States' Dependence Level on Federal Allocation and Internally Generated Revenue in Nigeria: An Assessment

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ABSTRACT
This study examined states' dependence level on federal allocation and internally generated revenue in Nigeria. The study used secondary data drawn from the Central Bank of Nigeria (CBN), National Bureau of Statistics (NBS), and National Extractive Industries Transparency Initiative (NEITI). The study used comparative analytics in its analysis. It was observed that most states in Nigeria generate about 15% internally and depend on Federal Allocation for about 85% every month for socio-economic fiscal obligations. For states and local governments in Nigeria to reduce their dependence on Federal Allocation and balance their financial sources, they should discover their statutory internally generated revenue sources and device appropriate means and mechanisms to make them functional. This will make the revenue sources more viable as they generate more revenues. Without viable and functional sources of internally generated revenues, any prolonged drop in global oil prices will drag Nigeria's economy to the trough, recovery of which may take a long time.

Keywords: *States' Dependence Level, Federal Allocation, Internally Generated Revenue (IGR), Nigeria.*

1.   INTRODUCTION

Nigeria operates three tiers of government and claims to be practicing federalism – the central government, the sub-national governments, which comprise 36 states and the Federal Capital Territory, and 774 local governments. With the three tiers of government structure, each tier is saddled with constitutional responsibilities including the provision of public services. In federalism, fiscal federalism implies that governments at the various tiers are sovereign in decision making and allocation of resources. In Nigeria, States and local governments depend more (about 85%) on Federal Allocation than internally generated revenues for their fiscal obligations and transaction (including payment of workers' salaries and pensions). Federal allocation is drawn from federal government revenue which largely depends on oil revenue. However, revenues from oil have been fluctuating, with subsequent effects on Federal Allocation. For instance, in 2011 oil revenue was ₦8879.0 billion but dropped to ₦8026.95 billion in 2012, and to ₦6809.23 billion in 2013. It further dropped to ₦6793.72 billion in 2014 (CBN, 2014).
Following the decrease in federal allocations due to fluctuations in oil revenues, many state

governments found it difficult to meet their obligations. For instance, in May 2021, the Ekiti State made an attempt to withdraw payment of the new minimum wage and consequential adjustment on the pretext of non-availability of funds. Of course, this attempt was resisted by the organized labour. The above scenario clearly explains the degree of vulnerability of sub-national governments to financial crisis in the absence of statutory allocation from the federation account. The heavy dependence on statutory allocation is thus manifested by the proportion of such revenue to the total revenue resources available to the states and local governments (Onwioduokit, 2002). On this point, the National Bureau of statistics, NBS, (2021) observed that most states in Nigeria generate about 15 per cent of their revenues and look up to Federation Account Allocation Committee (FAAC) every month for 85 per cent to discharge their financial obligations. With exception of Lagos State and few other states - Kaduna, Ogun, Oyo, Rivers and FCT; most of the states practically live on bailouts and loans during periods of drops in oil prices to meet their financial obligations.

Based on this observation, this paper seeks to empirically assess the level to which states in Nigeria depend on Federation Account and internally generated revenue. It also seeks to analyze the effects of the level of the dependence on states' economies. The paper has six sections. Following the introduction is section 2 which clarifies some concepts. Section 3 highlights the principles of revenue allocation in Nigeria. Section 4 analyses the Federation Account Allocation Committee (FAAC) Revenue Sharing Formula in Nigeria. Some effects of states' overdependence on FAAC are discussed in section 5. Section 6 offers recommendations and conclusion

2.   CONCEPTUAL CLARIFICATIONS
Revenue Allocation
   Revenue allocation has been broadly defined to include allocation of tax powers and the revenue sharing arrangements among the three tiers of government. (Olowononi, 2000). Under government's distribution function, it redistributes incomes and resources to promote national unity and equity. Revenue allocation can be described as a method of sharing the centrally generated revenue among different tiers of government and how the amount allocated to a particular tier is shared among its components for economic development (Dang, 2013; Uford, 2017). Nigeria's fiscal federalism has emanated from historical, economic, political, geographical, cultural, and social factors. In all of these, fiscal arrangements remain a controversial issue in allocating distributable pool account (DPA) of the federation since 1946 (Ekpo, 2004).

