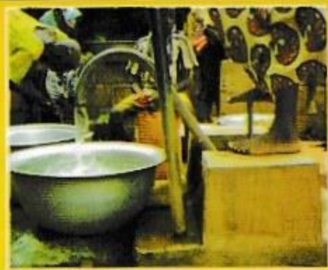
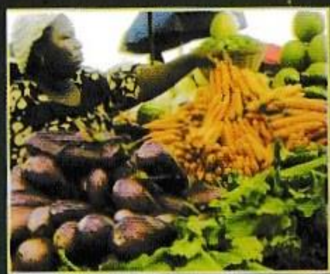
Key Issues
In Local Government and Development:
A Nigerian Perspective





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INTERGOVERNMENTAL FISCAL RELATIONS IN NIGERIA: STRUCTURE, LAPSES AND THE ROAD MAP

By

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Nigeria is a federation. This implies the division of powers between the central government with authority over the entire country and the other sub-national governments that collectively cover the entire area delineated as Nigeria. The sub-national governments are the state governments and the Local governments which constitute the second and third tiers of government respectively.

Intergovernmental fiscal relations in Nigeria connote the devolution of revenue-raising and spending responsibilities among the three tiers of government. Currently the Nigeria federal structure is made up of a federal government, 36 states, the federal capital territory and 774 local government areas.

Fiscal federalism or intergovernmental fiscal relations among the various tiers of government is warranted by the need to fashion out fiscal arrangements that would ensure fiscal balance in the context of macroeconomic stability.

There are two extreme perspectives from which fiscal operations of any economy may be viewed. There may be on one hand a highly decentralized fiscal system with no economic responsibilities for the central government. In this case, all economic functions are performed by the other lower tiers of government which are closer to the people. On the other hand, there may be total centralization where the central government takes full responsibility for the performance of all economic functions. In reality, there however, exists some degree of decentralization of fiscal responsibilities in all economies.

Fiscal federalism in Nigeria has historical, economic, political, geographical, cultural and social background and underpinnings. For instance, the country has gone though many years of military rule before the current democratic experiment which started in 1999. These regimes have had bearings on intergovernmental fiscal relations in Nigeria.

The paper explores the structure and lapses in intergovernmental fiscal relations in Nigeria and provides a road map for the future.

2.0 CONCEPTUAL AND THEORETICAL ISSUES

2.1 The Concept of Intergovernmental Fiscal Relations

From an economic perspective, a federal system of government is one in which the expenditure and revenue functions are divided among the different levels of government (Ebeajemito and Abudu, 1999). Such division serves to facilitate the provision of certain goods and services at the different levels. This is justified by the fact that public goods exist which may either be consumed nationwide or whose benefits are restricted to particular geographical areas. (Anderson, 1973). Resources are unevenly distributed geographically and this accounts for uneven development among countries and even within a given nation.

It therefore follows that modalities be put in place for the transfer of purchasing power from richer regions or states to poorer one in order to reduce inequality in the provision of services in all localities and also to ensure quality and social cohesion in a country.

Ter-Minassian (1997) points out spending responsibilities, raising of revenue, intergovernmental transfers and administrative aspects of fiscal decentralization as the main issues in intergovernmental fiscal relations.

There is broad agreement in the literature that decentralization of spending responsibilities to lower tiers of government will ensure efficient resource allocation for the provision of local public goods and services which would satisfy the yearnings of the people at that level. However, a centralized provision is necessary only for national public goods where benefits extend nationwide or whose provision is subject to substantial economies of scale. Examples of these include defence, foreign affairs, immigration, currency, infrastructure for interstate transport and communications (Musgrave, 1971).

Advocates of centralization hinge their argument on the fact that decentralization can crate distributional problems as well as problems of inability to achieve macroeconomic management objectives. They argue that centralization will significantly reduce disparities in the provision of public goods and services as well as social and political tensions especially where there are great disparities in income and resources among regions.

Moreover, for stabilization police to be effective, the central government should retain responsibility for expenditure which have strong impact on demand (Tanzi, 1976).

