AFRICAN MULTIDISCIPLINARY JOURNAL OF DEVELOPMENT

FISCAL ALLOCATION IN NIGERIA: POLITICS OF DERIVATION PRINCIPLES

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ABSTRACT

Fiscal allocation in Nigeria has been one of the most intractable and controversial issues. This paper seeks to explore this interesting subject as it analysis the derivation principle with respect to the actual expectations from it, and then present the advantages and challenges. While adopting the Political Economy approach, the study sought to analyse the realities and challenges facing Nigeria; living in an inter-dependent world and how Nigeria ensures and maintains an inter-dependent economy in her relationship with the various competing tiers of government within the polity. The study discovered that the structure of Nigeria's federalism, the major source of Nigeria's revenue i.e., oil affects and determines the way and manner in which the fiscal allocations and reallocations are made...this invariably affects the pace of growth and development in the Country. The study recommended that there is need for a review of the present fiscal allocation formula and each tiers of the federating unit should have equal representative in the review committee. Secondly, Investment should be made in agriculture which is one of the key sectors that sustained the economy of Nigeria before the discovery of oil in a commercial quantity.

Keywords: *Fiscal Allocation, Derivation Principles, Politics, Political Economy Approach*

INTRODUCTION

Fiscal allocation in Nigeria has been one of the most intractable and controversial issues. Particularly, the `principle of derivation' has been highly contentious in the country's fiscal federalism since oil discovery in 1958. The derivation principle seeks to allocate natural resource (say oil and gas) revenues accruable to the federation's account, on the basis that is perceived to be equitable, given particular consideration to the resource-producing states and regions, Adebayo, (1988). Since the introduction of the principle by the then colonial administration, the formula underlying it has undergone numerous retrogressive alterations, following a pattern that has concentrated revenues with the central (federal) government. The percentage revenue due to producing states has declined from the initial 50% share to 1% in the 1990's, and subsequently was increased again to a currently 13% share which does not reflect full offshore derived revenues. This has been considered unfair and unacceptable by the producing states especially Akwa-Ibom and Ondo states whose oil is virtually 100% offshore, which technically limits their benefits from the principle of derivation. This has resulted to the continuously seen agitations by these states for equitable share of her God given natural endowment for its effective development.

The equitability proposed by the derivation principle in its original sense is of great importance because it is an instrument that can promote diversification of revenue generation streams for the country and support economic development as well as reduce the hostility in the Niger Delta and any other resource rich region in the future. States and regions with natural resource endowments other than oil and gas will now be compelled to develop these natural resource(s) and hence, benefit from the principle. Unfortunately, the principle has been highly compromised by various political and ethnocentric factors, leaving the producing states (minority) with very low percentage derivation.

This paper seeks to explore this interesting subject as it analysis the derivation principle with respect to the actual expectations from it, and then present the advantages and challenges. section two defines and explains the derivation principle and the expectations that are associated with it; section three presents the problems and dissatisfaction of the current derivation percentage; section four presents the advantages and challenges and finally, section five concludes and recommendations.

LITERATURE REVIEW

The principle of derivation is a component of fiscal federalism and ensures that a region or state retains a certain percentage from oil tax revenues derived from the exploitation and extraction of natural resources (like oil and gas) in its territory. This revenue is calculated based on the direct contributions from a natural resource state. As it was originally practiced, after deduction of the percentage derivation, the remainder is sent to the federation's account for onward sharing among all states. Unfortunately, today the case is different.

Brief History about the Principle of Derivation in Nigeria

The principle was first open to discussion in 1946 by the Phillipson commission who regarded it as a way of making regions with natural resources benefit from their God given endowment based on contribution to the central revenue pot (Adebayo, 1988). The principle of derivation became the major basis of revenue allocation

between 1954 and 1957 due to the dominance of Nigerian's export market by the three main ethnic groups especially with cocoa from the West (Anugwom, 2001).