Federation
 A federation emerges either by aggregation of previously independent sovereignties to become a single sovereign state such as Australia, Canada, and United States, or by devolution, that is, decentralization of certain level of political authority to sub-national governments within a sovereign state such as Nigeria, India, and Pakistan (Dang, 2013). Thus, along this line, fiscal federalism could be taken to mean a constitutional arrangement or a system of government where revenue and expenditure functions, otherwise called fiscal responsibilities, are divided among the tiers/levels of government, that is, federal, state, and local governments (Akindele, 2002, Asuqo, et a., 2024). In undertaking this division, economics emphasizes the need to focus on the necessity for improving the performance of the public sector and the provision of their services by ensuring a proper alignment of responsibilities and fiscal instruments. The Nigerian Federal system plays a preeminent role in this distributive process. Succinctly, owing to its explicit legitimation and accommodation of sectional-territorial constituencies (Dang, 2013).

3.   PRINCIPLES OF REVENUE ALLOCATION IN NIGERIA

Revenue allocation refers to the redistribution of fiscal capacity among the various levels of government or the disposition of fiscal responsibilities among the three tiers of government. Revenue sharing arrangement has two levels: one is the vertical allocation which is among federal, state, and local councils, another is the horizontal allocation, among the states and local governments. Revenue allocation is meant to attain two broad objectives, namely; efficiency and equity. However, the allocation formula is guided by certain allocation principles like population, equality of states, internal revenue generation, and landmass and principle of derivation.

These principles according to Salami (2011) are explained below;

- Derivation Principle: The principal believes that revenue in the federation account should be allocated on the basis of each state's contribution to total revenue. That is, all revenue which can be identified as having come from, or can be attributed to, a particular region or a state should be allocated to it (Phillips, 1971). This principle was criticized because it makes rich states (or naturally endowed states) richer since the more endowed or developed states will contribute more to the federation account, starving the less endowed or less developed states of developmental funds. It can, therefore, lead to greater disparity among the states and subsequently lead to instability within the country.
- The Principle of Need: The principle advocated that states are not equally endowed with resources, some states are more populated and developed than others, and therefore, more resources be given to the less developed states to bridge the gap in development.
- The principle of National Interest: The principle is based on the importance attached to developing all the states to increase progress and sense of belonging. It will promote national unity by sharing the revenue in the federation account equally among states. This formula was to strike a balance between equity and needs of national economic/political growth leading to stability.
- The principle of Independent Revenue: This principle advocates that states can introduce or charge revenue yielding taxes within the state if it is a stable source of revenue but must conform to the principles of taxation within the economy and take into consideration national interest.

4.   FEDERATION ACCOUNT ALLOCATION COMMITTEE (FAAC) REVENUE SHARING FORMULA IN NIGERIA

At the end of every month, the Federal Government gathers all the money it had generated from crude oil sales, custom duties and taxes, and so on. 13% of any revenue made from natural resources is return to the origin states of those resources in line with the derivation principle (13% Derivation). The rest of the funds are shared across the three tiers of government. The federal government keeps 52.68% for its budget, 26.72% is shared for the states, while local Governments get 20.6%. There are two components of revenue allocation formulae used for the disbursement of the federal allocation by the Federation Account Allocation Committee in Nigeria are: Vertical Allocation Formula (VAF), and   Horizontal Allocation Formula (HAF).

(i)   Vertical Allocation Formula (VAF), as a formula shows the percentage allocation to the three tiers of government. That is; federal, states, and local governments. This formula is applied vertically to the total volume of disbursable revenue in the Federation Account at a particular point in time. The VAF allows every tier of government to know what is due it; the Federal Government on one hand and the

36 states and 774 Local Governments on the other (Bashir, 2008). The current net Vertical Allocation Formula is on the net federation account revenue distributable (i.e after statutory deductions such as 13% derivation and other charges and costs and excluding VAT) is as follows:

Federal Government takes 52.68%. This is further divided into general ecological problems (1%), Federal Capital Territory (1%), Development of natural resources (1.68%), statutory stabilization (0.5%), and the balance of 48.5% for the Federal Government. State Government-26.72% and Local government gets 20.6%.

In addition to the federation account distributable revenue above, there is also a separate sharing ratio for Value Added Tax in which Federal gets 15%, States share 50% and Local Governments share the balance of 35%.

