distribution of income as it is now in most developing and developed federal countries is unjust, hence the concern with redistribution as a means of achieving equity in distribution of income and wealth.

This happens to be the most controversial of all roles to be performed by sub-central authorities. It is controversial because quite a number of economists argue that the role can best be performed by the central government. While other Economists have argued that the sub-central authorities can also provide a pareto superior redistribution, or at least an equal redistribution network to the central government, but certainly not a pareto inferior redistribution. This section will examine the conventional argument for optimal redistribution at the national level, the weaknesses of these arguments and the alternative argument in support of sub-central redistribution.

---------------------

17 For the main stream arguments that gave central governments this role, see the writings of Buchanan J.M., (1950) "Federalism and Fiscal Equity", American Economic Review, Vol.40; pps.583-599; Musgrave R.A., (1971) op.cit., pps.3-13; and Oates W.E., (1972) op.cit.
The conventional writers argue that redistribution from one jurisdiction to another, simply because people in a certain jurisdiction desire to see the level of income of people in other areas increased is not likely to be optimal. This is because independent action on the part of each small jurisdiction will result in sub-optimal amounts of redistribution.\(^1^8\) Also redistribution at the sub-central level is not likely to be optimal in that 'exclusion principle does not apply, as such citizens of one jurisdiction may through utility interdependence, benefit from redistributive activities in other areas',\(^1^9\) hence the free rider effect may result in inefficiencies.

It is also argued that redistribution cannot be achieved at the sub-central level as long as people are mobile. This is because it is assumed that people act rationally and coupled with the fact that they are mobile, imply that they can decide to migrate at any time they so wish. The migration can be either to escape being excessively taxed for redistributive purposes on the part of the rich, or move and enjoy the benefits of redistribution on the part of the poor. What this means in essence is that, if one community is trying to pursue redistributive income policies in favour of the poor, while another community is not doing so, there is every tendency for the rich in the community redistributing income to migrate to the other community where they will not be taxed heavily for redistributive purposes. Equally there is a

\(^{1^9}\)Ibid.
tendency for the poor to migrate to localities with redistributive programs. This migration has a lot of implications. If the rich migrate, the local communities redistributive activities will be thwarted, and the poor in that community will be worse-off, because the communities tax base is reduced. The poor migrating to a community with redistributive program on the other hand bring about a serious congestion cost to the public goods provided. Hence redistribution at the sub-central level is inconsistent with the goal of maximising social welfare as long as resources are mobile.

As a continuation of the problem of mobility of individuals, it is argued that jurisdictions may try to compete for members, the competition is mainly to attract not only new residents but also additional Business Investments, so that their tax base can be enhanced. Hence some jurisdictions will be reluctant to raise tax rates for fear of discouraging potential entrants, ‘such a competition so the argument goes leads systematically to less than efficient levels of provision of the public services consumed in these jurisdictions’. Baumol also argued in the same line, when he was discussing urban crisis. This competition is not likely to be avoided, because taxes at the local level are mainly benefit related taxes. This means that each individual

-------------------
pays tax on the basis of the benefit he receives from the
public good consumed by him. This results in the per-unit
rate paid being equal to the individuals Marginal Rate of
Substitution of the public good and a numeraire good. It is
only the central government that imposes an ability to pay tax
so as to avoid this unhealthy tax competition.

The conventional approach has been severely criticised by
other writers. This criticism is based mainly on the fact
that, they feel sub-central governments can equally play a
redistributive role. We now discuss the three main criticisms
against the conventional approach.

For one, the benefit-received principle of taxation that
is predominantly used at the sub-central level does not
necessarily avoid redistribution, at least with respect to
decreasing cost services (this pertains to an industry that
does not have competitive pressure). Since to achieve
efficiency with decreasing cost services, correct benefit tax
(implying the price of public good provided) will be set equal
to Marginal Cost, meaning that price equal to Marginal cost.
Any other tax level that does not equate Marginal cost will
not result in an optimum social welfare. This equality does
not cover average cost if it's declining, as such sub-central
governments will have to finance the deficit created. This
they cannot do because they are constrained from
redistribution. This inconsistency makes it imperative that
sub-central governments be allowed to engage in
redistribution. So pareto optimality will require a two-part
pricing system. One, where the consumer is made to pay a
price equal to the Marginal cost for him to use the service; and two a one time lump-sum fee (which potential users will have to pay as well) sufficient to cover any resultant deficit.\textsuperscript{22} This lump-sum fee has distributional effects.

Secondly, without a redistribution function, an autonomous government can hardly be said to be existing. If the central government can determine the distributional preferences of society and satisfy them, then there is no need of having sub-central governments. Otherwise for what purpose will a government be set up if according to Tresch, 'it does not have the ability to determine a set of distributional rankings among its constituents such as by means of a social welfare function'.\textsuperscript{23} Allowing all tiers to have a social welfare function, which has to be maximised will entail that each tier has some redistributive role to play.

Thirdly, each governmental tier has distributional preferences and that social welfare rankings differ among governments. As such people choose different jurisdictions to stay in based not only on fiscal issues, but on some social and fraternal ones. This runs contrary to the assumptions of a single national social welfare ranking which is thought to be just for all.

The argument put forward by most writers in support of a redistribution role for sub-central governments is that, if

\textsuperscript{22}Tresch R.W., op.cit., p.593.

\textsuperscript{23}Ibid.
these governments will be given the autonomy of having their own identity and hence a social welfare function that they are to maximise, then this will allow them have an input into policy decisions and allow them make autonomous decisions with regards to how best their jurisdictions will be run. They argue that interpersonal redistribution is conducted by sub-central level governments, while Grants-in-Aid can be used by the central government to effect redistribution among jurisdictions which is tuned towards equalising the different jurisdictions fiscal capacity performance, and potential, taking into consideration their needs and relative cost differences.

Tresch's argument is that there should be stronger national redistributive policies, such that even if one moves from one jurisdiction to another either to escape redistribution program or to enjoy it, he will still stay in a jurisdiction trying to maximise its own social welfare function, subject not only to its citizens financing it but also from grants coming from the central government. The grants are expected to equalise the fiscal opportunities of the different jurisdictions. Hence this will discourage migration. As such this model avoids the fear of tax competition and incompatibility problem of the conventional arguments, since the population is assumed to be non-mobile.

Pauly also argued that sub-central governments do have positive redistributive role to play. He introduced a spatial

---

dimension element and the use of utility interdependence in his model. The addition was based on Hochman and Rodgers work of pareto-optimal redistribution.\textsuperscript{25} The model showed that with spatial effects local governments are efficient mechanisms for redistribution even when tax payers move. Taxpayers who move away to avoid welfare taxes, also lose the benefits of welfare payments in ameliorating an external diseconomy from the poor, since that diseconomy disappears with distance. However Pauly concluded if there is only some spatial effect, then local governments alone will not perform efficiently the redistributive function. It requires a Federal system with a strong central government influence.

The basis of all arguments in support of income redistribution at the sub-central level is that, it can best be accomplished through the help of the national government. This help can come through things like Revenue Sharing, or Matching Grants. This is so because the sub-central governments redistributive role is constrained by so many factors among which is resource inadequacy. Despite the problems of financial inadequacy, they still spend most of their resources in supplying public and merit goods, such as Education, Health, and Welfare programs, which in themselves do have a substantial redistributive potential.

The major difference in the treatment of the redistributive role by the two different approaches i.e., the conventional and the alternative approaches are that; on the

on the one hand, the conventional approach argued against sub-central redistribution because of the mobility of resources, on the other hand, the alternative approach argued that sub-central governments are the ones performing redistributive activities among people since they know the social welfare rankings of the people more, because of their proximity to them. That is not saying that the central government does not perform redistributive function, they do also perform some through grants to lower jurisdictions, as well as through the proper administration of ability to pay taxes.

The fear among most economists who view the problem of redistribution as a responsibility of the national government and not sub-central governments is mainly based on the free mobility of resources from one jurisdiction to another. This is brought about by the fact that, the fiscal capacities and needs of the jurisdictions differ in so many respects. This difference is one of the main reasons for the migration of resources from jurisdiction to jurisdiction. However, if the fiscal capacities and needs of all jurisdictions are the same, this conclusion might not have been arrived at. Hence taking into consideration the fact that different jurisdictions have different fiscal capacities, the central government can formulate policies of fiscal equalisation which involve revenue transfers from jurisdictions with a high ratio of capacity to need to jurisdictions with a low ratio. As such to achieve the objectives of setting up these sub-central governments, the central government will have to design equalisation measures aimed at equalising the fiscal opportunities of the different communities.
The two economic roles discussed here are mainly related to states in developed countries, however by the nature of the economies of developing countries these roles are not played to perfection. The next section will examine the roles they perform and why they were assigned those specific roles.

1.6. ROLES OF STATE GOVERNMENTS IN DEVELOPING COUNTRIES.

As against the arguments advanced in the section above, with regards to what is now conventionally regarded as the economic roles of state governments in a developed country, it will be of obvious importance to pinpoint the specific and particular roles played by state governments in developing countries. Since for obvious structural reasons they are not likely to perform the same roles to perfection. In developing countries, the role of state governments are more critical, in that there are so few of the facilities which are taken for granted in the more developed countries, so few resources for developing services and so many strident demands from every community for more amenities. This section will examine the specific developmental roles played by state governments in developing countries, and the reason they are assigned such roles. Most of the inference to be drawn will be with respect to the situation in Nigeria.

Inefficiencies are quite common in resource allocation, even at the state level, and the problem is further compounded by increased governmental interference. The state governments provide a basis for the attainment of economic efficiency, in that public goods to be provided takes into account the
preferences of members of the states, but on the other hand, the cost is not necessarily borne by members of the states directly. In other words benefit pricing is not working so efficiently in this case, hence the inefficiency. Individuals in the states do not migrate to other states simply because of differences in tastes, hence Tiebout's thesis on creating equilibrium will not work here, because people in these countries have more issues to consider, such as societal, family as well as political issues in moving hence interstate migrations are not rampant. Public goods and services are provided at the state level, but as mentioned earlier they are not benefit priced. The revenue most of the states raise on their own, for instance in Nigeria is less than 30 percent of the amount they spend in maintaining the administrative machinery, and providing the necessary public goods and services. Public provided services such as Health Care and Educational tuition are free for instance in Nigeria.

In the area of achieving equity in income distribution, the states play a greater role here. The activities in this direction range from the existence of progressive income tax, such as the pay-as-you-earn, the exemption of people below a certain income range from paying tax, to the fact that most state government expenditures do have a redistributive potential in them. These are expenditures on road

---

26 This figure relates to the situation in Nigeria, and some African, Asian, and Latin American countries, where the remaining amount comes from the Federal Government in the form of Unconditional and Conditional Grants.

27 Under health care provision, some states charge a nominal fee for obtaining hospital card, while in others Amenity ward facilities are paid.
construction, social welfare, education, and health. The redistributive nature of the program will be discussed in greater length later.

The roles of state governments in developing countries can largely be categorised as developmental. Developmental in the sense that they aid in the provision of more jobs, better education, increased availability of life-sustaining services, such as health care etc. They employ more people than the central government, they aid in increasing Agricultural and Manufacturing output through the incentives they offer, they also help in developing rural markets.

The state governments in Nigeria have a separate administrative machinery from the central government, and they employ their own workers, without fear of a 'strict' embargo from the Federal Government. Lack of a 'strict' embargo on employment from the federal government allows the states to keep on employing people to man their numerous offices. Just like the federal government, the states have a paraphernalia of ministries and state parastatals, which are quite necessary at times, if the governments are to fulfill the specific responsibilities they are bestowed with. To fulfill this, each state has a civil service commission, given the responsibility of employing people to man different offices. In addition the Permanent Secretaries in each Ministry and the General Managers of state parastatals are given the powers to recruit people, especially in the lower cadres. This multiplicity of recruiting agencies result in many people employed, thereby making state governments to be the largest
employers of labour in most developing countries. In Nigeria for instance the state and local governments combined together employ more workers than the federal government. This to a great extent reduces the problems of unemployment, though more often it results in a heavy bureaucracy.

The states by the nature of their expenditures and activities aid in increasing Agricultural and Manufacturing output. Starting with the Agricultural sector, the states supply agricultural implements; provide free extension services; provide fertilisers, insecticides, and herbicides at subsidised prices; buy-off from farmers some of their produce; construct feeder roads to link up the rural and urban areas, as well as a host of other incentives. This set of incentives are meant to induce farmers to produce more. In the industrial sector, the states give incentives to small-scale business-men to start-off, as well as to locate in certain areas of the state and to operate a specific type of business that the state administrators feel will be in the best interest of the people in the state. The state government on their own set up industries mostly in partnership with the federal government or with private individuals, as well as luring some big businesses to locate in their states by generously offering them land and some other incentives. These two sectors not only help in raising output, but also help in reducing unemployment, which results in enhanced incomes thereby increasing effective demand which encourages further production. However, from a pure theoretical viewpoint this will be seen as a case of encouraging competition among the states, which is inefficient in the
The state governments spend quite a lot in the fields of social services provision than the federal governments. This is more visible with expenditures on education and health, which of course has immense developmental importance. By educating a people you are enhancing their productivity as well as enlightening them more. The states run Model Primary Schools, Secondary Schools, Vocational Schools, Teachers Training Colleges, Adult Education Institutes, Polytechnics, and even Universities. All these schools are geared towards educating people, which in turn raises their understanding of the world they live in, and hence resulting in an educated labor force. And it is on record that an educated workforce increases the overall productivity of the economy. The states also run and finance hospitals, rural health centres and dispensaries, in order to ensure a proper administration of Health care services. The provision of these services results in the availability of more healthy and productive workers.

An intentional policy is pursued for the opening of rural markets, as a stimulant to further production both of cash and food crops, by the state governments. Towards the achievement of such a policy objective Feeder Roads are being constructed to link up the villages, thereby in the process opening up the rural areas. In addition the states provide pipe-borne water

to both the urban and rural areas, for both animal and human consumption. Construction of feeder roads reduces the local peasants problems of transporting their products to markets and provision of good drinking water reduces the possible rate of migration to semi-urban and urban areas, as the 'Bright Light' theory will suggest.

Overall most state government activities are redistributive in that it has been shown that most of their expenditures have some redistributive potential. On the revenue side, the states employ a progressive tax, in respect of Personal Income Tax through direct assessment; and the Pay-As-You-Earn Tax. Though there are some taxes that can be considered regressive, a typical example in Nigeria are the Community and Cattle Taxes. In Nigeria state dependence on federal revenues has become so much to the extent that when federal subventions did not come early enough, most of the states fail to even pay the salaries of their workers. Despite the reliance the services they provide are mainly redistributive in that they go towards helping the poor, most of whom in some years and in certain states are not made to pay any Tax.

A wide range of functions are performed by more than one level of government. For example, the Federal Government, the State Governments and the Local Governments all provide Educational and Health facilities. However, certain levels of governments are seen to have specialised in some economic and social functions. For instance, though the Federal Government performs some social and economic functions, however, it tends
to spend more on National security including the police and issues of Foreign Affairs. The state and local governments are not only inclined towards the provision of social services but also perform economic activities. The most notable among the economic activities that they perform are in the fields of Agriculture, Energy, Transport, Industry, and Commerce. The efforts of the states in this direction are meant to reduce the hopeful negative effects of regional inequalities which may arise as a result of federal performance of these functions.

Why are the states assigned these responsibilities?, they are assigned these functions mainly because they are expected to enhance the federal governments developmental goals, by providing services based on peoples preferences in their respective states. The nature of the services and the proximity to the residents play a great role in it’s being left in the hands of state governments. It can be said that for the purposes of internalising the benefits, it’s of importance to leave them in state hands, but in this case most of the services provided do exhibit spillovers, hence the need to provide more of it. Despite the spillover effects, services such as education, health, water supply, refuse-disposal, specific rural development programs and fire-fighting services requires the government that provides them be very near those who benefit from it.

The Local Governments cannot effectively handle some of these functions, because of the way they are at present; they are poorly managed, not adequately funded and above all they
are considered inferior in terms of adequate personnel to run them, as well as their competence in executing plans.

The Federal Government equally cannot effectively perform these functions because they have more expenditure responsibilities to cope up with in the areas of National Defence, Foreign Affairs, Police and of course other Economic services. Hence because of the distance they are not likely to satisfy most of the requirements of people residing in the different states, as such the states are in a better position to provide these range of services.

With such responsibilities to be performed by the states and the seeming reliance on the Federal Government for revenues to perform such functions, necessitate a just distribution of revenue from the federal government. The just distribution can best be achieved by trying to equalise the fiscal opportunities of the different states. Such that each is provided with sufficient resources to provide its members with an adequate level of public goods and services.

The fact that the state governments play a greater role in providing public goods rather than raising revenue partially explains the need for the existence of a revenue sharing and grant schemes. Further since the fiscal potentials and fiscal capacities of states are not the same, means that the revenue sharing scheme should aim towards equalising these differences. Otherwise there will be a pronounced variation in per capita incomes and wealth in the different states, which will not auger well for overall national development.
1.7. Summary.

The overall aim of this study is to examine the structure of fiscal decentralisation, as well as the nature of revenue sharing and equalisation attempts in Nigeria, in the light of the disparities in the natural and human resource endowments of the different states in Nigeria. However, to achieve this objective will first require an examination of the different types of grants in use and the theoretical roles played by sub-central governments. The consensus in the literature is that states can effectively perform allocative functions, while a relatively smaller number of economists agree with the idea of the states being allowed to perform distributive roles. The arguments advanced for this are discussed in detail in the chapter. Finally we discussed the possible roles states perform in developing countries, that will justify any form of intergovernmental transfers. The next chapter will examine the structure of the Nigerian economy, with a detailed discussion of finances of the federal government.
CHAPTER TWO
STRUCTURE OF THE NIGERIAN ECONOMY.

This chapter is intended to give a brief on the salient aspects of the structure of the Nigerian economy, which will be of use to this study. The main areas it will touch upon that are of interest are: the growth of the nations Gross Domestic Product and the different sectoral contributions, as well as the growth of the government sector over the years. This will show the growth of the economy and in particular the growth of the petroleum sector and the enhanced revenue position of both the Federal and State Governments. Further, we will discuss the structure of finances of the federal government of Nigeria. This is important because inferences will be drawn later from the classification.

2.1. GENERAL INTRODUCTION.

Nigeria lies entirely within the Tropical zone, in between longitude 3° and 14° East, and latitude 4° and 14° North. It covers an area of 923,769 sq.kms.\(^1\) Being in the tropics it has two main seasons, a dry season lasting between November to April, when the Harmattan winds blow from the North East, and a wet season, lasting from May to October, where the Monsoon winds blow from the South West. The Northern part of the country is generally more drier than the south, with an average annual rainfall of 50.8cms., and an

---

average high and low annual temperatures of 43°C and 10°C respectively. This excludes the Jos Plateau, which is generally more cooler than any other part of the country. The Southern part is more humid, with an annual average rainfall of almost 380cms., and an annual low and high temperatures of 23°C and 30°C respectively. Because of these seeming climatic variations in the two different parts of the country, the crops grown both for domestic consumption and exports are different, however that is not implying that the priority given to Agriculture, in the different states that constitute the Nigerian nation are very much dissimilar.

The country has the largest population in Africa, with an estimated population of 99.7 million in mid-1985. However the population is very much unevenly distributed. The unevenness can be attributed to so many factors, such as, political, economic, social, geographical or even historical. The unevenness in population distribution, can also partly explain some of the disparities in the levels of development between States/Regions in the country. This is more so because most of the revenue sharing acts/laws incorporate a population factor in it. The higher the population of a state the more you receive from the Federal Government as grants. The annual average growth rate of the country's population between 1980 and 1985, was estimated to be 2.5 percent. The urban population as percentage of total

---

The percentage of urban population in large cities was only 17 percent in 1980, while the percentage of urban population in cities of over 500,000 persons in 1980 was 58 percent.

The country was a former colony of Great Britain, and obtained political independence in 1960, later to become a Republic in 1963, though still a member of the Commonwealth of Nations. As at then, there were only four Regions in the country, namely, The North, The West, The Mid-West, and The East. After the second coup d'état of 1966, which brought in General Gowon to power, the four regions were further sub-divided into 12 states with the promulgation of Degree No. 15 of 1967. The states were: Benue/Plateau, East Central, Kano, Kwara, Lagos and Mid-West. Others are: West Central, North Eastern, North Western, Rivers, South Eastern, and Western states. General Gowon was ousted in a bloodless coup in 1975. The new Head of State to replace him, i.e., General Murtala Mohammed, effected a change in the 12 state structure in 1976. He increased the number of states to 19 in the country with effect from February 1976. The new states were: Benue, Plateau, Kano, Kwara, Lagos, Imo, Anambra and Rivers. Others are: Bendel, Kaduna, Cross Rivers, Bauchi, Borno, Gongola, and Sokoto. The remaining states are: Niger, Oyo, Ogun and Ondo. The states structure remained as it is until 1987, when two new states were created, making the number of

---

states in the country. The new additions are Katsina from Kaduna state and Akwa-Ibom from Cross-Rivers. The historical development of these states structure is important especially when we come to see their effects on the different revenue allocation formulas being suggested and then later passed into law.

The country’s Gross National Product per capita as at 1985 was US$800, and its annual average growth rate between 1965-1985 was 2.2 percent. On the other hand, the average annual rate of inflation growth was 14.5 percent between 1965-1980, this later came down to 11.4 percent between 1980-’85, which still in the process engulfs all the anticipated Gross National Product increase per capita.

The country’s Gross Domestic Product at 1977 factor cost was N14,827.6million in 1965 and it’s now estimated to be N51,071 million in 1985 at 1977 factor cost. Agricultural sector use to be a major contributor in the 1960’s, with as much as 46.7 percent of the country’s Gross Domestic Product in 1965 and this declined to 17.9 percent in 1985. The Mining and Quarrying sector was contributing just 15 percent in 1965, and this rose to a peak of 30.8 percent in 1972 and was contributing an estimated 18.3 percent in 1985, (see Tables 2.1 and 2.2.). The services and manufacturing sectors all had their relative share increased from 29, and 7 percents respectively in 1965, to 32 and 9 percents respectively in 1985. This sectoral contribution will be

---

examined in detail later. Further the percentage of population of working age (i.e., between 15-64 years) is 49 percent of the country's population, where the percentage of Labour Force in Agriculture was 72 percent in 1965. This fell to 68 percent in 1980. While the percentage of Labour Force in Industry and Services were 10 and 18 percent respectively in 1965, this rose to 12 and 20 percents respectively in 1980. The annual average growth rate of Labour Force in the country was 3 percent between 1965-'80, and 2.6 percent between 1980-'85. The overall implication is that still most of the active Labour Force in the country are in Agriculture, meaning in the rural sector, despite its relative underdevelopment.

It is a country where the situation in the social services sector tells of the more serious problems in the country. For instance, in the Health sector, the population per physician was 44,330 in 1965, and this improved to 12,000 per physician in 1981. While the population per nursing person was 5,780 in 1965, and 2,420 in 1981. In the same vein the number enrolled to primary schools as percentage of age group to primary schools were 32 and 92 percent for 1965 and 1984 respectively, while those enrolled in secondary schools were only 5 percent in 1965, and 29 percent in 1984. This is a country where despite the anticipated 100 percent absorption of pupils from primary schools to junior secondary schools (as per the requirement of the new National Policy on

---

6Ibid., Table 32., p.264.
7Ibid., Table 31, p.262.
Education) none of the states in the country could even boost of absorbing more than 60 percent. Yet despite the seeming serious demand for social services, expenditure on defence even in peace times far exceeds the overall outlay on social services.

The structure of the country’s Merchandise trade reflect the ones of most oil producing and exporting countries. The overall merchandise exports in 1985 was placed at US$12.6 Billion, while its imports for the same year was US$8.9 Billion. However, out of the exports, Fuels, Minerals, and Metal constitute 96 percent in 1985 as against 32 percent in 1965, the relative contribution of primary commodities dropped from 65 percent to 3 percent in 1965 and 1985 respectively. Petroleum exports alone fetched N135 million in 1965 and as much as N11.0 billion in 1985. On the other hand, manufactures, machinery, transport and equipment dominated the imports, constituting as much as 72 percent of total imports in 1985, while the importation of food items constituted 21 percent of imports in 1985, though it was as low as 9 percent in 1965.8

Despite the seeming unexpected increases in governmental revenues in the early 1970's, the country is externally indebted to the tune of US$18.4 billion as at 1985. This consists of:

1. The long term debts: divided into (a) Public and Publicly Guaranteed of US$13 billion, and (b) Private

____________________
8Ibid., Table 10 and 11, p.220 and 222.
non-guaranteed of US$416 million;

2. Short-term debt of US$5 billion.

The total long term debt disbursed and outstanding as percentage of Gross National Product in 1985 was 17.8 percent and the debt service of the long term debts as percentage of Gross National Product was 5.5 percent. Going by a developing country standards, the percentage is gradually becoming high. With the crisis in the oil market, the problem of debts and debts servicing are bound to become more acute for the Nigerian state, in the 1990's.

2.2. GROWTH AND STRUCTURE OF PRODUCTION.

The country's growth rate has been generally low and declining despite the seemingly unexpected revenue increases of 1974. Though the country's Gross Domestic Product has been rising by value, never-the-less the actual growth rate has been on the decline for some years, to the extent that the rate was negative for some years. The growth in value terms can be attributed to a number of factors, which will be discussed below.

The structure of demand shows that private consumption in 1985 was as much as 72.3 percent of Gross Domestic Product, with an average annual growth rate of −1.95 percent for the years 1981–'85. Public consumption, comprising of all current expenditure for purchases of goods and services by all levels of governments, and capital expenditure on Defence and Security consists of 9.8 percent with an annual average growth rate of 0.76 percent during the period
1981–’85. Gross capital formation grew at an average annual rate of -13.89 percent between 1981–’85, and an overall contribution of 15.4 percent to Gross Domestic Product in 1985. Exports of goods and non-factor services stood at 18.1 percent of GDP in 1985, and grew at an annual average of 6.3 percent during 1981–’85. Though gross capital formation has been growing at an average negative rate, yet the exports of goods has been rising at an average positive rate. This is mainly because of increased exports of petroleum rather than because of increased Investments and savings by individuals and Governments in further production.

The Nigerian economy was mainly Agriculturally based until recent times when the petroleum sector took over. However, the sector was the main source of growth of the country’s economy in the 1950’s and ’60’s. Despite the advent of petroleum, the sector still contributes immensely to the nations growth. The annual average growth rate of the sector from 1980–’85 was 1 percent. The sector still employs a considerable number of the country’s economically active population. It employed 57.8 percent in 1985. (see Table 2.3.).

Production in the Agricultural sector is mainly of two types: (1) The Large scale plantations, and (2) The Small Scale Peasant producers. The second category produces most of the nations output, with the use of the most simplest of production techniques, which includes hoes, cutlasses, or oxen-driven ploughs. The area cultivated by each farmer in this case is small, mostly less than a hectare because of
land fragmentation that exists within families over family or communal land. Agricultural production in the country is largely dictated by weather conditions in the different parts of the country. Hence different parts of the country are known to have specialised in the production of different crops. This in return not only affects the incomes of the producers, i.e., the small-scale farmers but also affects the amount they export in the process contributing to the revenues realised by the Federal Government, which ultimately affect the revenues that accrues to the different states in the country through the various revenue sharing schemes in existence.

The Agricultural sector, despite its relative decline in terms of importance, has been a major source of employment, as well as being a sector with a great degree of export potentials, inspite of the role of the petroleum sector. It also use to be an important source of obtaining tax revenue for the government, though the revenues even as at then depended on the world export prices of the goods, as well as the producer prices paid by the defunct Marketing/Commodity boards to the farmers, as well as the rate of export duties. Further it provide linkages to other sectors by itself providing input for further local processing in the country.

The Mining and Quarrying sector took over in terms of revenue generation importance from the Agricultural sector. The sectors contribution to Gross Domestic Product was N2,223.1 million in 1965, and this later rose to an estimated N9,355 million in 1985. It’s sudden rise in importance can
mainly be attributed to the advent, exploration and export of petroleum resources. Other mining activities carried on in the country are: those of Tin, Columbite, Lead and Zinc, in addition to Coal and Iron Ore. Despite the enormous contribution of the sector to the nations revenue and Gross Domestic Product, it is a highly capital intensive sector. This results in low labour absorptive capacity, hence provides employment to a small proportion of the country's population, in that it was as low as 0.4 percent of the countries total of gainfully employed in 1985.

The Manufacturing sector in the country is equally growing, though not at a fast rate as the Mining and Quarrying sector. The sector contributed just 1.9 percent to the nations Gross Domestic Product in 1965, and this later grew steadily to an estimated 10.5 percent in 1985. Further the sector employs more people than the Mining sector, in that 16.8 percent of the country's total gainfully employed were engaged in the sector in 1975, this later increased to 18.2 percent in 1985, though a substantial proportion of that are in Textiles. Some of the other Manufacturing activities, are mainly in Food and Beverages Industry, Tobacco, Beer and Spirits Industry, Wooden products, Paper and Printing Industry, Cottage and Crafts Industry etc. Most of the activities are essentially urban, because most of the manufacturing industries (apart from cottage and crafts) are found in state capitals, possibly with the exception of towns like Aba in the Eastern part of the country.

9 The different sectoral contributions to GDP are presented in Tables 2.1., and 2.2.
The Construction sector is another area of importance. It grew in terms of Gross Domestic Product contribution from 3.6 percent in 1965, to reach a peak of 15.6 percent in 1980, and was estimated to be 13.7 percent in 1985. The growth can mainly be attributed to the increased revenues coming from the petroleum sector which enabled the government to undertake so much construction work, not only intended to reanimate and reconstruct the war damaged areas of Eastern Nigeria in the early 1970’s, but also to engage in Road, Highway, and more office building constructions. The sector employed around 0.9 percent of the country’s gainfully employed in 1975, this later increased to 1.2 percent in 1985.

The Communication and Transportation sector, have similarly shown a relative increase over the years. Starting from a contribution to Gross Domestic Product of as much as 3.9 percent in 1965 and rising to an estimated 4.8 percent in 1985. Employment in the sector is not so high in relative terms to other sectors, it is as low as 0.6 percent of gainfully employed in 1975 and a mere estimated 0.7 percent in 1985.

The Distribution sector has been a major contributor to the country’s Gross Domestic Product, ranging from 20 percent in 1973, and growing steadily to a peak of 24.6 percent in 1979, and subsequently dropping to an estimated 22.7 percent in 1985. Equally the sector employs quite a considerable proportion of the country’s gainfully employed. The proportion was 12.2 percent in 1975, and this rose to an
estimated 16 percent in 1985.

2.3. GROWTH OF THE GOVERNMENT SECTOR.

This is examined in two respects. The first sees the growth of the government sector in relation to expenditures incurred and their relative proportion to GDP. The second considered the growth of the oil sector which boosted the revenue position of the federal government.

2.3.1. The Growth of Expenditures.

Public expenditure of the Nigerian government has been on the increase since 1970, (This is shown in Tables 2.8 and 2.9). The factors responsible for such a tremendous increase are many, but the most remarkable are the reconstructions of the early 1970s of the war damaged parts of the country, and the inducement that increased revenues coming from the oil sector offered. For instance Total Expenditure has increased from N1,130.1million in 1970 to N23,695.6million in 1980, which is almost 21 times.

The extent of the growth can be more visible when Public expenditures are related to the country’s Gross Domestic Product, (see Table 2.4.). Here expenditure has been divided into current and Investment for the purposes of giving a clearer picture of attempts at development. The Total Expenditure as a percent of the country’s Gross Domestic Product was a mere 14.7 percent in 1970, and this rose to a peak of almost 54 percent in 1980.
In 1970, current expenditure on goods and services constituted 6.5 percent of Gross Domestic Product, while Investment expenditure was just 2.9 percent in the same year. This trend started to change for the better, when Public Investment expenditures constituted a greater percentage of Gross Domestic Product than Public current expenditure on goods and services. The relative contributions were 19.1 percent and 7.3 percent for Investments and current expenditures in 1980 respectively. This shows in relative terms the amount of resources used by the government to boost it's Investments domestically. However transfers seem to have a higher share in terms of Gross Domestic Product contribution, though it's not an indicator of the governments serious redistributive activity.

Overall the government sector has grown tremendously over the years, since as it's noticed, the expenditures used are just for the Federal Government, if those of state and local governments are added, it will constitute quite a great proportion of the country's Gross Domestic Product. Public expenditures in the country are likely to be high for some years to come, not only because of Federal government spending activities, but those of states and local governments.

2.3.2. Growth of Oil Sector and Federal Revenues.

The situation in the Petroleum sector as shown in Table 2.5. depicts a remarkable transformation. A transformation which ensured a change in the relative
contributions of the different revenue sources. Federal revenues coming from oil constitute just 26.3 percent of total revenue in 1970. However, the situation changed in 1974 when 82.1 percent of the nations total revenue came from that source alone. This is mainly due to happenings in the market for oil, when the price of oil increased from US$2.42 per barrel in January 1971 to US$14.69 per barrel in January 1974. This is coupled with the increase in oil production from 1.531 million b/d in 1971 to 2.254 million b/d in '74.¹⁰ Later the relative share declined a bit, due to among others the happenings in the market for oil, most especially in 1978, when it declined to 62.3 percent of total Federal Revenues. Despite the happenings in the oil market, still the relative contribution of oil to federal Revenues is quite substantial, in that it accounts for 73 percent on average every year from 1979-1984.

Seeing the overall growth of the government sector over the years, both in terms of expenditures and revenues. It is now pertinent to discuss the structure of the finances of the federal and state governments in Nigeria.

2.4. FEDERAL GOVERNMENT FINANCES.

For a thorough examination and analysis of the finances of Nigerian Federal Government one needs to broadly divide the finances into two:

(1) To examine the revenues that accrue to the government, the sources of the revenues and the relative contribution of each of the sources. The examination of the various revenue sources is intended to show the sources that contribute much to the nations revenue which are under federal government jurisdiction, and hence the need for redistributing the proceeds to lower jurisdictions.

(2) We examine the expenditure pattern of the federal government. The expenditure pattern will further be sub-divided into current and capital expenditures. This will allow for an easy process of examining the various expenditure heads and see the relative importance attached to each, and the resources devoted to each head. This will in turn show the need or otherwise of state and local governments coming to spend in the relatively insufficiently funded sectors, assuming they have the constitutional backing to incur expenditures in those sectors.

2.4.1. Federal Government Revenues.

This section will discuss the current revenue position of the Federal Government as well as the sources that the revenues come from. For a start, it is important to first note the gradual growth of the nations current revenue from 1970–’85. In 1970, the total current revenue of the federal government of Nigeria, as can be seen from Table 2.6. was N633.2 million, with import duties alone contributing 34 percent of that (see Table 2.7.). As at then proceeds from petroleum profit tax and mining rents and royalties have also
started growing, though they only constituted 26 percent of total current revenues as at 1970. The country's current revenues started growing steadily, rising to N4,537 million in 1974. This is an increase of over 700 percent in a period of only 4 years. This was because it was the year when petroleum profit tax and mining rents and royalties started gaining prominence. This happened despite an increase in the country's traditional revenue sources of import duties, which increased by almost 60 percent. The overall revenue position started to rise again, and reached a peak of N15,234 million in 1980, from where it started to decline gradually, mainly because of developments in the oil industry.

To enable one examine the various revenue heads, it will be good to divide current revenues into three distinct subheads, viz: Direct Taxes; Indirect Taxes; and Other Revenues.

2.4.1.1. Direct Taxes.

This comprises of revenues obtained from sources such as, personal income tax, company income tax, petroleum profits tax, capital gains tax, stamp duties, and penalties. This source contributes immensely to national revenues in the country, as can be seen from Tables 2.6 and 2.7. This source contributes a yearly average of 50 percent of the nations total current revenue from 1970–’85.

The most important source and contributors to the nations revenue are the Company income tax (charged on the
profits of companies other than the oil mining enterprises) and the petroleum profit tax. These two contribute immensely to the actual current revenues of the federal government. The company income tax for instance contributed N45.8 million in 1970 which was 7.2 percent of total current revenue collected that year. It's overall contribution in actual amount has been rising steadily up to 1980, where it contributed as much as N579.2 million. The rate of the tax was fixed at 45 percent in 1972 and later increased to 50 percent in 1978.\textsuperscript{11} The amount collected declined in 1981 to N483 million, and reached it's peak of N734.0 million in 1982, from then onwards it started to fall. In terms of percentage contribution, it has been on the increase since 1970. The gradual increase in relation to the contributions of other sectors, was 3.8 percent of total current revenue in 1980, and 6.2 percent of the same in 1982.

The petroleum profits tax saw a phenomenal growth in its relative contribution to total current revenue. From a contribution of N97.6 million in 1970, which was only 15.4 percent of total current revenue during that year to a phenomenal rise to N2,872.5 million in 1974, and contributing 63.3 percent of total current revenues. This phenomenal increase can be attributed to the developments in the market for oil, in that the period coincided with the time when the prices of crude petroleum was increased by the Organisation of Petroleum Exporting Countries (OPEC) in 1973 and '74.

From then onwards the contribution of this source dominated all others, though it has been fluctuating due to the conditions in the oil market. All the same, since 1974, it has been contributing not less than 35 percent of the country's current revenue. On average it has contributed 49 percent yearly to the country's current revenue from 1974 to 1985.

The personal income tax, though graduated on an ability to pay principle in theory, does not contribute much in relative terms. As can be seen from Tables 2.6 and 2.7. The relative contribution of this sector has never been more than 0.3 percent for the years 1970-'85. The largest contribution of this sector was in 1974 and '75, when it contributed N11.1 million and N15.9 million respectively, constituting 0.25 and 0.29 percents of total current revenues. In the same vein, the contributions of capital gains tax, stamp duties and penalties, which are all lumped up under 'Other Tax Revenue' is not much. It has never exceeded 0.5 percent of total current revenue from 1970 to 1985.

2.4.1.2. Indirect Taxes.

This consists of revenues obtained through the imposition of import, export and excise duties. The tax deals mainly with trade and manufacture. The overall contribution of Indirect Taxes combined is also quite impressive, despite the role played by the petroleum sector. The taxes contributed a sum of N369.4 million in 1970, which was 58.3 percent of total current revenue for that year.
This relative contribution though has been rising in real terms but, in relative terms the percentage contribution has been falling. It fell to as low as 10.9 percent of total current revenue in 1974, though it picked up in later years, reaching up to 22.7 percent in 1978 and then started to fall. Despite the picking up, it has not attained the relative percentage contribution that it did in 1970. The average yearly contribution of the source from 1974 to 1985 was 15.7 percent.

The major contributing source are import duties. This source alone contributed N215.6 million of current revenue in 1970, which was 34 percent of total current revenue. It was the largest single source that contributed so much that year. Still, the source contributes much in actual terms, though in relative terms, its average yearly contribution has been on the decline. It contributed only 7 percent of total current revenue in 1974, and an average yearly contribution of 11.6 percent from 1974-'85. It's contribution runs to over a Billion Naira from 1978 to 1985, with the exception of 1979, when it was only N870.6 million.

