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Fiscal Federalism and Oil Derivation Fund in Nigeria: The Challenges Of Effective Utilization

Fatai Olubunmi Adesanmi[1]*

[1] *Department of Public Administration Faculty of Administration and Management Sciences Olabisi Onabanjo University, Ago-Iwoye, Ogun State*

Corresponding Author: bunmiadesanmi@yahoo.com

Abstract

The 13% oil derivation fund has generated a whooping sum of revenue to the oil producing states capable of jigging the development drive of the states. Unfortunately, the developments of the states are still stunted. The study scrutinized the 13% oil derivation fund which emanates from the application of the derivation principle and the challenges facing its effective utilization by the oil producing states within the intergovernmental fiscal structure of Nigeria. These were with a view to providing information on mechanisms for judicious utilization and templates for assessing effective administration of oil derivation funds for socio-economic development in the oil producing areas. The study employed data generated from primary and secondary sources to execute its objectives. A total of 300 respondents at 100 each were purposively selected from three out of the nine oil producing states. The study identified withholding of funds by the state government, corrupt practices, poor monitoring and poor accountability as some of the challenges that are preventing the effective utilization of the oil derivation fund. The study recommends constitutional review of the provisions on derivation fund management, effective monitoring and reform of the administrative mechanisms to eliminate corruption in the handling of the fund to bring about effective utilization of the fund to spur development.

Keywords: *Federalism, Fiscal federalism, Derivation fund, Utilization, Development*

INTRODUCTION

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The major reason why fiscal federalism is wired into the operation of a federal state is to ginger even distribution of resources for meaningful development and to make all the tiers of government to effectively perform their respective functions. Fiscal federalism is essentially about the allocation of government spending and resources to the various tiers of government (Tanzi, 1995). Federalism depicts a government structure with multilevel arrangements in the performance of government functions. Scholars have identified different forms of federalism and three of them stood out. These are fiscal, political and administrative federalism. Of importance to this paper is the fiscal federalism.

The essence of government is to perform functions (Rivlin, 1991) and the functions depend on the view of government adopted. Varian (1990) noted that government practically exist to correct the failures of the free market in the efficient allocation of resources, equitable distribution of income, and economic stability, growth and development. It can therefore be stated that government has three major functions which are, allocation, distribution and stabilization. All these functions are targeted at driving social welfare and development

Development is seen as quantitative and qualitative transformation from a state of dependency, poverty, disease, autocracy, economic backwardness, social decadence, agrarian and political subjugation, to one with distinguishing features of freedom, abundance, social order, welfare, good health, democracy, civility, egalitarianism, peace and security, as well as political independence (Smith 1975). This is in consonance with Langdon's view, that development is, "the elimination of poverty among its inhabitants and the emergence of relatively egalitarian and participatory society, with an advanced material standard of living" (Langdon, 1994). Development of human society is thus premised on certain agencies and the amalgam of interests of these agencies with the implication of development on one hand and availability cum management of resources on the other. The oil producing states of Nigeria seem to be the worst hit by poor scio-economic development due to the negative effects of oil related activities which led to unending agitations and clamour for development. The people demanded for fiscal federalism with the toga of resource control and federal government responded with increased derivation fund from paltry 3% to 13% of oil resources, which took effect from May, 1999. The 13% derivation fund segregates the states of the federation into high and low income earners, as oil producing states began to enjoy the enhanced derivation largess.

1. In the last twenty-two years of the 13% derivation regime, the oil producing states has indeed received huge revenue as oil derivation fund. The oil producing states are challenged in the effective utilization of the fund. The region with highest allocation from the federation accounts (due to the derivation fund), fares miserably in development indices like access to good education, stable school enrolment, access to healthcare delivery/life expectancy, good road, potable water, quality of human life, effective management of ecological problems, response to emergencies, job opportunities, access to capital, employment opportunities, etc. There is no doubt that a very huge amount of revenue has been realised by the oil producing states as derivation from crude oil, but the development of the oil producing states is skewed due to challenges in its effective utilization.

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2. Following the increase of derivation to 13% in 1998 and subsequent implementation by the Obasanjo regime in May 1999, it has been estimated that more than N10 trillion accrued to the nine oil producing states between 1999 and 2021 (CBN, 2021; FMF, 2021). There seem to be challenges inhibiting the implementation, as a clear indication of the challenges, the oil producing states fares miserably in socio-economic development manifesting in the sharp deterioration of income distribution leading to owing of workers' salaries for months (Sala-i-Martin and Subramanian, 2003; IMF 2013; TI, 2020). Niger Delta region in particular and oil producing states in general is disproportional when compared with the amount accrued so far.

