

AN ANALYSIS OF REVENUE ALLOCATION MECHANISMS AND THEIR EFFECT ON NIGERIA'S ECONOMY

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Abstract:

Public revenue is a critical element in financing government operations and achieving sustainable economic development. In Nigeria, public revenue is broadly categorized into federation revenue and independent revenue. Federation revenue, which comprises oil and non-oil sources, is centrally collected and paid into the Federation Account—an account constitutionally mandated by Section 162 of the 1999 Constitution of the Federal Republic of Nigeria. This account serves as a distributable pool from which allocations are made to all tiers of government: federal, state, and local. The independent revenue, on the other hand, is generated directly by each level of government within its jurisdiction. This paper examines the structure and significance of revenue allocation through the Federation Account and explores its impact on economic growth in Nigeria. It analyzes the constitutional foundation, sources, and mechanisms of distribution, highlighting the pivotal role the Federation Account plays in national development. Understanding the balance between revenue collection and equitable distribution is essential for evaluating fiscal federalism and assessing how revenue impacts macroeconomic performance. The study contributes to ongoing discourse on resource control, fiscal accountability, and efficient utilization of public funds for developmental purposes in Nigeria.

Keywords: *Public Revenue, Federation Account, Economic Growth, Fiscal Federalism, Nigeria*

1.0 INTRODUCTION

Public revenue is income generated by government from all of its activities or operations. It is a segment of total funds needed to finance government activities. In the words of Dang (2013), public revenue is the income that accrues to the government to finance its economic activities. This income is generated from many sources; such as taxation, fees, fines, grants, foreign investments, sales of national assets, public borrowing, among others. In Nigeria public revenue is of two forms; federation revenue and independent revenue. Federation revenue is revenue belonging to the entire federation while independent revenue is the revenue raised by each tier of government independently within its jurisdictions. Federation revenue is broadly categorized into two via: oil revenue and non-oil revenue. Federation revenues are paid into the federation account. Federation Account is an exceptional account that is required to

be maintained by the federation of Nigeria (Omodero, 2019). It was established by Section 162 of the 1999 Constitution of the Federal Republic of Nigeria. Federation account is an account into which shall be paid all revenue collected by the government of the federation (ICAN, 2019). It is a distributable pool account from which allocations are made to the central government and its component units on such terms and in a manner prescribed by the law. All other revenue from other sources belongs to either the federal, state or local government within its jurisdiction.

Federation account allocation is the disbursement of revenue in the federation account to the different levels of government. Dang (2013) defined revenue allocation 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. Federation allocation arrangement in Nigeria is at two levels via: vertical allocation and horizontal allocation. While vertical allocation refers to revenue sharing among the different tiers of government within a federation based on given pattern, that is, sharing among the federal, state and local governments; horizontal allocation refers to revenue sharing among the components states and local governments. Currently, the vertical allocation formula is 52.68% for the federal government, 26.72% for the state government and 20.60% for the local government; while horizontal allocation applies principles of derivation, population, equity, internal revenue effort, and landmass. Economic growth can be defined as the increase in the production of goods and services over a specific period (Pettinger, 2019). In the words of Akachi (2020), it is the increase in the value of an economy's goods and services which creates more profit for businesses. It is usually measured by Gross Domestic Product (GDP). GDP refers to the value of all final goods and services produced within a country over a period. Sustained economic growth improves the economic wellbeing and quality of life of a nation, region, and local community. Economic growth is the underlying reasons for revenue allocation to the three (3) tiers of government from the federation account (Federation account allocation to Federal, state and local government area). Thus, this study examined the impact of federation account allocation to the three tiers of government on economic growth.

2.0 LITERATURE REVIEW

2.1 Conceptual Review Federation Revenue

Federation revenue is revenue belonging to the entire federation. It is the federation's financial resources which are allocated to federating units in a federation. Omodero (2019) defined federation resources as centrally generated revenue in the federation by collective efforts of the entire federating units. In the words of Olaoye and Akintayo (2022), Federal revenue generally represents the revenue generated into the federation account based on the collective resources (especially natural resources such as crude oil) of the country which is distributed among the three tiers of government.