The contribution of export duties has been quite insignificant. The contribution of this source has not been much even in 1970, that is before the petroleum sector became the major revenue earner. It's contribution in 1970 was 6.5 percent of total current revenue and henceforth, it has been less than 1 percent. Excise duties are the second in terms of overall contribution under indirect taxes, in that their relative annual average contribution to total current revenue
from 1970-'85 was 6.7 percent. This figure is not representative of most years, since in some years, such as 1975, '76 and '77, the contribution is as low as 2.2 percent of total current revenue. Excise duties contributed as much as 17.7 percent of total current revenue in 1970, but since then, the relative contribution has been on the decline just like other sources. This can vividly be seen in Table 2.6. and 2.7.

2.4.1.3. Other Revenues.

This consists of most revenue generating activities not shown under either Direct or Indirect taxes. Among them are Interest and payments realised from loans given out; the rents, royalties and fees from mining activity; licences, fees, earnings and sales; and rent on government property. The revenue accruing to the government from this source has also shown a tremendous increase over the years, mainly because of Mining rents and royalties. Overall this source only contributed N119.4 million in 1970, which was 18.8 percent of total current revenue. This is just 1 percent more than the contribution of excise duty alone in that year. However, the sector later witnessed a phenomenal increase in 1974, when the contribution of this source increased in real terms from N326.2 million in 1973 to N1,006.7 million in 1974, which is an increase of over 300 percent. Subsequently it kept on rising and falling both in actual and relative terms.

The most important source is mining rents, royalties and
fees. This source alone contributes a yearly average of 21.9 percent of total current revenue from 1970-'85. The relative contribution steadily grew, starting from as low as 10.8 percent in 1970, though with fluctuations in relative contribution it reached a peak of 34 percent in 1979. The relative contribution of the two other sources, that is Interest and Payments and those lumped up under Miscellaneous revenue is not much. Though Interest and Payments contributed as much as 3.5 percent of total current revenue on average per year from 1970-'85. Miscellaneous revenue on the other hand contributes just an average of 1.4 percent per year over the same period.

Overall one can notice the gradual departure in the country from a strong reliance on Indirect taxes as a major revenue source to a shift to Direct taxes, mainly because of the increased revenues coming from petroleum profits tax.

2.4.2. Federal Government Expenditure.

Total expenditures of the Nigerian Government just like its revenue generation was on the increase over the years. It was only N1,130.1 million in 1970, and this gradually increased, reaching a peak of N23,695.7 million in 1980. The phenomenal increase started in 1974, when total expenditures were N4,260.3 million as against N1,778.8 million the previous year. However, total expenditure started declining after 1980, mostly because of the dwindling nature of the revenues coming from the petroleum sector.
To fully examine the various expenditure heads and their relative contribution, as well as critically examine the relative amounts spent on the different sectors will require dividing expenditures broadly into two, viz: Current or consumption expenditure; and capital or Investment expenditure.

2.4.2.1. Current Expenditure.

This comprises of expenditures on such things as personnel emoluments, maintenance of roads, buildings, plant and machinery in all sectors, be it Administrative, Social, or Economic services sectors. It also, includes transfers, in the form of debt servicing, statutory and non-statutory allocations to states and local governments, as well as pension and gratuity payments.

This kind of expenditure takes a greater portion of the overall expenditure of the government of Nigeria. It takes a yearly average of 69 percent from 1970-’85 of the governments total expenditure. The remaining 31 percent goes to capital expenditure. The most prominent in terms of both actual and relative expenditures under this sector are transfers, and expenditure on Administration and Internal security.

Transfers involving transfers to development fund, pension and gratuity payments, statutory and non-statutory allocations to states and local governments, and the servicing of debts takes a lion share of current expenditures per year from 1970-’85. Transfers to states and local
governments in the form of statutory and non-statutory allocations account for an average of 47 percent of current expenditures per year, from 1970–’85. Public debt charges, takes as much as 11 percent of total current expenditure on average per year from 1970–’85, to service both internal and external debts. The actual amount paid for the servicing of external debts was low in relative terms from 1970–’77. However it started rising up in 1978, when 2.2 percent of total current expenditure was devoted to it alone, while 7.9 percent of current expenditure was devoted to servicing Internal debts during the same year. External debt servicing rose to 9.6 percent of total current expenditure in 1983, with a total monetary outlay of N1,147.4 million. The sum of N1,525.8 million was spent on public debt charges alone in 1983. This is by far smaller than the sum of N3,783.6 million spent in the previous year, which was as much as 25.6 percent of total current expenditure, (see Tables 2.8. and 2.9.).

The administrative sector, consisting of current expenditure on General Administration and Internal Security is one of the major current expenditure heads, and used to be the major head. For instance 50.5 percent of total current expenditure in 1970 was devoted to the sector. This can partly be explained by the need for stability in the country, since the country’s civil war came to an end in that year. The relative amount spent on the sector declined in later years, to as low as 11.9 percent in 1979, though the actual amounts have been rising and falling, but still its quite substantial, being an average of over one billion Naira every
The next in terms of importance apart from transfers and administration are expenditures on social and community services. Expenditures in this sector gained considerably from structural shifts in expenditures going to the two sectors mentioned earlier. The sectors overall expenditure was as low as 1.8 percent of total current expenditure in 1970, which was just N16.6 million. Expenditure to this sector increased phenomenally to 11.6 percent of total current expenditure in 1976, with a monetary outlay of N634.6 million. This increase can mainly be explained by the introduction of the Universal Primary Education and the initial monetary outlay required for the successful take off of the programme. It can be seen from Tables 2.8 and 2.9 that 9.5 percent of the years total current expenditure was spent on Education amounting to N522.0 million, which sharply contrasts with educational expenditure in 1970, which was only N3.2 million, and constitute 0.35 percent of total current expenditure. The relative amount spent in this sector declined in later years, but still the amount spent on the education sub-sector far exceeds the governments expenditure on Health, which was just 1.2 percent on average per year of total current expenditure from 1970–’85.

The last sector, is that of economic services, and as a group they account for the smallest percentage of federal government current expenditures. Expenditures on economic services consists of expenditures on Agriculture, Construction, Transport and Communication and other economic
services. The average expenditure per year on this sector was 2.8 percent of total current expenditure from 1970-'85. Expenditure on construction is the most dominant in the sector, in that the amount spent on it per year is running at an average of 1.5 percent of total current expenditure. The relative amount devoted to Agriculture has been on the decrease since 1973. This is so, despite the seeming interest of giving priority to Agriculture in most Budget documents from 1977 to date, as well as with such programmes like Operation Feed the Nation (OFN) and the Green Revolution programmes, which are meant to reactivate the sector.

2.4.2.2. Capital Expenditure.

Capital expenditures comprises of expenditures on fixed capital formations, as well as on loans to states and local governments for incurring capital expenditures. This can also be sub-divided into expenditures on administration, economic services, social and community services and transfers. The totals of capital expenditure as percentage of total expenditure is not as large as that of current, in that it constitute an average of 31 percent per year from 1970-'85. With the relative lowest proportion being 16 percent in 1971, and a peak of 39 percent in 1977. In monetary terms it’s N173.8 million in 1971, and this increased to N5,442.3 million in 1977. (See Tables 2.10 and 2.11.). Overall the amount spent has been fluctuating possibly going in consonance with the revenue position of the central government as well as it’s priorities.
Capital expenditure on General administration and defence use to take a major share of total capital expenditure, in that it was as high as 65 percent of total capital expenditure in 1970, amounting to N145 million. Though the country's civil war ended early that year, yet the amount was quite enormous. The relative amount spent on Defence and General Administration, started to gradually decline reaching to a low level of 9.6 percent of total capital expenditure in 1982.

With the relative decline of expenditure on General Administration and Defence, Economic services took over as the major capital expenditure head. 19.6 percent of money spent on capital expenditure in 1970, went to economic services, which was N43.4 million, the proportion spent on these services rose to a peak of 64 percent in 1980, which was N5,448.7 million. The amount spent on economic services per year on capital items was placed at an average of 44 percent of total capital expenditure from 1970-'85. The relative share spent on Agriculture was an average of 6 percent per year for the same period. This is because of the importance attached to Agriculture. The sub-sectors accounting for most of the expenditures are Transport and Communication, Construction and Manufacturing. Capital expenditures on Transport and Communication involving the construction of highways, inter state roads, runways, and telecommunication facilities were quite tremendous, amounting to an average of almost 21.5 percent per year of total capital expenditure from 1970-'85. Construction and Manufacturing sub-sector which is the second in terms of
relative importance had 17.0 percent of total capital expenditure spent on it in 1977. Henceforth, the yearly average for the sub-sector was 16 percent from 1977–’85, of total capital expenditure. This in itself exceeds the amount spent on General Administration and Defence for the same range of years.

Transfers consisting of loans on lent to states as well as the fulfillment of certain financial obligations also constitute a sizeable sum. Transfers were just 13 percent of total capital expenditure in 1970, and this steadily rose to 22 percent, and reached a peak of 37 percent in 1971 and 1972 respectively. From then onwards, it started to decline downwards with an occasional fluctuation, up to a record low of 1.0 percent of total capital expenditure in 1981. It started to rise in 1982, constituting 34.6 percent of total capital expenditure as can be seen from Tables 2.10 and 2.11. The transfer help to reduce the financial pressures that most states and local governments end up with, in that it allows them to have ready loans payable within reasonable time limits. In cases of default, the repayment is effected by directly deducting it from the states share of the federation account.

Capital expenditures on social and community services are the least, despite the immense developmental importance of the sector. The average capital expenditure on that sector per year is 15 percent from 1970–’85. This is not uniform, in that capital expenditure on the sector was as low as 1.45 percent in 1970, with a monetary sum of N3.2 million,
this rose to a peak of 26 percent of total capital expenditure in 1975, with a monetary outlay of N631.1 million. Subsequently the relative amount spent on the sector dropped. The amount spent on Education and Health which are the two main subheads under the sector is not much. For instance, capital expenditure on Education has been fluctuating and reached its peak in 1975 and '76, of 17.9 and 12.5 percent of total capital expenditure respectively. This tremendous increase can be explained by the preparations for the implementation of the Universal Primary Education. From 1976, the relative share dropped to an average of 5.5 percent of total capital expenditure per year from 1977-'85. On the other hand, capital expenditure on Health has not being quite significant, in that it constitutes less than an average of 2.0 percent of annual capital expenditure from 1970-'85.

The most important thing to note is that, the relatively small amounts spent on both social and community services as well as economic services is mainly because the states as well as the local governments also perform most of these roles, by virtue of the constitutional responsibilities they are bestowed with. The fact that the lower jurisdictions also perform some of these roles partly explain the relative little resources devoted to it by the federal government, since they assume the states will fill up the gap with the revenues they generate as well as the transfers they receive from the federal government, in the form of grants or loans.

2.5. Summary.
This chapter, has albeit briefly traced the growth of the government sector, which is seen in two perspectives, i.e., the growth in public expenditure vis-a-vis the country's GDP, and the growth of the oil sector and it's noticeable effect on federal revenues. This lead us to a discussion of the revenue structure and expenditure pattern of the federal government in the country. The next chapter examines the finances of state governments and the history of revenue sharing in Nigeria.
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Total GNP</td>
<td>14,850</td>
<td>15,240</td>
<td>15,860</td>
<td>16,530</td>
<td>17,240</td>
<td>17,990</td>
<td>18,780</td>
</tr>
<tr>
<td>Other services</td>
<td>3,460</td>
<td>3,690</td>
<td>3,920</td>
<td>4,150</td>
<td>4,380</td>
<td>4,610</td>
<td>4,840</td>
</tr>
<tr>
<td>Construction</td>
<td>2,220</td>
<td>2,330</td>
<td>2,440</td>
<td>2,550</td>
<td>2,660</td>
<td>2,770</td>
<td>2,880</td>
</tr>
<tr>
<td>Agriculture</td>
<td>1,370</td>
<td>1,480</td>
<td>1,590</td>
<td>1,700</td>
<td>1,810</td>
<td>1,920</td>
<td>2,030</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>5,740</td>
<td>6,030</td>
<td>6,320</td>
<td>6,610</td>
<td>6,900</td>
<td>7,190</td>
<td>7,480</td>
</tr>
<tr>
<td>Mining</td>
<td>870</td>
<td>980</td>
<td>1,090</td>
<td>1,200</td>
<td>1,310</td>
<td>1,420</td>
<td>1,530</td>
</tr>
</tbody>
</table>


Note: GNP is Gross Domestic Product at market prices in 1960-65 terms (in constant 1960-65 dollars).
<table>
<thead>
<tr>
<th>Source: Calculated from Table 2.1.</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Wire Lead</td>
<td>7.9</td>
<td>8.0</td>
<td>8.1</td>
<td>8.2</td>
<td>8.3</td>
<td>8.4</td>
<td>8.5</td>
<td>8.6</td>
<td>8.7</td>
<td>8.8</td>
<td>8.9</td>
<td>9.0</td>
</tr>
<tr>
<td>Glass Tube</td>
<td>3.0</td>
<td>3.1</td>
<td>3.2</td>
<td>3.3</td>
<td>3.4</td>
<td>3.5</td>
<td>3.6</td>
<td>3.7</td>
<td>3.8</td>
<td>3.9</td>
<td>4.0</td>
<td>4.1</td>
</tr>
<tr>
<td>Ceramic Tube</td>
<td>3.2</td>
<td>3.3</td>
<td>3.4</td>
<td>3.5</td>
<td>3.6</td>
<td>3.7</td>
<td>3.8</td>
<td>3.9</td>
<td>4.0</td>
<td>4.1</td>
<td>4.2</td>
<td>4.3</td>
</tr>
</tbody>
</table>

Note: The table represents the index values for various types of electronic components from 1965 to 1976.
Table 2.3.
Sectoral Distribution of Total Gainful Employment in Nigeria.
Selected Years: 1975-'85. ('000)

<table>
<thead>
<tr>
<th>SECTOR</th>
<th>1975</th>
<th>1980</th>
<th>1985</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Amount</td>
<td>%</td>
<td>Amount</td>
</tr>
<tr>
<td>Agriculture</td>
<td>17,860</td>
<td>64.0</td>
<td>18,480</td>
</tr>
<tr>
<td>Mining and Quarrying</td>
<td>110</td>
<td>0.4</td>
<td>123</td>
</tr>
<tr>
<td>Manufg. and Processing</td>
<td>4,690</td>
<td>16.8</td>
<td>5,236</td>
</tr>
<tr>
<td>Building and Construction</td>
<td>250</td>
<td>0.9</td>
<td>339</td>
</tr>
<tr>
<td>Utilities</td>
<td>30</td>
<td>0.1</td>
<td>47</td>
</tr>
<tr>
<td>Trade and Distribution</td>
<td>3,410</td>
<td>12.2</td>
<td>4,681</td>
</tr>
<tr>
<td>Transport and Comm.</td>
<td>170</td>
<td>0.6</td>
<td>185</td>
</tr>
<tr>
<td>Services</td>
<td>1,390</td>
<td>5.0</td>
<td>1,709</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td>29,910</td>
<td>100.0</td>
<td>30,000</td>
</tr>
</tbody>
</table>

Source: 1. Third National Development Plan 1975-'80. Vol.1 Table 32.2. p.370
### Table 2.4.
Federal Government Expenditure as Percentage of Gross Domestic Product for Selected Fiscal Years. N (Million).

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Cur. Exp. on Goods &amp; Services.</td>
<td>499.7</td>
<td>724.7</td>
<td>1,995.3</td>
<td>3,193.6</td>
<td>4,463.6</td>
</tr>
<tr>
<td>GDP at Current Prices</td>
<td>7,683.0</td>
<td>18,868.0</td>
<td>34,081.4</td>
<td>43,887.2</td>
<td>44,128.0</td>
</tr>
<tr>
<td>Current Exp. as % of GDP</td>
<td>6.5</td>
<td>3.8</td>
<td>5.8</td>
<td>7.3</td>
<td>10.1</td>
</tr>
<tr>
<td>Investment Exp.</td>
<td>221.0</td>
<td>1,549.4</td>
<td>5,197.0</td>
<td>8,395.6</td>
<td>5,696.9</td>
</tr>
<tr>
<td>Investment Exp. as % of GDP</td>
<td>2.9</td>
<td>8.2</td>
<td>15.2</td>
<td>19.1</td>
<td>12.9</td>
</tr>
<tr>
<td>Transfers</td>
<td>409.4</td>
<td>1,986.2</td>
<td>5,144.7</td>
<td>12,106.4</td>
<td>11,078.3</td>
</tr>
<tr>
<td>Transfers as % of GDP</td>
<td>5.3</td>
<td>10.5</td>
<td>15.1</td>
<td>27.6</td>
<td>25.1</td>
</tr>
<tr>
<td>Total Exp.</td>
<td>1,130.1</td>
<td>4,260.3</td>
<td>12,337.0</td>
<td>23,695.6</td>
<td>21,238.8</td>
</tr>
<tr>
<td>Total Exp. as % of GDP</td>
<td>14.7</td>
<td>22.6</td>
<td>36.1</td>
<td>54.0</td>
<td>48.1</td>
</tr>
</tbody>
</table>


Note: Expenditure figures are obtained from Tables 2.8. and 2.10.
Table 2.5.  
Federal Government oil Revenues and Total Current Revenues.  
1970-1984 N (Million)

<table>
<thead>
<tr>
<th>YEAR</th>
<th>Fed. Rev. From Oil.</th>
<th>Total Federal Revenues.</th>
<th>Oil Rev. as % of Total.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1970</td>
<td>166.4</td>
<td>663.2</td>
<td>26.3</td>
</tr>
<tr>
<td>1971</td>
<td>510.2</td>
<td>1,169.0</td>
<td>43.6</td>
</tr>
<tr>
<td>1972</td>
<td>764.3</td>
<td>1,404.8</td>
<td>54.4</td>
</tr>
<tr>
<td>1973</td>
<td>1,016.0</td>
<td>1,695.3</td>
<td>59.9</td>
</tr>
<tr>
<td>1974</td>
<td>3,726.7</td>
<td>4,537.0</td>
<td>82.1</td>
</tr>
<tr>
<td>1975</td>
<td>4,271.5</td>
<td>5,514.7</td>
<td>77.5</td>
</tr>
<tr>
<td>1976</td>
<td>5,365.2</td>
<td>6,765.9</td>
<td>79.3</td>
</tr>
<tr>
<td>1977</td>
<td>6,080.6</td>
<td>8,042.4</td>
<td>75.6</td>
</tr>
<tr>
<td>1978</td>
<td>4,654.1</td>
<td>7,469.3</td>
<td>62.3</td>
</tr>
<tr>
<td>1979</td>
<td>8,880.8</td>
<td>10,912.4</td>
<td>81.4</td>
</tr>
<tr>
<td>1980</td>
<td>12,353.8</td>
<td>15,234.0</td>
<td>81.1</td>
</tr>
<tr>
<td>1981</td>
<td>8,564.4</td>
<td>12,180.2</td>
<td>70.3</td>
</tr>
<tr>
<td>1982</td>
<td>7,814.9</td>
<td>11,764.4</td>
<td>66.4</td>
</tr>
<tr>
<td>1983</td>
<td>7,253.0</td>
<td>10,508.7</td>
<td>69.0</td>
</tr>
<tr>
<td>1984</td>
<td>8,209.7</td>
<td>11,738.5</td>
<td>70.0</td>
</tr>
</tbody>
</table>


Note: Figures shown as oil revenues are the sum of proceeds of Petroleum profits tax and Mining Rents and Royalties.
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>2.6</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2001</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2002</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2003</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2004</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2005</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2006</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2007</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2008</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2009</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2010</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2011</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2012</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2013</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2014</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2015</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2016</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2017</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2018</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2019</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2020</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Percentages</td>
<td>3.8</td>
<td>5.4</td>
<td>7.2</td>
<td>1.8</td>
<td>0.6</td>
<td>0.7</td>
<td>1.5</td>
<td>0.5</td>
<td>0.7</td>
<td>2.5</td>
<td>2.9</td>
<td>3.0</td>
<td>3.3</td>
<td>3.7</td>
<td>2.5</td>
<td>1.6</td>
<td>0.6</td>
<td>0.6</td>
</tr>
<tr>
<td>Revenue (Blk)</td>
<td>$0,000</td>
<td>$0,000</td>
<td>$0,000</td>
<td>$0,000</td>
<td>$0,000</td>
<td>$0,000</td>
<td>$0,000</td>
<td>$0,000</td>
<td>$0,000</td>
<td>$0,000</td>
<td>$0,000</td>
<td>$0,000</td>
<td>$0,000</td>
<td>$0,000</td>
<td>$0,000</td>
<td>$0,000</td>
<td>$0,000</td>
<td>$0,000</td>
</tr>
</tbody>
</table>

Source: Compiled from Table 2.6.
<table>
<thead>
<tr>
<th>Year</th>
<th>Jan</th>
<th>Feb</th>
<th>Mar</th>
<th>Apr</th>
<th>May</th>
<th>Jun</th>
<th>Jul</th>
<th>Aug</th>
<th>Sep</th>
<th>Oct</th>
<th>Nov</th>
<th>Dec</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1965</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>0</td>
</tr>
<tr>
<td>1966</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>0</td>
</tr>
</tbody>
</table>

*Note: Data in billions.*
<table>
<thead>
<tr>
<th>TABLE 2.9</th>
<th>CURRENT RECOGNITION OF THE FEDERAL GOVERNMENT OF NIGERIA 1970-1985</th>
<th>(Percentages)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>TOTAL</strong></td>
<td><strong>TOTAL</strong></td>
<td><strong>TOTAL</strong></td>
</tr>
<tr>
<td>0.2%</td>
<td>0.6%</td>
<td>0.8%</td>
</tr>
<tr>
<td>10.8%</td>
<td>12.9%</td>
<td>15.8%</td>
</tr>
<tr>
<td>3.0%</td>
<td>3.0%</td>
<td>3.0%</td>
</tr>
<tr>
<td>15.0%</td>
<td>15.0%</td>
<td>15.0%</td>
</tr>
<tr>
<td>25.0%</td>
<td>25.0%</td>
<td>25.0%</td>
</tr>
<tr>
<td>23.0%</td>
<td>23.0%</td>
<td>23.0%</td>
</tr>
<tr>
<td>10.0%</td>
<td>10.0%</td>
<td>10.0%</td>
</tr>
<tr>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
</tr>
<tr>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
</tr>
<tr>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
</tr>
<tr>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
</tr>
<tr>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
</tr>
<tr>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
</tr>
<tr>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
</tr>
</tbody>
</table>

**Source:** Compiled from Table 2.8.
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Income Tax</td>
<td>20</td>
<td>22</td>
<td>15</td>
<td>16</td>
<td>16</td>
<td>15</td>
<td>13</td>
<td>10</td>
<td>9</td>
<td>8</td>
<td>12</td>
</tr>
<tr>
<td>Business Taxes</td>
<td>9</td>
<td>9</td>
<td>9</td>
<td>9</td>
<td>9</td>
<td>9</td>
<td>9</td>
<td>9</td>
<td>9</td>
<td>9</td>
<td>9</td>
</tr>
<tr>
<td>Other Income</td>
<td>6</td>
<td>6</td>
<td>6</td>
<td>6</td>
<td>6</td>
<td>6</td>
<td>6</td>
<td>6</td>
<td>6</td>
<td>6</td>
<td>6</td>
</tr>
</tbody>
</table>

**Note:** Insufficient data.

**Source:** Central Bank of Nigeria, Economic and Financial Review, Various Issues.
### Table 2.10

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Total</td>
<td>9.3</td>
<td>15.9</td>
<td>34.5</td>
<td>42.7</td>
<td>54.0</td>
<td>65.7</td>
<td>72.6</td>
<td>78.1</td>
<td>81.2</td>
<td>83.3</td>
<td>85.0</td>
<td>85.0</td>
<td>85.0</td>
<td>85.0</td>
<td>85.0</td>
<td>85.0</td>
<td>85.0</td>
</tr>
<tr>
<td>Income</td>
<td>8.0</td>
<td>7.0</td>
<td>6.0</td>
<td>5.0</td>
<td>4.0</td>
<td>3.0</td>
<td>2.0</td>
<td>1.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td>Farms</td>
<td>1.3</td>
<td>2.2</td>
<td>3.1</td>
<td>4.0</td>
<td>5.0</td>
<td>6.4</td>
<td>7.0</td>
<td>7.7</td>
<td>8.0</td>
<td>8.3</td>
<td>8.5</td>
<td>8.5</td>
<td>8.5</td>
<td>8.5</td>
<td>8.5</td>
<td>8.5</td>
<td>8.5</td>
</tr>
<tr>
<td>Nonfarm</td>
<td>6.0</td>
<td>6.0</td>
<td>6.0</td>
<td>6.0</td>
<td>6.0</td>
<td>6.0</td>
<td>6.0</td>
<td>6.0</td>
<td>6.0</td>
<td>6.0</td>
<td>6.0</td>
<td>6.0</td>
<td>6.0</td>
<td>6.0</td>
<td>6.0</td>
<td>6.0</td>
<td>6.0</td>
</tr>
</tbody>
</table>

**Notes:**
- The table above presents data on income distribution from 1970 to 1986. The figures represent the percentage of income earned by different sectors.
- Income categories include 'Total,' 'Farms,' and 'Nonfarm.'
CHAPTER THREE.

STRUCTURE OF STATE FINANCES AND THE HISTORY OF REVENUE SHARING IN NIGERIA.

This chapter examines in detail the nature of fiscal relations between the federal government on the one hand and the state governments on the other. This includes the nature of intergovernmental transfers and borrowing powers, and the history of revenue sharing in Nigeria. The discussion on revenue sharing program is intended to be a preamble to its use in subsequent chapters, when we examine it's effect on fiscal decentralisation and whether: (a) it is substitutive or stimulative of state expenditures; (b) it results in equitable income distribution; and (c) it provides an adequate flow of resources to the state governments.

3.1. STATE FINANCES IN NIGERIA.

This section will examine the structure of state finances in Nigeria. Just like the examination of federal government finances, it will similarly be broadly divided into two, i.e., the revenue structure and the expenditure patterns of the states. However, it need be noted that the revenue structure across all the states seem to be similar, with federal statutory allocation contributing the most. In the same vein their expenditure patterns are similar, in that most states attach priorities nearly as similar as those of other states, hence most of them spend more or less similar proportion of their revenues on social service provision. We now examine the revenue and expenditure patterns in some
3.1.1. State Revenues in Nigeria.

The revenue structure of states in Nigeria, just like other federal countries will be more explicitly presented if divided broadly into three major heads. These are:

1. Statutory and Non-Statutory allocations giving to the states by the federal government, by virtue of their constitutional responsibilities which has to be performed;

2. The revenues generated internally by the states, within their own boundaries from the taxes, fines fees, and licences that they levy; and,

3. The loans they incur. The loans can be from the Merchant, commercial or development banks. This aspect will not be discussed at length here.


Federal Government allocation to the states constitute the main source of revenue for states in Nigeria. These allocations come in the form of statutory and Non-statutory grants, which has been discussed in the last chapter briefly to show the proportion of states revenue that it constitutes. The states distribution of federal grants to the states for the years 1978-'79-'85, is shown in Table 3.1.

The table shows the relative amounts distributed to the 19 states in the country from 1978-'79-'85. The proportions
differ among the states mainly because of the revenue allocation formula in use at different times. This is because three different formulas were used between the period, i.e., one between 1978/'79-'80, the other between 1981-'84, and the new decree of 1984, for 1985. Further, the figures though obtained from central bank publications are estimates for 16 of the states, hence it's difficult to give a precise explanation of happenings with regards to the amount distributed to other states.

It can clearly be seen that the relatively most populous states in the country, i.e., Kano, Oyo and Bendel receive more in relative terms to other states. However, the amount so given to them may not necessarily be solely dependent on population as will be discussed later. Similarly, those states with a relatively smaller population receive relatively less, as can be seen with the case of Niger and Ogun states.

The statutory allocation and grants to the states has been rising from 1978/'79 up to 1981. The increase can mainly be attributed to gradual increase in revenues coming to the federal government. The amount disbursed to states increased in 1981, despite the relative decline in the nation's revenue. This increase on the other hand can be attributed to the enactment and passage into law of the allocation of revenues act of 1981. This act incorporates a formula that gives more revenues to states. From that time onwards, the relative amounts given to states started to decline in actual monetary terms, mainly because of the
Relatively less populous states like Niger and Ogun being the two states with the lowest population in the country, in that the population of the two states combined constitute approximately 5 percent of the country’s, receive a yearly average of 3.8 percent of the nations federal grants to the states. The situation with the more populous states is somewhat different. For instance, Kano and Oyo states population constitutes around 19.5 percent of the country’s, yet they receive a yearly average of 7.1 percent of the total grants disbursed to state governments. Despite the enormity of the population the disbursement of grants is not so much inclined to population only otherwise, the large states should have had a share greater than this.

Table 3.2. reiterates the fact mentioned above, that federal grants are not solely distributed on a per capita basis, since the grants per capita on a yearly average to the two low populated states were 66.3 and 48.3 for Niger and Ogun states respectively. On the other hand, the highly populated states have a lower per capita grant allotment, being only 29.6 and 27.5 on a yearly average for Kano and Oyo states respectively. This is based on the years 1980–’85. This goes to buttress the fact that other factors seriously affect the amount of revenues disbursed to the states, in this case the equality clause in use for revenue allocation is mainly instrumental to the shift in balance. This is more so the case because the federal government believes that the
states, no matter the population must at least run basic services and undertake to fulfill a certain degree of minimum responsibility.

3.1.1.2. Internally Generated Revenues.

The internally generated revenues are those raised by the state governments themselves, within their boundaries and through their own efforts. The revenue sources in this case are those that they have a fair amount of control over. These are mainly in the form of state taxes, consisting of the Pay as you earn (PAYE), tax through direct assessment, entertainment tax, stamp duties, sales tax, fines, fees and licences, rent on government property and interests, dividends and loan repayments. The amounts raised from most of these sources are for the state governments to keep and use. The amounts raised by the state governments and the per capita revenue generation in each state is shown in Table 3.3.

Overall, the states on a yearly average raise about 20 percent of the revenues they spend locally. This is shown clearly in Table 3.3. The states rely on grants and loans for the remaining amount. However, even with loans, theoretically the states cannot borrow out of the country without the federal government being a guarantor. So the states in essence have the option of only borrowing easily within the country.

The relative amounts generated internally by the states
differ, for the obvious reason that their revenue bases are not the same. A state like Lagos for instance, by virtue of being the federal capital, hence houses more businesses than any other state in the country, raises more than 60 percent of its revenue requirements on average every year. This fact is clearly seen in Table 3.3. where the per capita revenue generated internally by Lagos state is running at an average annual rate of N84 from 1978/’79-1985. This contrasts sharply with happenings in a state like Sokoto, where the amount generated internally per capita is just N3.8 on a yearly average for the same range of years.

The per capita revenue generation across the states, shows an interesting pattern, in that those states with a relatively low population generate more revenues per capita over the years, than the most populous states. Taking the case of the initial two lowly populated states of Niger and Ogun, once again, we see that they generate an annual average of N5.7 and N13 respectively for the years 1978/’79-1985. On the other hand, highly populated states of Kano and Oyo generate an annual per capita average of N4.2 and N5.4 respectively, for the same range of years. This is lower than the average per capita internal revenue generation for all the states in the country, which is calculated to be N7.1. The contrast is not intended to imply that the revenue base of the two lowly populated states is more than the ones in the highly populated states.

The deviation from the mean of per capita revenue generation internally and the federal grants distributed to
the states from 1980-'85 is given in Table 3.4. This deviation is computed mainly for finding an average state with regards to the two. The deviations showed that Bauchi state will fit as an average state, in terms of both per capita internally generated revenues and per capita federal grants. This is because the deviation of the state from the national average is the least in relation to others.

The variations of per capita revenue generation from the annual average is not so dispersed as might have been thought. The dispersion ranged from a maximum of N2.9 below the national average to a height of N6.7 above the national average.

3.1.2. State Government Expenditures.

The expenditures incurred by the states will also be broadly categorised into two, i.e., current and capital expenditures. However, before going into the categorisation, it is important to first look at total state expenditures in general. The overall totals of state expenditures on an annual average from 1980-'85, constitutes 21.3 percent of the nations GDP at 1977 factor cost. Further, the combined amount spent by the state governments constitutes as much as 42 percent of annual yearly expenditure of the federal government. The overall annual average of per capita expenditure of all states is running to N82. This compared to the average revenue per capita of barely N47.1, means that the states do engage in deficit spending over the years.
3.1.2.1. Current Expenditures.

This is the expenditure relating to the day to day running of the governmental apparatus. The totals spent by each of the states for this purpose are presented in Table 3.5. Overall just like with the federal government, it constitute quite a sizeable sum of total expenditures. In that on average it constitutes as much as 58 percent of total state expenditures. The remaining is taken care of by expenditures on capital items.

Looking at Table 3.5., and examining the situation of the states individually presents an interesting pattern. The fact that even the state with the lowest population in the country account for an annual average current expenditure of N130 million between 1980-'85. The state in question is Niger, while an equally less populous state like Ogun spends even more. This happens in a situation where the most populous state i.e., Kano, barely spends approximately N210 million on a yearly average, while the representative average state chosen earlier on, i.e., Bauchi spends a modest amount of N145 million on average per year. This goes to show the extent of costs incurred in running the state civil service as well as other major expenditure heads under current expenditure. So irrespective of a states population the administrative machinery has to continue. This is mainly responsible for a higher per capita expenditure in lowly populated states than in the highly populated ones.

This interesting situation suggests that the less
populous states spend more in relative terms per capita and tax less in relative terms. Hence a likely migration situation as a result of differences in net fiscal residuas might occur theoretically. Meaning that people will be induced to migrate from more populous to less populous ones. This is mainly because the grants they receive per capita is higher and the expenditures they incur per capita is equally higher, though the revenues generated internally per capita are higher. Yet one cannot be certain, that expenditure benefits are likely to be higher. The difference in Net Fiscal Benefits in the states will be discussed in chapter seven.  

3.1.2.2. Capital Expenditures

The totals of capital expenditures for all the states in the country is presented in Table 3.6. It need be noted that overall expenditure on capital items takes a lesser proportion of states total expenditures as against current. Though this is supposed to be the expenditures of the states on items of a more permanent nature, which assumably aid in raising total output, by itself transferring the value in it on to goods produced. Yet it's financing is very much tied to borrowings and surpluses from current account for a substantial part of it, as against recurrent expenditure which is tied more to federal government grants and internally generated revenues.

A clearly noticeable thing about Table 3.6. is the continuance of the pattern of expenditure across the states.
Still a state like Lagos, Oyo, Kano, and Bendel spend relatively more than most other states. Apart from the likely reason of having to cater for more people and provide more amenities, one can add that the cost of public service provision is relatively higher in those areas by virtue of the fact that each of the states contain a big urban centre. Though it is not often that high expenditures are associated with high costs, yet some studies have shown how costs differ from metropolitan states like Lagos and Kano\(^1\) with others that are not.

Given the importance of federal transfers and the effects that each revenue allocation formula recommended has on the overall quantum of revenues that goes to states and local governments, we now examine the history of revenue sharing in the country.

3.2. HISTORY OF REVENUE SHARING IN NIGERIA.

Revenue Sharing in Nigeria entail a series of unconditional statutory allocations given to state and local governments, such that they can perform the specific responsibilities assigned to them. It is quiet obvious that the fiscal position of sub-national governments is not the same in all federations. Fiscal position here refers to the relationship existing between a jurisdictions relative

---

ability to generate revenues from its own internal sources and the expenditures required to provide a certain level of public goods and services. In pursuit of interpersonal equity, most federations use equalisation devices in revenue sharing formulas to ensure that resource disparities which results in differences in fiscal positions are minimised.

As older federations had a series of problems with regards to what factors to consider and what weights to attach to the various revenue allocation formulas and equalization attempts in their early years as a federation. Similar problems were encountered in Nigeria, though with a more volatile and seemingly different factors that affect the formulas. We now examine the history of revenue sharing in Nigeria, and the possible factors that were considered in each of the commissions recommendations.

Before the amalgamation of the Southern and Northern protectorates in 1914 to form what is now known as Nigeria, each of the protectorates has its own fiscal arrangement. However, from the time of the amalgamation to 1980, eight different commissions were established in pursuance of a suitable revenue allocation formula for the country. This started with the Phillipson commission of 1946 and the latest

---

was the Okigbo commission of 1980. This does not include the decrees passed by the different military regimes in the country, which also have serious effects on the amount and distribution of revenues accruing to states and local governments.

The history of revenue sharing is closely tied to the history of constitutional developments in the country, in that almost all constitutional changes are followed with the setting up of a commission to re-examine revenue sharing. The initial need for revenue sharing in Nigeria was necessitated by the proposals contained in the Richards constitution of 1946. The constitution gave the newly established regions then of the North, West and East some measure of administrative authority and responsibility, while the fiscal powers were in federal hands. By virtue of these responsibilities, it became imperative that revenues have to be transferred to them to enable them perform the designated functions effectively. We now examine the different commissions set up and the nature and basis of their recommendations.


This is the first of the fiscal commissions set up to recommend a suitable administrative and financial arrangement between the centre and the regions, and which goes in conformity with the provisions of the Richards constitution.

The commission broadly identified two classes of
revenues. The two revenue classes identified were: Regional and Non-regional revenues. The Regional revenues are those identified within the regions and collected locally by the regions. These include direct taxes on personal incomes, licensing fees and rents from government property. The commission recommended that the regions can retain these sources. The non-regional revenues are those that the federal government collects, such as import, export and excise duties and company income tax. This source is the one recommended for distribution between the centre and the regions.

The commission recommended an allocation pattern between the centre and the regions share of revenues based on three principles, these are: Derivation, Even progress and Population. The statistical basis for using the other principles did not exist as at then, hence it was only the derivation principle which was used. This specific principle requires that each region be given a portion of federal revenues in accordance with it's relative contribution to it. Even then the application of derivation principle encountered serious set-backs because of statistical reliability, to the extent that the relative contribution of the regions to total revenues was difficult to ascertain. Hence more often the claims of the regions and the receipts of the federal government were not the same. Some of the regions claim more revenues from federal sources than they contribute, so a great deal of controversy ensued as to which region is developed at the expense of the others. This controversy and the creation of a quasi federal structure of government by
3.2.3. The Chick Commission (1953).⁴

Following the anticipated changes that the lyttleton constitution will bring, i.e., the issues of self government for two of the regions (west and east), this commission was set up. The commission was given the responsibility of ensuring that the total revenue available in Nigeria is distributed according to the needs of the centre and regions, and in strict adherence to the principle of derivation. The recommendation of the commission resulted in an increased share of the revenue going to the regions because of the emphasis on regional autonomy following the self government of two regions. Further the derivation principle used widened the existing disparity in the revenue position of the regions.

The commission was given the total revenue available as its reference point, they expanded the revenue to be covered for distribution by including Mining rents and royalties and personal income tax. Later problems of measurement as happened with recommendations of earlier commissions and instability in export duty receipts necessitated a revision of the recommendations of this commission. In this regard the constitutional conference of 1957 created the basis of reviewing the scheme. Hence the Raisman commission was

appointed in 1958 to review tax jurisdiction as well as the allocation of revenue.