Hence, the tendency in most federations is for the federal government to retain responsibility for strategic sectors like education, health, the environment, agriculture, forestry, fishing with which it also shares responsibility with the state governments. Local governments are left to regulate local businesses.

2.2 Theoretical Issues

Economic efficiency is the focus of the principle of resource allocation. This is also based on the principle of pareto-optimality a condition whereby no reallocation of resources should increase the well-being of one person or group of person without making someone else or group worse off. (Leftwich, 1976; Spencer, 1974; Okoh and Egbon, 1999; Iniodu and Archibong, 1999).

The principle of pareto-optimality brings to the fore two fundamental resource allocation principles, namely:

- any resource allocation pattern which benefits at least one person, a group of persons or a section of a nation without hurting another person, group of persons or a section of the nation should be pursued, because it gives room for the attainment of economic efficiency.
- the effect on social welfare of any allocation which benefits some while hurting others is difficult to determine due to the fact that inter-personal comparison of utility cannot be made.

It is the scope of functions performed by the central, state and local governments that distinguish the different forms of federalism.

Such distinction can be based on geographical area over which they have jurisdiction. Conventionally, the central government has jurisdiction over defence, currency, and central banking. Regional, state and provincial governments exercise powers over non-overlapping subsections of the country in such matters as law and order, social services, commerce, and local governance among other things. Local governments have jurisdictions over non-overlapping areas within a state or province such as pet control, tenement rating, primary education, dispensaries, orphanages, markets, motor parks etc.

Economic theory suggests that the provision of pure public goods such as defence should be assigned to a single unit of government with jurisdiction over the entire country. This is due to the minimization of per capita cost and the benefits of economics of scale. In the case of semi-public goods, there is justification for the involvement of state and local governments in their provision since these goods can be supplied to only a limited area at a given time at minimal cost (Olowononi, 1999). In which case, a high quality service can be supplied to additional households and over a wider area up to a given limit without extra cost. Beyond this limited area, the benefits reduce to zero. In this case, the semi-public goods should be provided by a number of state governments.

In a situation that a certain tier of government is responsible for the provision of pure public goods which are characterized by joint supply and non-exclusion, and another level of government is responsible for the provision of semi-public goods, some degree of centralization is required. Moreover, where other local public goods such as primary education, registration of births and deaths and marriages which require very large number local government to provide abound, further decentralization becomes necessary.

According to Broadway et al (1994), the combination of transfers, tax sharing and harmonization systems comprise fiscal relations among federating units. Such fiscal relations enable the federation to achieve the fullest benefits of decentralized fiscal responsibility, while at the same time preserving the efficiency and equity of the national economy.

Decentralization and fiscal arrangements go together. The more decentralized the federation, the more important the system of fiscal arrangements; and the more effective fiscal arrangements, the more confidence one has in advocating the decentralization of decision-makign (Anyanwu, 1999).

Decentralization can be either fiscal and/or administrative. Administrative decentralization, according to Tanzi (1995)(exists when most taxes are raised centrally, but funds are allocated to decentralized entities that carry out their spending activities as agents of the central government and according to the guidelines or controls imposed by the central government. According to Bahl and Linn (1992), administrative decentralization refers to central government decision-making which is passed down to a regional or even local level but without any autonomy for local governments.

Fiscal decentralization exists when sub-national governments have constitutionally assigned powers to raise some taxes and carry out spending activities within dearly established legal criteria (Tanzi, 1995).

The objectives and General Principles of Fiscal Relations in a Federation

Anyanwu (1999) outlines the following objectives of fiscal relations in a federation:

(a) ensuring correspondence between sub0national expenditure responsibilities and their financial resources (including transfers from the central government) so that functions assigned to sub-national governments can be effectively carried out;

(b) increasing the autonomy of sub-national governments by incorporating incentives for them to mobilize revenues of their own;

(c) ensuring that macroeconomic management policies of the central government are not undermined or compromised;

(d) giving expenditure discretion to sub-national governments in appropriate areas in order to increase the efficiency of public spending and improve the accountability of sub-national officials to their constituents in the provision of sub-national services;

(e) incorporating intergovernmental transfers that are administratively simple, transparent and based on objective, stable, non-negotiated criteria;

(f) minimization of administrative costs and, thereby, economize on scare administrative resources;

(g) provision of "equalization" payments to offset differences in fiscal capacity among states and among local governments so as to ensure that poorer sub-national governments can offer sufficient amount of key public services;

(h) incorporation of mechanisms to support public infrastructure development and its appropriate funding;

(i) supporting the emergence of a governmental role that is consistent with market-oriented reform; and

(j) ensuring that fiscal relations among federating units is consistent with nationally agreed income distribution goals (see Sewell and Wallich 1994; Litvack and Wallich 1993).