Federation revenue in Nigeria is broadly categorized into two via: oil revenue and non-oil revenue. Oil revenue refers to earnings from transaction and activities relating to crude oil such as sale of crude oil, oil pipeline license fees, rent of oil well, penalties for gas flared, oil exploration license, among others; while non-oil revenue refers to other earnings other than earning from oil transaction such as import duties, excise duties, companies' income tax, stamp duties, capital gain tax, among others. Federation revenues are lodged in the federation account.

Federation Account Allocation

Federation revenue allocation is the disbursement of revenue in the federation account to the different levels of government. Dang (2013) defined revenue allocation 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. According to Ordu and Omesì (2022), it is the redistribution of fiscal capacity between the various levels of government, or the disposition of fiscal responsibilities between tiers of government.

Olowononi (2000) in Ordu and Omesì (2022) defined revenue allocation to include allocation of tax powers and the revenue sharing arrangements not only among the three levels of government but among the state governments as well. In the words of Ohiomu and Oluyemi (2018), it is the redistribution of fiscal capacity between the various levels of government or the disposition of fiscal responsibilities between tiers of government. They also stated

that revenue allocation is meant to attain two broad objectives namely efficiency and equity. Revenue is allocated to the Nigeria federation units to meet up with their various constitutional assigned expenditure, as such is expected to grow the economy. Revenue allocation is done in such terms and manner as prescribed by the law. These terms and manner are known as revenue allocation formula. In other words, it is the basis of sharing revenue. Currently, revenue allocation in Nigeria is done by the Federation Accounts Allocation Committee (FAAC) in conjunction with the Revenue Allocation, Mobilisation and Fiscal Commission (RAMFC).

Value Added Tax (VAT)

VAT is a tax imposed on value which the seller or supplier of good or services add to the goods or services before selling or supplying it. The introduction of VAT was necessitated by the need to boost the revenue of the government from non-oil sources following the fluctuations in oil revenue due to the oil glut in the international market. VAT was introduced in 1994 fiscal year with the promulgation of VAT Decree No.102 of 1993 at the rate of 5% and is being administered by Federal Inland Revenue Service (FIRS). Currently, VAT is at the rate of 7.5%. Though VAT is a federation revenue payable into the federation account, it has a separate allocation ratio different from other federation revenue. Therefore, VAT is allocated thus: Federal Government = 15%

States Governments = 50%

Local Governments = 35% (FAAC, 2022)

Economic Growth

Economic growth is the continued increase in the overall goods and services produced in an economy (Rosa, 2018). According to Munichello (2021), it is an increase in the production of economic goods and services compared from one period of time to another. In the words of Pettinger (2019), it is an increase in the capacity of an economy to produce goods and services compared from one period of time to another. Economic growth is an important macro-economic objective because it enables increased living standards, improved tax revenues and helps to create new jobs (Tejvan, 2016).

Economic growth is usually measured by Gross Domestic Product (GDP). GDP is the total value of all final goods and services produced within a country over a period of time. It is the monetary value of goods and services produced in a given economy in a given period of time; (Pettinger, 2019). GDP can be measured in nominal or real terms. Nominal GDP measures the total value of an economy's goods and services using current prices without adjusting to account for price changes from inflation, while Real GDP (RGDP) measures the total value of goods and services of an economy by adjusting the nominal GDP to take into consideration the influence of inflation. Economic growth is usually presented as the annual percentage increase in RGDP.

Factors Influencing Economic Growth

Schumpeter (2011) identified five factors impacting economic growth. He opined that countries that recognize these five factors will have higher growth rates and improved standard of living for their people. Such factors include:

- i. **Human Resources:** The quality of the human resources in terms of skills, education and training has a direct impact on the growth of an economy. A skilled and well-trained work force is more productive than illiterate and unskilled workforce and will therefore produce a higher quality output that adds efficiency to an economy.
- ii. **Infrastructure:** Improved and increased investment in physical capital such as roads, electricity, factories, machinery etc. reduces the cost of economic activity and increases the efficiency of economic output. Modern and well-maintained facilities are more productive than physical labour leading to higher productivity. This higher productivity leads to increased output thereby increasing growth rate of the economy.

iii. Natural Resources: The availability and quantity of natural resources such as oil, mineral deposits, land, water, forests, natural gas etc. affects the growth rate of an economy. The discovery of more natural resources and the country's effectiveness at utilizing and exploiting the natural resources will give a boost to the economy by increasing the production capacity. **iv. Technology:** Improvement in technology has a high impact on economic growth. Technology increases productivity with the same level of labour thereby accelerating growth at lower costs.

v. Law: This refers to the institutional and legal framework regulating economic activities. Economic rules and regulations should be economic friendly such that it encourages economic activities leading to increased production thereby boosting economic growth.