3.2.4. The Raisman Commission (1958).^5

The recommendation of this commission both with regards to tax jurisdiction and revenue allocation were quite historic. The commission recommended that the federal government be given the powers to harmonize tax laws in the country, most especially with regards to personal income tax. It recommended the creation of a Distributable Pool Account (DPA). The proceeds of which is to be distributed to the regions on the basis of these four principles: continuity of government services; minimum responsibilities of government; need; and balanced development. The formula stipulates that each major revenue head be divided into three, the first portion to be retained by the federal government, the second to the regions on the basis of derivation and the third part to the Distributable pool account, which is further sub-divided to the regions. Forty percent of the proceeds of the Distributable pool account goes to the Northern region, thirty one percent to the Western region, twenty four percent to the Eastern region and five percent to Southern Cameroon (because it was part of Nigeria as at then).

The recommendations of the commission were in use up to 1964. The advent of oil and the increased revenue earnings from it, the enactment of a Republican constitution in 1963

---

and the creation of a Mid-Western region in 1964 created a need to review the revenue allocation arrangement in the country. Hence this necessitate the setting up of the Binns commission in 1964.

3.2.5. The Binns Commission (1964).^6

This commission was given the responsibility of recommending a basis for the distribution of the Distributable Pool Account (DPA), among the regions, as well as Mining rents and royalties, most especially since oil has started showing promising signs of becoming a major revenue source. The commission recommended that 35 percent of revenues coming from import duties, and mining rents and royalties be added to the DPA. In addition it recommended the use of a new principle that is 'financial comparability'. This principle involve examining the services provided by a regional government, it's own revenue raising efforts and it's cash position. Overall the DPA was distributed to the regions according to these percentages: North 42 percent, East 30 percent, West 20 percent and the newly created Mid-west 8 percent.

The recommendations of this commission barely worked for two years. This was because of two main developments. The military coup d'état of 1966, and the subsequent creation of 12 states in the country in 1967 to replace the former 4

---

grants account, which is to be funded from proceeds of on-shore mining rents and royalties, precisely 5 percent of it. The remaining 25 percent is to be distributed as follows: 15 percent to the federal government; and 10 percent to the respective states where the oil was extracted.

The proceeds of the SJA is to be distributed on the basis of balanced development, derivation, basic needs and national minimum standards, while the proceeds of the special grants account were to be disbursed on the basis of tax effort, balanced development and national interest.

The report of this committee was not accepted by the military government and the report was not even published. From then onwards, the military government has been using a series of decrees and amendments to existing decrees to solve the problems of revenue allocation.


After the civil war, the federal government started to shift an increasing portion of the nations revenue to itself. As such the enactment of this decree resulted in a reduction in the states share of revenues, ranging from a reduction of 40 percent of export duties, 50 percent from motor fuel and excise duties and 5 percent from mining rents and royalties. The DPA distribution formula was amended such that half of the pool was to be distributed in equal parts to each state, while the other part is allocated on the basis of population.
In 1971, another decree was promulgated which gave the federal government the sole right to off-shore rents and royalties (i.e., Decree No. 9 of 1971). The distinction between on-shore and off-shore also started from 1971.

3.2.9. Decree No. 6 of 1975.

This decree made it compulsory that all revenues to be shared by the states, should pass through the DPA, with the exception of 20 percent of on-shore mining rents and royalties which goes back to the states where oil was extracted from. Hence it requires 100 percent of duties on hides and skin, 80 percent of on-shore mining rents and royalties, 100 percent of duties on motor fuel and Tobacco, 50 percent of excise duties and 35 percent of import duties must pass the DPA.

3.2.10. Aboyade Technical Committee on Revenue Allocation (1977).\(^8\)

Following the political programme being implemented for the purpose of transferring political leadership to civilians in the country, and the preparation for drafting a new constitution necessitated having a more permanent revenue allocation formula based on more specific factors for incorporation in the new constitution. In addition it was to take care of the 19 state structure created since 1976, with the promulgation of Decree No. 12 of 1976. This committee

---

was specifically set up to review the existing revenue allocation arrangement and to recommend proposals for incorporation into the constitution.

The first notable recommendation of the committee is that of establishing a Federation Account, whereby all federally collected revenues should be paid into the account. This includes even the lucrative petroleum profits tax and the companies income tax. The proceeds of the federation account is to be shared among the Federal Government, State Governments and for the first time the Local Governments. The distribution of the proceeds of the federation account among the three tiers of government was in the order of 60 percent to the federal government, 30 percent to the state governments and 10 percent to the local governments. In addition the committee recommended the setting up of a special account mainly meant for the benefit of mineral producing areas and areas in need of rehabilitation from emergencies and disasters. Three percent of the proceeds of the federation account is needed to fund this account and this should come out of the federal governments share of the account.

The committee recommended five different principles for sharing the proceeds of the federation account between the states. Each of the principles has different weights. The principles and the weights attached to each are:

(a) Equality of Access to Devt. Opportunities 25%.
(b) National Min. Standards for Nat. Integration 22%.
(c) Absorptive Capacity 20%.
(d) Independent Revenue and Minimum Tax Effort 18%.
(e) Fiscal Efficiency 15%.

The recommendations of the committee were not accepted by the defunct Constituent Assembly. The reasons for the rejection are quite varied, ranging from it's being too "technical", too "unrealistic", to being too "politically insensitive". Hence the problem of the absence of a reliable basis to distribute federal revenues continued up to 1980. In 1980, the civilian government of President Shagari set up the Okigbo commission.

3.2.11. Presidential Commission on Revenue Allocation
(The Okigbo Commission 1980).^9

Despite the rejection of the recommendations of the Aboyade Technical Committee by the then Constituent Assembly, most of it was used by the then Military Government. Further the Constituent Assembly agreed to the idea of establishing a Federation Account and incorporated it into the constitution.

The fact that already there has been a constitutional provision as to the existence of a general fund in this case the federation account. The work of the commission was mainly to recommend how the proceeds of the account was to be shared between the three tiers of government. The recommendation is presented in Table 3.9. The 7 percent

---

allotted for special funds is further distributed into 2.5 percent for Federal Capital Territory, 2 percent for Mineral Producing Areas, 1 percent for Ecological Problems and 1.5 percent as Revenue Equalisation Fund. This recommendations were partially adjusted and passed into law by the defunct National Assembly with the distributions, shown in column 3 of Table 3.9. However, the special fund in this case is devoted mainly to federal capital and ecological problems. The state governments got 31.5 percent, out of which 1.5 percent goes to revenue equalisation fund, while 5 percent goes to mineral producing areas. Lastly the local governments had their 10 percent intact.

Table 3.9.

Presidential Commission on Revenue Allocation and the National Assembly Approved scheme for Sharing the Federation Account in Nigeria. (Percentages).

<table>
<thead>
<tr>
<th>FUNCTION</th>
<th>P.C.R.A. Recommended (1)</th>
<th>Nat. Assembly Approved (2)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>(2)</td>
<td>(3)</td>
</tr>
<tr>
<td>Total Fed. Govt.</td>
<td>60.0</td>
<td>58.5</td>
</tr>
<tr>
<td>Fed. Govt.</td>
<td>53.0</td>
<td>55.0</td>
</tr>
<tr>
<td>Special Fund</td>
<td>7.0</td>
<td>3.5</td>
</tr>
<tr>
<td>State Governments</td>
<td>30.0</td>
<td>31.5</td>
</tr>
<tr>
<td>Local Governments</td>
<td>10.0</td>
<td>10.0</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>100.0</strong></td>
<td><strong>100.0</strong></td>
</tr>
</tbody>
</table>
As regards sharing of the proceeds of the states joint account among the states of the federation, the commission recommended four distinct principles. These are: minimum responsibilities of government (equality of states); population (need); social development factor (judged by the level of primary school enrolment); and Internal revenue effort. The weights attached to each of the factors by the commission were not altered by the National Assembly when they passed it into law. These are 40 percent for minimum responsibility; 40 percent for population; 15 percent for social development factor, which consists of 11.25 percent to direct enrolment into primary schools and 3.75 percent for inverse enrolment and finally 5 percent for internal revenue effort.


Following the overthrow of the civilian government of President Shagari in December '83, the new military regime amended some portions of the revenue allocation law of 1981. The revisions were minor but significant to some extent. The Federal Government share of the federation account was fixed at 55 percent, those of State Governments at 32.5 percent and Local Governments still retained their 10 percent. 1.5 percent of the proceeds of the federation account was assigned for the development of mineral producing areas, and the remaining 1 percent for the amelioration of ecological problems. Further, the decree stipulated that 2 percent of revenue obtained from minerals extracted from mineral producing areas is to be paid directly to the states where
the minerals were extracted in direct proportion to their value. The 2 percent is to come from the states share.

3.3. REVIEW OF THE COMMISSIONS RECOMMENDATION.

The history of revenue sharing has been increasingly noted with political bitterness and unreliable basis of arriving at the recommendations put forward. Further and most importantly none of the commissions had real sound theoretical basis for their recommendations, neither do they have a better format for reducing inequalities in regional/state incomes, or achieving fiscal equalisation between the regions/states.

With most of the commissions recommendation the principle of derivation is enclosed, not because of closing the regional/state disparities in income, nor to encourage the achievement of efficiency in resource allocation, but to cater for an incentive to those who by geographical accident contribute more revenues to the nation, hence in the process the clause keeps on widening the income gap between states/regions. Though there are clauses that calls for equality and need, in some of the recommendations, however, these are not based on a sound theoretical footing either. In that more often than not, the need index is measured just in terms of the number of people in a state/region not on the number who actually need a specific service.

The Okigbo commission at least showed concern with the group of people who need a specific service in each
jurisdiction. This the commission did by incorporating the social development factor, though they gave it an arbitrarily low weight, but it shows an improvement in the system of revenue allocation in the country.

It is noteworthy that none of the commissions really took so much keen interest in the relative cost differences between jurisdictions, which assumably will affect the cost of public service provision. For example, it will be more expensive to build a block of primary school in Lagos and Kano than in Minna and Bauchi.

Further none of the commissions recommendation made it explicitly clear that it intends to equalise the fiscal capacities and needs of the regions/states in the country. The absence of a clear cut statement notwithstanding, yet the revenue allocation formulas consist of some clauses meant to reduce the regional/state disparities in income, though not on an interpersonal basis. The notable clauses being with respect to need, internal revenue generation and social development factor. Most of the commissions see the problem of achieving equity lying mainly in increased transfers to the regions/states rather than to individuals directly. Since the most recent recommendation is that of the Okigbo commission, we will examine the theoretical basis of their recommendations.

3.4. THEORETICAL BASIS OF THE PRESIDENTIAL COMMISSION ON REVENUE ALLOCATIONS RECOMMENDATIONS.
Though, as mentioned earlier, this is an improvement on the recommendations of earlier commissions on the principle of revenue allocation in Nigeria. Yet, it also has its flaws.

The commissions major work was to suggest an appropriate basis for sharing the federation account, between the federal, state and local governments. The first thing they did was to examine an estimate of the revenues that all the governments generate, and the expenditures they incur, and on the basis of the two determine the amount to be given to each tier. They found out that the federal government raise a yearly average of 94 percent of total revenues, mainly from its very lucrative federal sources, as shown in Table 2.6., as against 6 percent for the states, for the years 1976/'77 to 1979/'80. While in terms of expenditures the states and local governments incur a yearly average of 40 percent of the nations total expenditure as against the federal governments 60 percent for the same range of years. This is what informs the commissions recommendations of a 60, 30 and 10 percents to the different tiers. The inappropriateness of this approach will be discussed later.

The commissions basis for distributing the states joint account was the use of budgetary figures of expenditures and revenues. For instance the 40 percent attached to minimum responsibilities of government was based on calculating the

---

10 For the Figures see Federal Republic of Nigeria, Report of the Presidential Commission on Revenue Allocation (1980), Vol.1, Tables 5-2 and 8-2, pps. 55 and 82 respectively.
"proportion of recurrent expenditure to total federal revenues of the state with the smallest budget between the fiscal years 1976/'77 - 1979/'80." However, the population factor which is intended to be an indicator of need is chosen arbitrarily. While the social development factor used primary school enrolment as a measure of development need for the reason that the commission claims their is no sufficient information, and the commission arrived at that figure by looking at the percentage of total statutory allocation that goes to the states as federal government grants for education. The last, i.e., internal revenue effort is calculated by the commission not on the basis of each regions taxable potential and the use of an average tax rate which is to be applied to all states tax bases but was simply arrived at based on the amount the states raise and the proportion it constitutes of total expenditures of the states.

The major issue is that how did the recommendations of the commission conform with the theory of revenue sharing as pertains to equalisation.  

The first major flaw in the commissions work is with respect to a proper definition of fiscal equity. They took the issue of achieving equalisation mainly on the basis of


achieving equity among the states and not between individuals. This is made very clear by the commission when they wrote:

As we are concerned with states and governments, we do not go beyond them to consider the equity of interpersonal distributions.

Though there is a theoretical flaw in the examination of the concept of equity with respect to equalisation in the commissions work, never-the-less the distribution of funds to the states can serve as an indirect way of correcting for differences in fiscal residuas, despite the fact that the grants so given are unconditional grants, which allows the jurisdictions to spend it the way they so feel.

The choice of the four factors for distributing the states joint account has each a justification. The use of population as an indicator of need, social development as an indicator of development expenditures and internal revenue effort are all theoretically justifiable yardsticks. The relative weights so attached for instance in the case of population can be justified because this will result in equalising incomes, since giving that percentage as per capita grants will result in below average per capita income states having a boost in income. However, assigning only 15 percent to social development factor is inadequate, since the states expenditures on education, and health alone constitute almost 25 percent of their total expenditures, coupled with the fact that the social development factor

---

allocation is intended to equalise the states provision of these services. This suggests that the relative amount attached to the factor should have been higher in relation to the equality clause of minimum responsibilities of governments. This is more so because the states are not equal in terms of population, land area, or size, hence the equality proposition is not theoretically justifiable, since equality with respect to states is really difficult to comprehend.

3.5. FORMS OF INTERGOVERNMENTAL TRANSFERS FROM FEDERAL TO STATE GOVERNMENTS.

There are fundamentally four different types of transfers in Nigeria, and these are: (1) Statutory Allocation; (2) Non-Statutory Allocations; (3) Loans; and (4) Direct Federal Government Activities in the states. Though for the purpose of this work we will only concentrate on the first two, all the same, the four will each be discussed briefly.

3.5.1. Statutory Allocation.

The statutory allocations are the grants disbursed to the state governments from the revenues that accrue to the Federal Government, which is meant for sharing among the different levels of government as a constitutional right. The amount given is normally pegged to a specific percentage of the amount collected by the federal government, which are meant for sharing between the governments. The amounts vary
for different years, depending on the quantum of money collected for distribution, and the formula in use for disbursements at that time.

The overall amount disbursed to the states and local governments in 1970 was N267.6 million, which was 29 percent of the current expenditure of the federal government for that year, (see Tables 2.8 and 2.9). This amount kept on increasing year after year, up to 1977, when it was N1,572.5 million, i.e., 25 percent of total current expenditure. The overall amount dropped in 1978 to N1,240 million and increased to N4,670.4 million in 1981, constituting 30 percent of total current expenditure. The increase in 1973-'75 can mainly be attributed to the increased inflow of petroleum revenues, while the phenomenal increase in 1981, can be attributed to the enactment of the Revenue Allocation Act of 1981 which entailed more revenue transfers to states and local governments. The amounts have been decreasing since then because of the seeming decrease in the nations current revenues. The relative contribution of the two major revenue sources i.e., petroleum profits tax and mining rents and royalties have been declining due to fluctuations in the market for oil.

However, 4 main questions need to be asked to ascertain a distinctive stimulative, equalizing and developmental role for statutory allocation. The first of the questions is whether the distribution is equitable?, secondly do the grants have a substitutive effect?, thirdly do they change in the same proportion to inflation and income growth?, and
fourthly, how regular and easily predictable are they?. The answers to these questions are provided in chapter five.

3.5.2. Non-Statutory Allocations.

The Non-Statutory grants are discretionary grants given to the states by the Federal Government to supplement their revenues. The grants are normally for a specific purpose/activity which the Federal Government wants the states to accomplish. Hence in this case, it depicts the Federal Governments priorities and plans of action. In the case of Nigeria, it can be for such things like the Universal Free Primary Education, the take-off of newly created states, or the take-off of the newly reconstituted local governments. The main necessity for such grants was when the states were receiving a lower percentage of nationally collected revenues.

Since this grant is discretionary and mainly related to the priorities of the Federal Government then they also determine the quantum to give to the states, be it large or small. It can be seen that in 1970-'72, the amount given in each of the years is less than N100,000. However as can be seen from Table 3.10. it rose to N502.2 million in 1976. The reason for this phenomenal increase can mainly be explained by the money given to the newly created states to take-off, the amount given for the take-off of the Universal Free Primary Education, and the take-off of the newly reconstituted Local Government councils. No non-statutory payments were made since 1981, mainly because the Federal
Government now feels the states have more resources at their disposal, especially with the passage into law of the 1981 revenue allocation act. Further, no new program has been initiated by the federal government which needs a national spread and requires special allocation in order to achieve it.

3.5.3. Loans.

Transfers can come in form of loans to the states, thereby reducing the states hardship of going to the Development/Commercial/Merchant Banks to seek for loans. This is not implying that they do not patronize these Banks. This loan offers far more advantages than a conventional loan from the capital market, in that at times they are even written-off, especially with the creation of new states.

The loan-on-lent to the states are the loans procured by the federal government and given on lent to state governments. These are applied to the capital account of the states. They represent proceeds of development loan stocks raised by the federal government, part of which it retains for it's own use. The sums disbursed by the federal government for this purpose are varied over the years, ranging from as low as N20.4 million in 1970, constituting 9.2 percent of total capital expenditure to N2,427.8 million in 1982, constituting 30.5 percent of total capital expenditure. This source of funds is very important to the states, since it is seen that statutory transfers are not sufficient, and surpluses on current account will not ensure
the achievement of their developmental responsibilities.\textsuperscript{14}

3.5.4. Federal Presence.

The states end up with real resources transfer as a result of the activities of the federal government in the states, most especially the activities of Federal ministries and Parastatals, in the fields of reducing unemployment. This element of federal presence in the states, at times allow for redistribution from state to state. The more the activities of a federal government in a state in a certain area, the less will be the expenditure of the state in that area. For instance, the activities of the federal government that result in construction of schools and hospitals will help tremendously to raise the level of social services provision as well as reduce the pressure on the states with regards to providing those services. Similarly, federal government activities that result in location of industry, construction of road and Agricultural promotion etc., in a state will also aid in the development of that state.


This chapter has discussed the finances of states in Nigeria, where it is found that the amount they raise as revenues is less than 30 percent of the amount they spend, the deficit is covered by revenue transfers from the centre

(in the form of either statutory or non-statutory allocations) as well as loans. Also it was found that most of the expenditures are on recurrent items rather than capital. The chapter further discusses the history of revenue sharing in Nigeria with specific emphasis on the recommendations of the different revenue allocation committees set up and the factors they took into consideration in the design of the various revenue allocation formulas they recommended. This led us to a discussion of the most recent formula in use and the theoretical basis of the formula. It was found that the theoretical basis is weak, in that the committee saw it’s work as basically that of finding a politically acceptable formula for sharing federally collected revenues among the governmental tiers, and the criteria of sharing the funds among the states. This partially explains why the minimum responsibility of governments factor was given so much weight. The next chapter discusses fiscal decentralisation in Nigeria.
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Total</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>9.6</td>
<td>9.1</td>
<td>8.7</td>
<td>8.3</td>
<td>7.9</td>
<td>7.4</td>
<td>7.0</td>
<td>6.6</td>
<td>6.2</td>
<td>5.8</td>
<td>5.4</td>
<td>5.0</td>
<td>4.6</td>
<td>4.2</td>
<td>3.8</td>
</tr>
</tbody>
</table>

Table 3.2.
Federal Grants Per Capita to State Governments in Nigeria.

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Anambra</td>
<td>38.1</td>
<td>35.6</td>
<td>31.8</td>
<td>30.8</td>
<td>26.2</td>
<td>30.4</td>
</tr>
<tr>
<td>Bauchi</td>
<td>41.6</td>
<td>46.2</td>
<td>36.8</td>
<td>35.9</td>
<td>31.6</td>
<td>37.5</td>
</tr>
<tr>
<td>Bendel</td>
<td>95.6</td>
<td>81.4</td>
<td>59.5</td>
<td>57.8</td>
<td>51.9</td>
<td>55.6</td>
</tr>
<tr>
<td>Benue</td>
<td>50.6</td>
<td>46.8</td>
<td>38.3</td>
<td>36.9</td>
<td>31.0</td>
<td>33.6</td>
</tr>
<tr>
<td>Borno</td>
<td>39.8</td>
<td>44.8</td>
<td>34.8</td>
<td>33.1</td>
<td>29.4</td>
<td>34.0</td>
</tr>
<tr>
<td>C/Rivers</td>
<td>40.2</td>
<td>36.6</td>
<td>31.9</td>
<td>35.9</td>
<td>26.6</td>
<td>28.9</td>
</tr>
<tr>
<td>Gongola</td>
<td>41.6</td>
<td>44.0</td>
<td>35.6</td>
<td>34.6</td>
<td>28.7</td>
<td>34.6</td>
</tr>
<tr>
<td>Imo</td>
<td>45.6</td>
<td>40.2</td>
<td>33.7</td>
<td>32.9</td>
<td>26.4</td>
<td>32.4</td>
</tr>
<tr>
<td>Kaduna</td>
<td>34.4</td>
<td>33.1</td>
<td>30.4</td>
<td>29.6</td>
<td>26.4</td>
<td>32.4</td>
</tr>
<tr>
<td>Kano</td>
<td>21.8</td>
<td>32.9</td>
<td>33.4</td>
<td>29.3</td>
<td>27.5</td>
<td>33.0</td>
</tr>
<tr>
<td>Kwara</td>
<td>55.8</td>
<td>60.2</td>
<td>44.5</td>
<td>41.8</td>
<td>35.6</td>
<td>45.0</td>
</tr>
<tr>
<td>Lagos</td>
<td>55.1</td>
<td>55.3</td>
<td>51.5</td>
<td>48.1</td>
<td>40.5</td>
<td>48.6</td>
</tr>
<tr>
<td>Niger</td>
<td>77.4</td>
<td>83.2</td>
<td>58.5</td>
<td>53.2</td>
<td>55.6</td>
<td>70.0</td>
</tr>
<tr>
<td>Ogun</td>
<td>56.7</td>
<td>56.6</td>
<td>47.7</td>
<td>44.7</td>
<td>40.1</td>
<td>44.3</td>
</tr>
<tr>
<td>Ondo</td>
<td>40.6</td>
<td>40.7</td>
<td>36.2</td>
<td>34.6</td>
<td>26.1</td>
<td>29.7</td>
</tr>
<tr>
<td>Oyo</td>
<td>32.0</td>
<td>30.6</td>
<td>27.3</td>
<td>25.9</td>
<td>22.8</td>
<td>26.9</td>
</tr>
<tr>
<td>Plateau</td>
<td>49.8</td>
<td>52.1</td>
<td>39.4</td>
<td>38.1</td>
<td>28.4</td>
<td>28.7</td>
</tr>
<tr>
<td>Rivers</td>
<td>130.1</td>
<td>115.6</td>
<td>83.7</td>
<td>78.8</td>
<td>69.9</td>
<td>74.3</td>
</tr>
<tr>
<td>Sokoto</td>
<td>30.8</td>
<td>34.2</td>
<td>28.7</td>
<td>27.6</td>
<td>23.3</td>
<td>28.4</td>
</tr>
</tbody>
</table>

source: computed from Table 3.1.
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales</td>
<td>5.6</td>
<td>5.7</td>
<td>5.9</td>
<td>6.2</td>
<td>6.5</td>
<td>6.9</td>
<td>7.2</td>
<td>7.6</td>
<td>7.8</td>
<td>8.2</td>
<td>8.7</td>
<td>8.9</td>
<td>8.9</td>
</tr>
<tr>
<td>Finance</td>
<td>0.8</td>
<td>0.9</td>
<td>1.0</td>
<td>1.2</td>
<td>1.3</td>
<td>1.5</td>
<td>1.6</td>
<td>1.8</td>
<td>2.0</td>
<td>2.3</td>
<td>2.5</td>
<td>2.7</td>
<td>2.7</td>
</tr>
<tr>
<td>Total</td>
<td>6.4</td>
<td>6.6</td>
<td>7.0</td>
<td>7.6</td>
<td>7.9</td>
<td>8.4</td>
<td>8.8</td>
<td>9.4</td>
<td>9.8</td>
<td>9.5</td>
<td>9.9</td>
<td>9.6</td>
<td>9.6</td>
</tr>
</tbody>
</table>

Source: (1) World Development Indicators, World Bank; (2) Annual Report on the Accounts, Reserve Bank of India.
Table 3.4.

Deviations from the Mean of Federal Grants and Internally Generated Revenues Per Capita 1980-'85 (N).

<table>
<thead>
<tr>
<th>STATES</th>
<th>FED.GRANTS</th>
<th>INTERNAL REV.</th>
</tr>
</thead>
<tbody>
<tr>
<td>National Average</td>
<td>40.0</td>
<td>7.1</td>
</tr>
<tr>
<td>Anambra</td>
<td>-7.9</td>
<td>2.5</td>
</tr>
<tr>
<td>Bauchi</td>
<td>-1.3</td>
<td>0.5</td>
</tr>
<tr>
<td>Bendel</td>
<td>26.9</td>
<td>5.1</td>
</tr>
<tr>
<td>Benue</td>
<td>-0.5</td>
<td>-2.0</td>
</tr>
<tr>
<td>Borno</td>
<td>-4.0</td>
<td>-2.4</td>
</tr>
<tr>
<td>C/Rivers</td>
<td>-6.6</td>
<td>-2.6</td>
</tr>
<tr>
<td>Gongola</td>
<td>-3.5</td>
<td>-3.1</td>
</tr>
<tr>
<td>Imo</td>
<td>-5.4</td>
<td>2.0</td>
</tr>
<tr>
<td>Kaduna</td>
<td>-8.7</td>
<td>-1.5</td>
</tr>
<tr>
<td>Kano</td>
<td>-10.3</td>
<td>-2.9</td>
</tr>
<tr>
<td>Kwara</td>
<td>7.1</td>
<td>-1.2</td>
</tr>
<tr>
<td>Lagos</td>
<td>9.8</td>
<td>*</td>
</tr>
<tr>
<td>Niger</td>
<td>26.3</td>
<td>-1.4</td>
</tr>
<tr>
<td>Ogun</td>
<td>8.3</td>
<td>4.9</td>
</tr>
<tr>
<td>Ondo</td>
<td>-5.3</td>
<td>1.8</td>
</tr>
<tr>
<td>Oyo</td>
<td>-12.4</td>
<td>-1.7</td>
</tr>
<tr>
<td>Plateau</td>
<td>-1.0</td>
<td>1.4</td>
</tr>
<tr>
<td>Rivers</td>
<td>**</td>
<td>6.7</td>
</tr>
<tr>
<td>Sokoto</td>
<td>-11.1</td>
<td>-3.3</td>
</tr>
</tbody>
</table>

Source: Computed from Tables 3.2. and 3.3.

Note: * the amount generated is not used for computation, because it will give a poor and grossly inflated average.

** the amount estimated here is unrealistic, hence if used will make the relative deviations unrealistic.
### Table 3.5.
Current Expenditure of State Governments in Nigeria.
(N-Million).

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Anambra</td>
<td>256.2</td>
<td>337.5</td>
<td>412.3</td>
<td>442.9</td>
<td>246.3</td>
<td>290.3</td>
</tr>
<tr>
<td>Bauchi</td>
<td>102.7</td>
<td>117.7</td>
<td>176.7</td>
<td>185.3</td>
<td>140.3</td>
<td>148.4</td>
</tr>
<tr>
<td>Bendel</td>
<td>244.3</td>
<td>358.7</td>
<td>365.9</td>
<td>419.2</td>
<td>365.5</td>
<td>396.7</td>
</tr>
<tr>
<td>Benue</td>
<td>137.4</td>
<td>175.4</td>
<td>225.9</td>
<td>245.1</td>
<td>156.1</td>
<td>173.5</td>
</tr>
<tr>
<td>Borno</td>
<td>231.7</td>
<td>218.0</td>
<td>223.5</td>
<td>290.0</td>
<td>95.8</td>
<td>150.8</td>
</tr>
<tr>
<td>C/Rivers</td>
<td>273.2</td>
<td>330.7</td>
<td>256.6</td>
<td>271.1</td>
<td>213.3</td>
<td>288.1</td>
</tr>
<tr>
<td>Gongola</td>
<td>118.2</td>
<td>181.3</td>
<td>202.0</td>
<td>170.4</td>
<td>123.7</td>
<td>176.7</td>
</tr>
<tr>
<td>Imo</td>
<td>339.5</td>
<td>337.2</td>
<td>349.8</td>
<td>417.6</td>
<td>356.6</td>
<td>365.1</td>
</tr>
<tr>
<td>Kaduna</td>
<td>245.1</td>
<td>254.4</td>
<td>274.3</td>
<td>320.9</td>
<td>217.7</td>
<td>240.3</td>
</tr>
<tr>
<td>Kano</td>
<td>168.4</td>
<td>204.4</td>
<td>190.2</td>
<td>232.4</td>
<td>243.9</td>
<td>245.8</td>
</tr>
<tr>
<td>Kwara</td>
<td>181.5</td>
<td>223.6</td>
<td>164.2</td>
<td>176.8</td>
<td>187.2</td>
<td>208.8</td>
</tr>
<tr>
<td>Lagos</td>
<td>344.6</td>
<td>369.1</td>
<td>415.5</td>
<td>446.4</td>
<td>337.2</td>
<td>523.1</td>
</tr>
<tr>
<td>Niger</td>
<td>103.3</td>
<td>133.2</td>
<td>146.3</td>
<td>152.9</td>
<td>134.1</td>
<td>129.3</td>
</tr>
<tr>
<td>Ogun</td>
<td>124.1</td>
<td>193.5</td>
<td>158.6</td>
<td>203.0</td>
<td>214.3</td>
<td>208.8</td>
</tr>
<tr>
<td>Ondo</td>
<td>249.1</td>
<td>299.2</td>
<td>257.9</td>
<td>264.0</td>
<td>329.0</td>
<td>176.0</td>
</tr>
<tr>
<td>Oyo</td>
<td>236.2</td>
<td>300.2</td>
<td>351.1</td>
<td>423.5</td>
<td>171.6</td>
<td>422.3</td>
</tr>
<tr>
<td>Plateau</td>
<td>215.1</td>
<td>237.6</td>
<td>250.1</td>
<td>246.0</td>
<td>303.5</td>
<td>186.0</td>
</tr>
<tr>
<td>Rivers</td>
<td>373.3</td>
<td>333.9</td>
<td>n.a</td>
<td>n.a</td>
<td>161.2</td>
<td>322.1</td>
</tr>
<tr>
<td>Sokoto</td>
<td>221.6</td>
<td>245.4</td>
<td>239.8</td>
<td>292.1</td>
<td></td>
<td>177.4</td>
</tr>
</tbody>
</table>

Total 4254.0 4944.9 4733.9 5262.1 4125.9 4823.1

Table 3.6.
Capital Expenditure of state Governments in Nigeria.
(N-Million).

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Anambra</td>
<td>178.6</td>
<td>438.1</td>
<td>476.0</td>
<td>347.2</td>
<td>23.3</td>
<td>85.5</td>
</tr>
<tr>
<td>Bauchi</td>
<td>157.7</td>
<td>181.5</td>
<td>357.0</td>
<td>322.9</td>
<td>37.1</td>
<td>57.2</td>
</tr>
<tr>
<td>Bendel</td>
<td>206.8</td>
<td>626.1</td>
<td>416.7</td>
<td>330.6</td>
<td>31.5</td>
<td>67.1</td>
</tr>
<tr>
<td>Benue</td>
<td>236.6</td>
<td>323.0</td>
<td>344.7</td>
<td>266.0</td>
<td>107.2</td>
<td>-</td>
</tr>
<tr>
<td>Borno</td>
<td>247.6</td>
<td>414.0</td>
<td>444.7</td>
<td>401.5</td>
<td>9.4</td>
<td>39.6</td>
</tr>
<tr>
<td>C/Rivers</td>
<td>260.6</td>
<td>325.2</td>
<td>250.3</td>
<td>289.8</td>
<td>4.5</td>
<td>16.7</td>
</tr>
<tr>
<td>Gongola</td>
<td>62.8</td>
<td>301.2</td>
<td>353.7</td>
<td>336.6</td>
<td>17.7</td>
<td>72.0</td>
</tr>
<tr>
<td>Imo</td>
<td>620.0</td>
<td>408.7</td>
<td>282.1</td>
<td>391.8</td>
<td>25.7</td>
<td>36.4</td>
</tr>
<tr>
<td>Kaduna</td>
<td>159.7</td>
<td>386.1</td>
<td>373.8</td>
<td>354.0</td>
<td>62.8</td>
<td>76.2</td>
</tr>
<tr>
<td>Kano</td>
<td>270.4</td>
<td>450.6</td>
<td>376.0</td>
<td>276.9</td>
<td>66.8</td>
<td>118.7</td>
</tr>
<tr>
<td>Kwara</td>
<td>244.6</td>
<td>210.9</td>
<td>210.9</td>
<td>255.3</td>
<td>12.9</td>
<td>15.5</td>
</tr>
<tr>
<td>Lagos</td>
<td>453.0</td>
<td>386.4</td>
<td>272.0</td>
<td>564.4</td>
<td>97.9</td>
<td>168.8</td>
</tr>
<tr>
<td>Niger</td>
<td>160.5</td>
<td>267.7</td>
<td>134.0</td>
<td>176.1</td>
<td>8.8</td>
<td>16.6</td>
</tr>
<tr>
<td>Ogun</td>
<td>178.8</td>
<td>210.6</td>
<td>181.7</td>
<td>217.4</td>
<td>19.2</td>
<td>28.5</td>
</tr>
<tr>
<td>Ondo</td>
<td>251.5</td>
<td>337.8</td>
<td>284.6</td>
<td>277.4</td>
<td>19.4</td>
<td>34.4</td>
</tr>
<tr>
<td>Oyo</td>
<td>286.9</td>
<td>379.1</td>
<td>420.4</td>
<td>396.2</td>
<td>64.0</td>
<td>80.6</td>
</tr>
<tr>
<td>Plateau</td>
<td>187.7</td>
<td>342.4</td>
<td>355.5</td>
<td>333.0</td>
<td>-</td>
<td>5.4</td>
</tr>
<tr>
<td>Rivers</td>
<td>380.4</td>
<td>533.6</td>
<td>n.a</td>
<td>n.a</td>
<td>n.a</td>
<td>44.8</td>
</tr>
<tr>
<td>Sokoto</td>
<td>178.6</td>
<td>381.5</td>
<td>412.5</td>
<td>291.7</td>
<td>42.3</td>
<td>70.0</td>
</tr>
</tbody>
</table>

Total    | 4697.0 | 6913.5 | 5946.6 | 5828.8 | 650.3  | 1034.0 |

Table 3.7.
(Percentages).

<table>
<thead>
<tr>
<th></th>
<th>April '59-March '66</th>
<th>April '66-March 69</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Fed. DPA Reg/State</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Govt.</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Import duty:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tobacco</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>Motor Fuel</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>Alcoholic Beverages</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>Others</td>
<td>60 30</td>
<td>65 35</td>
</tr>
<tr>
<td>Excise duty:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tobacco</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>Others</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>Export duty:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Produce, Hides &amp; Skin</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>Rents &amp; Royalties</td>
<td>20 30 50 15 35 50</td>
<td></td>
</tr>
</tbody>
</table>

Table 3.8.

<table>
<thead>
<tr>
<th>TAX</th>
<th>April '69-March '75¹</th>
<th>April '75-March '79²</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Fed.</td>
<td>DPA</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Import duties:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tobacco</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>Motor Fuel</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>Alcoholic Bevs.</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>Others</td>
<td>65</td>
<td>35</td>
</tr>
<tr>
<td>Excise duties:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tobacco</td>
<td>50</td>
<td>50</td>
</tr>
<tr>
<td>Others</td>
<td>100</td>
<td></td>
</tr>
<tr>
<td>Export duties:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Hides &amp; Skin</td>
<td>100</td>
<td></td>
</tr>
<tr>
<td>Com. Profits Tax</td>
<td>100</td>
<td></td>
</tr>
<tr>
<td>Pet. Profits Tax</td>
<td>100</td>
<td></td>
</tr>
<tr>
<td>Rents &amp; Royalties:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>On-Shore</td>
<td>5</td>
<td>50</td>
</tr>
<tr>
<td>Off-Shore</td>
<td>100</td>
<td></td>
</tr>
</tbody>
</table>

Table 3.10.
Statutory, Non-Statutory Allocations and Loan-on-Lent to State and Local Governments in Nigeria. N(Million).

<table>
<thead>
<tr>
<th>YEAR</th>
<th>Statutory Allocation</th>
<th>Non/Statu. Allocation</th>
<th>Loan-on-Lent. Allocation</th>
</tr>
</thead>
<tbody>
<tr>
<td>1970</td>
<td>267.6</td>
<td>i</td>
<td>20.4</td>
</tr>
<tr>
<td>1971</td>
<td>330.8</td>
<td>i</td>
<td>27.6</td>
</tr>
<tr>
<td>1972</td>
<td>331.0</td>
<td>i</td>
<td>155.4</td>
</tr>
<tr>
<td>1973</td>
<td>307.3</td>
<td>11.8</td>
<td>130.6</td>
</tr>
<tr>
<td>1974</td>
<td>643.0</td>
<td>0.5</td>
<td>325.9</td>
</tr>
<tr>
<td>1975</td>
<td>1,039.9</td>
<td>9.1</td>
<td>310.5</td>
</tr>
<tr>
<td>1976</td>
<td>1,142.8</td>
<td>502.2</td>
<td>200.6</td>
</tr>
<tr>
<td>1977</td>
<td>1,572.5</td>
<td>424.4</td>
<td>437.7</td>
</tr>
<tr>
<td>1978</td>
<td>1,240.0</td>
<td>532.6</td>
<td>104.7</td>
</tr>
<tr>
<td>1979</td>
<td>2,044.0</td>
<td>827.5</td>
<td>617.9</td>
</tr>
<tr>
<td>1980</td>
<td>3,095.3</td>
<td>599.3</td>
<td>303.7</td>
</tr>
<tr>
<td>1981</td>
<td>4,670.4</td>
<td>-</td>
<td>2.4</td>
</tr>
<tr>
<td>1982</td>
<td>4,264.4</td>
<td>-</td>
<td>2,427.8</td>
</tr>
<tr>
<td>1983</td>
<td>4,274.6</td>
<td>-</td>
<td>1,834.9</td>
</tr>
<tr>
<td>1984</td>
<td>4,195.0</td>
<td>-</td>
<td>2,133.0</td>
</tr>
<tr>
<td>1985</td>
<td>4,966.0</td>
<td>-</td>
<td>2,197.0</td>
</tr>
</tbody>
</table>

Source: Extracted from Tables 2.8 and 2.10.
Table 3.11.
Statutory, Non-Statutory Allocations and Loan-on-Lent to State and Local Governments as Percentage of Total Current and Capital Expenditures in Nigeria. (Percentages)

<table>
<thead>
<tr>
<th>YEAR</th>
<th>Statutory Allocation</th>
<th>TYPES OF ALLOCATIONS</th>
<th>Non/Statu. Allocation</th>
<th>Loan-on-Lent. Allocation</th>
</tr>
</thead>
<tbody>
<tr>
<td>1970</td>
<td>29.4</td>
<td></td>
<td>i</td>
<td>9.2</td>
</tr>
<tr>
<td>1971</td>
<td>36.0</td>
<td></td>
<td>i</td>
<td>15.9</td>
</tr>
<tr>
<td>1972</td>
<td>23.4</td>
<td></td>
<td>i</td>
<td>34.4</td>
</tr>
<tr>
<td>1973</td>
<td>25.3</td>
<td></td>
<td>1.0</td>
<td>23.1</td>
</tr>
<tr>
<td>1974</td>
<td>23.7</td>
<td></td>
<td>0.02</td>
<td>21.0</td>
</tr>
<tr>
<td>1975</td>
<td>21.9</td>
<td></td>
<td>0.2</td>
<td>8.8</td>
</tr>
<tr>
<td>1976</td>
<td>20.9</td>
<td></td>
<td>9.2</td>
<td>4.7</td>
</tr>
<tr>
<td>1977</td>
<td>25.1</td>
<td></td>
<td>6.8</td>
<td>8.0</td>
</tr>
<tr>
<td>1978</td>
<td>17.4</td>
<td></td>
<td>7.5</td>
<td>2.0</td>
</tr>
<tr>
<td>1979</td>
<td>24.5</td>
<td></td>
<td>9.9</td>
<td>12.8</td>
</tr>
<tr>
<td>1980</td>
<td>20.2</td>
<td></td>
<td>3.9</td>
<td>3.6</td>
</tr>
<tr>
<td>1981</td>
<td>30.1</td>
<td></td>
<td>-</td>
<td>0.1</td>
</tr>
<tr>
<td>1982</td>
<td>28.9</td>
<td></td>
<td>-</td>
<td>30.5</td>
</tr>
<tr>
<td>1983</td>
<td>35.9</td>
<td></td>
<td>-</td>
<td>31.3</td>
</tr>
<tr>
<td>1984</td>
<td>37.6</td>
<td></td>
<td>-</td>
<td>46.0</td>
</tr>
<tr>
<td>1985</td>
<td>37.5</td>
<td></td>
<td>-</td>
<td>28.8</td>
</tr>
</tbody>
</table>

Source: Computed from Table 3.10.
CHAPTER FOUR.