PRINCIPLES OF REVENUE (TAX) ASSIGNMENT

· **Efficiency of the Internal Common Market**

To ensure the above, taxes on mobile factors/resources (labour, capital, goods and services) are best left at the centre.

·· **National Equity**

Taxes which have redistributive consequences are best retained at the centre because uncoordinated state tax policies may unwittingly induce arbitrary differences in redistributive consequences for residents of different states.

Fiscal Need

To ensure accountability, revenue means should be matched as closely as possible to revenue needs. Hence tax instruments intended to further specific policy objective should be assigned to the level of government having the responsibility for such a service. Therefore progressive redistributive taxes, stabilization instruments and resource rent taxes would be suitable for assignment to the central government, while tolls on the inter-local roads would be suitable for state governments. The fiscal needs criteria suggests allowing sub-national governments access to taxes such as personal income taxes which are traditionally regarded as more suitable for national administration.

Administrative Costs

Tax collection involves collection and compliance costs. Thus for taxes whose base is mobile or where the tax base straddles more than one jurisdiction, administration and collection are better handled at the centre. Decentralization of such taxes will increase collection and compliance costs along with evasion and avoidance costs. Table 1 below presents the conceptual basis of tax assignment.

Table 1

Conceptual Basis of Tax Assignment

Tax Type	Determination of Base Rate		Collection & Admin	Comments
Custom Corporate income Resource taxes Rent (profit) tax Royalties/fees Severance taxes Production taxes Conservation charges Personal income	F F F S,L S,L F	F F F S,L S,L F,LS	F F F S,L S,L F	International trade taxes Mobile factor Unequally distributed Benefit taxes Environmental preservation Redistributing mobility, stabilization
Wealth taxes (Capital, Wealth transfers, inheritances) Payroll Value added tax	F F,S F	F F,S F	F F,S F	Benefit taxes Environmental preservation Redistributing mobility, stabilization
Single-stage sales Option A Option B	S F	S,L S	S,L F	Higher compliance costs Harmonized
"Sin" taxes Alcohol, tobacco, Gambling, betting Lotteries Race tracks	F,S S,L S,L S,L	F,S S,L S,L S,L	F,S S,L S,L S,L	Health care shared responsibility State and Local responsibility State and Local responsibility State and Local responsibility
Taxation of "Bads" Carbon BTU taxes Motor fuels Effluent charges Congestion tolls Parking fees	F F,S,L F,S,L F,S,L F,S,L L	F F,S,L F,S,L F,S,L F,S,L L	F F,S,L F,S,L F,S,L F,S,L L	Global/ national pollution By extent of pollution Tolls on road use By extent of pollution Tolls on road use Local congestion
Motor vehicles Registration Driver's licenses	S S	S S	S S	State revenue source State revenue source
Business taxes Excises Property Land Frontage/betterment Poll tax User charges	S S S S S,L S,L F,S,L	S S S S S,L S,L F,S,L	S S S S S,L S,L F,S,L	Benefit tax Immobile base Benefit tax immobile Benefit tax immobile Cost recovery Non distorting Payment for services

Source: Anyanwu (1999) Note: F = Federal S = State, L = Local
Source: Adapted from Broadway et al (1994)

To that level of government alone, and those exercisable by a level of government but whose revenues accrue to that level of government as well as others. The latter refers to revenues that are subject to inter-government sharing which make up the federation account. Table 2 below shows the assignment of tax powers in Nigeria federal system. Table 3 shows Nigeria's major taxes and the accompanying jurisdiction and right to revenue.