    (ii)   Horizontal Allocation Formula (HAF), as a formula is applicable to States and Local Governments only. It provides in bulk to the 36 States and the 774 Local Governments. With HAF, the allocation due to the State or Local Government is determined. Thus, it can conveniently be concluded that the VAF is for inter-tier sharing between the three tiers of government while the HAF is for intra tier sharing among the 36 States and the 774 Local Governments in Nigeria (Bashir, 2008).

Each state receives a proportion of federal revenues based on a "Horizontal Allocation Formula". The first 40% of the revenue is shared equally across the states. The rest is determined by population (30%), landmass (10%), IGR (10%) and social development factors (10%).

The Horizontal Allocation Formula which is more for the States and Local governments captures factors, principles and percentages as follows:

    a. **Equality-40%:** Here, the 40% of distributable revenue from the share of the States' 26.72% from the Federation account is divided equally across all 36 States. The remaining 60% of the 26.72% of the States' share of the Federation account is distributed as follows:

    b. **Population- 30%**: the 30% of States' share of 26.72% is shared depending on each state's share of total population as determined by the National Population Commission.

    c. **Landmass/Terrain-10%:** Landmass of a state or Local government shall be the proportional areal size (PAS) of the state or Local government to the total areal size of Nigeria, and shall be obtained as follows:

For each state (pas) = $\dfrac{\text{Area size of the state} \times 100}{\text{Total areal size of Nigeria}}$

The allocation due to terrain is made on the basis of the proportional areal size of the three identified major terrain types present in the state or Local government area respectively, which are: Wetlands/water bodies; Plains; and Highlands.

- **Internally Generated Revenue (IGR)-10%.** Each state is mandated to contribute 10% of its IGR into a joint state and Local government account to be shared equally

- **Social Development Factor-10%.** This comprises Education (4%), Health (3%), and Water (3%). Education as a parameter for Allocation to Social Development factor (SDF) relates to primary school enrolment which attracts 60% of the allocation to education while the remaining 40% is made using secondary school enrolment. Allocation on the basis of primary school enrolment is made solely on direct proportion to school enrolment. 50% of all allocation on the basis of secondary school is made on direct proportion to school enrolment while the remaining 50% is made in inverse proportion to school enrolment. School enrolment relates to public funded

schools only. Health as a parameter for allocation to Social Development Factor relates to the number of States/Local Government hospital beds that are and 50% of the allocation to health is made in direct proportion to the number of the state's hospital beds.

Furthermore, water as a parameter for allocation to Social Development Factor shall be presented by mean annual rainfall in the state headquarters and territorial spread of state. 50% of the allocation to water shall be made in direct proportion to the state's territorial spread, while the remaining 50% of the allocation to water shall be made in inverse proportion to the mean annual rainfall in each state headquarters, using the most current live year figures, the same year for all the States.

Sharing formulas and principles have experienced so many issues, as noted by Tom David West, former petroleum minster, "Southern oil-producing minorities want the principle of derivation, while the Northern minorities prefer land mass. There must be non-gotiable common grounds regardless of smaller local-interest consideration" (Onwioduokit, 2002).

**Figure 1: States' Total Receipt from FAAC Trend, 2011-2022**
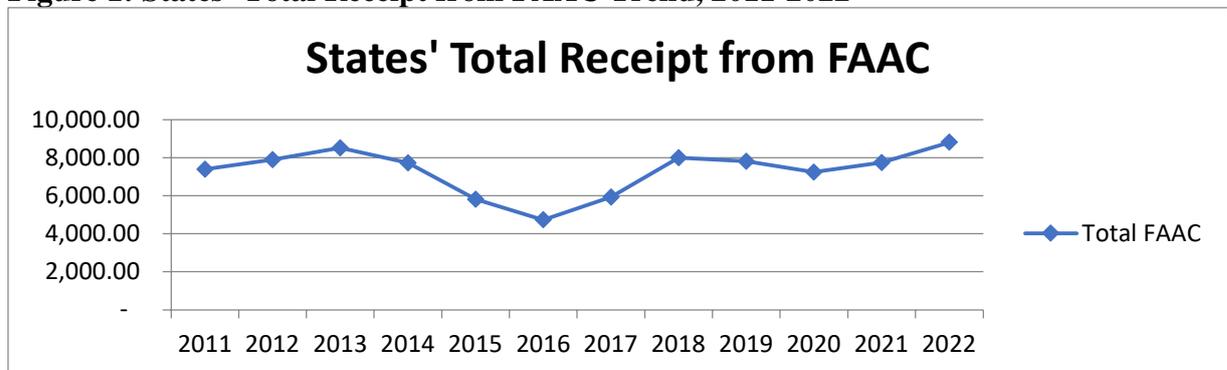
Source: National Extractive Transparency Initiative (NEITI) 2024