FISCAL DECENTRALISATION IN NIGERIA.

This chapter will examine the nature of fiscal decentralisation in Nigeria, as it relates to the country's level of development, and see the implications of that with regards to laid down theory of fiscal choice. The examination will start with a brief on earlier works on fiscal decentralisation as it pertains to it's measures and a country's level of economic development. This will entail a review of the theoretical basis of the issue considered, the ways it is tackled, and the results obtained. This will be followed by a definition of fiscal decentralisation as it is used within this work, and the three main measures of it employed in this study. To clearly delineate the factors that affect the degree of fiscal decentralisation in Nigeria, a model is built incorporating the measures mentioned. These measures are tested using a range of four independent variables to see the extent of fiscal decentralisation in a developing country like Nigeria. The findings are then compared to what obtains from the findings on developing countries as computed by Kee (1977) and Wasylenko (1987).

4.1. INTRODUCTION.

Given that decentralisation is of tremendous importance when it comes to the implementation of economic development policies, we here enumerate why it comes to be that important. Four main reasons are given for its need.
The first and most obvious is that decentralisation is seen to be a more economically efficient means of providing local services. The fact that different sub-central jurisdictions are likely to demand different amounts of public service means that these services are better provided by the sub-central governments. However, should the service be provided by the central government, when in reality demand for it is not the same across the jurisdictions, then inefficiency in production is likely to occur, because the service will surely be uniformly provided by the central government. To avoid such inefficiency, the sub-central governments should be allowed the freedom to provide the services within their jurisdictions in conformity to the demand for it.

Secondly, it can be argued that sub-central jurisdictions can perform some fiscal functions with relative ease and greater efficiency than the central governments. A good example of this is with regards to revenue generation. A sub-central government is in a better position to assess the value of property of individuals residing in their respective jurisdictions rather than a central government. Though this is subject to the sub-central governments having the right calibre of trained local personnel. The shortage of skill manpower in developing countries limits the amount of decentralisation. This phenomenon is pin-pointed by Martin and Lewis (1956) as a desire to economise on scarce administrative skills, which results in more centralisation.
Thirdly, decentralisation allows for a greater participation in a nation's democratic process. This as put by Wasylenko: 'by decentralising the delivery of public services local residents have an increased sense that through voting, they determine the direction of local service delivery. Local taxpayers also become more keenly aware of the connection between payment of taxes and the delivery of local services and thus learn fiscal responsibility. Increased participation in local government affairs in turn, leads to increased interest and voting participation in national politics, and greater overall participation in democracy'.

Fourth relates to the individual's role in the design and organisation of his own community's development. As Hicks (1961) argued, that economic activity by sub-central governments are the best way for people to attain development most especially with regards to public services, such as roads, water, etc., which if built by the local governments might attract a greater degree of commitment to maintain them, as against when built by the central government.

These four arguments are the main pillars upon which justifications for decentralisation lies. Though the proper degree of decentralisation is argued to depend on the importance attached to efficiency gains. These gains depend on the assignment of functions and because the theory of

fiscal assignment is developed with reference to industrialised countries, for which it is mainly influenced by the democratic processes of budget making, which utilises the median voter theories of budget determination, hence this suggests that decentralisation is not likely in developing countries. This is mainly because the median voter model of budget determination does not apply in developing countries, hence efficiency gains from decentralisation may not be as expected because voter preferences are not so readily translated into budget outcomes in these countries. Given these problems, we now examine the various hypothesis generated in the literature as they relate to countries level of development, economies of scale in production, problem of spillovers, redistributional problems and the diversity in demand and tastes in different jurisdictions.

The most noticeable relates to the inherent diversity in both the quantity and quality of public services that decentralised provision offers. This as mentioned earlier, is because of an anticipated difference in the preference patterns of citizens of different sub-central authorities that form a given country. It is argued that a centralised provision of public services which entail a uniform provision to all citizens in a given country, irrespective of possible preference differences is tantamount to forcing people to consume the same amounts of a public service. This is without any consideration to the possible differences in demand that might be existing across the sub-national governments. Hence, it is safe to conclude
that the "larger the size of the group served by a unitary system, and the more diverse the various geographical sub-divisions of the system, the less efficient will be the central provision of a public service".\(^2\) This theoretical fact made us to give the first notable hypothesis generated in the literature on Decentralisation. That is the greater the geographical diversity of the socio-economic characteristics of a jurisdiction, and the larger it's size, entail that greater decentralisation will be the best way to satisfy the varying demands of the citizens. This hypothesis has been tested and found to be true by most studies.

Now to the cost per unit of production. Since differences in the desired level of public services exist across sub-national governments, there is a strong tendency for each sub-unit, to attempt providing it's own services. The practice of such a small scale provision might result in the unit cost of provision being high, such that the likely advantages of decentralised provision will be lost in the process, hence economies of scale in provision will necessitate providing this service by central governments such that the unit cost of provision is spread over a wider range of individuals and making it relatively cheaper. The existence of economies of scale mars any advantage that decentralised provision of public services will bring about. This leads to the second major hypothesis, that, economies of scale in service provision discourages decentralisation.

The third major worry is with regards to interjurisdictional spillovers. This can be of benefits or social costs. Such spillovers are more often generated in the process of a decentralised provision of many services. Allowing them to happen without compensating the jurisdiction that either provide the benefits (if it is benefits) or compell them to pay the cost involved (if it is a generation of social cost), will result in non-optimal provision of such a service. Non-optimal provision means that inefficiency exists in the process by which the whole country will be better-off if it is removed. This leads us to our third hypothesis, that the extent of wide ranging externalities will be negatively related to the degree of decentralisation.

The last of the problems relates to governmental redistributive activities. If such a redistribution attempt is carried out by sub-central units, each within it's boundaries, there is every reason to expect that, independent action on the part of each of the jurisdictions will result in sub-optimal redistribution (Giertz 1976). There is every possibility that through utility interdependence citizens of other jurisdictions might benefit from this redistributive activity, as such the free rider situation that will arise ultimately will result in inefficiencies. This problem is compounded further if migration is allowed, in that the poor will be induced to move to areas where their net fiscal residua will be higher, and the rich moving out of jurisdictions that tax them much. So this leads us to the fourth hypothesis, that is, the need
for redistribution will be related in a negative fashion to the degree of decentralisation.\footnote{This is argued otherwise in the work of Pauly M.V., (1973) \textit{op.cit.}}

However, so many other factors come into play, among which are non-economic ones when considering the degree of decentralisation. The factors mentioned give credence to attempts at decentralisation either based on efficiency or equity grounds. The next question is to examine what specific factors are found that significantly affect the degree of fiscal decentralisation. To see this we need to review the literature in this area.

\textbf{4.2. LITERATURE REVIEW: DETERMINANTS OF FISCAL DECENTRALISATION.}

As against the stream of articles one sees, that relates to other aspects of fiscal federalism. This area has not had much in the few writings one sees, most of them were analyses that pertain to the structure of fiscal centralisation in the state-local sector in the United States. The others relates to examining decentralisation as it relates to economic development among different countries, mostly encompassing a cross section of developed and developing countries. The attempt in this study is to see the specific factors found to affect the degree of decentralisation in developing countries and use the same to see whether they explain the pattern of decentralisation in Nigeria.
Starting with Pryor's work, he rightly obtained "Centralisation Ratios" of public expenditures which is the share of expenditures which are directly made at the central government level. The determinants of centralisation were further examined by him, as they relate to the aggregate centralisation ratios, as well as for differential degree of centralisation for different expenditures within a single nation and the differential degree of centralisation of the same specific type of expenditure among many countries.

To test for the aggregate centralisation ratios he used both time series and cross-section data, further his study was in two parts, one was for nations and the other for the state-local sector in the United States. The results obtained for the cross-section study using data for the mid-1950's for a sample of countries and for 1962 in respect of state and local governments in the United States showed that the centralisation ratio is inversely related to income per capita and population. However, the time series result suggest otherwise, notably because among others, the change in composition of expenditures associated with a change in the per capita income is much different over time than over space at one point in time.

On the other hand Giertz in the same fashion, examined the extent of decentralisation at the state-local sector of the United States. This he did, based on the background of

---

the various hypothesis derived concerning decentralisation of governmental activities with respect to the size of the group being served; the geographical diversity of the socio-economic characteristics of the group; economies of scale; externalities; and the need for redistribution etc.

To test his hypothesis, he formulated three alternative measures of decentralisation, two of which are just the degree of fiscal decentralisation which are based on the distribution of expenditures and revenues between state and local governments. The third dealt with intergovernmental grants and overlapping responsibilities of different levels of governments. He used regression analyses to explain the variation across states for the three different measures of decentralisation, each of which has 15 independent variables. The findings were that, 80 percent of the variation in decentralisation among the states was explained by each of the three equations. The most notable finding as they relate to the coefficients of the independent variables can be summarised thus: that larger population size and greater land area are positively related to decentralisation. This also supports the argument advanced for economies of scale. Further, unequal distribution is negatively related to decentralisation, meaning that both higher per capita income and a more unequal distribution of income will result in less decentralisation among the states.

---

Oates and Wallis also made an attempt to explore empirically the extent and variation in fiscal decentralisation in the state and local sector in the United States. They saw that the state-local sector exhibits wide variation in the relative roles of states and local governments, both over time and across states. The problem is investigated within the existing theory of decentralised fiscal choice, whereby it is seen that decentralised provision of public services enhances the level of economic welfare by ensuring that public output is provided in accordance with the demands of local residents.

They calculated fiscal decentralisation ratios on both expenditures and revenues and the results obtained for the state and local government shares in public expenditures for selected years shows a strong trend towards centralisation, this they attributed to three logical reasons: firstly, that the relative fiscal performance of states has grown over the years; secondly, there might have been a shifting of service provision from local to state governments; and lastly, new services have been introduced and a greater proportion of that are performed by the state governments.

To achieve the main theme of their work, they formulated a set of seven different hypothesis for testing. These are in conformity to the primary determinants of the optimal

degree of fiscal decentralisation. These are conditions relating: to the land area of the state; the size of it's population and the geographical distribution of the population; the level of wealth and income in the state; and the extent of diversity of tastes for public outputs and their geographical distribution among the population. To test the seven hypothesis generated, an econometric technique was implored, first with the use of an error-components regression (for both multi and univariate), and then an OLS regression. The results show that the extent of fiscal centralisation varies inversely and significantly with both population size and urbanisation. Further, in the error-components analysis (multivariate) a positive relationship is observed between fiscal centralisation and the level of per capita income. This according to them is consistent with the view that higher income states will have a more pronounced inclination to engage in redistributive activities. This tends to give a disproportionately large role for the state governments.8

A relative deviation from this line of discussion is Pommerehne's9 discussion of six countries, in that he examined the factors that determine the demand for centralisation of governmental services in different countries, with the use of cross-sectional analysis.

---

8Ibid., p.22.

Pommerehne used the proportion of central government consumption in the overall governments consumption expenditures as a measure of centralisation. He did examine the determinants of fiscal centralisation among different countries with a series of additional variables that were not used before, such as degree of lingual homogeneity; degree of racial differences; degree of differences in religion; differences in culture and the degree of sectionalism. The results show that these additional variables do not influence the level of centralisation once the GDP and population variables are included in the regression equation.\footnote{Ibid., refer to equations 15.6-15.13., pp.301-303.} The other findings are similar to some of the ones obtained earlier, i.e., higher per capita GDP countries are less centralised. Similarly, countries with larger population are also less centralised. And finally, it was found that countries with more unequal distribution of income were more centralised. This finding reflects the desire to redistribute income in such countries by the central government, because it is seen to be performed more efficiently than would have been the case with local governments.

As a note of departure, the only extensive work of this sort done for Nigeria is a bold attempt by Ubogu (1982)\footnote{Ubogu R.E., (1982) "Fiscal Decentralisation and Economic Development Among Nigerian States", The Nigerian Journal of Economic and Social Studies, Vol.24, No.1, pp.1-22.} who conducted an investigation into the relations between the pattern of Fiscal decentralisation within the various
states of Nigeria and the level of economic development. It was a bold attempt because of the insufficiency of data, which compelled him to use cross-section data of as far back as 1973/’74, and the use of the former 12 state structure (despite the creation of a 19 state structure since February 1976), and he chose a sample of two states only for the extent of local government decentralisation.

He derived four different models, the first determines the elasticities between the states current expenditures, federal grants and the states own revenues, as well as the elasticities of substitution between the states current revenues, federal grants and states own revenues. The second considered fiscal decentralisation in the local government sector, by examining the role of grants from federal and state governments on local governments. The third and fourth were derived to consider the degree of fiscal decentralisation among the states.

His results showed that the most important factors that explain the variations in fiscal decentralisation among the states were federal government transfers, degrees of urbanisation and to some extent the share of Agriculture. However, per capita investment was found to be insignificant, meaning that the level of fiscal decentralisation does not depend on the level of development of the states.

---

\(^{12}\)Ibid., p.8.
Kee\textsuperscript{13} took a different dimension to the issues at stake he went out to investigate the relation between the patterns of fiscal decentralisation and stages of economic development specifically by examining the role economic variables play in explaining the degree of decentralisation of government finances. He carried out a regression analyses for two groups of sample countries. The first group consists of 64 developed and developing countries and the other was of 45 developing countries with a per capita income of U.S.$1,000 or less.

The factors that explain the variation in fiscal decentralisation are found to be slightly different in developed and developing countries. In the cross-section study of 64 countries, the consistent factors contributing to the variation were intergovernmental fiscal transfers, a dummy variable for the form of government (whether Federal or Unitary), per capita income and to some extent urbanisation. What this means is that "countries are more decentralised when they have higher intergovernmental transfers from central to local governments, more urbanised populations, higher per capita incomes and when they are organised as a federalist form of government".\textsuperscript{14} While in the 45 sample of developing countries, transfers, urbanisation and the openness of the economy are the prominent factors, while the federal form of government


\textsuperscript{14}This is as summarised in Wasylko M., (1987) op.cit., p.59.
losses its importance. This means that countries with more intergovernmental transfers are more decentralised, while those with more open economies are less decentralised.

The major irony of Kee's findings, is that fiscal decentralisation, seen as the independence of local governments is a function of it's dependence on central government funds.

The most recent analytical examination of fiscal decentralisation as it relates to differences between nations is that of Wasylenko. This study like Kee's took a sample of 49 countries, out of which 24 are industrialised and the remaining 25 are developing countries.

Similarly, his model has all of Kee's independent variables, further, he added two new variables, those of population size and land area of each country. The reasoning for the use of Kee's four variables are the same, i.e., countries with higher GDP are expected to be more decentralised, more urbanised population is expected to result in higher pressures on the central government for local provision of public goods. The more open an economy is the less decentralised it will be. And finally the larger the population size and land area, the more decentralised it will be expected. Are these confirmed by his findings?

15 Ibid., pp.57-71.
The four different measures of decentralisation he presented were estimated using OLS, with all six independent variables. For the pooled sample of industrialised and developing countries, the results for all the four measures look similar. It was found that the federalist dummy and the openness of the economy variables have the expected signs. It was also found that higher per capita GDP, results in greater decentralisation in three out of the four decentralisation measures. The one where the GDP per capita estimated coefficient is not significant relates to decentralisation measure with respect to own local revenues. However, running the results based on industrialised and developing countries separately gives a different result. They are weaker in both set of countries than the pooled results.

The conclusion is similar to Kee's, that income, a federal structure dummy and the economy's openness are statistically significant determinants of fiscal decentralisation. Though the significance depends on the decentralisation measure used. All three measures accept the conclusion reached above, but the last one that relates to state and local revenues from own sources has shown that per capita income has no effect on decentralisation.

To sum up most of the findings in the literature, one sees a little bit of divergence in the results obtained from one author to another. For instance, Pryor in his examination of American states found that higher incomes are positively related with decentralisation, while Giertz, on
the other hand found the reverse. Similarly, Kee and Wasylenko found higher incomes to be positively related with decentralisation. This ambiguity as pointed out by Stonecash does not help us to sort out competing theories, and he attributed the problem to the usage of cross-section analyses, which only sees the state of centralisation of a state as a product of its current economic conditions and not of any historical past. Also, he argued that cross-section analyses only shows the relationship shown across units and this will not necessarily reflect the actual change in relationships shown by individual units. Hence he suggested the use of time-series to cover for this ambiguity.

4.3. FISCAL DECENTRALISATION IN NIGERIA.

The literature just reviewed showed the various attempts at examining decentralisation. However, the areas touched upon are either the extent of centralisation in the state-local sector in United States or an examination of decentralisation across countries. The issue of centralisation/decentralisation within a developing country has not been addressed adequately, unless as part of a larger group of countries, and within this it is asserted that one should expect a significantly higher degree of fiscal centralisation in developing countries, because they

---

have a series of peculiar problems. Further, the fact that the results obtained were criticised on the grounds that cross-section analyses was used has marred any changing pattern that one might have predicted.

Hence this study will examine fiscal decentralisation in Nigeria, as it relates to the countries level of development as depicted by per capita income and urbanisation, the degree of openness of the economy and the ratio of intergovernmental grants to total expenditures between federal and state governments. The state-local sector as used in most studies is not used here because the local governments are still in their fiscal infancy, in addition to the enormity of problems involved in getting data from that governmental tier.

The second area to be touched upon is with regards to the mode of analysis. Since cross-section analyses has been argued to be the main cause of discrepancy in the results obtained, we will use a time-series analysis, that basically incorporates most of the features of decentralisation measures advanced by Kee and Wasylenko, with a little modification for Nigeria.

Irrespective of Keziah's (1980) depiction of a trend towards increased centralisation in planning in Nigeria, which Aluko (1978) argued earlier on has resulted in

increased economic inefficiency, this section will examine fiscal decentralisation between the federal and state governments in Nigeria, and see which factors determine the decentralisation derive. However, before going further, we need to first define what we mean by decentralisation and the measures to use.

4.3.1. Definition.

The definition of decentralisation as it relates to this work, sees it as the creation of autonomous and independent state governments by the federal government, such that the body created has sufficient independent fiscal responsibilities as they pertain to raising revenues and incurring expenditures. Such a body is assumed to have specific constitutionally assigned responsibilities to perform and constitutionally assigned revenue sources to tap, and they are not merely subordinates of the central governments administrative unit.

4.3.2. Measures

The problem is to measure the degree of such decentralisation. Two different types of measures are readily available, as suggested by Kee. These are:

---

(1) The qualitative approach, which relates to the degree of autonomy of local bodies or the absence of interference by the central government. This is difficult to quantify, hence we will just show the level of constitutional autonomy enjoyed by them. To see this we need to examine the structure of federalism in Nigeria.

The structure of federalism in Nigeria leaves a number of state governments which are created by the Federal Government, while Local Governments are created by state governments. Though the state governments are created by the Federal Government, they enjoy some level of autonomy. Autonomy in the sense that their scope for independent action is wide.

This level of autonomy, can however be tempered with if the central government wants to. This can come in the form of tempering with the states functions; the amount of grant funds to be given to them; or the level of Federal presence in the states. It is a point of fact that states are assigned functions to perform by law, and these functions cannot be altered just all of a sudden. However the Federal Government can always decide to attach conditions 'to the use of specific grant funds', as well as to the levels and standards of services to be provided. Though more often

---

19 The level of Federal presence in the state is normally judged by the different activities undertaken by the Federal Government in the state, with its own resources and not relying on the states to contribute to the activity.

20 Wolman H., (1982) "Local Autonomy and Intergovernmental Finance in Britain and the United States", in Rose R., and (Footnote continued)
than not, this seeming element of showing the powers of the federal government is not happening in Nigeria, mainly because of the nature of the revenue sharing arrangement in the country, whereby a lump-sum unconditional grant is given to the states, in the form of Statutory Allocation.

The constitutional division of powers between the different levels of government in the country has vested so much powers on the federal government. The First part of the second schedule of the 1979 constitution of the country has given the federal government exclusive legislative powers over 65 items. On the revenue side, this includes the power to legislate over custom and excise duties, import and export duties, taxes on incomes, profits, and capital gains, exchange control, mines and minerals etc. (This is discussed in greater detail in chapter two, and the various amounts raised under each head is shown in Table 2.6.). On the expenditure side, it's all encompassing, from expenditures on foreign affairs, defence, maintenance of law and order, international trade, to expenditures on Agriculture, Health, and Education which they share with the state and local governments. Further the constitution was quite unequivocal about the supremacy of the federal government, to the extent that it stipulates that all laws

20(continued)

made by the Federal Government shall supercede state laws, and if the states enact any law which turns out to be inconsistent with the laws made by the Federal Government, then the laws of the state are null and void for all the parts that are inconsistent with the federal law. The states share the concurrent functions stipulated at the second part of the second schedule of the constitution with the federal government.

The expenditure responsibilities of the states are enormous, and consists of activities under the range of economic, social and administrative services. In the economic services, they undertake expenditures in Agriculture, and related activities such as forestry, and fishing; Commerce; Transport; Rural development and Construction. In the social services sector, they incur expenditures on Health, Education and the provision of basic welfare facilities. They also spend a lot in the field of administration. The local governments on the other hand are assigned expenditure responsibilities over refuse disposal, primary education, market, motor park construction and maintenance etc.

The revenues that states generate falls short of the expenditure responsibilities they are expected to perform. This is because most of the lucrative revenue sources are controlled by the Federal Government. Hence the inadequacy

---

of revenues vis-a-vis expenditure responsibilities necessitate the Federal Government to effect revenue transfers to the states to enable them fulfill some of their constitutional responsibilities.

In this regard, the constitution made a specific stipulation with regards to the nations collected revenue. It stipulated that a 'Federation Account' be set up, and all monies accruing to the Federal Government of Nigeria be deposited into the account, except proceeds from the personal income tax of the personnel of the armed forces, the police force, Ministry of External Affairs and the residents of the Federal Capital Territory. The proceeds of the account is to be shared among the three different governments in accordance with a revenue allocation formula to be worked out. This resulted in the setting up of a revenue allocation commission in 1980 to recommend an acceptable formula. The recommendations of the commission were later discussed, modified and passed into law in 1981.

(2) The quantitative measure. This sees the relative share of state governments revenues and expenditures in total fiscal activities. Through this one can pin-point the extent of fiscal discretion that a sub-central government enjoys, considering the proportion of expenditures it incurs and the relative revenues available to it, as a proportion of total revenues. To obtain this, normally a ratio of state government expenditures to total government current

---

23 Ibid., Section 149(1), p.50.
expenditures is calculated, the same is done for revenues. This gives the decentralisation ratios in respect of both expenditures and revenues. However, two problems need to be sorted out here, i.e., the components of central government expenditures and revenue sources, as well as where to place intergovernmental grants.

As is expected, the ratio of state expenditures to total government current expenditures might give a distorted picture of local fiscal discretion if such a discretion is limited by the central government, in instances where the amount of total funds to spend, or on which functional heads to spend are dictated to the state governments. This as explained in the first measure is not the situation in Nigeria, hence the ratio is about the best measure one can use. The next deals with revenue measures. It is a fact that intergovernmental grants constitute a substantial portion of state revenues, though this does not necessarily mean that their scope for independent fiscal action is curtailed. So to handle this specific problem, two revenue measures are used.

For the purpose of this study, three measures of decentralisation are used using both expenditure and revenues. These are:

1. share of states expenditures in total government current expenditure. This includes expenditure on all sectors (F/D-1).

2. share of states revenue in total government current revenues, including intergovernmental grants and
shared taxes (F/D-2).

(3) share of states revenue (own sources only) in total
government current revenues. This excludes statutory
and non-statutory allocations of revenue from the
federal to state governments (F/D-3).

The decentralisation ratios obtained using these three
measures are presented in Table 4.1. None of the measures
shows a steadily rising pattern over the years. It is more
a case of fluctuation over the years. Expenditure
decentralisation was as low as 9.558 in 1975 and then rising
to 26.600 in 1976, mainly because of the creation of
additional seven new states, which ultimately forced the
states expenditures to increase in relation to total. This
is because more money is given to the states to ensure the
proper take-off of the newly created states. Similarly the
same trend is noticed with revenue decentralisation in that
there was a leap from 16.504 in 1975 to 21.926 in 1976, and
it is subsequently staying above 20.000 for the remaining
years under consideration. The decentralisation peak of
both was reached in 1983, i.e., the last year of the
civilian administration, coupled with the fact that it was
an election year. This is because for one, there was a
relative increase of almost 8 percent of the states
internally generated revenue. Secondly, Federal
government's current revenues and expenditures were
declining in relative terms in 1983, while the states were
on the increase,\(^{24}\) since the ratio is calculated using

\(^{24}\) See Tables 2.6, 2.7, and 3.5.
federal government figures, it became obvious that it has to increase. Subsequently the decentralisation proportion started going down from 1984, with the coming back of the military.

Table 4.1.

<table>
<thead>
<tr>
<th>Year</th>
<th>Exp.Decen. (F/D-1)</th>
<th>Rev.Decen. (F/D-2)</th>
<th>Rev.Decen(OSO) (F/D-3)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1970</td>
<td>18.079</td>
<td>19.598</td>
<td>6.897</td>
</tr>
<tr>
<td>1972</td>
<td>22.079</td>
<td>13.528</td>
<td>9.841</td>
</tr>
<tr>
<td>1974</td>
<td>12.571</td>
<td>12.028</td>
<td>5.978</td>
</tr>
<tr>
<td>1975</td>
<td>9.558</td>
<td>16.504</td>
<td>5.936</td>
</tr>
<tr>
<td>1976</td>
<td>26.600</td>
<td>21.926</td>
<td>5.352</td>
</tr>
<tr>
<td>1977</td>
<td>27.780</td>
<td>20.707</td>
<td>4.840</td>
</tr>
<tr>
<td>1978</td>
<td>22.103</td>
<td>25.916</td>
<td>5.578</td>
</tr>
<tr>
<td>1979</td>
<td>28.798</td>
<td>23.801</td>
<td>4.209</td>
</tr>
<tr>
<td>1980</td>
<td>21.758</td>
<td>22.315</td>
<td>3.114</td>
</tr>
<tr>
<td>1981</td>
<td>24.137</td>
<td>27.229</td>
<td>4.027</td>
</tr>
<tr>
<td>1982</td>
<td>24.274</td>
<td>25.625</td>
<td>4.673</td>
</tr>
<tr>
<td>1983</td>
<td>30.629</td>
<td>27.707</td>
<td>5.592</td>
</tr>
<tr>
<td>1984</td>
<td>27.023</td>
<td>25.143</td>
<td>5.948</td>
</tr>
<tr>
<td>1985</td>
<td>26.698</td>
<td>22.386</td>
<td>5.156</td>
</tr>
</tbody>
</table>


4.3.3. Model and Estimation.

Now that we have seen the degree of fiscal
decentralisation in Nigeria as presented in Table 4.1. We now examine some of the economic factors that can be used as explanatory variables to the degree of fiscal decentralisation. So many variables have been used in the literature, each of which has its justification. The most common ones being, per capita income, population size, urbanisation, land area, income inequality, intergovernmental transfers, the degree of openness of an economy, a federal dummy variable, and other non-economic factors, that are either political, historical, cultural, linguistic, religious, geographic etc. Some of these factors in some studies are significant and had the correct anticipated sign in explaining the degree of decentralisation in developing countries, while others are not.

For the purpose of this work, a behavioural model that anticipates and explains the fiscal decisions of states in developing countries is not offered, rather the model proposed here is in line with the practise of earlier studies that searched for a pattern which explains decentralisation in developing countries. In this sense decentralisation is examined as a function of four independent variables (where the first two relate to the countries level of development). These are: (1) per capita income (PCY); (2) urbanisation (URB); (3) ratio of intergovernmental transfers to total government expenditures (RGOE); (4) degree of openness, i.e., foreign trade as percent of GNP (OPN). These variables have been used and found to be consistently the most noticeable factors that
affect the degree of fiscal decentralisation, depending on which of the studies one examines.

The theoretical backing for the variables are obvious. Taking per capita income for instance, which in this case is taken to be the countries GNP divided by its population for the sample of 16 years chosen. It is hypothesized that the growth of per capita income over time results in more decentralisation. It is also empirically found that countries with higher GNP per capita are more decentralised. The reasoning for this, is that greater economic development is likely to result in states having a greater pool of skilled personnel competent enough to provide local public services, also economic development might result in a more sophisticated population that is likely to demand a more diverse range of local public goods. However, Peacock and Wiseman have argued otherwise with respect to income growth.25

In the same way, increasing urbanisation in a country is very likely to result in affecting fiscal decentralisation in a positive manner. This is because, with increasing drift to urban centres, pressures might induce the central government to transfer more fiscal functions to the sub-national governments, with the hope that it will be best accomplished efficiently if provided by the lower level

25 There argument is that as income grows, the countries will be more concerned with regional equity in public services, hence will prefer uniformity of service provision, than encourage decentralisation. See Peacock A., and Wiseman J., The Growth of Public Expenditure in the United Kingdom, Princeton University Press, Princeton N.J., 1961.
government.

The openness of economy factor is here measured by taking the ratio of total exports and imports to the countries GNP. This factor is important, especially in relatively open developing economies where customs duties form a significant proportion, and rapidly growing revenue source of the central government. Hence the more money they raise from this source, (if they are not made to share it with sub-national governments) the more centralised is the government, as such this factor is negatively related to decentralisation.

The last of the variables that relates to intergovernmental transfers is intended to see whether increased transfers results in more decentralisation, though it is an inferior decentralisation to the one that is achieved with own revenues. This specific aspect is discussed at great length in the next chapter.

4.3.4. Results.

The results of the determinants of fiscal decentralisation as presented in Table 4.2. using OLS shows quite an interesting pattern. The most remarkable is the significance of the ratio of intergovernmental transfers to total government current expenditures variable (RGOE), on all the three measures of decentralisation. The estimated coefficient is positive and statistically significant at the 0.95 in the first and second equations and 0.99 in the
third. What this means is that both expenditure and revenue decentralisation are greater, with a large amount of revenue transfer to state governments. Examining the revenue decentralisation aspect alone, does not tell us whether it substitutes or stimulates local tax effort. This aspect is discussed in the next chapter. What this finding suggest is that more decentralisation can be achieved directly by either assigning expenditure responsibilities or giving the state governments more revenue powers, or indirectly through giving them intergovernmental grants. This conforms to Kee's findings and the irony involved in fiscal decentralisation, i.e., decentralisation is a function of the state governments dependence on federal funds. Though this will suggest increasing centralisation, if the revenues given are specific or conditional grants, but the bulk of the revenues in this case are Lump-sum unconditional grants, hence the decision on what goods and services to provide is taken independently by the state governments.

Similarly, the openness of the economy (OPN), has the expected negative sign and is also statistically significant at the 0.99 and 0.95 levels. The impact of the openness variable, though negative on fiscal decentralisation means that the higher the openness of a countries economy in terms of foreign trade, the lower is the degree of fiscal decentralisation. This is mainly because the levies imposed and hence the quantum of custom duties generated which goes to the central government is responsible for the

---

26 Kee W.S., (1977) op.cit., p.94.
Table 4.2.
OLS Regression Results of Decentralisation Ratios and a Selection of Independent Variables.
N=16.

<table>
<thead>
<tr>
<th>Dec. Measure</th>
<th>Independent Variables</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>C</td>
</tr>
<tr>
<td>F/D-1</td>
<td>50.342</td>
</tr>
<tr>
<td></td>
<td>(0.4405)</td>
</tr>
<tr>
<td>F/D-2</td>
<td>34.727</td>
</tr>
<tr>
<td></td>
<td>(0.1089)</td>
</tr>
<tr>
<td>F/D-3</td>
<td>16.230</td>
</tr>
<tr>
<td></td>
<td>(0.1518)</td>
</tr>
</tbody>
</table>

Note: Figures in bracket are standard errors.
* significant at 0.99 level.
** significant at 0.95 level.

statistically significant estimated coefficient. This in turn confirms the hypothesis, that the larger the relative size of foreign trade transactions, the greater will be the revenue and as a result greater expenditure centralisation.

The urbanisation variable has a negative sign in the first two equations i.e. F/D-1 and F/D-2. It is however positive but not significant in the revenue decentralisation equation with own revenues only i.e. F/D-3. This finding counters the earlier ones examined in the literature that sees the urbanisation factor as constituting a major part of the expansion of local spending in developing countries. In fact equations F/D-1 and F/D-2 see greater urbanisation as resulting in less decentralisation. This can be explained
by the fact that in Nigeria, the growth of cities is not so fast in the states, rather expenditure increase are more noticeable in the Education, Health, Welfare and General Administration sectors than in specific urban programmes.

The per capita income variable is found to be positive and statistically significant at the 0.99 and 0.95 level in the first two equations. This disproves the conclusion in some works that fiscal decentralisation is a costly operation for developing countries, hence the attempts to economise on scarce trained personnel and aim at government efficiency, which is expected at the central level only does not hold in this case. The third equation on the other hand has a negative relation between fiscal decentralisation and per capita income.

4.3.5 Limitations.

The urbanisation variable as used in all the three equations is a product of estimation, rather than the actual composition of increased urbanisation noticed over the years. The reality though not fully documented shows the growth of urbanisation rising at more than the projected rate of population growth. Hence, this will certainly reduce the effective explanatory power of the variable.

Perhaps the major limitation is the lack of sufficient data on the finances of local governments, which if used

---

would have given a better and more realistic measure of decentralisation. The absence of local data which necessitated the use of states data only for practical convenience has restricted the generalisation of the results. As such one can not conclude that the fiscal decentralisation shown is perfectly a reflection of increased provision of public goods at the local level, because the fiscal activities of the 301 local governments in the country are not included in the calculation of decentralisation measures, further more, they are not used in the factors that determine fiscal decentralisation in the country.

4.4. Summary.

The chapter has examined the extent of fiscal decentralisation in Nigeria and the relevant factors that determine it. The factors chosen are based on their use by Kee (1977) and Wasylenko (1987), and how significant they were in explaining decentralisation in developed and developing countries. These are: foreign trade as percent of GNP; ratio of intergovernmental grants to total government current expenditures; urbanisation; and per capita income. Three different measures of decentralisation were calculated, consisting of one for expenditure decentralisation, and two for revenue decentralisation. A simple regression was run using the three measures as dependent variables to find the effect of the four variables mentioned above. The degree of economy’s openness and the ratio of grant to total expenditures were found to be
significant in respect of all three decentralisation measures. This implies that the greater the openness of the Nigerian economy the less the degree of fiscal decentralisation, also the greater the grant ratio the higher the degree of decentralisation. However, the urbanisation and per capita income variables are only significant in some of the measures and not in others. For instance the estimated coefficient of the urbanisation variable using the first two measures runs counter to most findings in the literature. The finding suggest that greater urbanisation results in less decentralisation. The per capita income variable on the other hand in the first two measures disproves the conclusion in the literature that higher per capita income in developing countries results in more centralisation.
Figure 4.1.
Expenditure Decentralisation in Nigeria.
Figure 4.2.

Revenue Decentralisation in Nigeria

Given that intergovernmental transfers are a common feature of a federal state, and these transfers are shown in chapter 1, take different forms depending on the ultimate objectives of the central government. This chapter examines the two main areas of this study, i.e., the reasons for the issuance of different types of grants and the roles they are expected to perform, as well as the impacts that the two main types of grants, i.e., matching and unconditional lump-sum grants, generate on the recipients. Going further, this chapter thus touches on two of the main objectives that this study aims at, i.e., what are the statutory allocations in Nigeria, are they stimulative or substitutive of local money, do they change with changes in the country's income, and lastly how predictable and regular are the allocations.

I. INTRODUCTION

Inter-governmenental transfers of whatever kind have been studied in two main ways over the years. These are:

--- Revenue Decentralisation 1
--- Revenue Decentralisation 2

YEAR

0 1 2 3 4 5

1 2 3 4 5

1 2 3 4 5

1 2 3 4 5

1 2 3 4 5

1 2 3 4 5
CHAPTER FIVE.

INTERGOVERNMENTAL TRANSFERS THEORY AND THE IMPACT OF STATUTORY ALLOCATION ON STATE EXPENDITURES IN NIGERIA.

Given that intergovernmental transfers are a common feature of a federal state, and these transfers as shown in chapter 1., take different forms, depending on the ultimate objectives of the central government. This chapter examines the two main areas of it's study, i.e., the reasons for the issuance of different types of grants and the hopeful roles they are expected to perform, as well as the impacts that the two main types of grants i.e., Matching and Unconditional lump-sum grants generate on the recipient jurisdictions. The chapter touches on two of the main objectives that this study aims at, i.e., what are the impacts of Statutory Allocations in Nigeria?, are they stimulative or substitutive of local money?, do they change with changes in the country’s income? and lastly how predictable and regular are the allocations.

