academicJournals

Vol. 7(1), pp. 1-14, January 2015
DOI: 10.5897/JASD2014.0303
Article Number: D12F4AA49306
ISSN 2141 -2189
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http://www.academicjournlas.org/JASD

Journal of African Studies and Development

Review

Resolving Nigeria's dependency on oil – The derivation model

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Received 30 September, 2014; Accepted 17 December 2014

Since the discovery of oil in commercial quantity in Nigeria in 1956 and the oil boom of 1970s, oil has dominated the economy of the country. Oil accounts for more than 90 percent of the country's exports, 25 percent of the Gross Domestic Product (GDP), and 80 percent of government total revenues. As a result, the economy of the country has been substantially unstable, a consequence of the heavy dependence on oil revenue, and the volatility in prices. The oil boom of the 1970s led to the neglect of agriculture and other non-oil tax revenue sectors, expansion of the public sector, and deterioration in financial discipline and accountability. In turn, oil-dependence exposed Nigeria to the vagaries associated with oil price volatility which threw the country's public finance into disarray. Moreover, since oil revenue dominates Nigeria's Federation Account, the sharing of oil rents govern intergovernmental fiscal relations in the country with an on-going tension between agitations by oil producing states for greater share of resources and demands for redistribution from other regions, particularly relatively less endowed ones. In this paper, the authors argue for a rethink in the current revenue sharing formula in Nigeria in favor of derivation. This will reduce ongoing tensions in the distribution of proceeds from oil between the federal government and states on one hand and between the federal government and oil producing states in Nigeria on the other hand. The authors argued for a rollback to the era when states/regions were accorded 50% retention of any proceeds accruing from their areas. This will make every state/region in Nigeria to look inwards and explore other resources that abound in their areas and will also help to diversify the economy of Nigeria away from oil.

Key words: Oil dependency, economic diversification, derivation formula, economic development.

INTRODUCTION

The volatility in crude oil production in Nigeria and fluctuations in international oil price has once again brought to the front burner anxieties about the future of the oil sector in the Nigerian economy. In the first quarter of 2014, the contribution of the oil sector as a percentage of the nation's real Gross Domestic Product (GDP) was estimated at about 14.75 percent, compared to 15.80 percent (a decline of over 100 basis points) in the

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corresponding period in 2013, according to the National Bureau of Statistics (NBS, 2014). Also, average daily production of crude oil was 2.29 million barrels per day (mbpd) in the first quarter, as against 2.35 mbpd in the corresponding quarter in 2013, based on data from the Nigerian National Petroleum Corporation (NNPC, 2014). Current average daily crude oil production is less than the projected 2.53 mbdp on which the 2014 federal government budget estimates are based. In terms of growth, oil sector GDP (with associated gas components) grew at 0.74 in the first quarter of 2014. Conversely, the non-oil sector continued to be a major driver of the economy, recording 7.89 percent growth in real terms in the same period (NBS, 2014).

The oil sector in Nigeria has witnessed disruptions in recent times due to pipeline vandalization, incidents of illegal bunkering and theft of crude. These have resulted in incessant declarations of force majeure by some International Oil Companies (IOCs) such as Eni (Agip), Total and Royal Dutch Shell. Estimates of revenue loss due to oil theft and vandalization are about $1.23billion in the first quarter of 2013 alone (NNPC, 2014). The federal government has in several global fora sought global clampdown on illicit trade in stolen crude oil as an antidote to oil theft. Nigeria has consistently argued that stolen crude oil ought to be treated globally in the same manner as stolen diamonds because they both generate blood money, aids corruption and violence and can provoke war (Ahmad and Mottu, 2003; Collier and Hoeffier, 2005; Brough and Elliot, 2008; Sampson, 2013). As a result of these ugly developments, the Federation Accounts Allocation Committee (FAAC)[1] has had to resort to the Excess Crude Account (ECA)[2] to shore up monthly allocations to the three tiers of government. There is also apparent lethargy on the part of IOCs in embarking on new investments especially in deepwater explorations as a result of uncertainties and the delayed enactment of the Petroleum Industry Bill (PIB)[3]. These somewhat gloomy scenarios together with the energy policies of the United States and China have reinforced concerns about the long term future of the oil sector in Nigeria and the country's near-total dependence on proceeds from oil (Uzor, 2013).