Statement of the Problem

The agitation for fiscal federalism otherwise known as resource control is in response to the socio-economic deficit prevalent in the oil producing states and the need to stem the wave of violence and civil unrests in the area. The nine oil producing states had earned N9.58 trillion as oil derivation fund within the first twenty years of the 13% oil derivation regime and the oil producing commissions established by the states applying their percentage of the derivation for socio-economic development, but have failed to positively affect their respective areas as they were rated poor/very poor in erosion control 87.7%, access to loan 82.9%, ports and jetties 75.4%, roads 75.9% and health 60.8%. The 13% derivation fund notwithstanding, there exists a wide gap between the fund available to the oil producing states and their general level of socio-economic development, while oil derivation funds is on a steady increase, infrastructural facilities are on a steady decline, revealing challenges in the utilization of the fund.

Objectives of the study

This study has as the major objective, the examination of the operation of fiscal federalism with specific focus on the agitation for and the inculcation of 13% oil derivation fund into the 1999 constitution of Nigeria, the establishment of state oil producing areas development commissions and the utilization of the oil derivation fund for development.

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Research Questions

To properly position this study, the following questions are raised and the findings of the study will proffer answers to them: What are the roles of the Oil Producing Area Development Commissions in the administration of derivation fund? What are the impacts of the oil derivation fund on the provision of socio-economic amenities in the oil producing states? What are the challenges militating against the effective utilisation of the oil derivation fund?

Methodology

Survey research design was adopted for the study. The oil producing states is the universe of the study where samples were drawn. The data for the study were specifically sourced from three (Delta, Imo and Ondo) out of the nine oil producing states. Questionnaire and oral interviews methods were used for collection of data for the study, using the instrument of purposive sampling. In-depth interviews were conducted for the traditional and opinion leaders. The grand total of sampled respondents for this study is three hundred (300). The five point Likert scale which were ordered in regression of Strongly Agree (5); Agree (4); Undecided (3); Disagree (2); Strongly Disagree (1), as well as Yes/No variables leading to open-ended responses were used due to the nature of the study, which required much description. Secondary data for this study were sourced from government publications and other official documents. The descriptive statistical techniques were employed in the analysis of the data.

Conceptual Framework

From the outset of this presentation, it is appropriate and necessary to clarify some key concepts employed in the study. These include concepts such as federalism, fiscal federalism and development.

Fiscal Federalism

Fiscal federalism is one of the variants of federalism. As stated earlier, federalism can be distinguished by the scope of functions performed by the central and state governments. Fiscal federalism bothers directly on allocation of tax and expenditure power to the tiers of government (Oates, 1972; Asobie, 1998). Fiscal

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federalism is a system of taxation and public expenditure in which revenue-raising powers and control over expenditure are vested in various levels of government within a nation, ranging from the national government to the smallest unit of local government (Ikeji, 2011). It is a system of performing government functions by different tiers of government.

Nigerian fiscal federalism structure involves the allocation of expenditure and tax raising powers among the federal, state and local government. It is also the financial relationship existing between and among tiers of governments (Akindele et. al, 2002). Fiscal federalism deals with the system of transfer or grants through which the federal government shares its revenue with state and local government. Fiscal federalism therefore refers to the fiscal arrangement among the different tiers of government in a federal structure (Ekpo, 2004). Simply put, fiscal federalism means the division of resources among the tiers of government in a federal system (Federal, State and Local government). In a federal system, there is the constitutional division of powers, functions and resources among the central, state and local governments.

Fiscal federalism as a concept was first introduced in Nigeria in 1946 (Ikeji, 2011) following the adoption of the Richards Constitution with the formation of a federation of three regions by splitting of the Southern Province to create the Eastern and Western Regions, and the Northern Region. Each of the three regions (East, West and North) had its own revenue base with a relatively weak federal government.

Nigeria fiscal federalism is a reflection of her constitution. The 1999 Constitution of the Federal Republic of Nigeria (as amended) lords the federal government over the states and local governments with regards to revenue allocation and disbursement (Akindele & Olaopa, 2002). The federally collected revenues are to be paid into the Federation Account for distribution among tiers of government in accordance with an agreed formula and up till today, federal government is allocated the highest share of the federally collected revenues. In addition, the fiscal system in Nigeria grants minimal fiscal autonomy to the sub-national governments (Salami, 2011). There is lopsidedness in the operation of Nigeria federalism. Fiscal imbalances have followed a distinctive pattern where the federal government is in a superior position and sub-national levels in the inferior position.