5.1. INTRODUCTION.

Intergovernmental transfers of what ever kind have been studied in two main ways over the years. These are:

(1) The impacts of such transfers on the receipient jurisdictions. Theoretical analysis of the impacts of grants on public expenditures have been initially based on the familiar theory of individual choice. The receipient of the grant is typically viewed in effect as an individual
decision maker with preference patterns of the usual type, defined over private and public goods. Within this structure there is a unanimity in the conclusion that a matching grant will induce greater expansion in spending on public goods than a lump-sum unconditional grant. This further leads to another crucial conclusion by most researchers, i.e., the level of the recipient governments level of expenditures increases, or at least does not decrease, as a result of the grants (Gramlich 1977). The first example of the use of indifference curve theory to show the effects of different types of grants on the budget of recipient jurisdictions is that of Scott (1952), and later of Williams (1966a), while a more complete one with a greater emphasis on Matching grants is that of Wilde (1971). Further, more work and modifications to the theoretical weakness of the analysis has been done by many economists. Among the most prominent are those of Bradford and Oates (1971a and 1971b); Oates (1972); McGuire (1973); Gramlich (1977); Winer (1983); and Hewitt (1986).

Additions to the examination of the impacts of grants were conducted using the determinants studies approach. This entail running a series of regression tests involving total expenditures, or expenditures on a specific function by a state or local government as a dependent variable and a host of other variables that affect state spending as explanatory variables. Among the common explanatory variables are grants per-capita, and income per-capita. Within this framework, grants are seen as the major variable that affect state spending. This approach has come under severe attack
from many economists, ranging from Pryor's (1967), who sees the group of studies as mainly empirical, with no real theoretical basis underlying the choice of variables or techniques, in that the group of independent variables are chosen based on the fancy of the investigator. Others criticize it because of the problems of simultaneous equation bias and multicollinearity. Despite the criticism, this approach is used in this work, for the purpose of examining the impacts of Statutory Allocation in Nigeria.

(2) The examination of the reasons why transfers are made. The most notable and explicit among the works are those of Gramlich (1977), and Break (1980). The reasons for the transfers have been aptly categorised into two by Gramlich. These are: (a) economic justifications, where one shows the central governments objective of achieving allocative efficiency, as well as equity in distribution and stabilisation; and (b) political and institutional justifications, where a real desire to keep the government close to the people is envisaged, such that a minimum level of service can be provided to all. Other examination of the reasons for grants are seen in a different light, i.e., with respect to the benefits that the central politician hopes to get from such transfers. This view point is started by Down (1957), and later refined and developed by Grossman (1987), where he developed a model to show the political capital that a federal politician hopes to derive from giving grants.

These two will be discussed in this chapter as they
pertain to the main theme of this work. However, before examining the impact of grants on the activities of state and local governments, it will be of importance to first trace the theoretical basis of grants issuance and the theoretical effects of different types of grants. This will serve as a preamble to a proper discussion of the effects of Statutory Allocation on the expenditures of State Governments in Nigeria.

5.2. RATIONALE FOR GRANTS.

Grants in whatever form they are, do have an obvious developmental role to play. The grants may be conditional or unconditional, yet they have a specific objective that they are to achieve. This section examines the various possible reasons why grants are given to sub-central authorities.

5.2.1. Grants to Correct for Externalities.

The most obvious of the Economic arguments in favour of grants arises from the problem of interjurisdictional spillovers. The spillover can be of benefits or costs to members of other jurisdictions. These spillovers are certainly inevitable considering the nature and character of the public goods and services provided. It is obvious that services such as Education, Health Care and Transportation do exhibit enormous amounts of spillover benefits to other jurisdictions. Hence it is in the best interest of the nation for the jurisdictions and there members to consider
the overall benefits and costs of whatever service they provide, such that the value they derive from the service is not worth only the amount they pay to enjoy the service, but also an 'additional amount of service to residents elsewhere'. Assuming no externalities exist in the operations of a sub-central government, then an optimal quantity of a public good (G) aimed at the maximisation of economic welfare of each jurisdictions citizens will be provided by a state or local government, where it's marginal rate of transformation (MRT) of the public good (G) and any other good or money income (X), is equal to the sum of all residents marginal rate of substitution (MRS) between the two goods, viz:

\[ \text{MRT}_{X,G} = \sum \text{MRS}_{X,G(A)} + \sum \text{MRS}_{X,G(B)} + \ldots + \sum \text{MRS}_{X,G(Z)} \]

However, any inequality in the two sides of the equation means that the optimality condition is violated, hence a marginal re-adjustment in the provision of 'X' and 'G', will make all citizens to be better-off.

Assume we have two jurisdictions, 'A' and 'B', and that the provision of good 'G' in one of the jurisdictions confers external benefits to members of other jurisdictions, yet despite that it does not affect the level of consumption in the jurisdiction producing the externality generating good 'G'. So welfare maximisation of each jurisdiction as

---


2This example is based on King's (1984) reformulation of Oates (1972) work.
depicted by the above equation will not be achieved, because external benefits that 'G' generates is disregarded.

This problem can be solved by the introduction of grants to correct for such deficiency. However, the other main task is how do we determine the optimal grant required to tackle the problem. Assuming 'X' and 'G' are produced under constant costs, and that each level of 'G' provided in state 'A', increases consumption of 'G' by each citizen in state 'B', by a constant fraction denoted by (β), of the increase in consumption that would result from an increase in provision of 'G' by one unit in state 'B'. The same obtains if state 'B' is the one producing the externality generating public good 'G'. So optimality requires:

\[ \text{MRT}_{X,G} = \epsilon \text{MR}_{X,G}(A) + \beta \epsilon \text{MR}_{X,G}(B) \quad \cdots 5.2.1.2. \]
\[ \text{MRT}_{X,G} = \alpha \epsilon \text{MR}_{X,G}(A) + \epsilon \text{MR}_{X,G}(B). \quad \cdots 5.2.1.3. \]

In the absence of externalities \( \alpha = \beta = 0 \), so each equation will just be like equation 5.2.1.1. Examining the effects of grants in only one direction, and assume that 'g_A' and 'g_B' are fractions of the cost of producing 'G', hence the MRT\(_{X,G}\) will now be different. This is given to be MRT(1-G\(_A\)), while the value of each grant per unit of 'G' is designated g\(_A\). Hence the respective optimising grant to cover the problem of externalities is given by this formula for g\(_A\), which is derived from King.\(^3\)

\(^3\)Ibid., pp.124-125.
The same applies to state 'B', if the grant is given to them for the correction of spillovers.

To sum up, \( g_A \) equals the fraction of the total marginal valuation of 'G' attributable to outsiders. Thus, if one third of the benefits accrued to 'B', then 'A' would require a grant paying one third of its cost. This means it would set production of 'G' at a point where the net marginal cost equalled the internal marginal benefit, so simultaneously equating total marginal costs and total marginal benefits. This ensures that the overall costs/benefits of the service 'G' is taken into consideration, which ensures optimality in provision.

It need be reiterated here, that if the spillover is of benefits, then the formulation above should hold, by using the central government as agent for ensuring that the benefits enjoyed by all citizens are paid by all. This payment method can come in the form of a Pigovian price reduction grant, in which case the federal government will match all state expenditures on the project, since a lump sum unconditional grant is seen not to be necessarily directed towards reducing the unit price of a service provided by a sub-central authority.

5.2.2. Reducing a Countries Fiscal Gap.
The next argument advanced for intergovernmental grants is that of closing a country's fiscal gap. This gap arises from the fact that, on the one hand central governments have more revenue raising powers (in addition to the fact that tax-evasion at the central level is lower than at the sub-central level), while on the other hand sub-central governments have more expenditure requirements (since they are closer to the people and provide mostly social services). Demand for increased expenditure in sub-central areas rises faster than revenue generation, especially when expenditure responsibilities are allocated among the levels of government on the basis of the attainment of economic efficiency, whereby the responsibility for a function should be assigned to the lowest level of government, within which the bulk of the benefits can be internalised. By assumption this means a major continuing role for sub-national governments on the expenditure side.\(^4\) However, on the revenue side, revenue instruments are assigned to the level of government which can best administer them, these are in terms of economies of scale in tax administration and potential mobility of objects of taxation within a country. These two factors result in assigning the most productive revenue sources to the federal government, making it rare for revenue and expenditure responsibilities to match.

In order to maintain fiscal stability it is necessary that there be a correspondence between resource availability and functional responsibilities at each level of government.

in the system. Otherwise state governments will be made to negotiate with the federal government for increased revenues, hence the amount of Investment funds will become difficult to predict and specific sectors or projects to benefit from these funds will reflect national priorities rather than those of the states. In addition the states will lose control over Investment decisions, in the process reducing their control over recurrent costs. This problem can be partially solved by increasing the revenues of sub-central governments, which may be in the form of lump-sum unconditional grants. This in the process alters the incomes available to them but not the relative prices.

5.2.3. Fiscal Equity Attainment.

This is a point fully stressed by Buchanan. The principle that people in equal fiscal positions should be treated equally. Two people are said to be equal, be it vertical or horizontal if they are seen to be equal both in the presence and the absence of any fiscal change, no matter where they live in the federation, or within a state. This will mean that each jurisdiction should be in a position to provide the same "average" level of public services by exerting the same "average" tax effort.

Quite a number of reasons have been advanced as to why different jurisdictions are likely to provide different levels of services. The reasons range from differences in tax bases, differences in costs of providing services, to differences in needs. Hence to achieve fiscal equity will
require the central government to provide lump-sum unconditional grants to the relatively poor jurisdictions, such that all regions will be in a position to provide the same level of services at the same tax rate. The lump-sum unconditional grant does not require any matching element on the part of the recipient, though it’s often tied to such factors as need, fiscal capacity and tax effort of the recipient, as well as the specific equalization objective of the central government, i.e., how it intends to achieve equity and the weights it attaches to the variables mentioned. This factor is discussed in greater detail in chapter 6.

5.2.4. Fear of Migration Inefficiencies.

The fiscal activities of sub-central governments can bring about a situation where people will be induced to migrate from one jurisdiction to another. These are inefficient both from economic and social points of view. First inefficiencies can occur where taxes exceed the Marginal Benefit derived from public goods and services provided. This can induce inefficient migration from jurisdictions with a high tax rate to those with low tax rates. The second area where inefficient migration is likely to occur is when a sub-central government undertakes redistributive budget policy. In such a case, even if other jurisdictions undertake the same pattern, people will still be induced to migrate to other jurisdictions with high-income in anticipation of having higher fiscal residua from redistribution.
This redistributive attempts results in people moving from one jurisdiction to another, either to escape being taxed heavily or to enjoy the higher incomes arising from higher fiscal residua of other jurisdictions. At times it may end up with tax competition which entails some jurisdictions reducing their tax rates hence resulting in non-optimal resource allocation. This is because, some jurisdictions intentionally reduce their tax rates to lure business-men into their areas, while poorer jurisdictions will have no option but to increase the tax rate at times, in order to provide services of nearly similar standards to those of the relatively rich jurisdictions. This inevitable issue of inefficient resource allocation arising from labour mobility, necessitate having transfers from the central government to the different sub-central governments. The transfer in this case will have to be aimed towards raising the 'ability of the states to raise tax revenues from various sources, or their tax capacity'.

5.2.5. Advantages to Federal Politicians.

The reasons given above for grants are the most common, and widely discussed in the literature, however, most of them fail to reflect happenings in the political market place. It is clear that recepients of grants have a lot of advantages in obtaining it, in that they gain the capability to provide: (a) more services without necessarily raising their tax rates; and (b) reduce their tax rates without

---

necessarily reducing their service levels. What political advantages do the central politician obtain by making such transfers? This view of rationale for grants is started by Down (1957), and later elaborated further by Grossman (1987). In his contribution to why grants are made by the central government, Grossman developed a utility maximising politicians model, based on Down’s earlier work, subject to interest group pressure. The interest groups in this case are sub-national governments. The model was built on three fundamental assumptions viz:

1. There is more than one political party in the country. This ensures that politicians will have to compete for votes. Such that each party in formulating it’s budget has to rank each expenditure or tax category according to it’s vote generating or loosing potential. In this case each politician presents a budget to his voters consisting of the most beneficial expenditures (such that more votes can be generated) and the least harmful taxes.

2. Budgets must always be balanced, such that in the absence of grants, expenditures of all governments must equal taxes generated. While in the presence of grants, the total constraint for the central government is that it’s taxes should equal it’s expenditures and the grants it makes; for the states, their total expenditures should equal a summation of their taxes and federal grants.

(3) The politicians are only interested in the votes they can generate, hence their utilities are a function of votes generated \((Vot^i_t)\).

Below we reproduce some part of Grossmans model. This will enable us to see the arguments he laid clearly.

Denote:

- \(\text{Exp}^i_t\) = own purpose expenditure by level of government 'i', in time period 't'. Where: 'i' = Federal or State., 't' = 0,1.
- \(\text{Tax}^i_t\) = own source taxation revenue of level of government 'i', in time period 't'.
- \(\text{IGG}\) = Intergovernmental grants from federal to state governments.
- \(\text{Vot}^i_t\) = Votes generated.
- \(\text{Pc}^S\) = Political capital a state politician has to offer a federal politician in exchange for IGG.

Going by assumption (2), it follows that in the absence of grants, the balanced budget will be:

\[
\text{Exp}^i_0 = \text{Tax}^i_0. \quad \ldots 5.2.5.1.
\]

However, introducing grant in say time period 1, will give a different budget formula.

\[
\text{Tax}^f_{t1} = \text{Exp}^f_{t1} + \text{IGG}, \text{ similarly, } \ldots 5.2.5.2.
\]
\[
\text{Exp}^S_{t1} = \text{Tax}^S_{t1} + \text{IGG}. \quad \ldots 5.2.5.3.
\]

Since it is assumed that the politician is trying to
maximise the votes he can generate, and the fact that in the absence of grants, the only tools available for him to do that are taxes and expenditures. Hence we can further assume that he has to maximise votes generated using these two tools:

\[ \text{Vot}^i_t = v(\text{Exp}^i_t, \text{Tax}^i_t) \quad \ldots 5.2.5.4. \]

subject to: \[ \text{Exp}^i_t = \text{Tax}^i_t. \quad \ldots 5.2.5.5. \]

Where the first order condition gives:

\[ \frac{\delta \text{Vot}^i_t}{\delta \text{Exp}^i_t} = -\frac{\delta \text{Vot}^i_t}{\delta \text{Tax}^i_t} \quad \ldots 5.2.5.6. \]

Equation 5.2.5.6. above shows the marginal vote gain of an additional expenditure and the marginal vote loss of an additional tax revenue. The equation testifies to one obvious fact, i.e., an additional expenditure affects the votes gain positively and an additional tax reduces the number of votes.

This formulation, has all along ignored the existence of special interest groups, as well as grants. However, if an interest group element is introduced into the model, politicians who are seen to be aiming for vote maximisation will be compelled to compete for the support of these groups. The attempt to woo these groups will mainly come in the way they rank expenditures and levy taxes, such that more votes are generated from expenditures, and vote loss is reduced to the barest minimum from taxes.
Given that grants are to be issued, then of what benefit are they to the central politician, considering the fact that he either has to impose more taxes or reduce own expenditures in order to make the grants. All these two have the disadvantage of resulting in reducing the possible number of votes to be generated in the process. This Grossman tested and found that grants can be given in anticipation of the political capital (support and votes) that a state politician can provide. However, it need be noted that though a state politician can muster sufficient political capital to sell to the federal politician, yet that does not necessarily imply a sizeable transfer of grants to such a state, since other factors such as population are taken into account.

Introducing grant into our initial formula which needs to be maximised will require adding the political capital element.

$$V_{t}^{f} = v(Exp_{t}^{f}, Tax_{t}^{f}, PC_{t}^{s}) \quad \ldots 5.2.5.7.$$  
subject to: $$Tax_{t}^{f} = Exp_{t}^{f} + IGG.$$  

The votes the federal politician expects, in order to get re-elected depends on the expenditures he incurs and the benefit incidence of these expenditures; the taxes he levies and their severity; and on the political capital he expects to generate from grants he gives to state politicians.

Because it is assumed that their is a direct relationship between intergovernmental grant and the
political capital variable, we re-write the maximisation function.

\[ V^f_t = \nu(Exp^f_t, Tax^f_t, IGG). \]

We can now take the derivatives of this with respect to expenditure, tax and intergovernmental grant.

\[ \frac{\delta V^f_t}{\delta Exp^f_t}, \frac{\delta V^f_t}{\delta IGG}, \frac{\delta V^f_t}{\delta Tax^f_t} \]

These also can be used to determine the optimal size of the budget of the central government, as well as the optimal size of the grant to be distributed.\(^7\)

The conclusion here, is that the political capital that a state politician can muster and sell to the federal politician also to a large extent determines the amount of grant funds that are disbursed to the state. Grossman (1987) has found that increased federal grant increases a state politicians political power and in return the federal politician receives the political support and endorsement of the state politician and his supporter. He showed that transfers are greater to states that can provide significant political capital to the federal politician.

5.3. ROLE OF GRANTS.

\(^7\)Ibid., pp.16-17.
There is a general need for intergovernmental transfer of revenue on grounds of the performance of worthy developmental roles. This happens to be the main purposes of grants according to Schroeder.\(^8\) To him grants help to provide a means to accomplish re-adjustments in spending, which may be in the best interest of the nation. By doing this then efficiency may be achieved in resource allocation, which may not be the case if state governments are left on their own. Equally since not all jurisdictions have at their disposal the same level of resources, grants can be redistributive, in that the differentials in tax capacity can be reduced.

Most transfers between governments are meant to be redistributive in that most of the goods provided by state governments do have redistributive potential. This is more visible in cases where differences exist between states where revenue bases and expenditure requirements are not the same, such that states with wealthy tax bases are often having a high concentration of industries while expenditure requirements are generally higher in rural areas 'where the population is dispersed and where greater backlogs exist in the provision of physical and social infra-structure'.\(^9\) So


such a situation requires an intergovernmental transfer to assure the provision of an adequate level of public services in poor states.

This aspect may be considered an inefficient case of resource allocation, because it will look as if productive resources are diverted from an area of high development potential to one of low development potential. This is the view of Scott, when he wrote:

'There is a valid objection on the grounds of inefficiency to making such transfers. This objection is that such transfers provide amenities to poor people in resource poor states, a situation which may be undesirable in the long run. . . . . transfers of government income from place to place counteract this incentive of labour mobility and thus prevent the maximization of national production.'

Scott's argument is not necessarily correct, since through such transfers, the government ensures a more efficient resource allocation pattern in the long run, in that labour productivity will be increased through more resources devoted to public expenditures in health, education, and similar sectors, and by providing social infra-structure which helps in enhancing capital productivity in poor and neglected areas. Buchanan argued that if the transfers are occurring within the Federal Government's fiscal system, which are assumably re-distributive in which case the transfer has no resource effects (which Scott feared) in the geographical sense, hence it's not inefficient. Since the transfer involve differential fiscal treatment among individual "equals" or among "like resource units".  

In terms of achieving efficiency, it's not necessarily of paramount importance in most developing countries, in that revenue transfers are made to state governments, while they in turn spend their money not in accordance in most cases with the rate they charge or tax their residents. Of course there are quite a number of expenditures incurred which are related to the cost of incurring them, and which are borne by the residents, but some expenditures are incurred to fulfill other developmental objectives rather than to ensure the achievement of efficiency in resource allocation.

Now that we have sketched the theoretical rational and roles that different grants perform, it is pertinent to show the effects of different types of grants on the recipient jurisdictions.

5.4. THEORY OF GRANT IMPACTS.

As mentioned earlier, there is a general consensus on the works on grant effects as regards how it affects expenditure. However, these effects are mainly concerned with the initial direct impact on the grantees. Other indirect effects which also in the long run affect budget policy are not yet considered in the literature. For instance as pointed out by King:

'An increase in grants may initially cause an increase in spending by the grantee and a reduction in its tax rates. These responses will lead to changes in consumers expenditure and saving and also perhaps encourage higher or lower tier authorities to alter their tax rates and expenditures. Further, there may

---

be changes in for example, land values, household and business location choices, investment decisions and traffic flows. Some of these induced changes could feed back to both grantor and grantee governments and cause new changes in their behaviour.'

This is an important and theoretically sound observation, yet this has not been discussed at length in most studies. This study just like most others will examine the direct effects only. Most studies have employed the use of consumer-theoretic approach, in which the sub-central receiving jurisdiction is seen as a single utility maximising consumer subject to the balanced budget constraint that total expenditures must equal total revenues.

This phenomenon of the impact of grants on sub-central governments spending is examined as an individual decision making process between a given public good and other goods or income. As an addition to this conventional method, Bradford and Oates argued that since grants are given to communities not individuals hence a broader way of examining the phenomenon need to be incorporated. The incorporation was of the political process which determines a communities choice of public goods and other goods based on a jurisdictions budget constraint.

So to enable us see the impact of grants on the receiving jurisdictions grants are broadly divided into two:

12 King N.D., (1984), op.cit., p.89.
a Lump-Sum Unconditional grant and a Matching grant.

5.4.1. Impact of Matching Grants.

The administration of this type of grant is normally intended to stimulate expenditures on a specific function. Using this type of approach, the recipient jurisdiction is assumed to be an individual decision maker with convex preferences defined over the grant aided good and other private goods. This type of grant results in a reduction of the relative price of the grant aided good. However, the resulting change in expenditure on that specific project as a result of issuing the grant depends on the price elasticity of demand of the grant aided good.

A vivid illustration is offered by figure 1, showing the effects of Matching grants. Government expenditures (or the provision of the grant aided good) is measured on the X-axis, and private goods (or money income) on the Y-axis. The communities initial budget constraint is given by line AB. The point C, is chosen by the community. That point offers the optimal satisfaction given the budget constraint. However, if a price reduction grant is given to the jurisdiction which pays the fraction BB'/OB", then there will be a reduction in the price of the grant aided good which necessitates a change in the budget constraint to AB". The exact level of increase in expenditures as a result of the grant is difficult to be determined, since the elasticity of demand of the grant aided good is not known.
The illustration in figure 1 shows that expenditures on the grant aided good has increased in a similar proportion to the amount of grants, i.e., CD=PG_1+PG_3. This shows a case of unit price elasticity of demand. However, if price elasticity is greater than one, i.e., δE/δG>1, then the communities demand for the good will be greater than the amount given to subsidise the provision of the public good, i.e., it will fall on the range between D and B". In the same vein were expenditure demand price inelastic, i.e., δE/δG<1, then the communities demand for the good will be smaller than the amount of grant and will find itself somewhere along FD in figure 1.

The range of the points from OCF, on the figure shows the Income Consumption curve, and that is the minimum amount that expenditures will increase given the price reduction grant. This assumes that price substitution effects are absent, hence only the income effect is working. However, the price effect enables us to move along a price consumption curve of ACD.

5.4.2. Impact of Lump-Sum Unconditional Grants.

Another way of stimulating expenditures is to use a lump-sum unconditional grant. This grant changes the income available to a jurisdiction, and going by the assumption that a community has preferences just like an individual, then this type of grant has only a pure income effect. However, given that we are talking of a collection of individuals that take a decision via a political process, in which case the
-5.23eff ects

of

such a grant

is not

likely

it were a p p li ed to an individual.
grant

changes

the

jurisdictions
re se ar ch er s
revenue
su rv ey
revenue
an

without

notably

sh aring
of

the

local

matching

a

veil

and

for

studies

di ff er e n c e

federal

in

the

or

Oates

to

cuts.

p a t te rn

some

conclude

s t r on gl y

un t i e d

as if,

made

However,

d i sbu rs es

makes

same

receipient

that
recent

'suggested

for tax cuts,

go ve rn m e n t

g o v e rn me nt s

to

requi re me nt

tax

have

is not a veil

appreciable

and

is

any

the

fact that this type of

avai la bl e

Br a d f o r d

em pi rical

sh aring

whether

incomes

The

to be

that

that it does make
of

expenditures,

untied

tax

aid to state

cuts

benefitting

individuals'.

Now
there

has

n e w one
the

ho w

do

been

to

slope

we

it's
of AB

right
and

are the same.

have

po s i t i v e

will

move

less

C

o c cu pi es

a

th rough

D,

budget

1 shows

co n s t r a i n t AB,

that
wi th

a

It is to be noted that

of the n e w bu dget constraint,

i.e.,

If both public good X and the other goods

to

elasticities,
F.

increase

higher

Figure

labell ed A'B'.

This

income e f f e c t . T h e
the

impact?

in the

that

income

from

than

pa ss es

the

a change

A'B'

initial

show

in

as

grants,

it's

is

of e x pe ndi tur es
earlier

is

the

in ex pe n d i t u r e here

though

curve.

slope

level

mentioned

increase

in di ff er en ce
and

the

the

The

steeper

is

j u r is di ct io n

fact

that A'B'

than AB",

mean

G r a m l i c h M.E., (1977) " I n te rg ov ern me nta l Grants; A Re vi ew
of the Em pirical Literature", in Oates E.W.,
(ed.) The
Poli ti ca l E c o no my of Fiscal Federalism, L e x i n g t o n B o o k s ,
M a s s a c h u s e t t s , p . 23*^7
^^It is ar gu ed that l u mp -s um u n c o nd it io na l grants do also
have a price effect,
see Oates W.E.,
(1979)
"L um p-sum
I n t e r g o v e r n m e n t a l Grants have Price Effects" in Miesz ko wsk i
P., and O a k l a n d H.W., (ed). Fiscal Fe de r a l i s m and Grants in
Aid, The Ur b a n Institute, W a s h i n g t o n D.C.


that with the normal properties of a convex indifference map, the tangency of A'B' with an indifference curve must lie to the left of D. Thus it can be said that an unconditional grant increases local public spending but by less than the amount of the grant, i.e., $0 < \delta E/\delta G < 1$. This grant reduces taxes and allows individual grantees to spend more on private goods. This will be tested with data on Nigeria to see whether the country's statutory allocation results in the same conclusion.

One of the most lucid presentation of the impacts of revenue sharing on the expenditures of sub-central governments using the indifference curve approach is presented by Fisher. So Fishers work can be used to further show how the impacts can be shown theoretically, however, paucity of data on some of the variables he used necessitate the use of a determinants study framework for the determination of the impact of grants on state spending in Nigeria.

The basis of the model developed by Fisher is that it tries to examine the effects of revenue sharing grants on sub-national governments public expenditure and welfare, taking into consideration the theory of intergovernmental grants with special reference to it's distributive effects.

Fishers model like most others, starts with an individual utility function, which is seen to be a function

of private goods or money income \((X_i)\), and public good \((PG_i)\). It is assumed that the individual has a fixed amount of money which he distributes in order to consume the two different goods; each state, that receives a grant selects a level of public expenditure from a set of the residents optimal public expenditure levels and collects taxes in exact proportion to the amount required to finance the selected optimal expenditure; distribution of tax burden is exogenous to the model; every individuals tax share is pre-determined and assumed constant; the central government collects taxes from all individuals and redistributes the same in the form of revenue sharing grants. An increase in state 'j’'s grant has to be accompanied by an increase in federal taxes sufficient to cover the increase in grants.

Denote:

- \(T_j\) = local taxes in sub-central government 'j'.
- \(M_j\) = Revenue sharing grant to sub-central government 'j'.
- \(C_i\) = central government tax for individual 'i'.
- \(h_i\) = is the individuals local tax share
- \(I_i\) = is his income.
- \(m_j\) = allocation coefficient of jurisdiction 'j', i.e., the fraction of the grant program to be received by 'j', which varies depending on what the revenue sharing grant is based on.
- \(F\) = funds to be distributed for revenue sharing purposes.

So the individuals utility function is given thus:

\[ U_i = u_i(X_i, PG_i) \quad \ldots 5.4.2.1 \]
This is monotonic and strictly quasi-concave.

On the other hand, each sub-central government faces a budget constraint which in turn affects the provision of the public good $PG_i$. The constraint is of the form:

$$PG_i = T_j + M_j.$$  
...5.4.2.2.

Since the revenue sharing grant is financed by the taxes collected by the central government, hence the following identity must hold:

$$\sum_{j=1}^{L} N_j = \sum_{i=1}^{N} C_i.$$  
...5.4.2.3.

So given the states budget constraint and the constraint on private consumption, a rational individual is said to aim at utility maximisation

$$X_i = I_i - h_i T_j - C_i.$$  
...5.4.2.4.

Since $T_j = PG_i - M_j$

$$X_i = I_i + h_i M_j - h_i PG_i - C_i$$

So the individuals maximisation problem using Lagrangian Multiplier equals:

$$\text{Max } L = U_i(X_i, PG_i) + \lambda(X_i - I_i - h_i M_j + h_i PG_i + C_i) = 0.$$  
...5.4.2.5.

This yields a demand function for $X$ and $PG$ for each individual. Assuming that the factors used for distributing federal government grants are exogenously determined. We add an allocation coefficient to our constraint, i.e., $m_j$. Grants to state 'j' = $M_j = m_j F$. 
The new constraint becomes:
\[ X_i + h_i^m F + C_i - I_i = 0. \ldots 5.4.2.6. \]

Since it is assumed that local tax shares are fixed, we further assume the existence of non-inferior pure public goods. The revenue sharing program will increase, not affect or decrease an individual's desired amount of public expenditure depending on whether the rule below obtains.

\[ h_i^m F \gtrless C_i \ldots 5.4.2.7. \]

In essence, this model has shown us how theoretically a change in grants can affect the level of expenditures and the direction of the change.

5.5. STATUTORY ALLOCATIONS AND STATE GOVERNMENT EXPENDITURES.

The structure of statutory allocation in Nigeria and the factors that come into play in the distribution of the Federation Account are fully examined in chapter three. It takes the form explained by Fisher,\(^{18}\) i.e., viewing revenue sharing as a whole into two, on the one hand as a program with two phase operation, where the federal government collects the funds and then re-distributes them to state and local governments. On the other hand as a process where revenue sharing is used for equalisation purposes, with allocations based on tax effort etc. The second part is discussed in the next two chapters while the expenditure impacts of the grants are discussed here. This part of the

\(^{18}\)Ibid., p.173.
chapter examines, four main issues which are central to the main theme of this study. These are: Firstly, do grants (in this case statutory allocations in Nigeria) have a positive effect on state expenditures?, if so, then by what proportion do state spending change with a change in grants. Secondly, are the statutory allocations stimulative or substitutive?, stimulative in the sense that a N1 increase in the grant will induce a more than N1 increase in state spending, and substitutive, in the sense that statutory allocations are used as a substitute for local money. Thirdly, we will examine whether statutory allocations change in relation to income growth. Finally will be an examination of how regular and easily predictable are they, since this has an influence on effective planning decisions by the states.

5.5.1. Impact of Statutory Allocations on State Expenditures.

In considerations of factors that affect local spending grants of whatever form have gained prominent importance of recent. Early works in this field that did not take grants into consideration as an important variable have come through a series of attacks. Notable among these early works is that of Fabricant, who did an early pioneering work of first introducing a three basic variable model, and tested their effects on local spending.\textsuperscript{19} The variables he used were: per capita income, population density and urbanisation. Bahl and Saunders later in 1966 used Fabricant's model though with

an addition. This time per capita grants were added, and it improved significantly the explained variation of the equation. Before then Sacks and Harris have also run a series of tests on the impact of Federal aid on Local spending, and their conclusion was that variability of federal aid is closely related to variability in the level of state expenditures. Further, and most importantly they added that an increasing portion of inter state differentials in state government spending can be attributed to intergovernmental flows of funds both within and between states. So assumably this provides a basis for the use of revenue sharing for equalisation of inter state differentials in state spending.

Given that a basis for a link in state expenditures and intergovernmental grants is laid earlier, mainly with the use of expenditure determinants studies, yet this aspect has not being examined by economists in Nigeria despite the long years of grant disbursements to states/regions.

5.5.1.1. Expenditure Determinants Studies.

A common approach is mainly used for most studies on grant impacts most especially as it relates to the determination of whether the grants issued are substitutive


\[\text{Sacks S., and Harris R., (1964) "The Determinants of State and Local Expenditures and Intergovernmental Flow of Funds", National Tax Journal, Vol.17, p.81-83.}\]
or stimulative. This approach is the expenditure determinant studies.

A model is normally developed where per capita state expenditures are seen as a function of several independent variables. This work is done in two parts, first, we measure the magnitude of state expenditures with a series of independent variables excluding grants; and second we use grants together with other independent variables to see the relative contribution of the grant variable to the explained variation of the dependent variable, as well as to see whether the grants are substitutive or stimulative.

Given that expenditures are a function of so many independent variables can be presented in this form:

\[ E = f(X_1, X_2, \ldots, X_n, FG) \]  \[ \ldots 5.5.1.1.1. \]

Where: 
- \( E \) = Expenditures of states.
- \( X_1, \ldots, X_n \) = Independent variables used in the determination.
- \( FG \) = Federal grants.

Since other studies have examined the impact by presenting local expenditures as a simple linear function of these independent variables in a per capita framework, we will use the same here. Hence equation 5.5.1.1.1. becomes:

\[ E = f(X_1, X_2, \ldots, X_n, FG) \]  \[ \ldots 5.5.1.1.1. \]

\[ \text{Where: } E = \text{Expenditures of states.} \]

\[ X_1, \ldots, X_n = \text{Independent variables used in the determination.} \]

\[ FG = \text{Federal grants.} \]

\[ \text{Since other studies have examined the impact by presenting local expenditures as a simple linear function of these independent variables in a per capita framework, we will use the same here. Hence equation 5.5.1.1.1. becomes:} \]

\[ 5.5.1.1.1. \]

---

\[ E/N = \alpha + \alpha_1 X_1 + \alpha_2 X_2 \ldots + \alpha_n X_n + \beta_1 \text{FG}/N. \]

Where:

\[ N = \text{Total population of a state.} \]

The value of the regression coefficient of per capita federal grants is the one that is conventionally used for the determination.\(^{23}\) Thus the determination of whether the grants are stimulative or substitutive is based on the value that the grant coefficient has. This is summarised below:

- If \( \beta_1 = 0 \): Substitution is complete, and federal grants do not effect a change in per capita expenditures.
- \( \beta_1 > 1 \): Federal grants are stimulative of state expenditures.
- \( \beta_1 < 1 \): Federal grant leads to a decline in per capita expenditures.
- \( 0 < \beta_1 < 1 \): Federal grants are substitutive of local money.

Most of the studies support the idea that states with a high per capita income, large fiscal bases and a high federal grant spend more on public services. In addition, most studies specifically on Revenue Sharing showed that the grants given result in higher expenditures, with virtually nothing left over for tax reduction.\(^{24}\) Among the notable ones in these studies are those of Bowman (1974) for...

\(^{23}\)A detailed discussion of its derivation is available in Osman, J.W., (1966) op.cit., p.363.

\(^{24}\)Gramlich (1977) op.cit., p.230.
unconditional grants given in W/ Virginia to independent school districts and that of Weicher (1972) for unconditional grants to school districts in cities where the districts are fiscally independent. A review of most studies have shown that grants were consistently significant and positive in these equations. Further, a systematic relationship is observed between local spending on the one hand, and income, grants and other socio-economic indicators on the other. This has been confirmed by most cross section studies conducted, which show that the proportion of expenditure variation "explained" by the variables exceed 0.5.25

Bahl and Schoeder have also used the determinants model to examine the Bureau of Internal Revenue Allotment and specific tax allotment in the Philipines. They examined the impacts of the two on General fund expenditures and Infrastructure expenditures. The model they built considered the two expenditure functions as interdependent, hence developed the following model:

\[
GF_p = f(AV_p, NA_g, IF_p, BIR_p) \quad \ldots 5.5.1.1.3.
\]
\[
IF_p = f(Pop, U, GF_p, STA_p) \quad \ldots 5.5.1.1.4.
\]

where:
- \( GF_p \) = per capita general fund expenditures.
- \( IF_p \) = per capita infrastructure fund expenditures.
- \( AV_p \) = assessed value of property per capita.
- \( NA_g_p \) = non-agricultural income per capita.
- \( U \) = percentage of population living in urban areas.
- \( Pop \) = total population

---

25 Inman P.R., (1979) op.cit., p.272.
They hypothesize that $\frac{\delta GF_p}{\delta BIR_p} \neq 1$, meaning in essence that the grant system does not stimulate local tax effort. So to estimate the impact of the two, i.e., BIR and STA, a two stage least squares estimation technique was employed, given an assumption of a linear relationship.

The first stage estimates regressed each of the two expenditure categories on all the pre-determined variables, such that:

$$ GF_p = a_1 + b_1 BIR_p + b_2 STA_p + b_3 \bar{X}. \quad \ldots 5.5.1.1.5. $$

$$ IF_p = a_2 + c_1 BIR_p + c_2 STA_p + c_3 \bar{X}. \quad \ldots 5.5.1.1.6. $$

where: $a_1$, $b_1$, $b_2$, $a_2$, $c_1$ and $c_2$ are estimated coefficients.

$b_3$ and $c_3$ are vectors of estimated coefficients.

$\bar{X}$ matrix of predetermined variables.

The second stage estimates involves:

$$ GF_p = a_3 + d_1 AV_p + d_2 NAG_p + d_3 IF_p + d_4 BIR_p \quad \ldots 5.5.1.1.7. $$

$$ IF_p = a_4 + e_1 Pop. + e_2 U + e_3 GF_p + e_4 STA_p \quad \ldots 5.5.1.1.8. $$

So substituting the result from first stage equations into the second stage equations and obtaining their partial differentials gives:

$$ \frac{\delta GF_p}{\delta BIR_p} = d_4 + d_3 c_1 \quad \ldots 5.5.1.1.9. $$

$$ \frac{\delta GF_p}{\delta STA_p} = d_3 c_2 \quad \ldots 5.5.1.1.10. $$

$$ \frac{\delta IF_p}{\delta BIR_p} = e_3 b_1 \quad \ldots 5.5.1.1.11. $$

$$ \frac{\delta IF_p}{\delta STA_p} = e_4 + e_3 b_2 \quad \ldots 5.5.1.1.12. $$
The figures obtained by the estimation of these partial derivatives gives the impacts of each of the revenue source to the two different expenditures. For instance, equation 5.5.1.1.9. above will tell us the impact of BIR per capita on general fund expenditures. There results shows that the grants are substitutive. Even then, the existence of a large backlog of unmet public service needs guarantees that any increase in the amount of revenue available to the government will find it's way into the local government budget. This situation reflects a combination of a high income elasticity of demand for public goods and the fact that once a government receives grant money, it is more likely to spend the money than return it in tax relief.\textsuperscript{26} This is the situation in most developing countries.

An addition to the determinants studies was made by Kurnow in a response to Fisher (1961), and Fabricants papers in this area. He argued that the use of a non-linear functional form will increase the amount of explained variation in per capita expenditures as against the additive relationship developed earlier on.\textsuperscript{27} This as he argued is because the basic variables are interdependent, in that the relationship between density and expenditures is not independent of the levels of income. So he suggested the use of a joint-regression model of this form:

\begin{center}
\textsuperscript{27}Kurnow E., (1963) "Determinants of State and Local Expenditures Reexamined", National Tax Journal Vol.16, pp.252-255.
\end{center}
So taking a semi-log of 5.5.1.1.13.

\[
E/N = \alpha + \alpha_1 \log X_1 + \alpha_2 \log X_2 + \ldots + \alpha_n \log X_n + \beta \log FG/N.
\]

...5.5.1.1.14.