The near total dependence of Nigerian economy on oil has dire implications for the economy (Emmanuel, 2004; Gary and Karl, 2003; Karl, 1997, Sampson, 2013). To buttress this point, in 2013, the stock of the nation's external reserves and Excess Crude Account witnessed various degrees of decline as a result of fluctuations in the price and quantity of oil. The CBN report (2014) shows that the gross external reserves as at December 31, 2013 stood at US$42.85 billion, representing a decrease of US$0.98 billion or 2.23 percent compared with US$43.83 billion at end-December, 2012. The excess crude account (ECA) also declined within the period. Earlier in the first quarter 2013, external reserves had climbed to its highest level in more than four years, hitting around US$48.57 billion in May (CBN, 2014). The drop in both the stock of external reserves and the ECA are attributable to a number of factors. First was the slowdown in Portfolio and Direct Foreign Investments (FDIs) flows in the fourth quarter 2013, which prompted increased funding of the foreign exchange market by the CBN to stabilize the national currency. Secondly, there was a drop in oil revenue inflow owing to decline in oil output – due to oil theft and pipelines vandalism at various times in 2013 which resulted in the loss of about 300,000 – 400,000 barrels per day (NNPC, 2014). Thus, this 'quantity shock' led to depletion in both accounts – the external reserves and the ECA. While the ECA and external reserves were getting depleted, the nation's stock of public debt was on the increase all through 2013. Indeed, according to the Debt Management Office (DMO, 2014), Nigeria's total public debt stood at N10.04 trillion (US$64.51 billion) as at end-December, 2013 – with the domestic debt standing at N8.67 trillion (US$55.69 billion) – representing 86.32 percent of the total debt.

It should be further noted that the Nigerian economy has been largely unstable, a consequence of the heavy dependence on oil revenue, and the volatility in prices. The oil boom of the 1970s led to the neglect of agriculture and other non-oil sectors, expansion of the public sector, and deterioration in financial discipline and accountability. In turn, oil-dependence exposed Nigeria to oil price volatility which threw the country's public finance into disarray (Adebayo, 1993; Adesina, 1998; Ahmed and Singh, 2003). According to Sala-i-Martin and Subramanian (2013), waste and 'Dutch disease' manifesting in rapid capital accumulation and negative

[1] The Federation Accounts Allocation Committee (FAAC) is a commission set up by the 1999 constitution of Federal Republic of Nigeria in charge of revenue allocation or the statutory distribution of revenue from the Federation Account among the different levels of government.

[2] The Nigerian Sovereign Investment Authority Act, 2011 (NSIA Act 2011) which establishes the Excess Crude Account has the principal aim of building a savings base for Nigerian citizens, enhancing the development of Nigerian infrastructure and providing stabilization support in times of economic stress, among others. The NSIA as the governing authority is empowered to make regulations and policies as it may determine to be most effective to achieve the objective of the fund. It also has the power to invest in equity, debt, private equity, real estate, infrastructure, fixed income securities and all other asset classes at the international and domestic level. Thus, the portfolio scope of the fund is subject to the assessment criteria, policies and procedures developed from time to time by the NSIA on the advice of its external asset managers. The Act requires adherence with the Generally Accepted Principles and Practices developed by the International Working Group of Sovereign Wealth Funds, otherwise known as the Santiago principles. The Act reflects the legal propriety of the Nigerian Sovereign Wealth Fund and is aimed at ensuring management independence and accountability, corporate governance, and transparency in the fund's transactions (NSIA Act, 2011).

[3] The Petroleum Industry Bill 2012 is a bill before the 7th National Assembly. It is an act to provide for the establishment of a legal, fiscal and regulatory framework for the petroleum industry in Nigeria and for other related matters. It is awaiting passage into law by the National Assembly in Nigeria.