Table 2: Tax Jurisdiction in Nigeria

Federal	State	Local
1. Import	1. Football pools and other betting taxes	1. Rates
2. Excise Duties	2. Entertainment taxes and estate duties	2. Tenement Rate
3. Export Duties	3. Gift tax	3. Market and Trading licences and fees
4. Mining Rents and Royalties	4. Land tax other then on agricultural land	4. Motor Park Duties
5. Petroleum Profits Tax	5. Capital gains tax (administration)	5. Advertisement fees
6. Companies Income Tax	6. Personal Income Tax (administration)	6. Entertainment Tax
7. Capital Gains Tax (Legal basis)	7. Stamp duties	7. Radio/Television Lice
8. Personal Income Tax		
9. Value Added Tax (VAT)		

Sources: Nigeria Constitutions, Report of the Presidential Commission on Revenue Allocation, 1980 and VAT Decree of 1993 (and subsequent amendment in 1996)

PRINCIPLES OF EXPENDITURE ASSIGNMENT

- **Geographical Dimension of Benefit**

  Each locality or jurisdiction should provide and fund services whose benefits accrue within its boundaries and to the extent possible, spending responsibilities should be given to the lowest level of government in a manner that is consistent with the efficient performance of that service.

- **Stabilization and Equity**

  Responsibility for stabilization policy is normally assigned to the central government. Moreover, responsibility for income redistribution for equity, including the social safety net, should be assigned to the central government, since labour and capital mobility often interfere with serious attempts by sub national government to effect income distribution.

- **Economies of Scale Spillovers/ Externalities**

  Where important economies of scale exist, it may make more sense to centralize the provision of such services. A case is often made for central government involvement in the provision of such services as education and health on the grounds of "spillover effects" or "externalities". Expenditure in these sectors is important for national development, welfare and income distribution. In practice the federal government delegates' responsibility for functions with such external benefits to sub national governments but also provides transfers to increase their supply.

3.0 THE STRUCTURE OF REVENUE (TAXING) POWER AND EXPENDITURE RESPONSIBILITY IN NIGERIA

3.1 Revenue (Taxing) Powers among the Tiers of Government in Nigeria

Each tier of government should be assigned revenue/ tax sources that are commensurate with its responsibilities. In the assignment of tax/ revenue powers, it is important to distinguish between those revenue powers which are exercisable by one level of government and the revenue which accrue

Table 3: Nigeria's Major Tax Jurisdictions and Right to Revenue (1999)

	Tables of Tax	Jurisdiction		Right to Revenue
		Law	Administration and Collection	
1.	Import duties		Federal	Federation Account
2.	Excise duties		Federal	Federation Account
3.	Export duties		Federal	Federation Account
4.	Mining rents and loyalties		Federal	Federation Account
5.	Petroleum profit tax		Federal	Federation Account
6.	Companies income tax		Federal /State	Federation Account
7.	Capital gains tax		State	State
8.	Personal income tax (other than those listed in 9)		Federal	State
9.	Personal income tax: armed forces, External affairs Officers, non-residents residents of the Federal Capital Territory and Nigeria Police Force		Federal	Federal
10.	Licences fees on television and wireless radio		Local	Local
11.	Stamp duties		Federal /State	State
12.	Capital transfer tax (CTT)		State	State
13.	Value added tax		Federal / State	Federal / State/Local
14.	Pools betting taxes		State	State
15.	Motor Vehicle and drivers' licences		State	State
16.	Entertainment tax		State	State
17.	Land registration and survey fees		State	State/ Local
18.	Property taxes and rating		Local	Local
19.	Market and trading licence and fees		Local	Local

Sources: Nigeria Constitutions Report of the Presidential Commission on Revenue Allocation 1980 and VAT Decree of 1993 (and subsequent amendment in 1996)

Table 3 shows that all the major sources of revenue-petroleum profit tax, import duties, excise duties, mining rents and royalties and companies income tax come under the jurisdiction of the federal government. With personal income tax (at the state level) and property tax (at the local government level) as Exception the states and local government have jurisdiction over minor and poor- yielding revenue sources. The implication is the serious overdependence of states and local governments on the federal level finances.