The sharing of funds from the federation account is one of the contentious and sensitive issues in the Nigeria polity. Chukwuemeka (2011) opines that fiscal

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arrangement among different levels of government is not as it should be, therefore it has to be worked out properly in order to ensure fiscal balance in the context of macro economic development and stability. Arowolo, on the problems associated with fiscal federalism in Nigeria, posits that, the matter of fiscal federalism has remained dominant and most contentious in Nigeria's polity. He asserts thus:

> "Over the years the fiscal federalism in Nigeria has crystallised and remained dynamic as a result of its multiplicity in terms of ethnic composition and pluralism *vis-à-vis* socio-cultural dimensions. It is naturally expected, therefore, that interactions in terms of fiscal relations will be characterised by hostile competition, unending struggle and survival of the fittest syndrome."(Arowolo, 2011)

Ikeji (2011) opines that fiscal federalism refers to the scope and structure of the tiers of government responsibilities and functions as well as the allocation of resources among the tiers of government. He remarks further that, the most important issue of fiscal federalism is the revenue allocation formula. That is, the sharing of national revenue among the various tiers of government which includes (vertical revenue sharing) as well as the distribution of revenue among the state governments (that is, horizontal revenue allocation).

Salami (2011) argues that, one issue that is critical to domestic resource mobilization and utilization is the issue of fiscal federalism. This is because Nigeria operates three tiers of government: Federal, State and Local Governments and with separate revenue, expenditure, and assigned responsibilities each. He however states that, all decisions (including resources) are controlled from the centre and that, the vertical revenue allocations tilt more towards the direction of the federal government.

Akindele & Olaopa (2002) identified the objectives of fiscal relations among units in a federation as to: ensure correspondence between sub-national expenditure responsibilities and their financial resources (including transfers from central government) so that functions assigned to sub-national governments can be effectively carried out; increase the autonomy of sub-national government by incorporating incentives for them to mobilize revenues of their own; ensure that the macroeconomic management policies of central government are not undermined or compromised; give expenditure discretion to sub-national government in appropriate areas in order to increase the efficiency of public spending and improve the accountability of sub-

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national officials to their constituents in the provision of sub-national services; incorporate intergovernmental transfers that are administratively simple, transparent and based on objective, stable, non-negotiated criteria; minimize administrative costs and, thereby, economize on scarce criteria and provide 'equalization' payments to offset the differences in fiscal capacity among states; among local governments so as to ensure that poorer sub-national governments can offer a sufficient amount of key public services; incorporate mechanisms to support public infrastructure development and its appropriate financing; support the emergence of a governmental role that is consistent with market-oriented reform; and be consistent with nationally agreed income distribution goals.

There are principles that guide the operation of fiscal federalism. Ikeji (2011) put across nine basic principles that guide the implementation of intergovernmental fiscal relations in a federal arrangement and are corroborated by Agiobenebo (1999). These are: Diversity Principle; Equivalence Principle; Centralized Stabilization Principle; Principle of Minimum Provision of Essential Goods and Services; Principle of Fiscal Equalization; Principle Efficiency; Derivation Principle; Locational Neutrality Principle; Centralized Redistribution Principle.

Fiscal federalism is essentially about the allocation of government spending and resources to the various tiers of government (Oates, 1972; Tanzi, 1995; Akindele and Olaopa, 2002). Perhaps the most important issue of fiscal federalism is the revenue allocation formula, the sharing of national revenue among the various tiers of government (vertical revenue sharing) as well as the distribution of revenue among the state governments (that is, horizontal revenue allocation). In the words of Obi (1998), “the issue of revenue allocation strikes at the very basis of existence of the Nigerian federation and the rules of entry and exit from the ruling class”. In any federal system, there must be an arrangement of how the revenue of the state will be shared among the federating units. In supporting this view, Watts (1970) argues that:

> “Federal finance is an extremely important and controversial subject because: first, it affects the allocation of administrative responsibility because the financial resources available will place limits on the scope of administration which, either level of government has the major financial resources, second, it finds in its hands the means of political control; third, it is significant also because the assignment of fiscal and expenditure powers will determine which governments are able to use these instruments to control the economy.”

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Fiscal laws in Nigeria tend to give more powers to the federal government than the other sub-federal units combined. In fact, there is an increased dependence of the sub-federal units on the federal government particularly for their finances. As a result, there are dissatisfaction, discontentment, conflicts and agitations by the other two tiers against the federal government for self-reliance (Ekwueme, 2010; Ehwarieme, 1999).