From the period of oil discovery in 1958, the percentage derivation due for mineral producing states began to decline. This trend called for concern when recommendations made by the Binns commission of 1964 rejected the principle as part of the revenue allocation formula. When the military took over power in 1966, it set up an interim committee (Dina committee) that again recommended the derivation principle due to its relevance. The committee argued that the rent from the onshore oil exploration be fully given to the state from which the extraction was made, while 10% of the royalties be shared on derivation (Ekpo, 2004). However, the military government rejected the committee's recommendations and then enacted Decree 13 of 1970, which adopted a revenue allocation formula on the basis of 50% on equality of states and 50% on population, retaining derivation only on onshore exploration. This favoured the non-oil producing states (majority) than the producing minority. By this time oil contributed about 70% of the total revenue accruing to the federation's account. The principle has continued to undergo retrogressive changes as different administrations took over power.

What is expected?

Considering the evolution of the principle of derivation and the rationale behind its applicability prior to the discovery of oil in Nigeria, it is expected in a fair sense, and in the absence of true federalism in Nigeria that the principle bequeathed to us by the founding fathers be maintained. Different bodies and groups have continued to call for the original 50% derivation used in the era when groundnut from the North and cocoa from the West dominated the country's export market. For Example, The Kaiama declaration[3] of 1998 lamented the declining trend of the percentage derivation since the discovery of oil in the Niger Delta, and called for a reverse of the principle. This is what the oil rich Niger Delta region continues to ask for, since federalism in Nigeria has become a politically manipulated practice by the power dominant majority, creating a serious barrier to the resource control agitators. The expected percentage derivation should be able to reflect positively on the citizenry under normal circumstances (checks and balances).

Current Percentage Derivation

Fiscal federalism in Nigeria is a system that is practically shallow compared to the actuality of the system. When juxtaposed with practices in some federal states like Canada, Australia, USA etc, it can be rightly said that the Nigerian Practice is far from rigorous. In the above mentioned states, constituent tiers of government have exclusive (full) control over natural resources in their respective territories, but pay necessary taxes to their central (federal) governments.

However, Nigeria has adopted a system many now refer to as fiscal centralism (where revenue allocation and fiscal policies are left to the central government) and not the fiscal federalism (decentralised and devolved revenue allocation and fiscal policies) it so claims to practice. Despite Nigeria's developing state, it would have been possible to maintain the expected principle, especially now that the local work force has improved. However, political sentiments have been applied in administering the percentage derivation due to natural resource producing states. This practice has indeed fall short of its expectation due to this political manoeuvring of reaping revenues to the central government; where the ethnic majority and non-oil producing states have higher control of power, and in return providing the minority and oil rich states with a token of compensation for playing host to the central government's joint ventures with oil companies. This has become possible because the 1976 constitution vest all mineral rights exclusively to the control of the federal government. The application of the principle since the country's independence has failed to encourage and attract the development of other abundant natural resources other than oil and natural gas, as percentage derivation due to mineral producing states continue to decline. Currently, it is set at 13%, which is still insignificant, unfair and unacceptable to the agitators of resource control (Niger Delta). Although, there is an increase compared to the immediate past 1% derivation.

13% Derivation

At the end of every month, the Department of Petroleum Resources provides production figures per state for crude oil and gas to the Revenue Mobilization Allocation and Fiscal Commission (RMAFC). Computing indices is carried out monthly per commodity and takes into consideration the following:

i. The allocation of revenue (abolition of dichotomy in the application of derivation) Act, 2004
ii. Report on familiarization/verification to oil producing states, 2006
iii. Report of inter-agency meeting on the attribution of offshore oil wells/fields to littoral states (kano retreat), 2008
iv. The 86-number oil well granted to Rivers state by the Supreme Court judgement of 18th March 2011 in the case of AG of Rivers state vs. the AG of Akwa Ibom state and the AG of the federation.
v. The Supreme Court judgement of 10th July 2012 in the case of AG of Cross Rivers state vs. the Ag of Akwa Ibom state and the AG of the federation
vi. The report of the inter-agency technical committee on the determination of the location of Aje oil wells