Where \( E/N \), \( X_1 \ldots X_n \), and \( FG/N \), are as defined earlier. Bahl and Saunders using this form tested it with data from U.S.A., and found a slight improvement in the amount of explained variation that the equation provided. 28

5.5.1.2. STATUTORY ALLOCATION: Stimulative or Substitutive?

Given the general idea presented above, we now examine the impact of grants on state spending in Nigeria, using the determinants studies approach. Though we intend to obtain a simple linear regression of per capita total expenditures on three independent variables. These are: per capita income, each states population density and per capita grants for all the states in the country. Yet to see the impact of per capita grants on the equation, we will first run a regression of the other variables on their own, and see their effects on state spending and later add the per capita grant variable and see if it enhances the explanation of the spending variation. Secondly we will use Kurnows usage of a non linear relationship to explain the same phenomenon, using a similar approach as above.

28 Bahl R., and Saunders J.R., (1966) op.cit., p.530. The results for the test using Kurnows formulation for two different years, i.e., 1942 and 1962, showed an increase of almost 1 and 8 percent for the two years respectively.
We derive two simple linear regression equation of this form:

\[ \text{EXPS} = \alpha + \beta_1 \text{PCY} + \beta_2 \text{PD}. \]  \hspace{1cm} ...5.5.1.2.1.

\[ \text{EXPS} = \alpha + \beta_1 \text{PCY} + \beta_2 \text{PD} + \beta_3 \text{PCG}. \]  \hspace{1cm} ...5.6.1.2.2.

Where:

- \text{EXPS} = \text{per capita total state expenditures}.
- \text{PCY} = \text{per capita income}.
- \text{PD} = \text{population density}.
- \text{PCG} = \text{per capita grants}.

**Kurnow's Semi-log Formulation.**

As mentioned earlier, Kurnow felt that the use of a semi-log formulation will increase explained variation of the model. This he argued is because a linear functional form will not account for a possible interdependence of the variables considered in the equations.

So to test Kurnow's conclusions equations 5.5.1.2.1. and 5.5.1.2.2. have been turned into semi-log form as presented below and tested using 1980 and 1985 Nigerian data.

\[ \text{EXPS} = \alpha + \beta_1 \log \text{PCY} + \beta_2 \log \text{PD}. \]  \hspace{1cm} ...5.5.1.2.3.

\[ \text{EXPS} = \alpha + \beta_1 \log \text{PCY} + \beta_2 \log \text{PD} + \beta_3 \log \text{PCG}. \]  \hspace{1cm} 5.8.1.2.4.

The results of the first additive linear equation is presented in Table 5.1, while a test of Kurnow's non-linear equations are presented in Table 5.2.
5.5.1.2.1. Empirical Findings.

As with most studies of the impact of lump-sum unconditional grants, which ascertains that they are substitutive. This study hence intends to find out whether statutory allocations in Nigeria (1) are stimulative or substitutive, which going by the formulations above means that $\beta_3 > 0$; (2) going by Sacks and Harris hypothesis, they play an increasingly important role in the determination of interstate spending levels; and (3) whether they have shown a positive trend towards income equalisation. To test this, two different approaches were used, and data was obtained for all the 19 states (as per the time span the study covered) in the country for the years 1980 and 1985, using Ordinary Least Squares technique.

Table 5.1. shows the results of regressing equations 5.5.1.2.1. and 5.5.1.2.2. In the case of equation 5.5.1.2.1., which includes only per capita income and population density as explanatory variables, it has for both years offered a relatively lower explanation of the observed variation in per capita state expenditures. The values obtained were 0.3884 in 1980 and 0.4226 in 1985. However, including per capita grants and regressing equation 5.5.1.2.2., i.e., state expenditures on grants, income and population density, shows a remarkable upward adjustment in the values for the adjusted R-squared. It’s value has increased to 0.7580 in 1980 and 0.7892 in 1985. This is an increase of almost 3 percent between the years. This goes to show the tremendous role that statutory allocation perform in
the factors affecting state expenditures. This is because the inclusion of the grant variable has considerably increased the amount of explained variation in state expenditures. The difference in the increase of the explained variation of the two equations runs as much as 37 percent for each of the two years respectively.

To answer our first reason for undertaking this regression, we need to focus attention on the estimated coefficient of per capita grant. In both years it shows a positive figure, with Beta coefficient of 0.311 and 0.335 for the years 1980 and 1985 respectively. Beta coefficients are calculated in this case mainly because they are known to be used in measuring the relative importance of the variables that describe the variation in a given dependent variable. The estimated coefficients obtained for per capita grants in both years provide a greater explanation of the variations in per capita state expenditures. The per capita grant estimated coefficient has a value of as much as 0.8379 in 1980 and 0.9695 in 1985. This by most standards can be said to be not significantly different from one or even more, considering the fact that the estimated coefficient are statistically significant at the 0.01 level. Since in reality, not much of a substitution takes place between federal grants and local money, hence one can conclude that for each N1.00 increase in statutory allocation per capita, state expenditures per capita will increase by approximately N1.00 or more, but not less. This means that statutory allocation are stimulative of state expenditures, with an estimated coefficient that is significantly not different from one. The explained variation
of per capita state expenditures between 1980 and 1985 has increased by almost 3 percent. This can be attributed to a relative increase in the quantum of revenues that accrues to the states as statutory allocation, with the promulgation of the 1981 revenue act.

As per the second reason, i.e., with regards to whether statutory allocations play an increasingly important role in state expenditure determination as hypothesized by Sacks and Harris, and later supported by Bahl and Saunders (1965) work in which they used a shorter time span. However, there later work has disputed their earlier endorsement of the work. Though a short time span is used in this study, yet it can be said that Sacks and Harris hypothesis of increasing importance of federal aid as a determinant of state expenditures is not supported by this result. In that the marginal contribution of statutory allocation to the explained variation of state spending between 1980 and 1985 is not significantly different. This is because it is around 37 percent for each of the two years. However, this does not erode the fact that they play a significant role in the determination of state expenditures.

As for the third reason, which relates to the income variable. It can be noticed that there is a slight variation of the income variable. The relative significance of the estimated coefficient for this variable has changed with the introduction of federal aid into the equation for both years. When statutory allocation was introduced in to the equation in 1980 the relative importance of the income variable
declined from 0.0852 to 0.0271. However, the introduction of
the same in 1985 did not show a similar trend in the decline
of the income variable, in that it is 0.0819 before the
introduction and 0.0391 after. This result implies that the
1981 revenue allocation act is moving towards greater
equalisation of income over the years to come. We will see
whether this inference has some substance when we examine the
use of revenue sharing for fiscal equalisation in subsequent
chapters.

Now we examine whether Kurnows method can provide a
better explanation of the explained variation in state
spending.

Kurnow's Formulation.

The results presented in Table 5.2, shows that at least
in Nigeria's case, Kurnows formulation as far as 1980 is
concerned does not offer a higher explained variation than
what obtains in the additive linear specification. In that
the adjusted R-squared for 1980 using Kurnow's semi-log
functional form, and using the same variables is 0.6893 as
against 0.7580 in the earlier additive model. However, the
situation is different in 1985, where Kurnow's semi-log
formulation offers a greater explanation to the variation in
per capita state spending.

Now to the three issues examined earlier on, the results
similarly show that statutory allocations are substitutive
for both years, with an estimated coefficient of 0.6586 and
0.5781 in 1980 and 1985 respectively. In this model, a N1 increase in statutory allocation results in state expenditures per capita increasing by N0.659 and N0.578 in 1980 and 1985 respectively. As per the increasing importance of statutory allocations to state expenditure determination, we can see that the marginal contribution of statutory allocation to the explained variation of state spending slightly changed from 30 percent in 1980 to 35 percent in 1985. Hence here, one can confirm Sacks and Harris hypothesis, though still the extent of change is not large. As per the last point with regards to income equalisation, the results confirmed the conclusions drawn earlier on, that the variations in the relative significance of the income variable with and without the grant variable is lower in 1985. Hence the trend suggests a gradual equalisation of income over the years.

Seemingly the choice of any of the approaches results in similar outcomes, hence for the sake of the three issues we have discussed, the use of each of the approaches will be justifiable.

To sum up this section wanted to find out whether statutory allocations: (1) have a positive impact on state spending on the one hand and on the other whether the statutory allocations are either stimulative or substitutive; (2) play an increasing role in per capita state expenditure determination; and (3) lead towards the equalisation of incomes. These three are answered by the results presented in Tables 5.1. and 5.2. First, statutory allocations have a
positive impact on state spending, in fact it is the most dominant variable, that explains a greater proportion of the explained variation in state spending, and they are seen to be stimulative in the linear model, because the estimated coefficient of the per capita grant variable is not significantly different from one. However, the non-linear model (i.e., Kurnows) shows a case of substitution of federal money for locally generated money. This is because, the value of 0.6586 and 0.5781 were obtained for the estimated coefficient of per capita grants for the years 1980 and 1985 respectively. This shows that 0 < \beta_3 < 1. As per the second question, we saw that though statutory allocations play a prominent role in the determination of state spending, but it does not play an increasingly important role as ascertained by Sacks and Harris. Finally, the third question with regards to income equalisation was found to be true, though further work will be conducted on that in subsequent chapters.

Though the use of Kurnows formulation showed a case of substitution, yet that does not necessarily mean that the states accumulate large cash balances from the substitution of federal for local money, this is because in the years between 1980 and 1985 most of the states run budget deficits.\(^{29}\) Hence, it is more reasonable to conclude that increased revenues coming to the states are all spent, for their exists a series of unmet public service needs that has to be satisfied (just as Bahl and Schoeder found in the

\(^{29}\)See Tables 3.1, 3.3, 3.5, and 3.6 in Chapter 3.
Philippines. Though economic theory would suggest a reduction in state taxes, yet no evidence exists of the use of statutory allocations for such a goal. In fact even, the cancellation of the community and cattle taxes in some states in 1979\textsuperscript{30} was not based on increased revenues obtained from federal sources.

5.5.1.2.2. Limitations.

The nature of the calculation of the independent variables is perhaps first and foremost the major limitation of this work. In that per capita income is obtained by dividing total income by total population, irrespective of whether they encompass only producers or not, hence this depresses income figures of areas with a high proportion of non producers, such as elderly people not in gainful employment, children and full time housewives. This study did not adjust the population variable to reflect only producers, which would have resulted in changes in the estimated per capita income variable. Further, the use of a states land area for the computation of the population density might result in distortions to the analysis, when one considers that there are some states that are sparsely populated while others are densely populated. Despite this fears the model was tested.

Also the aggregation undertaking in the estimation

\textsuperscript{30}These two taxes were abolished in 1979, by Kaduna and Kano state governments. This gesture was subsequently taken up by other states. However, the cancellation was more political than for substitutive purposes.
whereby only total expenditures are considered has reduced to some extent, explanations with regards to what the effects of the variables are on development expenditures. To run a test of such would have provided an answer to one of the major policy objectives of the federal government i.e., it's attempt to induce state and local governments to spend more on economic development purposes and less on consumption of goods and services.

5.5.1.1.2. STATUTORY ALLOCATION: Growth in Proportion to Income?

Though the distribution of the statutory allocation, as discussed in the last chapter is based on such factors as population, minimum responsibilities, and social development, which are meant to take account of the states expenditure needs. However, this does not necessarily mean that an income equalising situation is achieved between states. This is because the effects of the factors used for the determination of each states share of statutory allocation are not necessarily working in the same way. For instance population just takes the absolute number of people available rather than the relevant population group that need a specific service, hence such is very likely to result in a wider income disparity than would have been otherwise. The other that seems more absurd is the minimum responsibilities factor, which is just considered an equality variable in the distribution of national revenues. Equality of states does not allow for a fair interpersonal distribution, because equality of jurisdictions does not make an economic sense.
Table 5.3.

<table>
<thead>
<tr>
<th>Year</th>
<th>GNP (Million)</th>
<th>Stat. Allo. as Proportion of GNP</th>
</tr>
</thead>
<tbody>
<tr>
<td>1980</td>
<td>43188</td>
<td>0.071</td>
</tr>
<tr>
<td>1981</td>
<td>43713</td>
<td>0.106</td>
</tr>
<tr>
<td>1982</td>
<td>52512</td>
<td>0.081</td>
</tr>
<tr>
<td>1983</td>
<td>55037</td>
<td>0.077</td>
</tr>
<tr>
<td>1984</td>
<td>59445</td>
<td>0.070</td>
</tr>
<tr>
<td>1985</td>
<td>65253</td>
<td>0.076</td>
</tr>
</tbody>
</table>


To the growth of statutory allocation in relation to income, we need to examine the growth of the nation's Gross National Product, and compare that with statutory allocation as proportion of it. This will give us a good glimpse of the growth or otherwise of statutory allocation in relation to National Income growth. Table 5.3. presents such a relation. The table shows that statutory allocation does not increase in the same proportion to Gross National Product, neither does it grow faster, from 1980-1985. It on the contrary has been declining both as a proportion of Gross National Income as well as in per capita terms.

To conclude this segment, Table 5.3. has shown us that statutory allocations to states in Nigeria does not increase in relation to the country's national income.
The final point relates to the stability and predictability of this revenue source. For the states to plan effectively, they need to have a fairly reasonable estimate of the amount they expect from each revenue source, and most importantly the federal grants. This is more so, since the federal grants constitute almost 70 percent of their revenues. The practice is that this transfers come at sometimes irregular intervals, while expenditures must generally be paid out in a continuous stream, especially salaries. Most disturbingly, the states estimates of their expectations from this revenue source is almost always more than they obtain. Further and most disturbingly, the grants do not grow in proportion to income growth or inflation as such this makes the states always on the loosing side. Hence more often than not effective plans are not properly implemented within the period planned for it.

5.6. Summary.

This chapter has albeit discussed the two major perspectives in which intergovernmental grants are studied. This is followed by an examination of the rational for the issuance of grants and the roles different types of grants play. The major reasons for the grant issuance are categorised into economic and institutional. Further, we examined the impact of the two major types of grants, i.e., Matching grants that change the relative prices faced by a jurisdiction and a lump-sum unconditional grant that results in a shift in a jurisdictions budget line. With this in mind, we examined the impact of statutory allocations on
state expenditures in Nigeria, with the broad usage of a simple linear and a non-linear regression equation with the use of OLS technique. The findings were that, first grants are of tremendous importance in explaining the explained variation of state spending, and secondly it is found that statutory allocations in the linear model are stimulative of state expenditures, mainly because the estimated coefficient of the grant variable is not significantly different from one, while the non-linear model suggests that they are substitutive of local money, though that does not go to say that real substitution takes place. Finally we found out that the allocations do not grow in relation to the country's income, nor the rate of inflation, rather they are declining in relative terms.
Table 5.1.

<table>
<thead>
<tr>
<th>Year</th>
<th>Equation</th>
<th>C</th>
<th>PCY</th>
<th>PD</th>
<th>PCG</th>
<th>$R^2$</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>5.5.1.2.1.</td>
<td>-1.8358</td>
<td>0.0852*</td>
<td>0.0924*</td>
<td>-</td>
<td>0.3884</td>
</tr>
<tr>
<td>1980</td>
<td></td>
<td>(0.0251)</td>
<td>(0.0315)</td>
<td>0.2551</td>
<td>0.2197</td>
<td>0.3884</td>
</tr>
<tr>
<td></td>
<td>5.5.1.2.2.</td>
<td>-16.3260</td>
<td>0.0271</td>
<td>0.1008*</td>
<td>0.8379*</td>
<td>0.7580</td>
</tr>
<tr>
<td></td>
<td></td>
<td>(0.0218)</td>
<td>(0.0218)</td>
<td>(0.1932)</td>
<td>0.0811</td>
<td>0.2397</td>
</tr>
<tr>
<td></td>
<td>5.5.1.2.1.</td>
<td>-16.7480</td>
<td>0.0819*</td>
<td>0.1391*</td>
<td>-</td>
<td>0.4226</td>
</tr>
<tr>
<td>1985</td>
<td></td>
<td>(0.0168)</td>
<td>(0.0261)</td>
<td>0.4760</td>
<td>0.5221</td>
<td>0.4226</td>
</tr>
<tr>
<td></td>
<td>5.5.1.2.2.</td>
<td>-33.2710</td>
<td>0.0399</td>
<td>0.1403*</td>
<td>0.9695*</td>
<td>0.7892</td>
</tr>
<tr>
<td></td>
<td></td>
<td>(0.0228)</td>
<td>(0.0227)</td>
<td>(0.3502)</td>
<td>0.2321</td>
<td>0.2832</td>
</tr>
</tbody>
</table>

Note: (1) Figures in brackets are standard errors.
(2) The figures below the standard errors are Beta coefficients.
(3) * means significant at 0.01 level.
Table 5.2.

<table>
<thead>
<tr>
<th>Year</th>
<th>Equation</th>
<th>C</th>
<th>PCY</th>
<th>PD</th>
<th>PCG</th>
<th>$R^2$</th>
</tr>
</thead>
<tbody>
<tr>
<td>1980</td>
<td>5.5.1.2.3.</td>
<td>-3.0129</td>
<td>0.9235*</td>
<td>0.2657*</td>
<td>-</td>
<td>0.3805</td>
</tr>
<tr>
<td></td>
<td></td>
<td>(0.1859)</td>
<td>(0.0906)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>5.5.1.2.4.</td>
<td>-2.4269</td>
<td>0.4337</td>
<td>0.2430*</td>
<td>0.6586*</td>
<td>0.6893</td>
</tr>
<tr>
<td></td>
<td></td>
<td>(0.2491)</td>
<td>(0.0785)</td>
<td>(0.2058)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1985</td>
<td>5.5.1.2.3.</td>
<td>-4.2838</td>
<td>1.0289*</td>
<td>0.3527*</td>
<td>-</td>
<td>0.4565</td>
</tr>
<tr>
<td></td>
<td></td>
<td>(0.1465)</td>
<td>(0.0709)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>5.5.1.2.4.</td>
<td>-4.3917</td>
<td>0.7219*</td>
<td>0.3459*</td>
<td>0.5781</td>
<td>0.8014</td>
</tr>
<tr>
<td></td>
<td></td>
<td>(0.1948)</td>
<td>(0.0640)</td>
<td>(0.2691)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Note: (1) Figures in bracket are standard errors.
(2) * means significant at 0.01 level.
Figure 5.1
CHAPTER SIX.  
FISCAL EQUALISATION THEORY.  

So far the discussion has been centered on fiscal decentralisation and the effects of statutory allocation. The main issues to face now is, since one of the stated national objectives of the Nigerian state is the creation of an egalitarian society. We now examine how revenue sharing can be used for the achievement of Fiscal equalisation. However, we need to first define what we mean by equalisation in this paper and why is such desirable?.

6.1. INTRODUCTION.

In all federal countries questions arise as to the nature of intergovernmental fiscal relations. These relations are seen in respect of the nature of imbalances between expenditure responsibilities and revenue sources among levels of government, as well as fiscal capacity and needs differences that exist among different jurisdictions. These two, necessitate adjustments in the fiscal relations between governments, and the solution can come in the form of transfers of funds, in either conditional or unconditional form.

Though economic analysis strongly supports the use of conditional grants because they are seen to be more effective in the attainment of economic efficiency, as well as taking account of externalities not accounted for, since they are not seen just as a rise in income that does not
alter relative prices. However, unconditional grants will be used in this section, because they leave some element of autonomy to the states, as well as aids in reducing fiscal mismatch. Further, greater horizontal equity is achieved with its usage. The fact that natural resources and land are geographically fixed, hence different states have different quantities of the two, in addition labour and capital are assumed to be mobile between provinces, (as long as there is adequate incentives to attract them), means in essence that disparities exist in all federations. Further, since boundaries between provinces are not drawn on the basis of economic considerations solely, it is normal to see that average incomes, average productivity and resource endowments differing substantially from jurisdiction to jurisdiction.

The existence of regional disparities, among all federations is the basis for equalisation payments. For this literature is readily available, however, the economics of equalisation payments on the other hand fundamentally relies on the wider literature on intergovernmental grants, in that, Equalisation is seen to be of either capacity, needs or potentials of the different jurisdictions in any given federal country. What is fundamentally required is to bring about a situation whereby citizens in the country who are seen to be equal in most respects are made to enjoy the same level of services at the same tax price, no matter the region they come from in the country. This of course necessitate taking into consideration the fiscal capacity, needs, relative cost differences and potentials of each
jurisdiction. However, one big question often not addressed to in the first instance is with regards to what do we equalise? will such an equalisation entail interpersonal or inter jurisdictional redistribution? do we equalise revenues or service levels? and above all of what theoretical significance is equalisation?.

To ensure the provision of public services on a near equal term to those of states with a relatively higher resource base, hence a higher tax base will require the financially weaker state to impose a tax of greater severity on it’s residents or to provide services of lower standards than the financially stronger states. This depicts a visible case of disparity, which result in different quantities of public services being provided.

The fiscal disparities existing among individuals and states can mainly be alleviated through the activities of the central government that ensures the fiscal capacities and needs of it’s states are reduced to the barest minimum. The equalisation of these capacities will entail making transfers of resources from the ones collected by the central government to the states in a way that equalises their opportunities, such that each state can provide similar public services at relatively similar tax rates. Though the best way to achieve equity will require dealing with the individuals rather than the states, i.e., ensuring equal treatment of equals both in the presence and absence of a fiscal action. The impracticality of this made it wise to equalise the states opportunities.
Equalisation within this paper aims at equalising the fiscal capacity of different jurisdictions based on their needs, such that they conform to a national average which ensures the provision of comparable levels of public services in each jurisdiction without resorting to unduly high levels of taxation. The next question to answer is why is such a thing desirable? what is the theoretical rationale for such an action?

It is a fact that in all federal countries, disparities exist in different regions, which in turn affect the tax base of the different regions, as well as the ultimate services provided. This is mainly because each jurisdictions endowment of natural and human resources is different from others. So the singular objective of trying to reduce regional disparities by central governments, which is necessitated by so many factors justifies the use of equalisation payments. However, some economists are opposed to its use, not because they do not want regional disparities reduced, but because they don't see equalisation payments as an appropriate tool for that purpose. (Scott: 1950; and Courchene: 1978.) These two see such transfers from high to low income regions as a cause of serious distortions in resource allocation, in that it interferes with the natural adjustment mechanisms of an economy from working effectively, because it discourages the mobility of production factors from poor regions to the relatively rich regions.

The literature on revenue sharing calls for equalisation
of both the fiscal capacity and needs of different states as a result of the seeming disparities between states. The basis of equalisation in this respect comes in two forms: the first deals with attempts at closing a country's fiscal gap because of the seeming vertical and horizontal fiscal imbalances in existence, which results in unequal fiscal residua of similarly placed individuals. This requirement necessitates the attempts at achieving equity in distribution. The second deals with the achievement of efficiency in resource allocation as a result of the serious distortions that arise if states are left on their own.

6.2. RATIONALE FOR EQUALISATION.

Equalisation is essentially desirable for two main reasons:

1. The existence of a fiscal gap between the federal government and the regions, as well as between regions which are attributable to so many factors. The gap results in vertical and horizontal fiscal imbalances related to revenue raising powers and expenditure needs of the different levels of government in question. We now see what literally vertical and horizontal fiscal imbalance mean.

Vertical fiscal imbalance concerns the level of disparities that exist between revenue sources and expenditure requirements among the various governmental tiers. This phenomenon occurs in all federations, for the main reason that the federal government by law more often
has more revenue sources at its disposal than expenditure requirements. While states and local governments similarly by law have more expenditure needs especially in the social services sector than adequate revenue sources to finance the level of expenditures they want to incur.

Horizontal fiscal imbalance on the other hand relates to the disparities existing among members of the same level of government. This imbalance is also related to the difficulties and differences of revenue raising as well as the cost differences existing among the same level jurisdictions with regards to public service provision. The differences that exist of revenue raising capacities of the states can be attributed to a number of factors. This may be religious, which affects revenues coming from gambling, population density which affects the cost of public service provision, resource endowment which affects revenues from royalties and land taxes, a high proportion of people of working age etc. Each of these factors affect the tax base of each state and in the process it's taxable capacity. Differences that may arise in these factors among the jurisdictions result in different treatment of individual equals in different jurisdictions. Further, differences also exist from the expenditure side, coming mainly in the form of characteristics of the states population i.e., states with high proportion of school children will entail more expenditures on education.

The inevitable existence of horizontal and vertical fiscal imbalance results in horizontal and vertical
inequities. This phenomenon will be reduced by equalisation payments.

2. Equalisation transfers also enables the achievement of efficiency in resource allocation in the long run. It's quite obvious that individuals acting rationally will in the absence of a state's fiscal action try to locate in a place where the value of one's marginal product is equal to what he is paid. This means that, free mobility of persons across state boundaries is very much likely to result in an efficient allocation, such that each factor will be paid a return equal to the value of its marginal product. However, interference by the government in terms of different fiscal activities will result in interstate differences in net fiscal benefits. This ultimately will require them to equalise real incomes in the different states, such that the desire to migrate to another state may no longer arise.

It is worth noting the equity and efficiency arguments for equalisation payments. We examine them one after the other.

6.2.1. Equity.

The problems encountered of horizontal and vertical fiscal imbalance results in individuals with the same income residing in different states of a given country not ending up with the same net fiscal benefit (NFB). The net fiscal benefit or fiscal residua is the difference one obtains from
the benefits he receives from state expenditures and the amount he is made to pay as tax. If he receives benefit more than the amount he pays as tax it's said that he has a positive net fiscal benefit, and if he pays more than the benefit he receives, he has a negative net fiscal benefit.

Granted that fiscal imbalance results in inequities. The next question is how do we view equity?. Equity has meaning only with respect to individual citizens, then how is equity achieved by a mere inter-governmental revenue transfer? This question is succinctly answered by Graham, when he wrote:

'It is through the higher levels of public services or lower levels of taxation experienced by citizens in low income provinces made possible by equalisation transfers that fiscal equity is achieved in relation to otherwise similarly situated citizens in corresponding localities in high income provinces.'

So equalisation transfers between governments aims to reduce the differences in the fiscal positions of individual states rather than trying to eliminate completely the inter personal differences in income. This goes in conformity to what Buchanan looked forward to, i.e., provinces should be aided to establish horizontal equity, this reasoning is similar to Kaldors compensation criterion, of losers after an economic change should be compensated by gainers. What does equity mean?.

Equity and it's use is broadly divided into horizontal and vertical. Vertical equity is concerned with the

---

relative weights to be given to changes in the well being of persons at different levels. While horizontal equity requires that any fiscal action meted out on a group of people with the same level of well being should end up having the same level of well being afterwards.

The achievement of vertical equity is normally undertaken by the federal government after seeing the effects of the states fiscal action on their residents as in Australia. The effect of the states fiscal actions within their jurisdictions to some extent determine the level of transfers from the federal government to the states. What it means here is vertical inequity is reduced by the federal government through equalisation transfers to the states.

On the other hand, horizontal equity can be achieved both by the federal and state governments fiscal actions. However, there are two different ways of achieving horizontal equity depending on how one views it. Boadway and Flatters agreed with the view that states on their own cannot achieve horizontal equity nation wide, hence the federal government need to come in and institute fiscal systems that will horizontally be equitable. If the federal government is to do this, it can adopt one of the two views of horizontal equity i.e., either the broad or the narrow view.² The broad view here refers to a situation where the federal government is made to account for horizontal equality.

inequities nationwide, as introduced by the fiscal actions of states such that the federal government should be made to off-set situations where some people are made better-off in one state than their identical counterparts in other states. While the narrow view takes the real income attained by individuals after states fiscal actions as a starting point for the federal government. The federal government here tries to ensure that people who are equally well-off with states fiscal action be the same in the presence of both states and federal fiscal actions. This assumes that the states engage in redistribution, aimed at achieving horizontal equity within their boundaries which they judge to be most desirable, considering the taxing and spending powers that they exercise. The federal government need not off-set nationwide horizontal inequities in this case.

Since the whole issue of equity which justifies equalisation payments is based on value judgements about the relative well being of different people in different jurisdictions. It’s worth giving an illustration of how equity can be achieved and the justification of it’s usage. However, to do this will require sticking to the use of equalisation as a measure of correcting horizontal inequity. Not that vertical inequity is desirable, but the conventional opinion is seen to relate equalisation with horizontal equity.

The illustration given by King\(^3\) readily shows much,

---

\(^3\) King D.N., (1984) op.cit., p.141.
i.e., states with an assumably similar unit cost and unit needs index, but a different income per head will ultimately have different tax yields per head even if the tax rate applied in the two states are similar, hence this in turn affects the service level provided, in that the states with a lower tax yield because of it’s lower income per head will end up providing less amount of public services to it’s populace than the other state, this is so despite the similarity of the unit costs and needs between the states.

In reality it’s rare if not impossible to have jurisdictions having the same unit cost index and the same unit needs index. Even if it happens, rarely will one see a situation of equality in fiscal residua, unless it’s also assumed that income per head is also equal. However, it’s worth noting that even if the costs index and income yields are similar across jurisdictions a difference in needs will result in different fiscal residua.

To sum it all if two individuals are staying in two different jurisdictions, with distinct differences in needs, unit cost of public service provision, yet pay the same amount as tax are bound to have different service levels. The difference in fiscal residua that will arise will end up having to effect equalisation transfers to the fiscally weak regions to off-set their inferior revenue position, in relation to their needs.

6.2.2. Efficiency.
In discussing efficiency, it is pertinent to first determine which level of government performs which function best and secondly what is the desirable effect of federal finance on regional resource allocation. The first part of the question has been discussed in detail in chapter 1. However, it need be reminded that most economists believe that the Allocation role can best be performed by the states, despite the fact that some still argue that productive efficiency may be hindered with equalisation grants, for two main reasons. First by changing the relative advantages and disadvantages of living in different areas, will influence location decisions by workers and perhaps cause them to live in areas where their Marginal Productivities will be lower than would have been the case in the absence of grants. Secondly, such grants might discourage recipient states from encouraging development in those areas, since they normally come in the form of unconditional grants.

Despite the arguments ensuing between Scott and Buchanan over the efficiency basis of equalisation grants. Still an efficiency basis exist for equalisation grants, for three fundamental reasons. The first is the seeming differences across jurisdictions over the type of workers more prevalent within a jurisdiction, and the endowment of land, capital and entrepreneurship in relation to labour. This results in some states having a higher per-capita tax base than others. The difference in tax base results in difference in service levels to be provided by different states. Equalisation payment will help in trying to effect an efficient
allocation, whereby even states with a low per-capita tax base will still have some of their populace not migrating.

The second case for equalisation grants lies with the fact that the unit cost index of states are different. Hence the cost of providing a public service varies from state to state. A state with a high cost of public service provision, such as an urban centre or a sparsely populated state may be compelled to impose taxes of greater severity in order to provide a needed public service. So to avoid this above normal taxation for similar goods requires an equalisation transfer.

The last of the basis for equalisation transfers to ensure efficiency in resource allocation stems from the fact that the needs of states differ, in that the number of persons requiring specific services are not the same. People may move in search of states where they feel they will pay less for similar services that they pay more in their own state. Such a movement will bring no gain to the whole society, hence the need for equalisation transfers to ensure that people stay in their states.

To show how efficiency can be achieved, we again assume the existence of two states 'A' and 'B'. Further assume that the only income to be considered here is wage income and for the meantime assume that there is no state government fiscal activity. Also assume that migration is costless, thereby workers can migrate if they so wish from one state to another, until the wage rates are equalised in
the different states. So what this means in essence is that under competitive conditions the Marginal Productivities of labour are equalised in the different states, hence ensuring efficiency. In this situation, the Marginal product of a given fixed supply of labour in state 'A' is equal to the one in 'B'. If for any reason, be it as a result of market failure or a states fiscal action that results in an inequality in the marginal product of labour in the two states, then this will mean an inefficiency in resource allocation, which can best be corrected by transfers of resources to the states in the form of equalisation payments.

Assuming the states engage in redistributive fiscal action, in the area of personal income tax. The use of a progressive tax in that regard will result in unequal per capita benefits in the different states, meaning that the net fiscal benefits of the states will be different. This will result in net fiscal benefits being higher in above average income states and lower with a serious deficit in below average income states. Since individuals move between states in response to differences in material rewards which may simply be the difference in personal income tax and the benefits derived from state expenditures, mean that resource allocation is inefficient. So to eliminate this inefficiency in different states allocation of mobile resources, requires an equalisation scheme which in the same vein goes to eliminate the differences in peoples net fiscal benefits. In this case, allocative efficiency in labour and equity in distribution are both achieved with the same
equalisation objective.

Seeing the basis upon which equalisation is desired, we need to examine the various perceptions, formulas, and models of equalisation advanced by many authors aimed at achieving the two major equalisation objectives.

6.3. EQUALISATION FORMULAS AND MODELS.

So much has been written on different measures to achieve equalisation, and the sorts of formula to use. The range starts from the grant commission recommendation in Australia in the 1930s, which seem to be the first justifiably rigid formula taking into consideration some serious thoughts on state requirements, to the works of Musgrave, (1961); Boyle, (1966); Mathews, (1974); Courchene, (1978); and King, (1984). This section will albeit briefly describe the development of the models and the limitation of most of them, which the model to be designed at the end will hopefully avoid.

Equalisation really depends on what is the governments objective, i.e., what does it really want to equalise?. To see to that we look at the initial equalisation attempts contained in Musgraves extensive work, which consists of six different plans of how equalisation can be achieved. Equalisation can be in the form of fiscal capacity, fiscal

---

potential, and actual outlays or performance. The plans can be broadly divided into three. This will later cover refinements by Boyle and King on Musgraves measures of fiscal potential and capacity equalisation. The three broad categories are: Equalisation of actual outlay or performance; equalisation of fiscal capacity; and equalisation of fiscal potential. The last two includes Boyle and King's refinement.

6.3.1. Equalisation of Actual Outlay or Performance.

This section relates to Musgraves plans 1 and 2. He envisages that in the first instance, the actual outlay per capita of different jurisdictions should be equalised, irrespective of the needs of the different states, such that the per capita outlays on state services are made equal in all states. Arising from the weakness in the plan he designed his second plan, which aims at equalising performance levels, and is based on the needs of the different states. However, the transfer called for in this plan is from low need high tax yield states to high need low tax yield states. This he himself envisages will result in a disincentive effect which might lead to a zero level of taxation. This is mainly because less will be obtained from high tax yield states if they realise that the less revenues they raise the less they will be required to contribute to the development of other states.

This can be illustrated thus: assume the following symbols.
$n = \text{number of states.}$

$m = \text{minimum outlay per unit of need.}$

$S_a = \text{subsidy obtained by state 'a'.}$

$E_a = \text{outlay by state 'a'.}$

$N_a = \text{index of need in state 'a'.}$

$t_a = \text{tax rate in state 'a'.}$

$g = \text{tax or subsidy rate required by the federal government to clear the central budget.}$

$r_s = \text{a standard tax rate.}$

$B_a = \text{tax base of state 'a'.}$

$P_a = \text{level of performance in state 'a'.}$

$T_a = \text{taxes collected by state 'a'.}$

To see the situation in the first plan, we assume that actual outlay in state 'a' depends on the taxes collected by the state and the amount of subsidy the state receives or is made to give.

$$E_a = T_a + S_a. \quad \ldots \ldots \ldots 6.1.$$ 

This is based on a strong principle that to achieve an equalisation of actual outlay then states with above average revenue are taxed and the proceeds given to states with below average revenue. This follows that the amount generated from above average states is equal to the amount distributed to below average revenue states. Hence the summation of all subsidies/taxes is equal to zero.

Solving the system for subsidies in state 'a' and taking its partial derivative with respect to a change in tax
collection gives:
\[ \frac{\delta S_a}{\delta T_a} = \frac{1}{n} - 1 \] ........ 6.2.

This is negative, hence an increase in tax yield of state 'a' if it receives a subsidy is reduced and part of it is given to other states. Here a disincentive to increased state taxes prevails which reduces the need for raising more taxes.

This disincentive necessitated Musgrave to design his plan two, since the needs of states did not feature in the first one. His plan two is aimed at equalising performance levels, since equalisation of actual outlays will not necessarily result in similar levels of performance.

To illustrate that, we see total outlays in state 'a' are still dependent on taxes collected in the state and subsidies received. Further we add another factor, this time performance level, which is presented as the ratio of outlays to needs in state 'a'.

\[ P_a = \frac{T_a + S_a}{N_a} \] ........ 6.3.

Further we assume the existence of an average need index which is equal to unity. If the need index in any one state is greater than unity, then the state is more needier than the average and vice versa. It is also assumed that the total of subsidies equal to zero.
Similarly solving for subsidies in state 'a' and taking a partial derivative with respect to changes in state taxation as done with respect to equation 6.2., we will have something in this form:

\[
\frac{\delta S_a}{\delta T_a} = \frac{N_a - n}{n} \quad \text{......... 6.4.}
\]

If average need is equated to one, then the derivative is negative, meaning as in the case of plan 1, an increase in tax yield of any state reduces its subsidy, however, in this case the loss is smaller if the states need is large. The two plans are severely criticized because they will ultimately push the system towards a zero level of taxation. This will happen because states that have an above average yield will not be encouraged to increase their taxation since they see it as being used to develop other areas.

6.3.2. Equalisation of Fiscal Capacity.

This is partly as laid down in Musgraves plan 3,\textsuperscript{5} and later refined by Boyle (1966) and King (1984). It requires that each state be provided with the means to provide services that enable them satisfy a centrally set level of performance. Normally it's the central government that will decide on what it wants to promote and the sort of performance level it wants to see attained, then the state governments are given the money based on the needs of the states and it's up to the individual states to spend the

\textsuperscript{5}Ibid., p.102-103.
money on the project or spend only a part of it, or more than that, which will entail dipping into their own sources. The states tax rate is not considered in this calculation.

The overall outlay here also depends on the amount the state receives in tax payments (though the states tax rate is not used here) and what comes as subsidy or goes as tax. A formula similar to (6.1) is given.

The subsidy formula in this case is in two parts: the first part depends on applying the standard tax rate to state 'a's tax base, as well as the average states tax base. If the standard tax rate is applied to the average base, it will yield the required revenue for an average base and need authority. The second part depends on the excess of expenditure needed to achieve a centrally set level of performance (m) as compared to the amount required by the average state. This is shown below:

\[ S_a = m(N_a - \bar{N}) + t_s(\bar{B} - B_a). \] ....... 6.5.

No adjustments are necessary to clear the central government budget because each part of the subsidy will equal zero for the group as a whole. So it's safe and reasonable to assume that whatever the levels set for m and \( t_s \), \( t_s \frac{\bar{B}}{\bar{B}} = m \bar{N} \). This equality is necessary in order to ensure that the standard rate provides the needed revenue for a state with average base and need.

This can be shown graphically as well, we take three states with no differences in production costs. Here the
states tax rate did not appear, hence the grant is just a parallel line from the tax base line. (see graph 6.1.a-c).

The lines $OT_A$, $OT_B$ and $OT_C$ show the pre-grant tax rate and outlays. The grants given in this case are not effort related, but a lump sum grant aimed at equalising the jurisdictions capacity to provide public goods and services.

With the introduction of grants, state $A$ is still an average state since $T_A$ and $G_A$ lines coincide. State $B$ is a below average state, in terms of revenue earnings, in that at the 10 percent standard tax rate, it’s revenue earnings is lower than the average, hence a lump-sum grant is given to state $B$ to enable it have the same resources to incur similar per capita expenditure to that of state $A$. State $C$ is an above average revenue state, and in it’s case the grant line $G_C$ is below the tax base line $T_C$. So the grant is a negative one in this case. Negative in the sense that the jurisdiction is taxed away to give some resources to below average jurisdictions.