Development

Development is seen as quantitative and qualitative transformation from a state of dependency, poverty, disease, autocracy, economic backwardness, social decadence, agrarian and political subjugation, to one with distinguishing features of freedom, abundance, social order, welfare, good health, democracy, civility, egalitarianism, peace and security, as well as political independence (Smith 1975). This is in consonance with Langdon's view, that development is, "the elimination of poverty among its inhabitants and the emergence of relatively egalitarian and participatory society, with an advanced material standard of living" (Langdon, 1994). Development of human society is thus premised on certain agencies and the amalgam of interests of these agencies with the implication of development on one hand and availability cum management of resources on the other.

Development can be distinguished from a closely related term, "growth." Just like development, growth is a form of progress, yet development is of a higher order. Growth connotes an expansion of more of the same, whereas development is an expansion at a higher level. Whereas growth is an expansion at the current level, development is an expansion at a new, unprecedented level (Stewart, et al, 2001a). For example, in business we might think of growth as a duplication of a retail store model into dozens of franchise operations; whereas development was the actual development of the franchise concept in the first place. Development is more of a movement to a higher qualitative level, whereas growth is a quantitative movement (Stewart et al, 2001b).In the broadest sense, development can be defined as an upward directional movement of society from lesser to greater levels of energy, efficiency, quality, productivity, complexity, comprehension, creativity, enjoyment and accomplishment.

Socio-economic development is simply a term used to refer to the socio-economic well-being of a country by promoting growth and high-quality standard of

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living. Adams (2006) defines economic development as the elimination or reduction in poverty, inequality, and unemployment within a growing economy. Musgrave and Musgrave (2004) lend credence to the fact that the requirements for economic and social development in low-income nations include those needed for consistent economic growth as compared with developed nations. In the above definitions, economic growth stands as a transiting phenomenon via which economic development is achieved. This means that there cannot be economic development without economic growth but there can be economic growth without economic development. This situation is evident in so many less developed countries (LDCs) like Nigeria. Economic growth is the increase in real GDP and this study considers it as economic development indicator.

The Oil Producing States and the Challenges facing the Utilization of Oil Derivation Funds

The 13% derivation fund which is allocated to the oil producing states which is directly proportional to the amount of crude oil lifted from each of the nine states, is believed to have been grossly mismanaged through high-level corruption, and outright stealing by the state officials, thereby making the oil producing states that are earning more than the other states not better in the provision of infrastructural facilities (West, 2007; Omotoso, 2010; Rewane, 2007). There exists a wide gap between the fund available to the oil producing states and their level of socio-economic development.

Attempt is made in this section to examine of the major challenges facing the utilization of oil derivation funds in oil producing states. Table 1 reveals four (4) major challenges militating against effective utilization of oil derivation fund in the oil producing states. The first, as agreed by all (100%) of the respondents to the questionnaire, was that the state governments often times withheld or in some cases disbursed less than the percentage of the derivation fund meant for the state oil producing areas development commissions.

The second major challenge found was that corrupt practices among the officials of government constituted a serious impediment to the effective utilization of oil derivation fund in the oil producing states. Overwhelming majority (98.8%) of the respondents agreed/strongly agreed with this. A third identified challenge, as agreed/strongly agreed by 97.6% of the respondents, was poor monitoring of the derivation fund by the State legislative arm, which had the oversight function to do that.

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The fourth challenge as revealed in the Table was poor accountability and feedback mechanisms, which created avenue for governors/members of the commission to divert oil derivation fund into private pockets. Also, an overwhelming majority (99.2%) of the respondents agreed/strongly agreed with this.

Table 1.Challenges facing the Utilization of the Derivation Fund

Assertions	Responses	Frequency	%	Cumulative %
The state government often times withhold or in some cases disburse less than the percentage of the derivation fund meant for the Commissions.	Strongly Agree	209	83.9	83.9
	Agree	40	16.1	100.0
	Uncertain	-	-	
	Disagree	-	-	
	Strongly Disagree	-	-	
	Total	249	100.0	
Corrupt practices among the officials of government portend a serious impediment to the effective administration of oil derivation fund in region.	Strongly Agree	202	81.1	81.1
	Agree	44	17.7	98.8
	Uncertain	1	.4	99.2
	Disagree	2	.8	100.0
	Strongly Disagree	-	-	
	Total	249	100.0	
Poor monitoring of the derivation fund by the state legislative arm is responsible for the poor administration of the fund.	Strongly Agree	185	74.3	74.3
	Agree	58	23.3	97.6
	Uncertain	4	1.6	99.2
	Disagree	2	.8	100.0
	Strongly Disagree	-	-	
	Total	249	100.0	
3. Poor accountability and feedback mechanisms create avenue for governors/members of the commission to divert oil derivation fund into private pockets.	Strongly Agree	192	77.1	77.1
	Agree	55	22.1	99.2
	Uncertain	1	.4	99.6
	Disagree	1	.4	100.0
	Strongly Disagree	-	-	
	Total	249	100.0	
Swampy terrain and other environmental constraints debar the effective utilisation of the fund	Strongly Agree	42	16.9	16.9
	Agree	24	9.7	26.6
	Uncertain	15	6.0	32.7