In addition, only crude oil and gas production within 200m isobaths water depth is used for the generation of indices and production data are received in arrears, meaning January 2015 data is used for April 2015 disbursement. When the Commission computes indices for any given month, it has to be approved by all 36 Commissioners (representatives of the 36 states) before same is forwarded to the Office of the Accountant General of the Federation (OAGF) for disbursement.

The 13% derivation fund is deducted from net mineral revenue first before the outstanding is shared among all states. The oil and gas producing states are paid their 13% derivation allocation based on the actual level of production for each of the producing states. Total Mineral Revenue (net) in the year was N2, 887,113,537,777.70. Therefore actual 13% derivation disbursement to States in the year was N375, 324,759,911.10. An initial analysis of actual disbursements shows that indices that were generated by the RMAFC from April – December 2015 were largely (70.83%) the same used for actual disbursements. Discussions were held with officers of the Commission and OAGF in order to understand the reasons for the differences 29.17% of the time. Both agencies gave assurances that there should not be any as the indices are scrutinized monthly by representatives from States both at the Commission (Commissioners, appointed by the Governors) and at the OAGF (through the FAAC committee which includes the Accountant Generals from all the States) who rely heavily on allocations. Control documents that were used to generate data for NEITI for 3 months gas indices were also used to establish the errors in data provided to NEITI for those same months. This reduced the instances with differences to 17.36%.

Having noted the degree of differences, we accept that the other differences were due to human errors. Consequently, we confirm that there is no non-trivial deviation in the allocation of mineral revenue. However, we note that there is a need to ensure efficient record keeping eliminating even the smallest of errors.

Problems and Dissatisfaction with the Current System

A vital problem with the present percentage derivation is the lack of sound technical basis or traceable mathematical derivation formula. Rather, it is a politically imposed type of compromise between ethnocentric parties. For Example, the current 13% derivation is a mean agreed value of a political negotiation in a constitutional conference held in 1995 between propositions by dominant 8% and opposing 18% parties (Ikpatt and Ibanga, 2003).

Another problem with the current percentage derivation is a constitutional one, and can be traced back to the Supreme Court ruling in 2002, where the federal government filed a suit against the littoral states at the Court requesting a resolution of the seaward margin of a littoral state within the federal republic of Nigeria for the purpose of calculating the amount of revenue accruing to the federal account directly from any natural resource obtained from that state in pursuant to Section 162(2) of the 1999 constitution of the Federal republic of Nigeria, Arellano-Yanguas, (2008). In its ruling, the apex court did sustain the plaintiff’s submission, declaring that for the purpose of calculating revenue accruing to the federal account directly from any natural resource obtained from a littoral state pursuant to section 162(2) of the 1999 constitution, the seaward margin will be the low-water mark of the land surface thereof or in specific cases (like in Cross River State) with archipelago of Islands, the seaward margin will be that of the inland waters within the state.

This judgement created a total dissatisfaction to the littoral states of the Niger Delta region especially Akwa-Ibom and Ondo states whose oil resources are virtually 100% offshore (probably beyond the low-water margin and inland waters within the state), thereby tactically sidelining them from offshore derivation benefits accruable to the federation's account.