2.2 Empirical Review

Ordu and Omesi (2022) investigated the relationship between value added tax (VAT) revenue and revenue allocation in Nigeria for the periods of 2000 to 2020. It aimed to ascertain the relationship between VAT revenue and VAT allocations to the federal, state and local governments for the periods studied. The study adopted the ex-post facto design and sourced data from the annual statistical bulletin of Central Bank of Nigeria 2020 edition. Data collected were analysed with descriptive statistics and trend analysis while regression was used in testing of the hypotheses. The study found that VAT revenue has positive and significant relationship with allocation to the federal, state and local governments in Nigeria for the periods studied. It recommended that federal government should not be left out in the sharing of VAT revenue and there should be improved and agreed equitable sharing formula that will ensure that the states and local governments get more share of the allocation especially as it concerns sharing of the VAT revenue. Also, the local governments should not be starved of their allocated funds by the states, especially as it concerns their share of VAT and other state allocations.

Edet and Harrison (2021) studied Revenue Allocation in Nigeria: Issues, Challenges and Prospects. It examined the issue of revenue allocation and identified major challenges which are embedded in it as well as outlining prospects for it in Nigeria employing both descriptive and historical methods. The study was of the view that in a bid to resolve the controversial issues surrounding the contentious revenue allocation in Nigeria, a high level of fiscal decentralization is required to replace the unfair revenue sharing formula currently on operation. Besides recommending a substantial review of the fiscal system, the paper concluded that revenue formula for revenue sharing in Nigeria should be guided by national interest which should supersede individual or primordial interest and sentiments.

Ejike (2021) evaluated the Impact of Apportioned Federal Allocation on Nigeria's Economy. It aimed to determine the impact of federation account allocated fund to the three (3) tiers of government on RGDP in Nigeria. The analysis engaged time series data collected from CBN Statistical Bulletin, 2019 edition for the periods of 1984 to 2019 and employed Ordinary Least Square (OLS) method to perform the multi-regression analysis. The study revealed that the federally apportioned earnings of the federal government have a major good effect on RGDP while federally apportioned earnings of the local governments have a strong important positive effect on RGDP. It also revealed that federally apportioned earnings of the state governments have a major damaging impact on RGDP. The study therefore concluded that misappropriation of state fund calls for serious concern and therefore recommended revenue sharing formula should depend on expenditure incurred on finished projects by the three tiers of government rather than any other parameter for effectiveness and efficiency in the public sector. Ugwuele and Ogbudebe (2021) studied revenue allocation and economic development in the south-eastern states in Nigeria for the periods of 1986 to 2016. It aimed to determine the extent to which revenue allocation to the

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federal, state and local governments and state derivation enhance economic development represented by per capita income (PCI) in south-eastern states of Nigeria. The study used time series data obtained from CBN Statistical Bulletin for the periods studied and employed Ordinary Least Squares technique to analyse the data collected. It found that revenue allocation to state government and state derivation has significant negative impact on PCI, while revenue allocation to the federal government has insignificant negative impact on PCI. The study also found that revenue allocation to local governments has a robust significant positive impact on PCI. It therefore recommended that more revenue should be allocated to the local government councils since they are closer to the people and are in the best position to boost economic through attending the Infrastructural needs that are glaring to them.