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for meaningful socio-economic development.	Disagree	127	51.2	83.9
	Strongly Disagree	40	16.1	100.0
	Total	248	100.0	

Source: Fieldwork 2020

The interviewees identified the basic challenges militating against the effective administration of oil derivation fund which included no formal forum for discussing the fund except for the information they were able to gather from the public domain, the receipt, disbursement and actual spending has nothing to do with them and that they were neither seen nor treated as stakeholders in the administration as well as utilization of oil derivation fund.

The interviewees equally identified corruption as another major challenge in agreement with the findings of the questionnaire. They put forward reasons for the prevalence of corruption in the management of the oil derivation fund. They affirmed that the fund was being considered a ‘free money’, not worked for, leading to a malady otherwise known as “easy money syndrome” and that either it was spent judiciously or not, another is expected at the end of the month. In the same vein, interviewees stated that sacrificing general good for personal gain by the leaders contributed immensely to the poor infrastructural development of the region. Most of the leaders were accused of seeking settlement from the government thereby prevented from being critical of the government over the mis-management of the fund. The issue of sentiments and ethnic affiliation on the part of the leaders were also advanced to have contributed to the gory state of infrastructural development of the oil producing states. The interviewees lamented that sometimes vociferous leaders were either blackmailed or settled with appointments into offices or financial inducements.

In a nutshell, the poor utilization of the 13% oil derivation fund debars adequate provision of infrastructural amenities which negatively affects the socio-economic development of the oil producing states.

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Major Findings

Pertaining to the challenges facing the effective utilization of oil derivation funds in the oil producing states of Nigeria, the study revealed as follows: withholding of certain percentage by the respective state government for reasons other than the provision of socio-economic amenities; corruption by state government and commission members constitute serious impediments to the utilization of the fund; poor monitoring of the derivation fund by the state legislative arm of the government; and poor accountability/feedback mechanisms.

Concluding Remarks

The oil producing states in particular and Nigeria in general remain stunt in development in spite of the enormous revenues from oil to the Nigerian state and oil derivation fund particularly available to the oil producing states since thimplementation of 13% derivation fund from 1999. As evident from the findings of the study, the agitation for fiscal federalism which led to the inclusion and implementation of the fund indeed open up a new lease of funding to the oil producing states and for more than 20years there is only marginal economic growth, a far cry from the quantum of money received by the states.

Part of the explanation provided among the myriads of challenges bedevilling the effective utilization of the fund for development is withholding of fund meant for the oil producing areas commissions. The state house of assemblies, have legislated on the establishment of oil producing areas development commissions and the percentage of the derivation fund that should go to the commission for the provision of socio-economic amenities were not being released as and when due. This amounted to starving the commissions of the needed resources to function. Unfortunately the most of the state house of assemblies have become a pawn in the hand of the state governors. They lack direction, the will and the effectiveness as a check on the arbitrariness of the state governors.

Other impediments to the effective utilization of the fund include high level corrupt practices among the state government officials and the civil servants; lack of

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proper monitoring of the receipt and disbursement of oil derivation fund by the house of assemblies; poor accountability and feedback mechanisms; and diversion of funds by the managers and other field agents.

The forgoing analysis indicate that much more social as well as economic development would have been achieved, the oil producing states would have been transformed, and indeed Nigeria if the oil derivation fund has been effectively utilized. The following recommendations to promote effective utilization of oil derivation fund for meaningful development in the oil producing states. There is the need to urgently review the constitutional provision(s) on the derivation fund and the procedural approach to its spending; set up a specialized body to monitor the entire process of derivation from the lifting of the crude to the disbursement of the fund and its utilization; corruption and corrupt practices among the handlers of the fund must be eliminated by putting in place effective monitoring system and accountability mechanisms in order to make the fund effective, efficient and productive; the utilization of the fund, awards of contracts and execution of projects must be made open to all stakeholders and the people of the region must be all inclusive.

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