Total Factor Productivity (TFP) characterized Nigeria's 54 year post-independence development experience. While capacity utilization averaged about 77 percent in 1975, it had declined to about 50 in 1983 and until very recently has languished at about 35 percent since the mid 1980s till date. Moreover, since oil revenue dominates Nigeria's Federation Account, the sharing of oil rents govern intergovernmental fiscal relations in the country with an on-going tension between agitations by oil producing states for greater share of resources and demands for redistribution from other regions, particularly relatively less endowed ones. Also, the history of successive revenue allocation arrangements in Nigeria has been most unstable and accompanied by distrust, inadequate information flows, a lack of transparency, and uncertain accountability (Aliyu, 1977; Ashwe, 1986; Jinadu, 1985; Mobogunje, 2001; Ahmed and Singh, 2003; Obinna, 1985; Mbanefoh, 1989, Uche and Uche, 2004). Indeed the present intergovernmental fiscal arrangement prevailing in Nigeria generates a large vertical imbalance in favor of the centre while allocations to the states do not depict any clear pattern of redistribution between regions or any correlation with relative needs. While in theory the arrangement takes into account the effort of each state to mobilize internal revenue, in practice, an equal weight is given for this variable in allocations. Thus, apart from failing to create an incentive to increase states' efforts at revenue generation, the federation account transfer does not appear to have any significant equalization effect. Oil-availability has also fundamentally altered fiscal governance in Nigeria. Like most other oil-producing countries, Nigeria has suffered from poor institutional quality stemming from oil proceeds, a factor which according to Sala-i-Martin and Sambaramanian (2013) has contributed to lower long run annual growth of 5 percent.

It is obvious from the foregoing that Nigeria's dependence on oil can no longer be sustained in the long term and efforts must be intensified to diversify the economy away from oil. One way of achieving this is through a roll-back to the derivation model which was in vogue in Nigeria before the discovery of oil in commercial quantities. The derivation model in revenue sharing in Nigeria requires that all revenues which accrue from or are attributable to a particular state (region) should be allocated in part or in full to such a state (region), irrespective of the fiscal jurisdiction involved or the machinery for the collection. The principle is closely related to the benefit principle of taxation. Its main attraction is that it ensures that a state (region) of origin of any particular revenue would receive more than any other state (region) from the revenue accruing from within it geographical boundary or area of jurisdiction (Nwokedi, 2007). This model worked so well before the scheme of amalgamation in 1914 as it instills healthy competition among the regions to exploit and develop resources within their respective regions. Each of the regions in Nigeria were comparatively well off through exploitation of resources where they have comparative advantage. There was then the groundnut pyramids in the Northern region, the flourishing Cocoa sector in the Western region and the Palm Oil Plantations in the Eastern region. These and many other resources were exploited, developed and exported and they provided the regions with ample revenues to run the regions successfully. The regions were fiscally independent and there was true fiscal federation in the country at the time. All these were to change with the discovery of oil in commercial quantity and near-total abandonment of agriculture over the years in Nigeria. We shall place analytical spotlight on these points later in the paper.

The major objective of this paper is to suggest a rollback to the use of derivation as a revenue sharing model as a way of resolving Nigeria's dependence on oil. To achieve this objective, the paper adopted the descriptive and historical analytical methodology. The rest of the paper proceeds as follows: following this introduction, section 2 reviews the oil sector and the Nigerian economy. In section 3, we reviewed some of the emerging threats to Nigeria's oil industry especially the ambitions US and Chinese energy policies to decouple their countries energy requirements from fossil fuel. In section 4, we provide a model for resolving Nigeria's decades-long dependence on oil. Discussions on the policy implication of a rollback to derivation model and possible benefits to the federation will be dealt with in section 5 while the paper is concluded in section 6.

The oil sector and the Nigerian economy

That the Nigerian economy is intricately interlinked with the oil sector is obvious. Crude oil receipts account for about 80 percent of total government revenue accruable to the federation account[4], 95 percent of foreign exchange earnings, about 15 percent to the country's GDP (14.85 percent in the first quarter of 2014), and 4 percent of total employment – thus making Nigeria one of the most oil-dependent economies in the world (Sampson, 2013). As such, any major shock in the international commodities market negatively affects the Nigerian economy as was evident during the global economic and financial crisis when crude oil prices plummeted from its record high of $147.50 per barrel in July 2008 to less than $40 per barrel in December 2008.

Indeed, but for the Excess Crude Account (ECA) that became handy as a fiscal buffer for the economy, the

[4] The 1999 constitution of the Federal Republic of Nigeria, Section 162(1) specifically provided that "the Federation shall maintain a special account to be called 'the federation account' into which shall be paid all revenues collected by the government of the federation, except the proceeds from the personal income tax of the personnel of the armed forces of the federation, the Nigerian Police force, the ministry or department of government charged with responsibility for foreign affairs and the residents of the Federal Capital Territory, Abuja" (FGN, 1999)

consequences of total dependence on oil earnings would have been catastrophic.