As shown in figure 1 above, the effect of the fall in oil prices is also clearly reflected in the allocation to States. Prior to the oil price bust, the allocation to States was trending upwards. However, with the sharp decline in oil prices, allocation to States took a sharp decline too. Governments at all levels had to take a pay-cut as oil revenue reduced. In light of the reduction in allocations from the Federation Account, States were forced to become fiscally responsible and took adequate steps towards effective fiscal management. The significant reduction in statutory allocations to sub-national units exposed States' huge dependence on federal allocations. It became evidently clear that almost all states in the country had become lax in their revenue generation efforts and had become totally reliant on these allocations to run their activities. For instance, in May 2021, the Kaduna State Government, embarked on mass sacking of workers and underpayment of salaries, due to fluctuations and decrease in the federal allocation package.

In January 2021, the Kano State Government, one of the first to commence the implementation of the ₦30,000 minimum wage, halted it and reverted it to the former ₦18,000 for its workers, insisting: "what we are getting now as government has reduced and we can't afford to pay the ₦30,000 minimum wage" (Guardian News Paper).

Figure 2: States' Revenue, Expenditure and Debt Trend
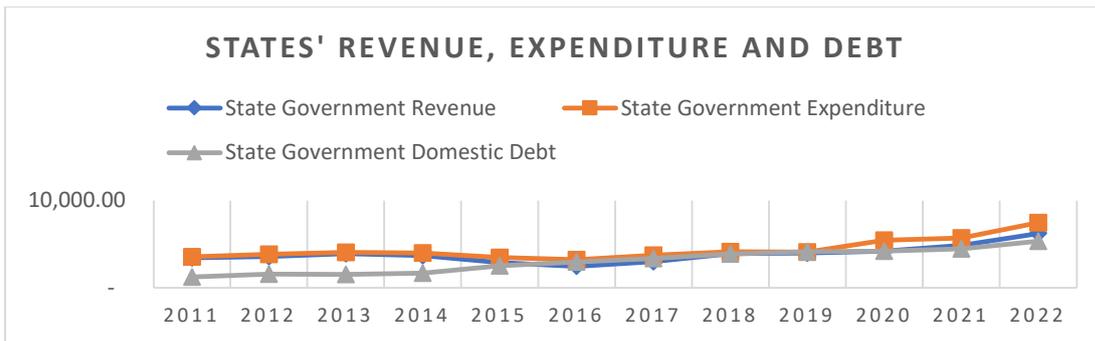
Source: Central Bank of Nigeria, CBN, 2024.

An increase in public expenditure during depression adds to the aggregate demand for goods and services, and leads to a large increase in income via the multiplier process; while a reduction in taxes has the effect of raising disposable income thereby increasing consumption and investment of the people. On the other hand, a reduction of public expenditure during inflation reduces the aggregate demand, national income, employment, output and prices; while an increase in taxes tends to reduce disposable income and thereby reduces consumption and investment expenditures (Jhingan, 2010). On this note, even when revenue was reducing, expenditure was still high (reducing at some points but not at the same rate as revenue), with the help of deficit financing as captured by debt. As revenue to states reduced, the higher the debt to compensate the high spending.