The federal government in Nigeria enjoys a greater ability to raise revenue to meet its expenditure obligations than do states and local governments. The tendency is such that all the fiscal resources are centralized at the federal level from where they are transferred to the states and local governments through the federation account and the local government joint account, respectively.

3.2 Assignment of Expenditure Powers / responsibilities in Nigeria

Table 4: Allocation of Expenditure Responsibility in Nigeria

Responsible level of Government	Expenditure Category
Federal only	Defence Foreign Affairs International Trade including export marketing Currency, banking, borrowing, exchange control Use of water resources Shipping, federal trunk roads Elections Aviation, railways, postal service Police and other security services Regulation of labour, inter state commerce, telecommunications, immigration Mines and minerals, nuclear energy, citizenship and naturalization rights Social security, insurance national statistical system (census, births, death etc) Guideline and basis for minimum education Business registration Price control
Federal-State (shared)	Health, social welfare Education (post primary/technology) Culture Antiquities Monuments, archives Statistics, stamp duties Commerce, industry Electricity (generation, transmission, distribution) Research surveys

Responsible level of Government	Expenditure Category
State only	Residual power, i.e., any subject not assigned to federal or local government level by the Constitution
Local Government	Economic Planning and Development Health Services Land use Control and regulation of advertisements, pets, small business Markets, public conveniences Social welfare, sewage and refuse disposal, registration of births, deaths. Marriages Primary, adult and vocational education Development of agriculture and natural resource

Source: Nigeria Constitutions

Table 4 above shows the allocation of expenditure responsibilities in Nigeria. The responsibilities which can be more efficiently undertaken by the federal government than the lower tiers of government, or where the benefit regions cover the entire country include national defence, banking, currency, coinage and legal tender; citizenship; weights and measures; nuclear energy; traffic on federal trunk roads; external relations (including borrowing and foreign trade).

Expenditure responsibilities whose benefit areas are more local than national, but with the possibility of spillover effects beyond boundaries are placed in the concurrency legislative list. These include industrial, commercial and agricultural development; post-primary education; and secondary health care.

Responsibilities which are purely local in character, which benefits accrue to a limited geographical area within the country, are assigned to local government councils. These include establishment and maintenance of cemeteries, markets, motor parks, public conveniences, and refuse disposal. Others are construction and maintenance of primary education and primary health care, as well as the development of agriculture and national resources (Anyanwu, 1997, 1999).

4. LAPSES IN INTERGOVERNMENTAL FISCAL RELATIONS IN NIGERIA

(1) There is no gainsaying the fact that intergovernmental fiscal relations in Nigeria is characterized by a very rich and powerful centre and poor, weak and dependent lower tiers of government.

One of the serious lapses in intergovernmental fiscal relations in Nigeria is the issue of over-centralization following decades of military rule. Elaigwu (2005) has discussed five factors which have built up such over centralization. As follows:

- The hierarchical nature of military rule which command structure was able to centralize powers with minimal resistance from sub-national units.
- The Nigerian civil war in the late 1960s resulted in the declaration of a state of emergency. Powers which were usurped by the federal government were never returned after the war.
- The creation of many new sub-national states which grew progressively from just three regions to 36 states and a Federal Capital Territory-reduced the resource based of the States.

2. The 1999 Constitution recognizes three tiers of government: federal, state and local. In the allocation of major policy areas and responsibilities, the constitution provides an exclusive list of central powers, a concurrent list of shared powers, with all residual powers going to the states and a fourth list of local government functions.
3. There are overlapping areas of jurisdiction including security, education, housing, agriculture, health, and water. For instance the Nigeria Police Force is in the exclusive list whereas some States are agitating for the right to establish their owns state police forces.
4. There is a general sense of complacency among the three tiers of government with regards to revenue generation. Each tier depends heavily on statutory allocations from the federation account, which in turn depends heavily on revenues from petroleum resources. This pattern obviously skews the development priorities of governments.
5. Whereas federalism is brought about by diversity among various states, the policy in Nigeria is in part, to treat all the states in the same way. The equal payment of subsidies, salaries and other benefits is likely to exacerbate regional economic disparities.
6. Revenue allocation in Nigeria among the different tiers of government does not follow the pareto-optimality principle. In which case, allocations of revenue do not make one person, a group of persons or a section of the country better off without making anyone else worse off.
7. The revenue allocation formulae in Nigeria over time seems unfair to the states and local governments. In the first instance only the "deferation account" (not total government revenue) is shared among the three tiers of government. Only

what is paid into the federation account is shared. The rest goes to the federal government. Moreover, it is the federal government that manages and/disburses special funds.