The upside of the oil sector notwithstanding, the focus of the sector at the expense of other sectors has been blamed for the abysmal performance and retarded growth of other sectors of the Nigerian economy notably manufacturing and agriculture (Obo, 1998; Fearon, 2005; Ehwarieme, 1999; DFID, 1999, 2001). In the era preceding the discovery of crude oil in commercial quantity, agriculture was the major source of foreign exchange. The groundnut pyramids of the Northern region, cocoa farms of the Western region and palm plantations of Eastern Nigeria were the major sources of foreign exchange that sustained these respective regions (Taiwo, 1999; Vincent, 2001; Teriba, 1999; Sala-i-Martin and Subramanian, 2013). The story of Malaysian farmers learning the rudiments of palm cultivation in Nigeria but now exporting palm produce to Nigeria underscores the neglect that agriculture has suffered. Malaysia is the world's largest producer of oil palm and the commodity is currently the country's leading agricultural export. Nigeria is still a net importer of food, including staples, despite having about 75 percent arable land of which over 50 percent is not cultivated (World Bank, 2005, 2006).

The manufacturing sector has not fared better since Nigeria joined the 'elite league' of petro-dollar countries. The sector has been performing sub-optimally in spite of the preponderance of incentive packages and government policies. Several studies have established a relationship between the decline in manufacturing and the discovery of crude oil in the country since the late 1950s (Ekundare, 1973; Danjuma, 1994; Mbanefoh, 1997; Obi, 1998; Colier et al, 2003; Emmanuel, 2004; Ramey and Ramey, 2005). It has been argued that the manufacturing sector has been ensnarled by the infamous resource curse or Dutch disease[5] with attendant under-capacity utilization (Gravin and Hausmann, 1998; Goodhand, 2003; DFID, 2001, 2003). The oil sector has not broadened the productive base of the economy and has not alleviated the unemployment situation in the country because it is not a labour-intensive industry. Although Nigeria's export trade is still tilted in favor of crude oil, recent trade figures indicate improvement in non-oil exports. According to the data from the Nigeria Bureau of Statistics (2013), non-oil export rose by 25.5 percent between 2011 and 2012, while the contribution of oil to total trade declined from 71.7 percent in 2011 to 69.2 percent in 2012. Statistics from the Central Bank of Nigeria (2013) also shows that between 2009 and 2012, the non-oil export industry grew at an average rate of about 23 percent annually. The trend is a noticeable departure from the past when crude oil export accounted for over 90 percent of the country's total merchandise trade. These developments suggest that the strategic programmes and policies of the Ministry of Industry, Trade and Investment to promote the development of the non-oil export sector and diversify the export base of the economy are beginning to yield results. The high incidence of unrecorded exports is still a challenge to the non-oil sector and this has affected accurate reporting of the performance of the sector. The non-oil sector is however still dominated by raw commodities and few products with little value addition to the economy.

Amid Nigeria's internal challenges that have culminated in reduced crude oil production, major agencies have cut their forecast for crude oil demand for 2014 (Hitchens, 2013; IEA, 2013). The downgrade in oil demand in 2014 is symptomatic of continuous unease about the challenges to the world economic recovery and the fragility of the euro-zone economies. Despite some cherry developments, there is still pessimism over the global economic outlook, with downside risks continuing to be presented by the sovereign debt crisis in the euro-zone which could negatively impact demand for crude oil in 2014. The Organization of Petroleum Exporting Countries (OPEC) in April 2014 trimmed its forecast for global growth in oil demand in 2014 for the second time in two months. OPEC now expects that world oil demand will rise by 800,000 barrels per day (bpd) in 2014, a cut of 40,000 bpd from its previous estimate after disappointing consumption in industrialized countries in the first quarter of the year. The 12-member cartel cited on-going challenges to the world economic recovery, especially in Europe, as posing considerable uncertainties for product demand. In March 2014, OPEC, which produces more than one in three barrels of crude oil consumed each day worldwide, reduced its overall demand numbers for crude oil by 10,000 bpd. In similar developments, the International Energy Agency (IEA) and the US Energy Information Administration (EIA, 2013) have also reduced their forecasts for global oil demand in 2014. The International Energy Agency (IEA) reduced its forecasts for global oil demand in 2014 for a third consecutive month, predicting the weakest consumptions in Europe in almost three decades. The IEA cut its estimate by 45,000 bpd, predicting that world consumption will