However, a Bill abolishing the offshore/onshore dichotomy ruling of the Supreme Court was signed into law by then President Obasanjo in 2004 after approval from the National Assembly. As this controversial magnanimity created applauses to the president from many Niger Delta political elites, some activists and professionals raised possible concerns about the new law (still in place). For Example, Ledum Mitee, president of the Movement for the Survival of Ogoni people (MOSOP), considers the law as a scratch on the surface of the numerous problems facing the oil-rich region, as core issues like environmental degradation, marginalization and the right of self-determination and natural resource control has failed to be addressed by the new law. Furthermore, the Executive Director of the Environmental Rights Action (ERA), Mr Douglas Oronto called for clarification on the meaning of the 200 meters depth Isobaths provided by the law as the new seaward margin for a littoral state. In the same vein, a onetime president of the Nigerian Bar Association, Mr O. C. J. okocha (SAN) questioned the ambiguity of the new margin and in his view; it may likely make no difference from the earlier judgment of the Supreme Court in 2002 as it concerns offshore derivation to littoral states. Finally, Professor Ben Nwabueze, one of the country's leading authority in constitutional law faulted the new law, saying what was (and is still) needed was (and is) a constitutional amendment, not an Act of parliament (Ojameruave, 2004).

Another salient dissatisfaction is the too much concentration of revenues at the central level with no positive impacts on the citizenry. Since the country gained independence in 1960, revenue allocation has continued to skew in favour of the federal tier of government, which has benefited as high as about 60% and as low as 40% of oil dominated revenue shared among the three tiers of government. This high concentration has promoted wasteful spending and encouraged corruption by the politically privileged elites at the central level. In Nigeria, the federal government has hijacked responsibilities traditionally should have been under the state control, all with the aim of concentrating greater revenues at its control. Examples include responsibilities like the police, public transport, etc. Unlike Nigeria, in the Australian federation, responsibilities are well shared with the federal level responsible for taxation, defence, foreign affairs, postal and communication and the powers to make laws over states/territories. It remains a fact that the federal government of Nigeria lacks basic plans for transforming resources into meaningful developments. This explains the reasons for its political system being classified as a "do or die affair" (Awolaja, 2011).

The gap between the federal government and the citizens is a major barrier on citizen's demands for concrete development. In addition the weak and corrupt representation both in national and state levels exacerbate the condition. Increasing state derivation may help reduce dependence on the federal government's monthly allocation; an exercise now considered a ritual that must be done. This change could likely increase the chances of accountability as government will be closer to the people, who in turn will stop at nothing to ensure their resources are rightfully channelled for equitable and meaningful development.

Advantages

There exist numerous benefits both to the federal and state tiers of government as well as local governments when the principle of derivation is implemented in its original sense. In the previous section, I have been able to highlight on some of the advantages. However, the expected principle may lead to:

1. Economic Diversification

It is an obvious fact that the principle of derivation will encourage diversification of the country's economic activities and increase revenue generation as well as reduce the prevailing revenue sharing ritual that has eating deep into the fabrics of the Nigerian system. This will only be possible when percentage derivation to mineral producing states become attractive. This could also compel non-oil producing states that are now highly dependent on the Niger Delta wealth for sustenance to develop the natural resources within its territory.

2. Human Capacity Development

The cornerstone of a country's economic success depends on how developed is the human wherewithal and competence. An economic diversification powered by the expected principle of derivation can fuel the development of human capacity of a nation, as the training and exposure of skilled professionals in the various industries which are technology driven and highly challenging, will become a necessity.

3. Investment and Job Creation

Also, rapid diversification will undoubtedly lead to investment opportunities and the creation of jobs for the increasingly high rate of unemployed Nigerian youths and possibly reduce crime level in the society.

4. Proper Development

The present percentage derivation has failed to reflect the needs of the local people and its governance. State and local governments should be able to handle development according to their felt needs and priorities, and not being constrained by lack of finances. Applying the derivation principle in its original sense may increase the chances of implementing programmes according to the needs and priorities of the people. For example, the Niger Delta region has continued to call for the remediation of its polluted environment whose damage came as a result of oil exploration; rather, the federal government has invested in what is not considered top priority.

5. Reduction of Hostility

Despite the fact that the oil producing Niger Delta region has long been agitating for resource control, a fair percentage derivation will reduce the agitation turned hostility especially on oil installations in the region and any other region in the future.