Figure 3: Internally Generated Revenues by States in Nigeria, 2013 -2020
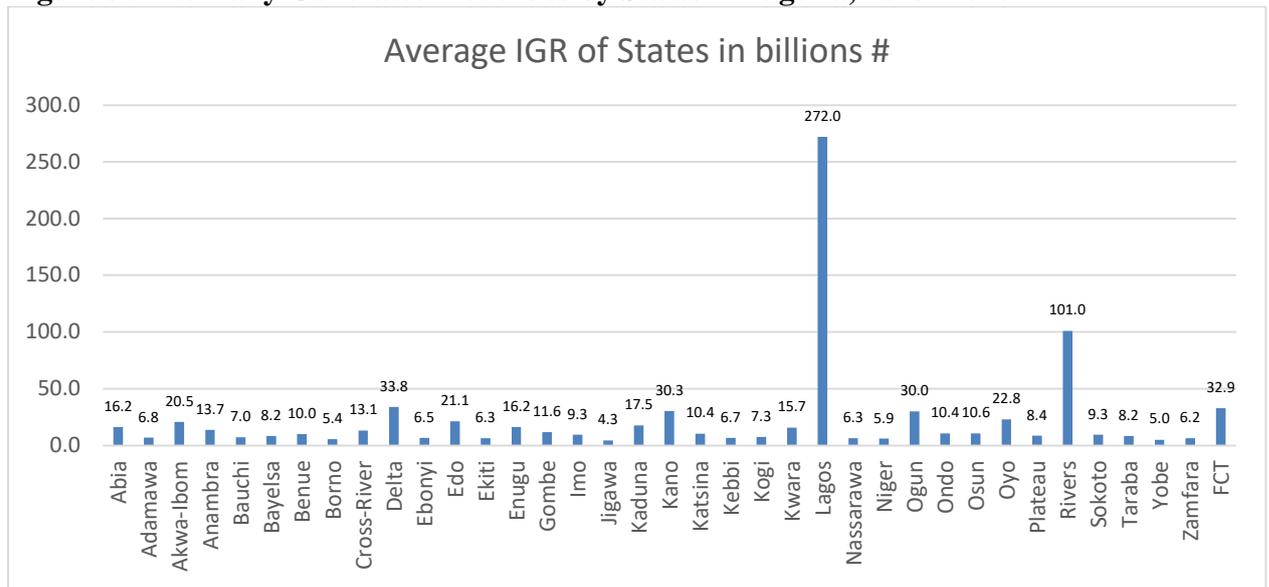
Source: Authors' computation from CBN (2024), NBS (2024) and NEITI, 2024

Figure 3 shows that on the average; Lagos state's IGR is ₦272.0 billion per annum and is the highest among states in the whole country. This shows the level to which Lagos can meet its financial obligations without being too dependent on FAAC. Besides Lagos, other states that made efforts to generate more IGR are: Rivers - ₦101.0 billion; Delta- ₦33.8 billion; FCT-₦32.9 billion; and Kano - ₦30.3 billion. Although with the IGR generated from the aforementioned states, the states could not carry out its financial obligations sufficiently without FAAC. Other states - Jigawa - ₦4.3billions; Yobe - ₦5.0billions and; Borno - ₦5.4 billion generated very little and were just existing at the mercies of FAAC and without it they may not make any progress in the long-run.