[5] Three major lines of argument have been employed in the theoretical literature to explain the resource curse - the tendency of natural resource abundance/dependence to stultify growth and development. One line follows what has come to be known as the *Dutch disease*. The second focuses on the *volatility effect* of natural resource export-dependence (Gravin and Hausmann, 1998; Ramey and Ramey, 1995; Okoh and Egbon, 1999; and Caballero, 2000), while the third discusses the *rent-seeking effects*. The rent seeking views assert that resource-dependence (especially oil) often lead to a vicious development cycle whereby all actors (public and private, domestic and foreign) have overwhelming incentives to seek links with the state in order to share in the resource pie. This incentive for rent-seeking penalizes productive activities, distorts the entire economy and hinders economic growth. In a dynamic setting, this may produce a *voracity effect* (Lane and Tornell, 1999). The *Dutch disease* thesis asserts that an increase in resource-based revenues (due to a boom) leads to an appreciation in the local currency, increases the capacity of the country to import *tradables* and also enlarges the demand for other goods and services, including *non-tradables* which must be produced locally. This forces a structural adjustment in the domestic economy as resources are diverted out of the non-resource tradable sector (represented by manufacturing) into the production of *non-tradables*. Thus typically, resource booms lead to the contraction of the non-resource (manufacturing) sector (Hausmann and Rigobon, 2003).

increase by a subdued 795,000 barrels a day, or 0.9 percent, to 90.58 million barrels a day in 2014. On its part, the US Energy Information Administration (EIA) cuts its world oil demand forecast for 2014 by 50,000 bpd to 960,000 bpd.

The reduction in forecast for oil demand for 2014 is a worrisome development for Nigeria. Nigeria's crude oil production has declined consistently since December 2013 and was 1.940 mbpd in April 2013 according to OPEC data, less than 2.53 mbpd estimated in the 2014 federal government budget. Although crude oil price is still well above the $79 per barrel budget benchmark, continuous weaker-than-expected crude oil demand could culminate in sharp decline in price. If this pessimistic scenario crystallizes, implementation of the 2014 budget will be in serious jeopardy with far reaching implications for the budget of the three tiers of government in Nigeria which depends largely on proceeds from the Federation Account.

It should be recalled that Nigeria has for long been the highest producer of crude oil on the African continent. However, there are threats to this decades-long dominance as some African countries are stepping up oil production and new discoveries of crude oil reserves in countries which hitherto were not members of the 'elite league' of oil producing countries. For instance, Ghana – West Africa's second largest economy is now an oil producing country and it expects production to more than double by 2021 as output rises at its Jubilee field and as other sites commences production (OPEC, 2013). The country also has new crude discoveries at different stages of appraisal and development. The return of normalcy in North Africa after the Arab Spring has also resulted in improved crude oil production in the region especially in Algeria and Libya until recent upheavals in Libya.