The major drawback of this approach is the neglect of the states tax rate, which leaves so much room for abuse and relaxation on the part of below average revenue states in there attempts at local revenue generation. In addition, the relative cost differences in between the jurisdictions is not taken into consideration.

6.3.3. Equalisation of Fiscal Potential.
This is based mainly on a priori calculated average potential level which is used to apply to all other states who may fall either above or below the average. This equalisation will essentially entail states having the same potential to incur expenditure which is done by taxing states with above average revenue potential and transferring the same to states with below average revenue potential. In this situation the grants so distributed are effort related, i.e., related to the tax rates and revenues of the different states.

Overall outlay depends on a state's tax rate; it's tax base and the subsidy it receives/tax it gives to the central government. This can be represented by this equation:

\[ E_a = B_a t_a + S_a \] ........6.6.

The amount of subsidy a state will obtain or the tax it will give depends on its tax rate and tax base. If the states tax base multiplied with its tax rate sums up to be less than the average tax base multiplied with the states tax rate, then its subsidy is bound to be positive. If on the other hand, the tax base multiplied with the states tax rate is greater than the average base multiplied with the states tax rate, then it will end up with a negative subsidy. This is represented by equation (6.7).

\[ S_a = (\bar{B} - B_a)t_a \] ........6.7.

By virtue of the fact that redistribution takes place between states, i.e., a state with a large base is made to
transfer some resources to low base states, hence the subsidy element has to equal zero in order to clear the central budget, i.e., going by Musgraves classification under plan four. So we will have a situation where the summation of subsidies is equal to zero.

In this case the sum of subsidies will not be equal to zero, if equation (6.7) is to be used, because it will only result in a positive or a negative subsidy. So to achieve a summation of zero, we add the federal governments tax rate to the states tax base.

\[ S_a = (\bar{B} - B_a) t_a - B_a t_g. \] ......6.8.

With the states own tax rate in the formula for the grant, it shows that the subsidy is effort related. In such a situation states with a tax base below the average will gain, if their tax rate is high, and states with a base above the average will be better-off if their tax rate is low. This is shown by equation 6.9. In the same vein, solving the system for \( S_a \) and taking the partial derivative with regard to \( t_a \) we get the following:

\[ \frac{\delta S_a}{\delta t_a} = \frac{(\bar{B} - B_a)(1-B_a)}{nB}. \] ......6.9.

However, the actual direction of payments and those who gain and lose mainly depends on the direction of differences between average tax base and the states tax base, as well as on the central governments tax rate. This is shown graphically (graph 6.2.a-c).
Assume we have three states, a, b and c, each of them has a different tax base, the same cost function (hence there is no difference in cost) and the overall outlay (which in this case will be assumed to be synonymous with the service provided) differs with changes in tax rates. The difference in expenditure (and so the service level provided) is because the tax base and the subsidy are not the same across the states.

Without a grant scheme, the states expenditures at different tax rates is given by the lines $T_A$, $T_B$ and $T_C$. Going by the graph and taking a standard tax rate of 10 percent, state A will incur expenditures on services worth 20 units, 10 units for B and 30 units for C. If the average is 20, then A is at the average, while B is below the average and C above it. However with a grant scheme, some states will gain more income meaning more expenditures and hence more services (it's assumed that more expenditures mean more services, which may not necessarily be so). While other states will lose revenue and achieve lower expenditures hence lower service levels.

The imposition of a subsidy is shown by the lines $G_A$, $G_B$ and $G_C$. In state A the lines $G_A$ and $T_A$ coincide, meaning that at whatever tax rate the state will not receive an additional grant or be made to pay out tax for purposes of equalisation to other states. This means that it's an average state. State B, on the other hand is a below average state. This is because in the absence of grants the states service level is below the average at the 10 percent
tax rate. If the grant is added it reaches the average states. However, it's worth noting that the state tends to gain more in terms of subsidies if it increases its tax rate, and reduces it's gains if it reduces the rate. This can be explained by the fact that the gap between $T_B$ and $G_B$ widens as tax rate increases and it narrows as the tax rate falls. Any equalisation derive will require that grants be given to state B such that at 10 percent tax rate, it will have the same expenditure potential as state A. State C is an above average state, in that even without the grant scheme, it has so much revenue at it's disposal more than the average at the tax rate of 10 percent. Since at that rate, the expenditure potential exceeds the average (and hence service level of 30 units). With the introduction of a grant scheme the state is being taxed away by the federal government for onward redistribution to other states for equalisation purposes. It will be much wiser for state C to reduce it's tax such that it will lessen it's income losses through the grant scheme. In essence, equalisation in this case requires the central government taxing state C more at the 10 percent tax rate, so that the proceeds can be given to state B to enhance its revenue potentials. This is to enable all three states have the same expenditure potential at the same tax rate.

The measures of equalisation using fiscal potential fundamentally ignored the problems of the needs of the respective states, hence it's not very representative of the requirements of an equalisation attempt aimed at removing inequity.
6.4. King’s "Alternative Equalisation Scheme".

With this consideration in mind, King designed his ‘alternative equalisation scheme’, which he hoped will solve the problems of horizontal equity attainment as well as ensuring a certain degree of tax effort on the part of the recipients. He modified the two earlier approaches by introducing grant lines which are identically curved in all the states under consideration. Below is reproduced Kings own graphs to illustrate his model of equalisation grants.

Using the same approach as in two earlier approaches, with three sample states, and with the same assumed relationship between tax rates and service level, he presented graphs 6.3.a-c. In this case state A is still the average state. The slope of the grant line makes it unwise for any state to lower it’s tax rate, because the slope is high at low rates, in essence the states are encouraged to raise their rates up to the uniform level expected, after which, it’s not profitable for them to raise the rates. The average level here is 10 percent. To buttress this point, take the case of state B, that receives grants, if it lowers its tax rate to a position, lower than the average of 10 percent, it will also be made to pay as well, so it’s not profitable for them to reduce their rates. Further, with the curvature of the grant line, it cannot raise it’s rate to unbearable proportions, since the grant curve starts to drop at higher tax rates, and will ultimately equal the tax

---

rate line and be even less than it. State C, on the other hand cannot reduce its tax rate, simply because it wants to reduce the amount it pays out to other states. For doing that will mean increasing the amount they pay out as grants.

In essence the curvature of the grant line discourages all states from arbitrarily either reducing their tax rates below the average of 10 percent given, because it will affect service levels, or raising tax rates because it may not necessarily be rewarding enough. The success of this approach depends on the extent of value judgement that the grantor intends to undertake, as clearly pinpointed by king himself.7

The major drawback of this approach is it's great degree of reliance on value judgement, most especially on the part of the grantor which ultimately determines the exact curvature of the grant line. Though a good attempt at equalisation grant design, never-the-less the consideration of tax rate as a basis for determining the revenue position of the states is not sufficient.

The practice in older federations, such as Canada and Australia, shows that fiscal capacity, and needs measures have been used and are still in use as a basis for rationalising the allocation of general revenue grant. This practice which in the process incorporates equalisation clauses has been achieved with elements of success in it's

applicability. The fiscal equalisation model to be built for the purpose of this work will be based fundamentally on the concepts of need, fiscal capacity and relative cost differences in revenue sharing arrangement in Nigeria. The model to be built is a refinement of the one designed for Australia by Mathews and equally tested by him using Australian budgetary figures for 1968-'69. The model incorporates the salient features of the formulas for fiscal capacity measurement and relative cost differences among the Australian provinces which also incorporates adjusted population taking into consideration, the proportion of population requiring a specific service.

6.5. Summary.

To summarise the discussion so far, it is a fact that disparities exist between jurisdictions, mainly with regards to resource endowments, land, labour and capital. This disparities affect each regions taxable capacity, needs and actual outlays. Further, their is a serious case of non-correspondence between the regions expenditure responsibilities and revenue raising powers, vis-a-vis that of the federal government. To ensure that some regions do not impose taxes of greater severity than that of other regions for the same service, equalisation transfers are called for. These transfers should take the form of fiscal transfers to low income high need regions to compensate them for their inferior fiscal capacity. So equalisation in this respect is to be seen as a case of equalising the fiscal capacity of jurisdictions based on their needs. The
desirability of this can readily be found in the literature on intergovernmental grants. In that the equalisation of each region's capacity based on its needs result ultimately in achieving equity in distribution, because of the fiscal residua that are being equalised all over the federation. Similarly, equalisation can aid in the attainment of efficiency in resource allocation as a result of the expected resource allocation distortions that will arise if states are left on their own to exercise their fiscal powers. This chapter, examined three major ways outlined in the literature as to how fiscal equalisation can be attained. These are: with respect to actual outlay/performance; fiscal potential of the states; and fiscal capacity. Each of these is examined, and its possible disadvantage is highlighted. Further, King's alternative equalisation scheme is discussed. However, the fiscal equalisation model to be built in the next chapter only took into account some of the broad principles laid in this chapter, but not the formulas.
Graph 6.1.a-c.

Equalisation of Fiscal Capacity.

State 'A'

State 'B'

State 'C'
Graph 6.2.a-c.

Equalisation of Fiscal Potential.

State 'A'

State 'B'

State 'C'
Graph 6.3.a-c.  
King’s Equalisation Scheme.

**STATE 'A'**

**STATE 'B'**

**STATE 'C'**
The previous chapter has discussed why fiscal equalisation is desirable and the numerous ways that it can be achieved. This chapter will first trace the degree of vertical and horizontal imbalance in the Nigerian federation, most especially the inter-state imbalances which necessitate the use of revenue sharing for equalisation purposes. This will be followed by a model of fiscal equalisation developed from refinement of Mathews model of Australia, to test the extent of equalisation being undertaken in Nigeria using the nations revenue sharing arrangement. The model so developed will incorporate measures of fiscal capacity, needs and the relative cost differences of the states in the country, in such a way that disincentives that arise due to equalisation attempts are reduced to the barest minimum.

7.1. INTRODUCTION.

Earlier in the last chapter we have shown that one of the main basis of equalisation transfers are the existence of vertical and horizontal fiscal imbalance in federal states. These imbalances result in different levels of governments having different powers over revenue raising and expenditure decisions which affect the levels of public services provided by each level of government. In the same vein, the same level governments have different resource base and hence different service levels, though, there
revenue and expenditure powers may be the same. Since this is a universal phenomenon, how does it manifest itself in Nigeria? and of what significance is it to the direction of revenue transfers.

Before embarking on the nature of inter-state inequalities and the extent of vertical and horizontal fiscal imbalance, of which the latter manifest itself in a series of inequalities. It is worth noting that whatever fiscal equalisation model is designed, it should take into account the extent and nature of such inter-state economic and social disparities, as well as the specific developmental role that each governmental tier is expected to perform. Given that the roles are adequately defined, (see appendix) then the equalisation attempt should try and ensure that the capacities, needs, and costs of public service provision of each jurisdiction is taken into consideration when making the necessary equalisation transfers, which are meant to stimulate growth in relatively backward areas.

7.2. VERTICAL AND HORIZONTAL FISCAL IMBALANCE IN NIGERIA.

It is a fact that the fiscal powers of different governments at different tiers are not the same, and are not likely to be the same within the same country. Similarly the resource endowments of states in the same country is not likely to be the same, because each states tax base and subsequently the revenue it generates is different from that of other states, which means the inevitable existence of
horizontal fiscal imbalance. To see the extent and severity of each in Nigeria we will discuss each separately.

7.2.1. Vertical Fiscal Imbalance.

The structure of finances both of the federal and state governments gives one major avenue that shows the nature of such an imbalance in any federal country. In Nigeria, a wide gap exists in the structure of finances of the federal and state governments. The reason for such a wide gap is not far fetched. This is because the national government has monopoly over most of the lucrative revenue sources (as shown in Chapter 2), i.e., Petroleum profits tax, company profits tax, mining rents and royalties, import duties etc. Despite the revenue sources it similarly has a lot of expenditure responsibilities, some of which it jointly shares with the states. The fiscal outlook and vertical imbalance in Nigeria is presented in Table 7.1. for the fiscal years 1980 and 1985.

The Table shows the magnitude of the vertical fiscal imbalance in Nigeria. The main bulk of revenues are raised by the federal government, while the states raised a mere 14.8 percent of the amount they spent in 1980 and 26 percent of the same in 1985. It is quite visible that the most lucrative taxes are controlled by the federal government, since in both years the overall amount generated from taxes both direct and indirect consists of over 60 percent of revenues of the federal government. While on the other hand the revenues generated internally by the states barely raise
Table 7.1.
Fiscal Outlook and Vertical Imbalance in Nigeria.
N(Million).

<table>
<thead>
<tr>
<th>Government</th>
<th>1980</th>
<th>1985</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Federal Government.
Revenues:
- Taxes: 10974   9981
- Others (Excluding Loans): 4259   4707
- Total Fed. Revenues: 15234   14689

Expenditures:
- Defence & Administration: 3206   3098
- Grants: 3694   4966
- Other: 16795   12791
- Total Fed. Expenditures: 23695   20855

State Governments.
Revenues:
- Own Revenues: 1327   1584
- Federal Grants: 4128   3261
- Total State Revenues: 5456   4844

Expenditures:
- Total State Expenditures: 8951   5857

| GNP       | 36078 | 51071 |

Source: Extracted from Tables 2.8, 2.10, 3.1, 3.3, 3.5, and 3.6.

more than 30 percent of their total revenues, though both governments run a series of budget deficits for all the two sample years. Yet the grants given to the states as percentage of total expenditure of the federal government is not encouraging considering the enormous constitutional functions assigned to the states. Grants given to the states by the federal government constituted only 15 percent
of total federal government expenditures in 1980 and 23 percent of the same in 1985. If dependence on Federal Government grants and borrowing is taken as a rough measure of vertical imbalance, then Nigeria has a large imbalance, in that Federal grants alone constitute more than 60 percent of the states income.

The table also shows the relative decline of the nations Total Expenditure over the two year period. Both the states and federal expenditures were on the decline, though the decline in respect of the states is more drastic. Similarly, the total revenues of both tiers were on the decrease, though the states relative decrease is greater than the federal governments. Since the nation has had uniform tax laws for the states, and specific areas have been earmarked for them to tap, this means in essence that their access to more revenues has it's limits. So this visible disparity in revenue access calls for either the states be made to have greater access to revenue sources with a high degree of elasticity, i.e., revenues that grow at a faster rate than Gross National Income, or more revenue transfers from the federal government to the states.

The problem of vertical fiscal imbalance and it’s severity in a sample of older federal countries is pointed out clearly by Hunter in 1974, when he tried to effect an inter-country comparison. This he did by obtaining a co-efficient of vertical balance, through the use of all states revenue sources (including loans) and total expenditures. Though the use of each income component would
have been the theoretical ideal, however, since the approximation of this ideal in practice is extremely difficult, hence he calculated the degree of vertical imbalance for Australia, Canada, West Germany and the United States of America, using the formula below.

\[ V = \frac{1 - G_o + G_c + B}{E} \]

Where: \( V \) = The degree of vertical fiscal imbalance. If it’s equal to zero, then there is perfect imbalance, and if it’s equal to one, then there is perfect balance.

\( G_o \) = Unconditional grants.
\( G_c \) = Conditional grants.
\( B \) = Net state government borrowing.
\( E \) = State expenditures including transfers.

The measure of imbalance for Australia and Canada were 0.35 and 0.72 respectively.\(^1\) The calculation done in the case of Nigeria with its data gave 0.289.\(^2\) This implies that vertical fiscal imbalance exists, hence this results in reducing the relative autonomy of the states to take expenditure decisions. This is mainly because in most federations the states do not raise enough revenues to cater

\(^2\) The figure is obtained by taking an average of 1980 and 1985 budgetary figures and using Hunter's formula.
for their aggregate expenditures. The severity of the problem calls for greater revenue transfers in the revenue sharing arrangement between the centre and the states in order to lessen the severity of the problem. Since the main aspect of this study deals with horizontal imbalance we now discuss the seeming state disparities and the nature of horizontal fiscal imbalance in Nigeria.

7.2.2. Horizontal Fiscal Imbalance and Inter-State Inequalities in Nigeria.

Due to the difficulties of obtaining figures on the different states income in order to allow for a better comparison of the states fiscal capacities other indices have been used by different authors to show the extent of disparity across the states in Nigeria. For instance, Adedeji\(^3\) used GDP per capita on a regional basis, to show the extent of regional disparities in the country in 1969. Later, Teriba and Phillips undertook an examination of the extent of regional disparities in levels of public service provision using indices, such as hospital beds per thousand, primary and secondary school pupils per thousand of the population and road mileage per square kilometre of land area.\(^4\) In the same vein, Diejemaoh and Anusionwu in their attempt at examining the structure of regional inequality in


Nigeria, which they considered to be a major source of political and social concern in the country, used major social and economic development indices on a per capita basis. These are: Government expenditure; Industrial output and employment; electricity consumption; distribution of total modern employment in the public and private sectors; and enrolment at the different levels of Education.\(^5\) Though they feel there are serious limitations to the usage of such indices, however, they still argued that differentials in these indices are of direct significance, since they reflect real differences in Economic welfare. However, one should note that differences in regional per capita income indicates only one dimension of the real regional inequalities in welfare terms.\(^6\) The most recent examination is that of Ashwe (1986). In his attempt to show the extent of regional disparities in the states he chose five sets of data which are readily available.\(^7\)

To examine the same phenomenon Ashwe's approach is used within this context for its seeming simplicity, easy applicability and availability of data. To show the differences Table 7.2. presents data on the budgetary activities of the states which shows clearly the fiscal


\(^{7}\) Ashwe C., (1986), op.cit., p.14., The five are: data on primary school enrolment; hospital beds per thousand of the population; domestic water consumption; federal employment in the states and statistics on the budgetary activities of state governments.
residua of the individuals in different states of the country, also to add to the analysis Table 7.3. presents the four different measures of disparities among states. These are the total population of each state, and the percentage it constitutes of national total; the people employed in federal civil service in each state, and the percentage of national total in each state; the number of primary school pupils and the enrolment per thousand of each states population, as well as hospital beds available per thousand of the population as broad indicators of need. For analytical purposes, we divide them broadly into two, and discuss each separately.

7.2.2.1. Budgetary Activities.

The most noticeable place of a difference is the revenues raised internally by the states and the expenditures they incur. This can be used to obtain the different states net fiscal benefits. Table 7.2. presents the difference between state own revenues and the total expenditures of the states.

Though it can be argued that states expenditure per capita is not necessarily a sufficient yardstick of the measure of how much state service is enjoyed by its resident. However, due to paucity of data we are made to rely on this to show the fiscal residua of individuals in different states. Column 5 of Table 7.2. shows the revenues generated by each state internally per capita, it has a national average of N19.8. Of this average, only 5 states
are above the national average, and a state like Niger has the lowest per capita own revenues which is as low as 25 percent of the national average. The product of Column 5, i.e., locally generated revenues per capita is subtracted from expenditures incurred by the states per capita, which is presented in Column 6 to give the product of column 7, which is the net per capita expenditures obtained by each citizen in his own state. This compares to Buchanans fiscal residua, i.e., the benefit received from government expenditure and the tax price one is made to pay.

The differences are quite clear and remarkable, in that a state like Sokoto has a fiscal residua of as low as N27.1 in the country, while a relatively more prosperous state like Lagos has as much as N93.0. It need be noted that these figures are merely used as proxies for the level of well-being in the different states, and are not intended to be a basis of the states real income measures. If the total expenditures of the states is dependent on the revenues they raise internally and the grants they receive from the federal government, then it follows that there is a great degree of horizontal inequity in the fiscal residua of individuals in different states. This can partly be attributed to a great degree of differences in tax base, in population and an inequitable revenue sharing formula.

7.2.2.2. Others.

---

8This caution was similarly extended by Ashwe C., (1986) op. cit., p.14. when he computed it for Nigeria using 1980 figures.
To further show why equalisation grants are justified in a federal country like Nigeria, we will examine the seeming differences within the states with regards to tax base, population of the different states, percentage of school age children, hospital beds per capita, and level of employment. This happen to be some of the obvious problems that escalates the magnitude of state inequalities in social service provision and necessitates the use of equalisation grants to achieve a minimum service level across the states.

In the absence of data on state incomes and other indices that will be of use in measuring relative income differences among individuals, the study uses employment in federal civil service in the states as a proxy for employment levels. The disparity here come to be handy and useful most especially when one considers the fact that the public sector in Nigeria is the major employer of Labour, and the pay-as-you-earn is one of the major sources of revenues for the states (the relative proportion that it contributes to total state revenues are given in chapter three). So differences in employment levels explain differences in revenue generation.

Examining Table 7.3, we can see that Lagos state alone has 40 percent of the nations federal civil servants, this partially explains the relative high revenues they generate internally as shown earlier. This contrasts sharply to what obtains in states like Ogun and Ondo, with barely 2 percent of the nations federal civil servants in each of the states. The relative insignificance means less money derived by the
state as taxes from people employed in the public sector.

The two variables on health and education can be used to show the differences in social service provision which clearly shows the need as well as the cost element of the different states, which necessitate more resources transferred to states with a higher need element. The two show the extremes of variation in social service provision. For instance, with a national average primary school enrolment per thousand of the nation's population as 0.171, nine of the states in the country have less than the average. This range from a high of 0.252 in Benue state to a low of 0.085 in Borno state. Similarly, wide disparities exist in the health sector, where hospital beds per thousand of the states population is as high as 2.037 in Bendel state and as low as 0.359 in Sokoto state. This means in essence there is almost 491 persons to a hospital bed in Bendel as against almost 2782 persons to a bed in Sokoto state. Such a disparity among states within the same country tells in clear terms the extent of regional disparities. Hence the existence of horizontal fiscal imbalance calls for the inclusion of equalisation clauses in the revenue sharing formula. Such that the likely fiscal residua differences that have arisen will be lessened to the barest minimum.

7.3. FISCAL EQUALISATION MODEL.

Different formulas have been laid down in the last chapter as to how equalisation can best be achieved, however, the main handicaps of the three different
approaches has been highlighted. This necessitate examining another approach. Since the revenue sharing arrangement in Nigeria is free from restrictions as to where the states can spend the money they are given, hence one resource allocation problem is solved.

Taking into consideration the fact that equalisation is principally meant to be conducted in such a way that the needs and fiscal capacities of the regions are met and equalised in the most optimal way requires examining how the grant distribution is done which reduces inequity between persons. In this regard the budget approach of Mathews is slightly reformulated and used in order to ensure relative ease in testing the model with Nigerian data. This is not intended to mean that the theoretical basis of the work is rejected, rather the reformulation only ignored some of the cost variables he included in his model, for which data on them across states in Nigeria are not readily available.

Mathews alternative distribution model combines the use of financial assistance and equalisation grants in Australia to formulate a general distribution model. The model took account of differences between different states in fiscal capacity and the relative costs of public service provision among the states. Further, the model did use adjusted population of the different states taking particular attention to Education and Health sectors, not simply the

---

9 See the test of the model in Mathews L.R., and Jay C.R.W., (1972) Federal Finance: Intergovernmental Financial Relations in Australia since Federation, Nelson, Melbourne, (Footnote continued)
lump sum of the states population.

7.3.1. Model.

Having mentioned this so far, we now derive the formula to be used, that will allow for a more equitable distribution of national revenues in Nigeria, which will hopefully reduce horizontal inequities. The situation at present shows a case whereby differential per capita payments are quite visible across the states. This difference is by no means attributable to real differences in relative needs, but rather an inadequate revenue sharing arrangement.

A general revenue distribution model, which takes account of differences in revenue raising capacity and relative costs among all the states, which in this case entails using a 19 state average, that is intended to serve as the basis of a representative states budget and revenue and cost differential assessment across the states, requires that each states statutory allocation be calculated using this formula (7.1).^9

\[
G_i = \frac{\alpha_i}{\sum_{i=1}^{19} \alpha_i} \cdot G
\]  
(7.1).

---

^9 (continued)
pp. 347-351.

Where $G =$ the total grant money to be distributed.

$G_i =$ grant that goes to state 'i'.

$\alpha_i =$ is an indicator of the relationship between relative costs and fiscal capacity. This is seen in relation to the per capita average national expenditures and revenues, as well as the rate of revenue raising and the proportion of a states population requiring a given service, and it is calculated thus:

\[
\alpha_i = \frac{\sum_{j=1}^{19} \left( \frac{\Sigma E_j \cdot \delta_i}{\Sigma P_j} \right) - \sum_{j=1}^{19} \left( \frac{\Sigma R_j \cdot \rho_i}{\Sigma P_j} \right)}{\sum_{j=1}^{19} \rho_a - \sum_{j=1}^{19} \delta_a} \tag{7.2}
\]

Where: $\frac{\Sigma E_j}{\Sigma P_j} =$ national average of state governments recurrent expenditure per head, based on the average of 19 states in the country.

$\frac{\Sigma R_j}{\Sigma P_j} =$ national average of states recurrent revenues per head, based on average figures for the 19 states in the country.

$\frac{\rho_i}{\rho_a} =$ the fiscal capacity of state i relative to the national average of the 19 states.

$\frac{\delta_i}{\delta_a} =$ the cost of providing services in
state \( i \), relative to the average cost of providing equivalent services in the 19 states. 

\[ P_i = \text{population of state } i. \]

The first part of equation (7.2) deals with the relative differences, in cost, needs as well as the representative governments expenditure, which is denoted here by the national average per capita expenditure of the states. The inclusion of expenditure, here ensures, that the actual expenditures of a state which represents the cost of providing public services in that state is compared to the national average. Since one of the main questions to be answered is the determination of the factors which are likely to make per capita expenditure needs vary from state to state, i.e., factors which make unadjusted population inadequate as an indicator of expenditure needs. The first part of the equation also examines the proportion of the population that enjoy a specific service in relation to the national average rather than just unadjusted population.

The second part of the equation, deals with the revenue aspect. The relative taxable capacities of the states is considered, mainly with the use of all revenues rather than breaking it into different types of taxes. Though revenue capacity in the aggregate is not necessarily equivalent to the summation of the capacity of individual state taxes and other revenue items, however, for purposes of analytical convenience, the aggregate revenue capacity
is used in model testing. Further the national per capita revenues are considered, this is to allow for proper inference and comparison of the revenue positions of the different states in relation to the national average, which later is to be used to justify the quantum of revenues that each of the states should get.

The model here sees revenue transfers which are aimed at reducing horizontal inequity as a function of population, the states fiscal capacity, its need index and the possible cost differences. However, one need to clarify further how the relative fiscal capacity index $\frac{\rho_i}{\rho_a}$ and the cost variability index $\delta_i/\delta_a$ will be calculated.

The relative fiscal capacities are calculated thus:

$$\frac{\rho_i}{\rho_a} = \frac{\sum_{x=1}^{n}\frac{R_{ax}}{\beta_x} \left( \frac{R_{ax}}{\beta_x} \cdot \frac{Y_{ix}}{P_i} \right)}{\sum_{x=1}^{n} \frac{R_{ax}}{\beta_x} / \frac{P_a}{P_a}}$$

Where: $\frac{R_{ax}}{\beta_x}$ = the national average rate of revenue raising in respect of revenue component $x$.

$\frac{Y_{ix}}{P_i}$ = the per capita base in respect of revenue component $x$ in state $i$.

$\frac{\sum_{x=1}^{n} \frac{R_{ax}}{\beta_x} / \frac{P_a}{P_a}}{\beta_x}$ = the national average per capita yield of revenue component $x$.

and $\beta_x$ = the weight given to revenue component $x$, equal to the ratio of total state collections of that
However, if we use a proportional tax, the fiscal capacity formula will be reduced to:

\[
\frac{\rho_i}{\rho_a} = \frac{\sum_{x} \cdot \frac{Y_{ix}}{P_i}}{\sum_{x} \cdot \frac{Y_{ax}}{P_a}}
\]  

(7.3a).

What this reduced form mean is that relative fiscal capacities can be determined by obtaining the respective per capita tax base of state i, with respect to the national average.

The relative cost index which pinpoints the specific services required and the proportion of the population which need such service is given by:

\[
\frac{\delta_i}{\delta_a} = \left[1 + \sum_{j=1}^{n} (Q_{ij}/Q_{aj} - 1)\right]
\]  

j = e, and h.  ...7.4.

Where:  \(Q_{ij}/Q_{aj}\) = the proportion of state i’s population requiring a particular service j relative to the national average.

\(\psi_j\) = the weight given to service j derived from the national average for all states in the country (in this case \(\sum \psi_j\) does not necessarily equal 1).
This model, explicitly shows how equalisation can be achieved with the use of general revenue grants. It does so by incorporating the differences in fiscal capacity, needs and relative costs among all states.

The structure of the model ensures that each revenue transfer to any of the states, aimed at reducing horizontal inequity which is necessitated by virtue of being at variance to the average national effort takes into consideration the population of the states as a broad measure of need, which is further subdivided into a benefit/cost framework, most especially with regards to school enrolment and hospital facilities availability. Further, the revenues of the states per capita are considered so that abuses to the grant distribution which will lead to allocative inefficiencies are reduced, in addition to the fact that the national per capita revenues are considered in the same light. The total expenditures per capita is calculated, such that national average will be obtained for comparisons.

The formula so given will reduce inequity, in that grants to states are based not only on the number of people residing in each jurisdiction, but also the recipients of the services so provided. Here for obvious data limitations the categories considered are only primary school children and hospital beds in the empirical work. The incorporation of this into the model helps to ensure that incentives do not emerge to encourage states with below average revenues from relaxing in their attempts at revenue generation for
the simple reason that revenues are transferred to them through the equalisation clauses.

7.3.2. Model Testing

Before undertaking to test the model it's of importance to pin-point the following salient points which will be of use in model testing later.

1. The revenues to be distributed for equalisation purposes are in the form of general revenue grants from the federal government to the states. The money is raised from the lucrative and relatively elastic federal sources which are tapped by the same government. As such the likely problems of disincentive as feared by most economists will not occur. In that, in this case above average revenue raising states will not be made to contribute resources to the development of below average states, they will only receive less in terms of grants from the centre. Further the states own tax rate will not be used mainly because of insufficient data on it.

2. The equalisation standard to be used for measures of fiscal capacity and service requirements will rely on the calculation of a national average figure. This figure will be used in each state, to obtain the relative figures needed for further analysis. However a representative average state will be
selected. The criteria of choosing the representative average state is by obtaining the mean value of the warranted grant i.e., the grant distribution suggested by this formula. The representative state is the one with the least deviation from the mean of warranted grants; the least deviation from the net of per capita state expenditures; the least deviation from the average national per capita state revenues generated internally by all the states; and has the least deviation from the average of federal grants per capita distributed to the states.

3. Instead of using a 6 state average as the case with Mathews formulation, this model will make use of all the 19 states in the country and later see how the budget and population characteristics of each of the states relate, and aid in achieving equity.

To test the model we can use equations 7.2, 7.3a, and 7.4, to have an expanded formula as given below.

\[
\alpha_i = P_i \left[ \frac{\sum_{j=1}^{19} [\psi_e Q_{ei} - 1] + \sum_{j=1}^{19} [\psi_h Q_{hi} - 1]]}{\sum_{j=1}^{19} \frac{Y_j}{P_j}} \right] \] 

\[
\left[ \sum_{j=1}^{19} \frac{Q_{ea}}{Q_{ha}} \right] - \left[ \sum_{j=1}^{19} \frac{Y_j}{P_j} \right] \] 

(7.5).

7.3.2.1. Empirical Findings.

The work involve solving equation 7.5 and substituting
the same into equation 7.1. in respect of each state in the
country, in order to obtain the warranted grants that
reduces inequity. The figures obtained will give the
recommended warranted grant that each state should have,
taking into consideration the needs of the states; the cost
of public service provision; and the fiscal capacity of each
state. The mean of per capita warranted grants is then
calculated and used as a representative state and compared
with the actual per capita disbursement of statutory
allocation to states in Nigeria to ascertain the extent to
which the actual distribution has gone in enhancing the
achievement of the nations objective of aiming at an
egalitarian society. The greater the deviation of the mean
of per capita warranted grants from the per capita actual
disbursements implies that inequity is growing with
statutory allocations to the state.

Since the revenues generated internally by the states
and the amount they get as grants determine their overall
expenditures hence the two are used to obtain a figure for
national average per capita state expenditures which is
calculated using 1984 Nigerian data to be N44.69, equally
national average per capita state revenues were calculated
to give a figure of N14.76. The reason for the use of total
revenues generated internally rather than the revenues
obtained from a specific tax source can be explained by
inadequate data for the different tax sources and other
internal revenues of all the states in the country.

To solve the equation, one need to solve the fiscal
capacity and cost variables separately. Since figures for major revenue components throughout the 19 states in the country is lacking. The calculation of the states fiscal capacity as equation 7.3a. wants us to do proved to be difficult, hence consumption expenditures were used as indicators of a state's revenue capacity.\textsuperscript{11} The fiscal capacity measures for each of the 19 states is presented in Table 7.5., column 4. \((\rho_i / \rho_a)\). Though the use of this technique leaves much to be desired, yet the results show a remarkable similarity to those of Table 3.3. The results clearly have shown that all states that generate relatively more revenues internally have fiscal capacities in excess of 1.00. With states like Bendel, Rivers, and Lagos having 2.00 and above. This contrasts sharply to what obtains in Sokoto and Kano states, with fiscal capacity measures of 0.48 and 0.57 respectively. A remarkable diversity exists among the states.

On the cost side, the weights to be assigned to each expenditure component was calculated based on the total of all the states expected outlay on the service in the fourth national development plan in relation to total outlays. For instance, \(\sum_{E_a}^\psi\) is obtained by dividing total expected expenditures on Education using it's total sectoral allocation in the fourth National Development Plan by total Expenditures which gave a value of 0.2. The same process was used for health, i.e., to obtain \(\sum_{H_a}^\psi\), and a figure of 0.07 was obtained.

\textsuperscript{11} This technique is equally used by Mathews when he tested his model in Australia., Ibid.
With regards to the adjusted population used, i.e., the two sectors of Education and Health. In the case of Education, the relative proportion of a state's population at primary schools was used as a broad measure of Education needs/costs, while the relative availability of Hospital beds was used for Health. These figures were divided by the national average to obtain the relative proportions required for this model. Table 7.4. gives the relevant figures. Column 5 of the Table gives the proportion of the state's population enrolled in Primary schools, \( e_i \) while column 6 gives the proportion of hospital beds to a state's population, \( h_i \). These two are divided by the national average to give the figures in columns 7 \( (e_i/e_a) \) and 8 \( (h_i/h_a) \) respectively.

Table 7.5. presents the actual/estimated amounts distributed to the states in 1984, (see column 7) and the one computed by the use of this model (column 6). It is to be noted that a state like Lagos is to receive less than the actual amount given to them earlier, mainly because of the numerous amounts of revenue they generate locally considering the number of federal civil service employees in the state; the relatively lower needs in relation to other states as manifested by having a higher ratio of pupils enrolment into primary schools to the national average; as well as higher ratio of hospital beds per thousand of the population, i.e., with values of \( e_i/e_a \) of 1.48 and \( h_i/h_a \) of 2.07; further they raise more revenues internally than all the states in the country, with a fiscal capacity variable having the highest value of \( \rho_i/\rho_a \) equal to 2.30; coupled
with the enormous federal government activity that takes place there. On the other hand, a very populous state like Kano, with low proportion of population in schools, low amounts of health facilities, as well as low internally generated revenues is most certainly going to end up with relatively more revenues. The enormous revenues that the formula suggested for Kano, is a response to the low relative proportion of the states school pupils to the national average \( e_i/e_a = 0.50 \), as well as the low proportion of hospital beds available to the national average \( h_i/h_a \) that is equal to 0.43, and the low revenues generated per head in the state, which is manifested in a low fiscal capacity variable of \( \rho_i/\rho_a = 0.57 \). It can visibly be seen that the warranted grants for Kano is as high as N326.8 million as against the actual/estimate of N228.2 million. In the same vein, Lagos state has a warranted grant of N51.3 million as against N113.4 million actual/estimate, i.e., less than 50 percent.

To compare the warranted with the actual/estimate grants, and see the one that is more likely to reduce horizontal inequities by at least reducing the gap in the relative grants offered to each state, we need to examine the deviation of each of the grants per capita from it's mean. Table 7.6, shows the deviation from the mean of per capita grants. It can be seen that the deviation from the mean is higher in the actual/estimate figures and lower in the warranted grants. So it goes without repetition that the warranted grant seems to be more worthwhile as a revenue sharing arrangement, in that it reduces the inequity.
involved in grant-per-capita distribution across the states.

To sum up the findings show that the model has suggested more grants to states with high population, low fiscal capacity and a higher need index as conventional theory of fiscal equalisation will suggest. This is visible from the results that recommends more grants to Kano, Sokoto, Oyo, and Kaduna states. While other states, with higher fiscal capacity, a relatively lower need index as measured by the two variables of Education and Health and relatively lower population, such as Lagos and Bendel have a relatively lower allocation than what they are given. This as well goes with the laid down theory.

7.3.2.2. Limitations.

The major limitation of this work can be seen in two different ways. Broadly categorised into: problem of estimating the different variables; and ignoring some vitally important variables that affect both the costs of public service provision and the fiscal capacity of any given area. We now discuss the two simultaneously.

Starting with the estimate of fiscal capacities of all the states in the country. It is conventional to use the total amount of revenue that will be raised from a given state, by applying a priori determined national average rate of each of the numerous kinds of state revenue sources. Such that it will enable the federal government to determine the extent of revenue generation effort that each state
exerts. This is more so, the case since the revenue capacity of each state in the aggregate is not necessarily the same as the summation of the capacity of individual states taxes and other revenue sources. The problems of obtaining data on each revenue source for use in determining a national average rate which subsequently will be used to ascertain each states fiscal capacity made us to abandon examining the individual revenue sources. Further, it made us to use recurrent expenditures of the states as a proxy for consumption expenditure which in itself is used to substitute for a states taxable capacity. Ridiculous as this may seem, data constraint leaves us with no better option. Hence this has reduced the extent of accuracy of the results, though it has still given us a glimpse of happenings in the fiscal scene. The non usage of each states individual tax effort, might be said from a purely theoretical view to result in allocative inefficiency.

With regards to the estimation of the cost factors, i.e., those factors that will make public expenditure needs/outlay to vary across states. We have only taken two factors into consideration, these are: Education and Health. Though good indicators in their own right, yet more variables should have been considered, such that price and cost differentials especially with respect to salaries which affect the states budget could have been incorporated. Also costs resulting from population congestion or sparsity were not considered, though they affect public service provision in metropolitan states as well as in sparsely populated areas. If such cost factors were considered, the grant
allocation recommended to a state like Lagos would have been higher.

7.4. Summary.

This chapter has briefly examined the existence of vertical and horizontal fiscal imbalance in the Nigerian federation which necessitate greater use of equalisation clauses in the nations revenue sharing arrangement. It has shown that the states revenues do not grow at the same rate as the nations total Expenditures. Further, it has also shown the wide horizontal variations existing between the states in both budgetary practices and other social and economic indicators that aid in determining their respective fiscal capacities and needs. Since the main purpose of this chapter is to develop a model of equalisation grants using the concepts of revenue raising and fiscal need, a model of fiscal equalisation was designed based on the fiscal capacity and relative cost differences of the different states. This model was tested using Nigerian 1984 data and it shows visibly, the extent of inequity existing among the states. The amount recommended by the model to be distributed to each state is compared with the actual/estimate disbursements to states, and it shows a great degree of deviation from the mean of per capita grants in the country, while the deviation is relatively less in respect of the figures obtained by the use of the model.
Table 7.2.
N(Million).