Akobundu, Okonkwo and Emeh (2020) investigated the impact of revenue allocation to education on economic growth in Nigeria for the periods of 1987 to 2018. The study collected data from the National Bureau of Statistics (NBS) and CBN Statistical Bulletin and employed multiple linear regression model and factor analysis to analyse the data collected. It found that there is a significant impact of government expenditure on educational growth in Nigeria. It therefore recommended that government attitude toward expenditure on education should be improved to save the educational sector and improve the productivity of its human capital and that revenue allocation to education should be properly and adequately allocated to the sector through the right educational officials and seriously monitored in order to achieve the objectives that would lead to educational growth.

Berembo and Igonikon (2020) investigated the relationship between government revenue and economic growth in Nigeria within the period of 2000-2017. Its specific objective was to ascertain the relationship between independent revenue of federal government of Nigeria and Gross domestic product (GDP) of Nigeria. Data were collected from Statistical bulletin of Central

Bank of Nigeria and National Bureau of Statistics annual reports (various years) analysed using Multiple Regression. The result of the study shows that federal government independent revenue has a significant and positive relationship with economic growth when measured on the GDP. This implies that government revenue when adequately utilized by leaders will achieve exportation and likely increase income level of the citizens thereby achieving overall economic which in turn leads to increase in development of the nation. The study therefore recommended that revenue leakages be reduced and prudent expenditure towards economic growth and development pursuits maintained.

Joseph and Omodero (2020) examined the relationship between government revenues and the economic growth of Nigeria. It aimed to ascertain the relationship between federally collected revenue and Value Added Tax (VAT) on economic growth in Nigeria. The study employed Ordinary Least Squares (OLS) regression technique to analyse data collected from the Federal Inland Revenue Services (FIRS), National Bureau of Statistics and CBN statistical bulletin spanning for the periods of 1981 to 2018. The study found that federally received revenue and VAT have a moderate positive relationship with the economic growth. The study provides evidence that there is a need for the government to formulate relevant revenue policies that will boost government income in order to have more favourable implication on the economy. Omodero (2019) examined the effects of apportioned Federal Revenue on economic growth-the Nigerian experience. The study aimed to determine the effect of the Federation account allocated funds on Nigeria's economic growth. It employed annual time series data covering a period of 1981 to 2016 which was collected from Central Bank of Nigeria (CBN) Statistical Bulletin (2016 edition); and analysed the data using ordinary least square (e-view). It found that federally apportioned revenue to the federal government and local government has a significant positive impact on economic development while federally apportioned revenue to the states governments has a significant negative influence on RGDP. The study

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recommended among others that revenue sharing formula in the country should be based more on impact of expenditure incurred on executed projects by each tier of government than on any other parameter to achieve fairness and efficiency in public service delivery at all levels of governance.

Onyia and Okereke (2019) investigated the impact of revenue allocation on economic growth in Nigeria using time series data from 1981 to 2016. It aimed to determine the impact of federal government revenue allocation share and state government revenue allocation shares on economic growth in Nigeria employing augmented unit root test, Co-integration test and the Error Correction Model to analyse data collected. The study found that revenue allocations to both the federal government and state governments have a significant positive impact on economic growth in Nigeria for the period studied., the study therefore recommended that the continuous agitation for more revenue allocation to states should be reviewed properly by federal government and state governments to ensure a sustained increase in the direction of the impact of it on real GDP.

Sani, Aondowase, Kabiru and Yerima (2019) examined the impact of revenue allocation on economic development in Nigeria using Johansen co-integration technique and Dynamic Ordinary Least Squares (DOLS) to analyse time series annual data from 1970 to 2018. The results indicated that only revenue allocation to the federal government has positive and significant impact on economic development in Nigeria, while revenue allocation to state and local governments has positive but not significant impact on economic development. The study therefore recommended that federal government should increase sources of revenue through economic diversification. This is expected to reduce heavy reliance of the government on crude oil and eventually promotes economic development in Nigeria. The study also recommended that state and local government should improve their internally generated revenue so as to augment allocation received from federal government. This is expected to improve economic development through increase in their capacity to take care of capital and recurrent expenditure.

2.3 Theoretical Framework

This study is anchored on the stewardship theory. The stewardship theory was propounded by Davis J. H and Donaldson L. in 1991. Stewardship theory explains the relationship between stewards (management) and principals (shareholder) of an organization. It illustrates a situation in which managers hold motives that are aligned with the objectives of their principals rather than pursue their individual goals. The managers see to the day to day running of the business and gives account of their transactions to their principal. A steward watches over shareholders' wealth and seeks to maximize it. Stewardship theory depicts people as collectivists, pro-organizational and trustworthy.