Figure 4: States' Revenue from FAAC and IGR Chart
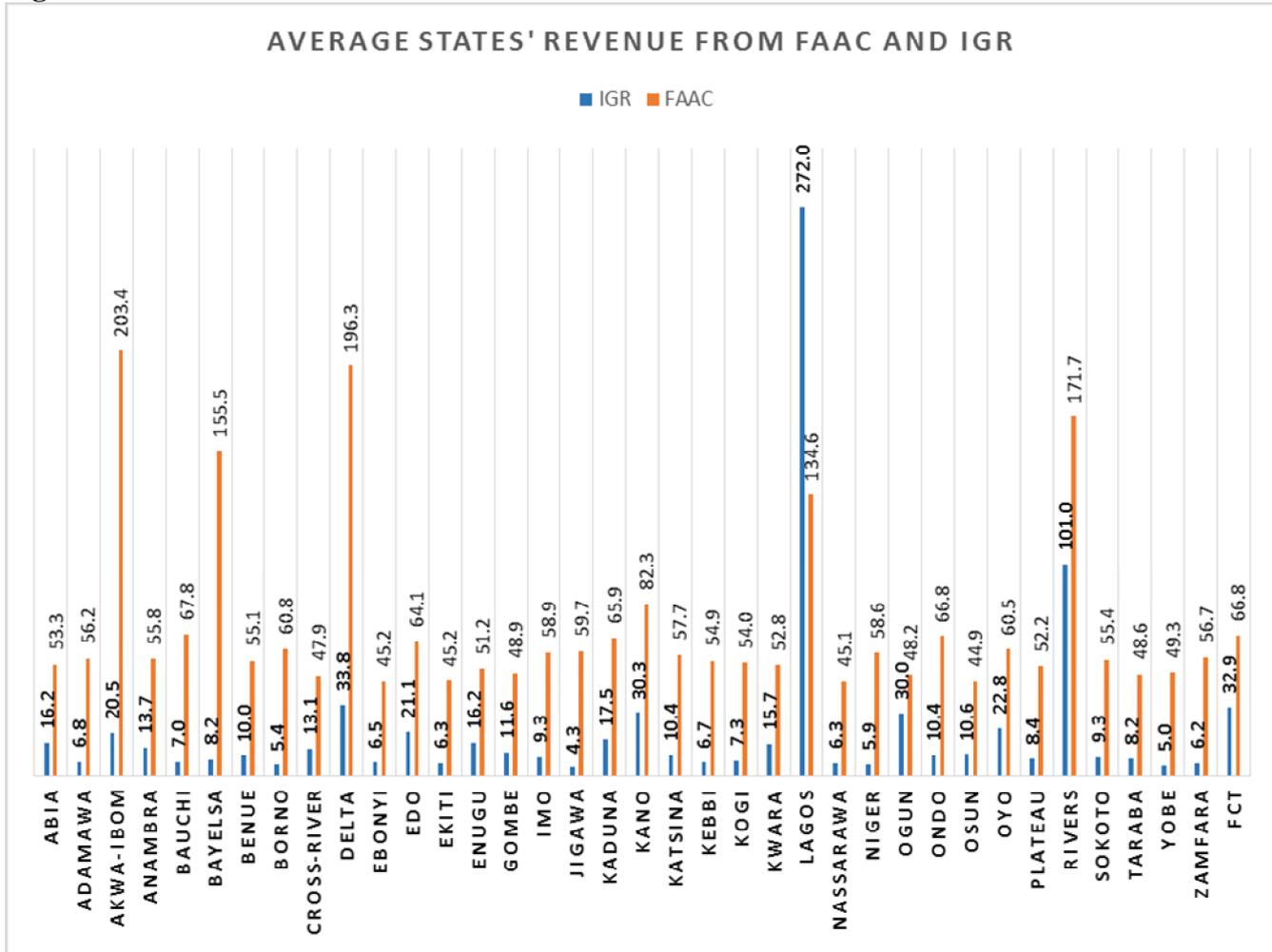
Source: Authors' computation from CBN (2024), NBS (2024) and NEITI, 2024

Figure 4 shows the States' average receipts from FAAC and IGR between 2013 and 2020. From the figure, the states with highest IGR are Lagos with ₦272.0 billion as the highest and Rivers, the second highest with ₦101.0 billion while those with lowest IGR include; Jigawa, with ₦4.3 billion, being the lowest, Yobe with ₦5.0 billion and Borno with ₦5.4 billion. On the other hand, the states with highest federal allocation included Akwa Ibom, Delta and Rivers, with ₦203.4 billion, ₦196.5 billion, ₦171.7 billion in that order.

States' Average Dependence on FAAC Receipt and IGR, 2013 - 2020

STATES	AVERAGE IGR (₦B)	AVERAGE FAAC (₦B)	AVERAGE TOTAL REVENUE (₦B)	% CONTRIBUTION TO TOTAL REVENUE AVAILABLE 2013-2020	
				FAAC	IGR
Abia	16.2	53.3	69.5	76.65	23.35
Adamawa	6.8	56.2	63.0	89.21	10.79
Akwa Ibom	20.5	203.4	223.9	90.84	9.16
Anambra	13.7	55.8	69.4	80.32	19.68
Bauchi	7.0	67.8	74.8	90.61	9.39
Bayelsa	8.2	155.5	163.7	95.02	4.98