8. Financial autonomy for Nigeria's sub-national governments (states and local governments) is almost non-existent. They have a restricted capacity to rely on their own resources because they have limited tax possibilities.

5. THE ROAD MAP FOR INTERGOVERNMENTAL FISCAL RELATIONS IN NIGERIA

In this discourse, we have looked at conceptual and theoretical issues on intergovernmental fiscal relations, the structure of intergovernmental fiscal relations, and the inherent lapses in intergovernmental fiscal relations in Nigeria.

In this section we proffer suggestions on the way forward as follows:

- To deal with the rising upheavals between the federal government and local communities, especially those in the oil producing regions, there is need to develop a transparent, fair, consensus-based framework for intergovernmental finances with revenue-expenditure correspondence. To achieve this

- **The aggregate required revenue by the federal,** states and local governments as well as oil producing communities for development and poverty alleviation must be determined. These would be based on their expenditure assignments and determined through painstaking studies and debates.

- **Responsibilities and revenue sources of various tiers of government must be realigned.**

While administrative efficiency should come to the fore in the assignment of revenue powers, the geographic range of benefits and economies of scale should be taken serious. Therefore, reassignment of responsibilities must be done and may involve to match revenue assigning to a high tier of government, responsibilities that would not be suitable for lower tiers of government. Also, a realignment of revenue powers to match responsibilities may entail transferring to lower tiers of government revenue sources that they can efficiently administer.

- **Reduction in Expenditure**

Some aspects of federal capital expenditure on sub sectors like defence could be reduced and the surplus integrated into the duration account for sharing among the various tiers of government.

- **Increase in internally-generated revenue**

The state and local governments must take steps to increase their internal revenues above existing levels. This could be achieved through improved efficiency in revenue collection from existing sources, and increase in the rate of existing taxes.

- **Review of Financial transfers system from surplus to deficit units.**

These include, grant system and revenue sharing. The federal government must review its "father Christmas" tendencies in terms of giving grants and aids. With regards to revenue allocation the formula should be reviewed in favour of the local governments and communities where the bulk of the citizens reside. However this should be matched with fiscal responsibility laws to forestall embezzlement of such funds. The concept of derivation should be redefined such that local governments benefit more from mining fees, rates, duties and royalties while the federal government retains a lesser percentage.

- The derivation principle should be handled in a way that would enable the oil producing states and local governments to handled their developmental problems according to their felt needs and priorities. Using a development commission and ministry can only constitute a second best option.
- It is important to look critically at the constitution of the federation account. The fiscal imbalance between the federal government and the two other lower tiers of government can only be resolved by discontinuing the financing of various first-line charges from the Federation Account before the application of the vertical formula. These first-line charges include funding of external debt service, national priority projects, NNPC priority projects, special reserve account and the excess proceeds of crude oil sales account.
- The problem of non-correspondence (the incongruence between tax powers/revenue sources assigned to different tiers of government) must be resolved.

A situation where most of the major sources of revenue come under the jurisdiction of the federal government, yet lower tiers of government are expected to generate internal revenue need to be reversed. By so doing the revenue base of these lower tiers of govern will broaden.

6. CONCLUSION

The dilemma that intergovernmental fiscal relations in the Nigeria Federation continues to grapple with as Bryce (1995) posited in the context of federal systems generally, is "to keep the centrifugal and centripetal forces in equilibrium, so that neither the planet states shall fly off into space, nor the sum of the central government draw them into its consuming fire". To achieve this, it is only fair to be fair.

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