The major assumptions of the stewardship theory are:

1. It describes people as self-actualizing and others-serving
2. It assumes that stewards subsume personal interest to those of the principal, placing higher utility on organizational goals than on individual goals.
3. It assumes that the use of formal controls such as monitoring and incentive compensation systems are unnecessary and potentially counter productive
4. Stewards are accountable for the resources entrusted unto them by the shareholders. Stewardship theory is relevant to this study in that, it upholds accountability for resources entrusted. The funds allocated to the federal, state and local governments from the federation account belong to the public, the entire citizens. The government are the representatives of the people charged with the responsibility of allocation and utilization of public resources. Thus, the government are stewards that should be accountable for the public fund entrusted.

3.0 METHODOLOGY

3.1 Research Design

The study adopted the *ex-post facto* research design. The *ex-post facto* research design also known as after-the-fact research is a research design in which the investigation starts after the fact has occurred without interference from the researcher. It is adopted for this study because it relied on already existing data which made it impossible to manipulate or control the variables.

The study covered the periods of 2004 to 2021 and made use of secondary source of data which were collected from Central Bank of Nigeria (CBN) Statistical Bulletin and Federation Account Allocation Committee (FAAC) reports for the periods of 2004 to 2021. The data gathered were analysed using the general multiple regression involving Ordinary Least Square (OLS) model employing E-view 9.5 version to test the hypotheses while descriptive statistics test, correlation test, and unit root test were used to analyse the characteristics of the collected data. P-value from the regression result was used in taking decision. Each hypothesis was tested at 5% (0.05) level of significance while the null hypothesis is to be accepted if p-value computed is greater than or equal to 5% i.e. accept H_0 if $p\text{-value} \geq 0.05$, otherwise it will be rejected.

3.2 Variable Operationalization and Measurement

The independent variable for this study is federation revenue allocation which is captured as federal government share, state government share and local government share; while the dependent variable for this study is economic growth.

Federal government share: This was measured using the value of allocation that federal government receives annually from the federation account for the periods under study.

State government share: This was measured using the value of allocation that state governments receive annually from the federation account for the periods under study.

Local government share: This was measured using the value of allocation that local governments receive annually from the federation account for the periods under study. **Economic growth:** This was measured as real gross domestic product (RGDP)

3.3 Model Specification

The regression model adopted for the study is:

$$RGDP = \alpha + \beta_1 FGS + \beta_2 SGS + \beta_3 LGS + U_t \text{ Where:}$$

RGDP = Real Gross Domestic Product

α = the intercept or constant

β_1 - β_3 = the coefficient of the independent variables to be determined

FGS = Federal government share

SGS = State government share

LGS = Local government share

U_t = Error term

4.0 RESULTS AND DISCUSSION Table 1: Descriptive Statistics

Parameters	GDP	FGS		
			SGS	LGS
Mean	56983750	2609.435	1612.171	1221.225
Median	59929893	2600.980	1597.640	1252.420
Maximum	69899950	3711.750	2251.340	1708.580
Minimum	35020549	1180.810	666.0400	507.8700

Std. Dev.	12678052	775.4054	513.5971	387.6259
Skewness	-0.477302	-0.268485	-0.379203	-0.390003
Kurtosis	1.708321	1.903422	1.926091	1.903073
Jarque-Bera	1.827291	1.055998	1.224326	1.283257
Probability	0.401059	0.589784	0.542177	0.526434
Sum	9.69E+08	44360.40	27406.91	20760.83
Sum Sq. Dev.	2.57E+15	9620057.	4220512.	2404062
Observations	18	18	18	18

Source: Researcher's Computation, 2022 using E-view 9.5

Table 1 above shows the descriptive result for the study. The mean of the chosen dependent variable which is economic growth (GDP) in Nigeria is 56983750 which is the highest compared to the mean of the independent variables (federal, state and local government share of federation account allocation). The mean value of Federal Government Share (FGS) stood at 2609.435 while those of State Government Share (SGS) and Local Government Share (LGS) are 1612.171 and 1221.225 respectively. The standard deviation of each variable appears to follow the same hierarchical trend as those of the mean value as LGS show the least deviation while GDP has the highest standard deviation value of the four variables. This trend also follows for the maximum and minimum values.