Challenges

Despite these numerous advantages, there exist various challenges to the actualization of a favourable percentage derivation. Some are:

1. Political and Capacity Problems

The highly competitive but fragmented political system in Nigerian (like in Peru) coupled with the lack of checks and balances pose a major challenge to the implementation of the expected derivation principle. In terms of capacity, we believe Nigeria has come of age, but the influence of the former tends to weaken the latter. Today, we have seen some sub-national governments performing well above average in Nigeria. This is possible because these governments decided to invest in human capacity development in order to strengthen their local labour force. Unlike Nigeria, the Peruvian fiscal decentralization policy based on the system of automatic transfers to mineral producing areas failed because it never took into consideration the strength of its human capacity at the local level before implementing the policy. Despite its longer period in the mining business, conflicts with neighbouring countries on territorial issues and political interests at the local level, and short-term policies contributed to the failure of this fiscal policy.

2. High Dependence on Oil Proceeds

It is a well-known fact that oil contributes over 90% of Nigeria's foreign earnings, and also its national budgets are predicated on the basis of yearly crude oil production and price. These dependences continue to sustain its importance and attract high political actors and interests, and also explain why oil is considered now in the country as a natural resource for all unlike the periods when groundnuts and cocoa dominated the export market.

In other words, upholding the expected percentage derivation may be perceived as unleashing financial threats on the federal government and the non-oil producing states.

3. Legal Regimes

The challenge posed by the country's legal regime which is under the federal government's control is indeed worrisome. For instance, the 1976 constitution vests mineral rights exclusively to the federal government's

control, the land use Act of 1978 and 1993, and the petroleum Act of 1969 are also legal regimes in favour of the federal government as it concerns natural resources. Repealing these repugnant laws has been faced with political manipulations from the federal government. This has always given the federal government the greater powers when it comes to the percentage derivation issue.

Correcting these anomalies is highly necessary. This could explain why violence and hostility seems to be a favourable option.

4. The Game with Fiscal Federalism in Nigeria

If true federalism that reflects on fiscal policies is allowed to thrive in the Nigerian polity, the problem of unfair or too much derivation as conceived by both the dominant and opposing parties will be a thing of history. This is a major challenge facing the country at this stage of its development, and correcting this will mean reducing developmental barriers and increasing the chances of attaining sustainable economic stability.

CONCLUSION AND RECOMMENDATIONS

The paper has been able to establish the derivation principle currently in operation, and that which existed during the periods when groundnut from the North and cocoa from the West were the main sources of foreign earnings for Nigeria. It was found that the principle has been under the influence of political and ethnocentric factors, creating the much seen problems and dissatisfactions in the system.

Also, analysis of various fiscal allocation commissions' recommendations prior to oil discovery in the Niger Delta indicated 50% as percentage derivation to natural resource producing regions and states. Unfortunately, this declined to a languishing 1% in the early 90's, and currently stands at 13%. The major problem with the current system is the lack of technical base or any form of mathematical calculation.

The paper has also been able to present some of the advantages and challenges of the expected percentage using Peru as an example.

Finally, the expected derivation principle (as opposed to resource control) as not presenting the best option for Nigeria's economic success, but however, provides an opportunity or a pathway to getting there, especially as it can support developments in non-oil producing states and not turning them into a dependent variable as can be seen today. In order to reduce this dependence, the government should apply for a start (say 3 to 5 year term) a derivation of not less than 25% of direct revenues gotten from the exploration and the exploitation of natural resources of a producing state, with no first line charge of any kind from the federal government. At the expiration of the proposed term, a review can be made to ascertain the level of success achieved before further steps are taking.

However, the country's main focus should be on establishing a true federalism that reflects fiscal autonomy and independence of the constituent tiers of government, while the federal government concentrates more on its tax functions. This I believe will open the doors for rapid economic development in Nigeria.

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