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Anambra</td>
<td>87.6</td>
<td>375.8</td>
<td>288.2</td>
<td>14.4</td>
<td>61.6</td>
<td>47.2</td>
</tr>
<tr>
<td>Bauchi</td>
<td>23.7</td>
<td>205.6</td>
<td>181.9</td>
<td>5.8</td>
<td>50.1</td>
<td>44.3</td>
</tr>
<tr>
<td>Bendel</td>
<td>162.7</td>
<td>463.8</td>
<td>301.1</td>
<td>38.7</td>
<td>110.4</td>
<td>71.7</td>
</tr>
<tr>
<td>Benue</td>
<td>36.6</td>
<td>173.5</td>
<td>136.9</td>
<td>8.9</td>
<td>42.3</td>
<td>33.4</td>
</tr>
<tr>
<td>Borno</td>
<td>34.0</td>
<td>190.4</td>
<td>156.4</td>
<td>6.7</td>
<td>37.3</td>
<td>30.6</td>
</tr>
<tr>
<td>Cross Rivers</td>
<td>64.2</td>
<td>304.8</td>
<td>240.6</td>
<td>10.9</td>
<td>51.7</td>
<td>40.8</td>
</tr>
<tr>
<td>Gongola</td>
<td>31.7</td>
<td>248.7</td>
<td>217.0</td>
<td>7.2</td>
<td>56.5</td>
<td>49.3</td>
</tr>
<tr>
<td>Imo</td>
<td>139.0</td>
<td>401.5</td>
<td>262.5</td>
<td>22.4</td>
<td>64.7</td>
<td>42.3</td>
</tr>
<tr>
<td>Kaduna</td>
<td>77.5</td>
<td>316.5</td>
<td>239.0</td>
<td>11.6</td>
<td>47.2</td>
<td>35.6</td>
</tr>
<tr>
<td>Kano</td>
<td>74.5</td>
<td>364.5</td>
<td>290.0</td>
<td>7.6</td>
<td>37.2</td>
<td>29.6</td>
</tr>
<tr>
<td>Kwara</td>
<td>46.8</td>
<td>223.5</td>
<td>176.7</td>
<td>15.6</td>
<td>74.5</td>
<td>58.9</td>
</tr>
<tr>
<td>Lagos</td>
<td>412.7</td>
<td>691.9</td>
<td>279.2</td>
<td>137.6</td>
<td>230.6</td>
<td>93.0</td>
</tr>
<tr>
<td>Niger</td>
<td>9.4</td>
<td>140.3</td>
<td>130.9</td>
<td>4.5</td>
<td>66.8</td>
<td>62.3</td>
</tr>
<tr>
<td>Ogun</td>
<td>55.0</td>
<td>237.3</td>
<td>182.3</td>
<td>20.4</td>
<td>87.9</td>
<td>67.5</td>
</tr>
<tr>
<td>Ondo</td>
<td>47.3</td>
<td>210.4</td>
<td>163.1</td>
<td>10.1</td>
<td>44.8</td>
<td>34.7</td>
</tr>
<tr>
<td>Oyo</td>
<td>141.0</td>
<td>502.9</td>
<td>361.9</td>
<td>15.8</td>
<td>56.5</td>
<td>40.7</td>
</tr>
<tr>
<td>Plateau</td>
<td>28.2</td>
<td>191.4</td>
<td>163.2</td>
<td>8.1</td>
<td>54.7</td>
<td>46.6</td>
</tr>
<tr>
<td>Rivers</td>
<td>77.6</td>
<td>366.9</td>
<td>289.3</td>
<td>25.6</td>
<td>122.3</td>
<td>96.7</td>
</tr>
<tr>
<td>Sokoto</td>
<td>35.9</td>
<td>247.4</td>
<td>211.5</td>
<td>4.6</td>
<td>31.7</td>
<td>27.1</td>
</tr>
</tbody>
</table>

Total/Mean | 1584.1         | 5857.1         | 4273.0       | 19.8               | 69.9             | 49.8             |

Source: Central Bank of Nigeria, Annual Report and Statement of Account 1986. Columns 4,5,6, and 7 are computed by Author.
Table 7.3.
Indicators of State Disparities (1982).

<table>
<thead>
<tr>
<th>States</th>
<th>Pop. % of Total</th>
<th>Fed. Employees in States</th>
<th>Pupils Enrol. Per State</th>
<th>Hospital Beds Per State</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1)</td>
<td>(2)</td>
<td>(3)</td>
<td>(4)</td>
<td>(5)</td>
</tr>
<tr>
<td>Anambra</td>
<td>6.4</td>
<td>14226</td>
<td>5.3</td>
<td>853.4</td>
</tr>
<tr>
<td>Bauchi</td>
<td>4.3</td>
<td>6484</td>
<td>2.4</td>
<td>434.1</td>
</tr>
<tr>
<td>Bendel</td>
<td>4.4</td>
<td>2223</td>
<td>4.6</td>
<td>859.9</td>
</tr>
<tr>
<td>Benue</td>
<td>4.3</td>
<td>872</td>
<td>2.6</td>
<td>975.7</td>
</tr>
<tr>
<td>Borno</td>
<td>5.4</td>
<td>663</td>
<td>2.5</td>
<td>404.3</td>
</tr>
<tr>
<td>Cross Rivers</td>
<td>6.2</td>
<td>1189</td>
<td>4.4</td>
<td>868.5</td>
</tr>
<tr>
<td>Gongola</td>
<td>4.6</td>
<td>693</td>
<td>2.6</td>
<td>470.2</td>
</tr>
<tr>
<td>Imo</td>
<td>6.5</td>
<td>9122</td>
<td>3.4</td>
<td>826.6</td>
</tr>
<tr>
<td>Kaduna</td>
<td>7.3</td>
<td>12765</td>
<td>4.8</td>
<td>1070.4</td>
</tr>
<tr>
<td>Kano</td>
<td>10.3</td>
<td>11485</td>
<td>4.3</td>
<td>1212.9</td>
</tr>
<tr>
<td>Kwara</td>
<td>3.1</td>
<td>8334</td>
<td>3.1</td>
<td>620.9</td>
</tr>
<tr>
<td>Lagos</td>
<td>2.9</td>
<td>106792</td>
<td>40.2</td>
<td>570.9</td>
</tr>
<tr>
<td>Niger</td>
<td>2.1</td>
<td>5740</td>
<td>2.2</td>
<td>450.7</td>
</tr>
<tr>
<td>Ogun</td>
<td>2.3</td>
<td>5452</td>
<td>2.0</td>
<td>426.3</td>
</tr>
<tr>
<td>Ondo</td>
<td>4.9</td>
<td>5175</td>
<td>1.9</td>
<td>691.9</td>
</tr>
<tr>
<td>Oyo</td>
<td>9.3</td>
<td>11109</td>
<td>4.2</td>
<td>1971.7</td>
</tr>
<tr>
<td>Plateau</td>
<td>3.6</td>
<td>7704</td>
<td>2.9</td>
<td>565.0</td>
</tr>
<tr>
<td>Rivers</td>
<td>3.1</td>
<td>8896</td>
<td>2.3</td>
<td>585.2</td>
</tr>
<tr>
<td>Sokoto</td>
<td>8.1</td>
<td>7560</td>
<td>2.4</td>
<td>684.0</td>
</tr>
</tbody>
</table>

Total/Mean | 5.2 | 265445 | 5.2 | 0.17 | 1.02

Table 7.4.

<table>
<thead>
<tr>
<th>States</th>
<th>Pop. '000</th>
<th>Pri. Pupil '000</th>
<th>Hosp. Beds</th>
<th>$e_i$</th>
<th>$h_i$</th>
<th>$e_i/e_a$</th>
<th>$h_i/h_a$</th>
</tr>
</thead>
<tbody>
<tr>
<td>Anambra</td>
<td>6029</td>
<td>800.6</td>
<td>7943</td>
<td>13.28</td>
<td>0.13</td>
<td>0.85</td>
<td>0.68</td>
</tr>
<tr>
<td>Bauchi</td>
<td>4076</td>
<td>343.3</td>
<td>2009</td>
<td>8.42</td>
<td>0.04</td>
<td>0.54</td>
<td>0.55</td>
</tr>
<tr>
<td>Bendel</td>
<td>4126</td>
<td>878.6</td>
<td>7993</td>
<td>21.29</td>
<td>0.19</td>
<td>1.36</td>
<td>2.15</td>
</tr>
<tr>
<td>Benue</td>
<td>4069</td>
<td>1030.1</td>
<td>1740</td>
<td>25.31</td>
<td>0.04</td>
<td>1.62</td>
<td>0.47</td>
</tr>
<tr>
<td>Borno</td>
<td>5025</td>
<td>469.8</td>
<td>2435</td>
<td>9.35</td>
<td>0.05</td>
<td>0.60</td>
<td>0.54</td>
</tr>
<tr>
<td>Cross Rivers</td>
<td>5831</td>
<td>990.2</td>
<td>6238</td>
<td>16.98</td>
<td>0.11</td>
<td>1.09</td>
<td>1.20</td>
</tr>
<tr>
<td>Gongola</td>
<td>4368</td>
<td>559.6</td>
<td>2445</td>
<td>12.81</td>
<td>0.05</td>
<td>0.82</td>
<td>0.62</td>
</tr>
<tr>
<td>Imo</td>
<td>6137</td>
<td>849.7</td>
<td>6023</td>
<td>13.84</td>
<td>0.09</td>
<td>0.90</td>
<td>1.10</td>
</tr>
<tr>
<td>Kaduna</td>
<td>6671</td>
<td>1284.5</td>
<td>6385</td>
<td>19.25</td>
<td>0.09</td>
<td>1.23</td>
<td>1.07</td>
</tr>
<tr>
<td>Kano</td>
<td>9681</td>
<td>749.6</td>
<td>3701</td>
<td>7.74</td>
<td>0.03</td>
<td>0.50</td>
<td>0.43</td>
</tr>
<tr>
<td>Kwara</td>
<td>2874</td>
<td>882.8</td>
<td>4181</td>
<td>30.70</td>
<td>0.14</td>
<td>1.96</td>
<td>1.64</td>
</tr>
<tr>
<td>Lagos</td>
<td>2825</td>
<td>655.6</td>
<td>5270</td>
<td>23.20</td>
<td>0.18</td>
<td>1.48</td>
<td>2.07</td>
</tr>
<tr>
<td>Niger</td>
<td>2003</td>
<td>445.7</td>
<td>1413</td>
<td>22.25</td>
<td>0.06</td>
<td>1.42</td>
<td>0.78</td>
</tr>
<tr>
<td>Ogun</td>
<td>2600</td>
<td>419.0</td>
<td>3075</td>
<td>16.11</td>
<td>0.11</td>
<td>1.03</td>
<td>1.34</td>
</tr>
<tr>
<td>Ondo</td>
<td>4576</td>
<td>744.6</td>
<td>7359</td>
<td>16.27</td>
<td>0.15</td>
<td>1.04</td>
<td>1.79</td>
</tr>
<tr>
<td>Oyo</td>
<td>8732</td>
<td>1982.5</td>
<td>6192</td>
<td>22.70</td>
<td>0.07</td>
<td>1.45</td>
<td>0.79</td>
</tr>
<tr>
<td>Plateau</td>
<td>3398</td>
<td>405.5</td>
<td>2941</td>
<td>11.90</td>
<td>0.08</td>
<td>0.76</td>
<td>0.95</td>
</tr>
<tr>
<td>Rivers</td>
<td>2883</td>
<td>406.3</td>
<td>3069</td>
<td>14.09</td>
<td>0.10</td>
<td>0.90</td>
<td>1.20</td>
</tr>
<tr>
<td>Sokoto</td>
<td>7609</td>
<td>710.9</td>
<td>2602</td>
<td>9.34</td>
<td>0.03</td>
<td>0.59</td>
<td>0.38</td>
</tr>
<tr>
<td>Total/Mean</td>
<td>93533</td>
<td>14609.4</td>
<td>83014</td>
<td>15.61</td>
<td>0.08</td>
<td>1.00</td>
<td>1.00</td>
</tr>
</tbody>
</table>

Source: Federal Office of Statistics, Annual Abstract of Statistics 1985, Tables 2.3, 3.6, and 5.2., Columns 5,6,7, and 8 are calculated by author.

Note: $e_i$ = proportion of states population enrolled in primary schools.
$h_i$ = proportion of hospital beds to states population.
$e_a$ = national average of $e_i$.
$h_a$ = national average of $h_i$.
<table>
<thead>
<tr>
<th>States</th>
<th>Y/P</th>
<th>$\delta_i/\delta_a$</th>
<th>$\rho_i/\rho_a$</th>
<th>$\alpha_i$ ('000)</th>
<th>$G_i$ Act/Est (N-Million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Anambra</td>
<td>40.85</td>
<td>0.94</td>
<td>0.92</td>
<td>172816.8</td>
<td>171.4 157.0</td>
</tr>
<tr>
<td>Bauchi</td>
<td>34.42</td>
<td>0.87</td>
<td>0.78</td>
<td>111535.1</td>
<td>110.6 126.5</td>
</tr>
<tr>
<td>Bendel</td>
<td>88.58</td>
<td>1.15</td>
<td>2.00</td>
<td>90198.2</td>
<td>89.4 212.9</td>
</tr>
<tr>
<td>Benue</td>
<td>38.36</td>
<td>1.08</td>
<td>0.86</td>
<td>144185.2</td>
<td>143.0 123.8</td>
</tr>
<tr>
<td>Borno</td>
<td>30.00</td>
<td>0.88</td>
<td>0.68</td>
<td>148742.2</td>
<td>147.5 147.0</td>
</tr>
<tr>
<td>Cross Rivers</td>
<td>36.58</td>
<td>1.03</td>
<td>0.82</td>
<td>197811.0</td>
<td>196.2 154.3</td>
</tr>
<tr>
<td>Gongola</td>
<td>28.31</td>
<td>0.93</td>
<td>0.64</td>
<td>141635.9</td>
<td>140.4 126.2</td>
</tr>
<tr>
<td>Imo</td>
<td>58.10</td>
<td>0.98</td>
<td>1.31</td>
<td>150068.4</td>
<td>148.8 151.1</td>
</tr>
<tr>
<td>Kaduna</td>
<td>32.63</td>
<td>1.05</td>
<td>0.73</td>
<td>241434.8</td>
<td>239.4 179.9</td>
</tr>
<tr>
<td>Kano</td>
<td>25.35</td>
<td>0.95</td>
<td>0.57</td>
<td>329546.9</td>
<td>326.8 228.2</td>
</tr>
<tr>
<td>Kwara</td>
<td>65.13</td>
<td>1.23</td>
<td>1.47</td>
<td>95599.0</td>
<td>94.8 103.4</td>
</tr>
<tr>
<td>Lagos</td>
<td>119.36</td>
<td>1.17</td>
<td>2.30</td>
<td>51766.4</td>
<td>51.3 113.4</td>
</tr>
<tr>
<td>Niger</td>
<td>64.10</td>
<td>1.06</td>
<td>1.45</td>
<td>53478.8</td>
<td>53.0 77.0</td>
</tr>
<tr>
<td>Ogun</td>
<td>51.03</td>
<td>1.02</td>
<td>1.15</td>
<td>74369.5</td>
<td>73.7 104.4</td>
</tr>
<tr>
<td>Ondo</td>
<td>46.83</td>
<td>1.06</td>
<td>1.06</td>
<td>145153.0</td>
<td>143.9 119.2</td>
</tr>
<tr>
<td>Oyo</td>
<td>37.67</td>
<td>1.07</td>
<td>0.85</td>
<td>307966.3</td>
<td>305.4 198.2</td>
</tr>
<tr>
<td>Plateau</td>
<td>50.50</td>
<td>0.94</td>
<td>1.14</td>
<td>85547.7</td>
<td>84.8 95.6</td>
</tr>
<tr>
<td>Rivers</td>
<td>105.20</td>
<td>0.99</td>
<td>2.10</td>
<td>38151.5</td>
<td>37.8 202.7</td>
</tr>
<tr>
<td>Sokoto</td>
<td>21.18</td>
<td>0.87</td>
<td>0.48</td>
<td>241922.6</td>
<td>239.9 177.2</td>
</tr>
</tbody>
</table>

Total/Mean 44.11 1.00 1.00 2821930.1 2799.0 2799.0

Source: Calculated from Table 7.4.
Table 7.6.
Deviation from the Mean of Per Capita Grants.
(per capita).

<table>
<thead>
<tr>
<th>States</th>
<th>$G_i$</th>
<th>Act/Est.</th>
<th>$G-G_i$</th>
<th>A/E-A/E.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Pop</td>
<td>Pop.</td>
<td>Pop.</td>
<td>Pop.</td>
</tr>
<tr>
<td>(1)</td>
<td>(2)</td>
<td>(3)</td>
<td>(4)</td>
<td>(5)</td>
</tr>
<tr>
<td>Anambra</td>
<td>28.42</td>
<td>26.04</td>
<td>0.18</td>
<td>-6.80</td>
</tr>
<tr>
<td>Bauchi</td>
<td>27.14</td>
<td>31.03</td>
<td>-1.46</td>
<td>-1.81</td>
</tr>
<tr>
<td>Bendel</td>
<td>21.68</td>
<td>51.59</td>
<td>-6.92</td>
<td>18.75</td>
</tr>
<tr>
<td>Benue</td>
<td>35.14</td>
<td>30.42</td>
<td>6.53</td>
<td>-2.42</td>
</tr>
<tr>
<td>Borno</td>
<td>29.35</td>
<td>29.25</td>
<td>0.74</td>
<td>-3.59</td>
</tr>
<tr>
<td>Cross Rivers</td>
<td>33.64</td>
<td>26.46</td>
<td>5.03</td>
<td>-6.38</td>
</tr>
<tr>
<td>Gongola</td>
<td>32.16</td>
<td>28.89</td>
<td>3.55</td>
<td>-3.95</td>
</tr>
<tr>
<td>Imo</td>
<td>24.25</td>
<td>24.62</td>
<td>-4.35</td>
<td>-8.22</td>
</tr>
<tr>
<td>Kaduna</td>
<td>35.89</td>
<td>26.96</td>
<td>7.28</td>
<td>-5.87</td>
</tr>
<tr>
<td>Kano</td>
<td>33.76</td>
<td>23.57</td>
<td>5.15</td>
<td>-9.27</td>
</tr>
<tr>
<td>Kwara</td>
<td>32.99</td>
<td>35.97</td>
<td>4.38</td>
<td>3.13</td>
</tr>
<tr>
<td>Lagos</td>
<td>18.17</td>
<td>40.14</td>
<td>-10.43</td>
<td>7.29</td>
</tr>
<tr>
<td>Niger</td>
<td>26.48</td>
<td>38.44</td>
<td>-2.12</td>
<td>5.59</td>
</tr>
<tr>
<td>Ogun</td>
<td>28.37</td>
<td>40.15</td>
<td>-0.23</td>
<td>7.30</td>
</tr>
<tr>
<td>Ondo</td>
<td>31.46</td>
<td>26.04</td>
<td>2.85</td>
<td>-6.79</td>
</tr>
<tr>
<td>Oyo</td>
<td>34.98</td>
<td>22.69</td>
<td>6.37</td>
<td>-10.14</td>
</tr>
<tr>
<td>Plateau</td>
<td>24.97</td>
<td>28.13</td>
<td>-3.16</td>
<td>-4.71</td>
</tr>
<tr>
<td>Rivers</td>
<td>13.12</td>
<td>70.30</td>
<td>-15.48</td>
<td>37.46</td>
</tr>
<tr>
<td>Sokoto</td>
<td>31.53</td>
<td>23.28</td>
<td>2.92</td>
<td>-9.55</td>
</tr>
<tr>
<td>Total/Mean</td>
<td>28.61</td>
<td>32.84</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Calculated from Table 7.4 and 7.5.
CHAPTER EIGHT.

POLICY RECOMMENDATIONS AND CONCLUSION.

The 1990's will be a period of fiscal adjustment for states. In that a state like Lagos being the richest in internal revenue generation, might have to struggle to hold their public service provision at a level they can afford, most especially with the movement of federal capital to Abuja hence some of the lucrative revenue sources that the state relies on. While the relatively poorer states will be struggling to raise service levels in response to the demands of an increasingly enlightened population. This will all take place with a background of an anticipated slow but positive growth rate, an anticipated reduced earnings from the petroleum sector and a clear uncertainty about the general level of prices considering the structural adjustment programme being pursued. This uncertainty is bound to result in states avoiding a commitment to long-term programs, as well as likely to shy away from new activities, hence this suggest either a more increasing federal role or an increase in grants.

8.1. POLICY RECOMMENDATIONS.

Whatever policy recommendations one need to put forward must be within the confines of the provisions for distribution of income and wealth contained in sections 16(2) a,b,c and d; and 17(3) a and d of the 1979 constitution which gives weight to the federal governments objective of creating a just and egalitarian society with
the positive hope that it will be attained. Given the nature of this work and its findings, where for instance, in chapter four it was found that grants do affect decentralisation in a positive way in the country, which is shown by the fact that the higher the ratio of grants to total expenditures, the greater the anticipated independence of the states in local fiscal discretion. It was also found in chapter five that the country’s statutory allocation affects the level of state governments spending in a positive way, though it is only found to be substitutive of local money and not stimulative. These two findings suggest a significant role can be played by grants, given the policy objective that is to be pursued.

Further, it was shown that states rely for almost 70 percent of their revenues from federal transfers, of which the main bulk of the transfers is in the form of statutory allocations which are basically lump-sum unconditional grants. Transfers of this sort do not require any matching element, hence one can conclude that they do not necessarily compell the states to follow the dictates of the federal government theoretically.

So given the importance of statutory allocations, and the attempts made with its use to achieve fiscal equalisation, the policy recommendations enumerated below, relate to: (1) improvement in the distribution of the federation account and the formula used for the distribution of the states joint account; and (2) how to raise budgetary efficiency and more revenues internally, within the states.
These are recommended within the confines of the sketchy data available and the theoretical position which ensures that relative equity is achieved and efficiency in social service provision is enhanced.

8.1.1. Federation Account Distribution.

Perhaps the first place to start is with the basis upon which the federation account is distributed between the federal, state and local governments, and the rational for it. Earlier in the text, we have seen that states and local expenditures between 1976/1977-1980 constitute a yearly average of nearly 40 percent of total expenditures. This explains why the PCRA recommended 30 percent to states and 10 percent to local governments. Since it is found that the independence of the states is a function of more grants, it is only logical to suggest more revenues to them from the federation account. Given the enormous constitutional responsibilities assigned to the states, it is logical to assign at least an extra 10 percent of the nations federation account, making it’s sum total to 40 percent, while the local governments retain their 10 percent. This is because of the obvious developmental advantages involved in decentralisation of more fiscal resources to the states, such that public service provision can be enhanced and fiscal residua differences narrowed. The extra 10 percent should specifically be tied to capital expenditures. This should be monitored closely by the central government.

However, such a formula based lump-sum transfers will
not be supported by economic theory, at least in the short run, because they are seen to be inefficient. As Scott (1952) pointed out, it is tantamount to diverting productive resources from potentially high development areas to low ones, hence thwarts national development. Further, the objective of fiscal responsibility that decentralisation teaches is eroded, in that local tax payers are no longer aware of the connection between payment of taxes and the delivery of public services. Given the nature of responsibilities performed by the states and its likely long-run effect on the economy, such transfers will not enhance inefficiency but rather promote efficiency in the long-run.

It is not only the quantum of the revenues that goes to the state and local governments that matters, but also the formula for the distribution of this revenue to them. We now examine this area.

8.1.2. States Joint Account Distribution.

The second area of improvement relates to how the 40 percent of the federation account recommended is to be shared to the states. The current formula has four factors with the weights attached to each as follows: minimum responsibility of government 40 percent; population 40 percent; social development factor 15 percent; and internal revenue effort 5 percent. Considering the two major theoretical guides to the work, i.e., efficiency attainment and the reduction of horizontal fiscal imbalance,
adjustments were suggested to the factors of minimum responsibility of government, and social development, in addition another factor is recommended, i.e., that of cost disability, which goes to compensate for high cost of public service provision in urban or densely populated areas. The adjustments are presented in Table 8.1.

Table 8.1.
Proposed States Joint Account Distribution.

<table>
<thead>
<tr>
<th>Principle</th>
<th>Weight (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Population</td>
<td>40.00</td>
</tr>
<tr>
<td>2. Minimum Responsibility of Govt.</td>
<td>30.00</td>
</tr>
<tr>
<td>3. Social Development Factor:</td>
<td>20.00</td>
</tr>
<tr>
<td>(a) Primary School Enrolment</td>
<td>15.00</td>
</tr>
<tr>
<td>(b) Hospital beds per '000 of Pop.</td>
<td>5.00</td>
</tr>
<tr>
<td>4. Cost Disability Factor:</td>
<td>5.00</td>
</tr>
<tr>
<td>(a) Urbanised population</td>
<td>2.50</td>
</tr>
<tr>
<td>(b) Population Density</td>
<td>2.50</td>
</tr>
<tr>
<td>5. Internal Revenue Effort</td>
<td>5.00</td>
</tr>
<tr>
<td>Total</td>
<td>100.00</td>
</tr>
</tbody>
</table>

The population factor is used as a broad indicator of need, and the weight assigned to it, though arbitrarily arrived at is appropriate. However, the factor of minimum responsibility of government which was similarly given 40 percent leaves much to be desired. Though it is arrived at considering the proportion of the smallest states recurrent expenditure to total federal revenue as an indication of the minimum financial responsibility of each state, yet the
amount is too much, taking into consideration that the states are dissimilar in so many respects. Granted that each state has a business of government to conduct, yet we suggest 30 percent be allowed for minimum responsibility of government. This is because any drastic cut in the relative percentage of this factor, as for instance suggested by Ashwe (1986)\(^1\) considering the wide ranging nature of regional disparities is very likely to result in greater cuts in spending by some states which ultimately will affect the provision of public services in the state, thereby instead of promoting equity in distribution of public services, further inequity is created.

The third factor of social development is seen as an indicator of development need. For this the current revenue allocation act uses only primary school enrolment for the main reason that data was not available on other development need indices. However, we here add health, because it is equally an essential public service provided by the states and data is readily available on health facilities availability judged in this case by hospital beds per thousand of the population. The availability of data on it lends it's usefulness as a basis of sharing the states joint account. It is recommended that 5 percent be based on it,

\(^1\)In a study by Ashwe C.C., (1986) op.cit., p.34., he suggested 20 percent for this factor, for no apparent reason, and hence when he calculated a new distribution, using 1980 budgetary allocations, he found an improved pattern mainly because he has increased the states share of federation account. However, if the states federation account share is left as it were, the distribution will be skewed against some states that rely on this factor for more revenues.
and that the share of funds should be inversely related to the factor, such that the least developed states in this respect will have more transfers.

A new factor is added to the current factors in use, i.e., that of cost disability. The consideration of this factor is important since costs of public service provision differs between states, for a number of reasons. Among these reasons are degree of urbanisation, geographical terrain, or population density. Such a difference is likely to affect individuals fiscal residua. Since data is readily available on population density and proportion of population that resides in urban areas in each state, we suggest that 5 percent of the states joint account be distributed on the basis of cost disability, such that cost differences in public service provision are reduced across jurisdictions. The 5 percent is to be shared equally between urbanised population and population density, of which the former varies directly with transfers while the latter varies inversely. The suggestion of 5 percent is based on the fact that 10 percent of states expenditures are found to be on works,\(^2\) hence to reduce the cost differences without seriously affecting expenditures we recommended this percentage.

8.1.3. Local Revenue Sourcing and Budgetary Efficiency.

Changes in the quantum of revenues from the centre

\(^2\)Ibid.
though of advantage, however, it further deepens the states dependence on it. Hence the states need to do something to enhance the revenues they generate internally. Given that taxes, licences, fees and fines contribute the greatest proportion of the revenues of states, i.e., before the introduction of the obnoxious development levies in 1985 and 1986. The recommendation will be centred around improving them and realising more from them at least in the short run.

The most serious problem with taxes is the lack of consistency within each state as to the amount deducted from individuals income through the Pay as you earn system and the assessment methods employed for tax through direct assessment. This happens despite the existence of a clear law governing how people should be taxed/assesed for tax purposes. For instance, it is not uncommon to find two people within the same state working for different establishments receiving the same income, and having the same tax rebate entitlements and yet paying different amounts as tax. In the process, so many people get away under taxed, and this is only discovered when they go to apply for tax clearance, which is now required for political aspirants and any other serious governmental business, be it applying for foreign exchange or tendering for government contracts. Hence for a start, we recommend an induction course for account clerks responsible for tax deductions and assessments within each state, aimed at familiarising them with the requirements of tax laws, such that the discrepancy and the consequent loss of revenue will be eliminated. The elimination of such a disparity will surely raise the
relative amounts of revenue realised by the states. This measure will not only enhance efficiency in revenue generation, but also reduce the inequitable taxation practice going on. In addition, the states should make it compulsory for applicants of tax relief to produce documentary evidence of the reasons they need the relief. Marriage certificates or Affidavits should be tendered for those who are married, and Birth certificates or statutory declaration of age for each of the children you claim to have.

The second major area is licences, fees and fines. Under this head we recommend an immediate 20 percent increase in private motor vehicle licensing/renewal for cars with an engine capacity of less than 2.0cc and 30 percent for those above. Also we recommend a 20 percent increase in private motor vehicle registration fees, as well as driving license initial issuance and renewal. As for special number motor vehicle registration, this should be increased by 100 percent. In addition, registration and renewal of contractors should also be raised by 20 percent. These recommendations are based on the believe that the people involved can afford to pay with relative ease. Further, each state henceforth should make it a point to adjust the amount collected from these sources in line with the inflation rate.

The last item of recommendation, which is not related to revenue raising is with increase in relative fiscal planning efficiency. Supplementary budgets were embarked on by most
of the states, during the civilian era of 1979-1983. This depicts a serious case of inefficient planning of fiscal affairs. Such a practice should not be allowed to raise its head in the 1990's, when we once more hope to have a civilian leadership. The elimination of supplementary budgets will go along way in improving fiscal efficiency in the operations of the states.

8.2. CONCLUSION.

In an attempt to see the structure of fiscal relations between states and federal governments, as well as to curve a definitive developmental role for grants in Nigeria the study examined three things, namely: the extent of fiscal decentralisation among the federal/state governments in Nigeria, and the factors that explain variations in decentralisation. Secondly, we examined the impacts of grants on the expenditures of states, with the hope of finding whether the nations statutory allocations are stimulative or substitutive of local money, and whether they grow in proportion to the nations income. And finally, we examined the extent of horizontal and vertical fiscal imbalance which should be a basis that shapes the attempts at fiscal equalisation in the country. We now give a brief on each of the findings.

The examination of fiscal decentralisation both in respect of revenues and expenditures reveals a similar trend, though as is seen in most other federations, expenditure decentralisation is higher than revenue
decentralisation. In an attempt to find the factors, that affect fiscal decentralisation four main recurring variables found in the literature were used, namely: ratio of intergovernmental grants to total government current expenditures; foreign trade as percent of GNP; per capita income; and urbanisation. On regressing these variables on our three decentralisation measures, it was found that the ratio of grant to total expenditures and the degree of the economy's openness were found to have the correct signs and significant. This finding though ironical, i.e., independence of states based on the grants they receive, however opened the door for further work on grant impacts and it's subsequent use for fiscal equalisation.

Given that decentralisation is seen to be a function of among others, grants and since the major grant source is statutory allocation, we decided to see it's impacts on states expenditures, in conjunction with two other variables, i.e., per capita income and population density. The findings showed that statutory allocation have a positive impact on state expenditures and is the dominant variable that explains a greater proportion of the explained variation in spending. However, two different results were obtained with regards to it's stimulative or substitutive nature. The linear model used showed that statutory allocations are stimulative of state expenditures because its estimated coefficient is found not to be significantly different from one, while the non-linear model showed that it is substitutive of local money even in a situation where real substitution is hardly seen in practice. However, an
important finding is the one that shows a trend towards income equalisation over the years. This provided the basis for a more detailed examination of the need for fiscal equalisation and how far it is pursued in the country.

Considering the nature of vertical and horizontal fiscal imbalance in the federation, and the effective roles that statutory allocation can play to reduce this, we examined fiscal equalisation and how to achieve it. The finding of our model suggested more grants to states with high population, low fiscal capacity and a higher need index as conventional fiscal equalisation will recommend, while a lower allocation is suggested to states with higher fiscal capacity and a relatively lower need index.

Though most of the findings can readily be explained by economic theory, however, the work on fiscal equalisation carried out though depicts clear case of inequity, need to be examined in greater detail by future research work, most especially when more data is available on each states fiscal capacities as measured by the Advisory Commission on Intergovernmental Relations of the United States.
APPENDIX.

1.0 Intergovernmental Division of Responsibilities.

1.1.0 Federal Government.
  1.1.1. Defence and Security.
  1.1.2. External Relations.
  1.1.3. Inter-State and International Roads.
  1.1.4. Port Facilities.
  1.1.5. Railways.
  1.1.6. Airport Facilities.
  1.1.7. Power.
  1.1.8. Communications.
  1.1.9. Higher Education.

1.2.0 State Government's.
  1.2.1. Secondary Education.
  1.2.2. Health.
  1.2.3. Urban Water Supply.
  1.2.4. Housing.
  1.2.5. Lighter Infrastructures including Secondary Roads.
  1.2.6. Agriculture.
  1.2.7. Light Industries.
  1.2.8. Town and Country Planning.
  1.2.9. Rural Electrification.
  1.2.10. Rural Water Supply.

1.3.0 Local Government's.
  1.3.1. Feeder Roads.
  1.3.2. Sewage and Refuse Disposal.
  1.3.3. Primary Education.
  1.3.4. Market Stalls.
1.3.5. Rural Health.
1.3.6. Cottage Industry.

2.0. Intergovernmental Sources of Revenue.

2.1.0. Federal Government.
  2.1.1. Import Duties.
  2.1.2. Excise Duties.
  2.1.3. Company Taxes.
  2.1.4. Personal Income Tax of Members of the Armed Forces and Diplomatic Corps.
  2.1.5. Stamp Duties.
  2.1.6. Capital Gains Tax.
  2.1.7. Mining Rents and Royalties.

2.2.0. State Governments.
  2.2.1. Personal Income Tax.
  2.2.2. Entertainment Tax.
  2.2.3. Stamp Duties.
  2.2.4. Land, Rents and Rates.
  2.2.5. Licensing of Mechanically Propelled Vehicle.

2.3.0. Local Governments.
  2.3.1. Community Tax.
  2.3.2. Licenses of Vehicles other than those that are mechanically propelled.
  2.3.3. Liquor Licenses, Fees and Rents.
  2.3.4. Market Fees and Levies.
  2.3.5. Tenement Rates.
  2.3.6. Levies and Dues on Outdoor Advertising and Hoarding.
  2.3.7. Taxes, Levies and Dues on:
      2.3.7.1. Shops and Kiosks.
2.3.7.2. Restaurants and other places for sale of food to the public; and

2.3.7.3. Laundries.

2.3.8. Pet Licenses.

2.3.9. Fees for Registration of Birth, Death and Marriages.

1.3.5. Rural Health.
1.3.6. Cottage Industry.

2.0. Intergovernmental Sources of Revenue.

2.1.0. Federal Government.
2.1.1. Import Duties.
2.1.2. Excise Duties.
2.1.3. Company Taxes.
2.1.4. Personal Income Tax of Members of the Armed Forces and Diplomatic Corps.
2.1.5. Stamp Duties.
2.1.6. Capital Gains Tax.
2.1.7. Mining Rents and Royalties.

2.2.0. State Governments.
2.2.1. Personal Income Tax.
2.2.2. Entertainment Tax.
2.2.3. Stamp Duties.
2.2.4. Land, Rents and Rates.
2.2.5. Licensing of Mechanically Propelled Vehicle.

2.3.0. Local Governments.
2.3.1. Community Tax.
2.3.2. Licenses of Vehicles other than those that are mechanically propelled.
2.3.3. Liquor Licenses, Fees and Rents.
2.3.4. Market Fees and Levies.
2.3.5. Tenement Rates.
2.3.6. Levies and Dues on Outdoor Advertising and Hoarding.
2.3.7. Taxes, Levies and Dues on:
2.3.7.1. Shops and Kiosks.
2.3.7.2. Restaurants and other places for sale of food to the public; and
2.3.7.3. Laundries.

2.3.8. Pet Licenses.

2.3.9. Fees for Registration of Birth, Death and Marriages.

BIBLIOGRAPHY

1.0. BOOKS.


1.7. Bahl, R.W., Johnson, M. Jnr., and Wasylenko M.J.,


1.14 David King, (1984) Fiscal Tiers: Economics of
Multi-Level Government, George Allen and Unwin ltd.
London.


1.34 ________ (1979) 'Lump-sum Intergovernmental Grants have Price Effects' in Mieszkowski P., and Oakland H.W., (ed). *Fiscal Federalism and Grants in Aid*, The Urban Institute, Washington D.C.


1.49 Stigler George., (1957) "Tenable Range of Functions of


2.0 JOURNAL ARTICLES.


2.16 Giertz J.F., (1976) "Decentralisation at the State and Local Level: An Empirical Analysis", *National Tax Journal* Vol.XXIX.


2.19 ___________ and Galper H., (1973) "State and Local


2.28 Kurnow E., (1963) "Determinants of State and Local Expenditures Reexamined", National Tax Journal Vol.16.


3.0 OFFICIAL PUBLICATIONS.


3.2 Economic and Financial Review of Various Years.


ABSTRACT.

Given the possible effective economic roles that sub-central governments can perform, i.e., those of Allocation and Distribution. This study examined the extent of fiscal decentralisation in Nigeria, with a view to seeing the relative degree of autonomy of the states. This autonomy is seen as a strong basis for allowing the states to undertake the two responsibilities effectively if the fiscal capacities, costs and needs of these jurisdictions are equalised. However, before seeing whether equalisation is feasible using grants, we runned a series of regressions to find out whether the tool for equalisation (which in this case is the country's statutory allocation) has an impact on state government expenditures. The results obtained showed that whilst there was an increasing trend towards fiscal decentralisation it was never-the-less not uniform over time. In consideration of the factors that affect the decentralisation drive we found the grant variable to be quite significant, implying that States independence is among others a function of grants from the Federal Government. Further it was found that grants (in this case only statutory allocation) are quite significant in the factors that affect State expenditures. Hence this suggest that fiscal capacity equalisation based on costs/needs can be effected by the States using federal grants. So ultimately we developed a model to show the extent of fiscal capacity equalisation undertaken using federal transfers, aimed at reducing horizontal fiscal imbalance. Deviations were found between the use of the formula for disbursements to states based on the fiscal capacity and needs/costs of each state, and the actual/estimated disbursements existing at present, suggesting that the problem of horizontal fiscal imbalance is not effectively tackled. This we hope will be remedied by the policy recommendations put forward.