Table 2: Regression Result

Dependent Variable: GDP

Method: Least Squares

Sample: 2004-2021

Included observations: 18

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	30080004	5706430.	5.271248	0.0002
FGS	-28604.06	11409.65	-2.507007	0.0062
SGS	68545.20	44054.76	2.555909	0.0037
LGS	-7338.866	59417.02	-0.123515	0.9036
R-squared	0.799391	Mean dependent var		56983750
Adjusted R-squared	0.753096	S.D. dependent var		12678052
S.E. of regression	6299652.	Akaike info criterion		34.35221
Sum squared resid	5.16E+14	Schwarz criterion		34.54826
Log likelihood	-287.9938	Hannan-Quinn criter.		34.37170
F-statistic	17.26751	Durbin-Watson stat		2.508818
Prob(F-statistic)	0.000081			

Source: Researcher's Computation, 2022 using E-view 9.5

Table 2 above shows the regression result conducted on the variables of the study. The result for federal government share of federation revenue (FGS) shows a t-statistics of -2.507007, P-value of 0.0062 and the beta

coefficient of -28604.06, State government share of federation revenue (SGS) has a beta coefficient of 68545.20, t-statistic of 2.555909 and a P-value of 0.0037 while Local Government Share of federation revenue (LGS) has a beta coefficient of -7338.866, t-statistic of -0.123515 and a P-value of 0.9036. This shows that FGS though statistically significant, relates negatively with economic growth (GDP) in Nigeria; SGS has a positive and significant impact while LGS were negative and insignificant.

The R-squared is 0.799391 showing that 79.94% variation in the dependent variable was explained by the independent variables while the remaining 20.06% is explained by other variables not captured by the model which is represented by error term (U_t).

4.1 Test of Hypotheses

The study hypothesized that revenue allocation to the three tiers of government (FGS, SGS and LGS) do not have significant impact on economic growth (GDP). Each hypothesis was tested at 5% (0.05) level of significance and decision while the null hypothesis (H_0) is to be accepted if p-value computed is greater than or equal to 5%. P-value statistics provides evidence that FGS and SGS has impact on GDP, while LGS has no impact on GDP. Therefore, H_{01} and H_{02} are rejected while H_{03} is accepted. But while the SGS has a positive impact, FGS has a negative impact on GDP in Nigeria. These findings are in line the findings of Berembo and Igonikon (2020), Morohunmubo, Adeshina and Ajibola (2020), Owolabi and Awoyinka (2020), and Omodero, Ihendinihu and Dandago (2019), but disagrees with the findings of Ejike (2021), Joseph and Omodero (2020), Omodero (2019), and Ohiomu and Oluyemi (2018).

5.0 CONCLUSION AND RECOMMENDATIONS

This study assessed the impact of federation revenue allocation on economic growth in Nigeria for the periods of 2004 to 2021. The components were measured as federal government, state government and local. The study reviewed related literatures and tested three hypotheses that were carefully formulated for the study employing Ordinary Least Square (OLS) regression analysis. The findings revealed that federal government share of federation revenue has a significant negative impact on economic growth in Nigeria; while state government share of federation revenue has a significant positive impact on economic growth in Nigeria; and local government share of the federation revenue has no significant impact on economic growth. Based on the findings, it was therefore concluded that federation account revenue among the three tiers of government has impacted economic growth in Nigeria for the periods of study covered.

RECOMMENDATIONS

The study therefore recommends the following:

1. Federal government should make efforts to embark on more developmental projects such as agricultural and industrial development with their share of federation revenue so as to positively impact and enhance the growth of the economy.
2. The continuous agitation for more revenue allocation to the states should be reviewed properly by federal government and state governments to ensure a sustained increase of the impact on economic growth.
3. The revenue accruing to the local government from the federation account should be improved so that development will be increased in the grass root. Also, the issue of State and Local governments' joint account should be abolished.

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