Benue	10.0	55.1	65.0	84.68	15.32
Borno	5.4	60.8	66.2	91.83	8.17
Cross River	13.1	47.9	61.0	78.58	21.42
Delta	33.8	196.3	230.2	85.31	14.69
Ebonyi	6.5	45.2	51.7	87.45	12.55
Edo	21.1	64.1	85.2	75.19	24.81
Ekiti	6.3	45.2	51.5	87.83	12.17
Enugu	16.2	51.2	67.4	76.00	24.00
Gombe	11.6	48.9	60.6	80.78	19.22
Imo	9.3	58.9	68.2	86.37	13.63
Jigawa	4.3	59.7	63.9	93.34	6.66
Kaduna	17.5	65.9	83.4	79.02	20.98
Kano	30.3	82.3	112.5	73.10	26.90
Kastina	10.4	57.7	68.0	84.78	15.22
Kebbi	6.7	54.9	61.6	89.14	10.86
Kogi	7.3	54.0	61.3	88.12	11.88
Kwara	15.7	52.8	68.4	77.12	22.88
Lagos	272.0	134.6	406.6	33.11	66.89
Nassarawa	6.3	45.1	51.5	87.68	12.32
Niger	5.9	58.6	64.4	90.89	9.11
Ogun	30.0	48.2	78.2	61.66	38.34
Ondo	10.4	66.8	77.2	86.49	13.51
Osun	10.6	44.9	55.5	80.89	19.11
Oyo	22.8	60.5	83.2	72.63	27.37
Plateau	8.4	52.2	60.6	86.13	13.87
Rivers	101.0	171.7	272.7	62.97	37.03
Sokoto	9.3	55.4	64.7	85.57	14.43
Taraba	8.2	48.6	56.8	85.55	14.45
Yobe	5.0	49.3	54.3	90.81	9.19
Zamfara	6.2	56.7	62.9	90.14	9.86
FCT	32.9	66.8	99.7	67.04	32.96

Source: Authors' computation from data from CBN, NBS and NEITI, 2024.

On the average, many states in Nigeria were funded mainly from federal allocations with as many as 25 states funding at least 80% of their budgets with their Federation Account Allocation. This poses so much financial burden to the economy such as high level of debt to unstable economic growth to instability in revenue profile due to shocks from global oil prices affecting the FAAC allocation to the states. The result of this weakened financial position is the struggle by most States in the Federation to meet their financial obligations, hence the rampant incidences of unpaid salaries and inability to complete ongoing capital projects in their respective jurisdictions.

5. ANALYSIS OF SOME EFFECTS OF STATES' OVERDEPENDENCE ON FAAC

Any state which has an unstable inflow of revenues is bound to have slow economic growth. On this note, projections could easily show that in the long run, states' dependence on Federal Allocation will have negative effects on the states' economies and the nation's economy at large if their IGRs do not improve. The possible effects include:

Retardation of States' Productivity: In a system where revenue is gotten mostly from federal allocations which have no relationship with the economic performance of the state, the state government stops caring about the economy of the states. Instead, they turn their attention to matters in Abuja as they try to preserve allocations. In the long run the productivity of states dwindles and fade away, just as agriculture in Nigeria faded away and left us with dependence on oil.

Increase in Number of Abandoned Projects: It is obvious that in the long run, if the funding of the federation account allocation declines steeply than expected, many states' projects will be abandoned as they will have no alternative funding. This could be seen for what happened to many states that expanded their Civil Service during oil price booms and struggled to pay salaries or fire workers when oil price slumped. The federal bailout states in 2015 for this reason. This could also be seen in their report of 30th August 2021. The Ekiti state government reported that it had restored payment of consequential adjustment of the minimum wage for officers on Grade Levels 7-8, which was hitherto suspended due to shortfall in revenue from FAAC. Mr. Akin Omole also added that the payment of 100% subventions to Ekiti state university, Ado Ekiti (EKSU) and Bamidele Olumilua University of Education, Science and Technology, Ikere-Ekiti (BOUESTI), had increased from 50% to 60% and would be reviewed upwards in September 2021.

Higher Rates of Government Debt: If states' productivity fades away, oil price slumps and federal allocations to states decline beyond expectations, majority of states will borrow more to fund the states' bills and projects there by putting the states in debt.

Economic Depression: If technical creativity or innovations make the demand for our crude oil to decline to unbearable level being that the states and Nigerian Economy at large depend on FAAC which oil is its major contributor, this will push our economy into depression.

6.   CONCLUSION AND RECOMMENDATIONS

Majority of states in Nigeria largely depends on monthly allocations by the Federal Government for their fiscal operations and obligations. This has been observed to have had detrimental effects on the generation of their internal revenues with consequent slow in economic growth. As it has been observed, any time global oil prices decrease, the Nigerian economy usually experiences recession/depression; sometimes, it is dragged to trough in its business cycle. States and local governments in Nigeria, therefore, should discover their statutory internally generated revenue sources and device appropriate means and mechanisms to make them functional. This will make the revenue sources more viable and will enable them to generate more revenue internally.

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