However, the most important threat to Nigeria's dominance is Angola. Angola has twice knocked off Nigeria from her decades-long perch as Africa's largest crude oil producer, first in April 2008 and secondly between May and October 2009. Although these periods coincided with decline in Nigeria's crude oil production due to agitations in the oil-rich Niger Delta region, the difference between Nigeria and Angola's production now stands at just 170,000 barrels per day. There is also noticeable preference for Angola as the choice destination for fresh investments by some International Oil Companies (IOCs). This development has elicited fears that Nigeria could permanently lose its position as the continent's top crude oil producer, a position held since the 1970s. Nigeria's proven crude oil reserves has remained at 37.2 billion barrels as at end 2011, representing 28.7 percent of Africa's total proven reserves of 128.578 billion barrels, according to the 2013 OPEC Annual Statistical Bulletin. Nigeria's proven crude oil reserves ranks as second largest in Africa after Libya's which stood at 48.01 billion barrels as at end 2012. Algeria with 12.2 billion barrels occupies the third spot in proven crude oil reserves while Angola, Nigeria's main rival in terms of production in the continent, ranks fourth with 10.47 billion barrels. The OPEC Annual Statistical Bulletin (2013) also shows that Sudan holds the continent's fifth proven reserves with 6.7 billion barrels while Egypt has the sixth largest reserves with 4.5 billion barrels. Gabon occupies the seventh position with 2 billion barrels, while other African crude oil producers collectively have approximately 7.5 billion barrels of crude oil reserves. While some African countries have had accretion to their proven crude oil reserves, Nigeria's proven reserves have remained stagnant at 37.2 billion barrels since 2006, a development that is symptomatic of lack of new crude oil discoveries. This state of affairs may not be unconnected with somewhat opaque regulatory environment in the oil and gas industry in Nigeria over the years. The situation has been com-pounded by the non-passage of the Petroleum Industry Bill (PIB) which is intended to provide a level playing field for the operators in the oil and gas industry, the oil host communities, the government and other stakeholders in the industry. The much awaited Petroleum Industry Bill (PIB) is presently before the Seventh National Assembly for consideration and enactment into law. The PIB was first presented to the Sixth National Assembly in 2009 but it was not passed into law before the expiration of that assembly. The bill is adjudged to be one of the most profound legislations in the history of Nigeria and the oil sector due to the critical role of the sector in the economy. Although Nigeria's upstream oil sector ranks as one of the most developed in the continent, it is yet to attain its full potentials. The PIB is expected to herald a new fiscal regime for the sustainable development of the oil sector and improved revenue for the country. As expected, the PIB has elicited reactions from several stakeholders. Whilst it has received groundswell of support from some quarters, others contend that it is not an all-purpose elixir that will address all the challenges of the oil sector. For instance, the International Monetary Fund (IMF) has canvassed for the early passage of the PIB. The IMF reckons that the bill would boost investment, government revenue and fiscal transparency. International Oil Companies (IOCs) on the other hand have maintained that the proposed higher taxes in the PIB would make exploration of oil and gas uneconomical in the country. They contend that the bill will make Nigeria's Production Sharing Contract (PSC) regime among the harshest in the world. The IOCs consider the PIB as extremely punitive towards them and this have somewhat stalled new investments. It is estimated that about $50billion planned investment especially in deepwater explorations is on hold and could be imperiled if the controversies surrounding the bill are not quickly addressed and the bill passed into law (NNPC, 2013).

As the PIB debate rages, it is pertinent to note that the legislation is not all about higher taxes and royalties

payable by IOCs, and instituting a Petroleum Host Communities Fund (PHC-Fund). The bill also seeks to make some profound changes in the oil sector by restructuring and improving the management of Nigeria's oil resources. It provides for the dismantling of the state-owned oil corporation – the Nigeria National Petroleum Corporation (NNPC) into nine commercially oriented and profit driven agencies that do not rely on government subsidies. The nine agencies will comprise two regulatory agencies, three funds, three commercial companies and one technical and support bureau. The NNPC would be restructured in the mould of Saudi Arabia's Aramco, Malaysia's Petronas and Brazil's Petrobras with improved corporate governance. The PIB also provides for the delisting of the NNPC from the Public Enterprises Privatization and Commercialization Act. It also requires the government to divest up to thirty percent and forty nine percent of the authorized shares of the National Oil Company and the National Gas Company respectively to the public in a transparent manner on the Nigerian Stock Exchange. The bill seeks to optimize domestic gas supplies, particularly for power generation and industrial development, and encourage domestic refining of crude oil (PIB, 2012).

Furthermore, to reinforce our call for quick diversification of the Nigerian economy away from oil, it is important to review emerging threats arising from impending paradigm shifts in energy policies of two of the world largest economies – the United States and China. Indeed, development in energy policies of these two countries is of strategic interest to Nigeria. The United States was until recently the largest importer of the country's crude oil – a position that China has currently taken. Therefore, any major shift in energy consumption by any of these countries could have negative consequences for Nigeria and other oil producing countries.

Emerging threats to Nigeria's oil dependency – US and Chinese energy policies

The United States is vigorously pursuing an energy policy which seeks to move the country towards attaining energy independence and away from Middle East and Africa energy sources. The United States is projected to become the world's largest producer of crude oil and other liquid fuels by 2020 and will be entirely self-sufficient by 2030, and a net exporter by 2035 according to some estimates (EIA, 2014). The International Energy Administration (IEA, 2013) believes that the United States will become the world's largest oil producer by 2017, overtaking current leaders Saudi Arabia and Russia. According to Powell (2013), by 2017 the US would no longer need to buy oil from any source but Canada. The quest for US energy independence has been bolstered by new drilling techniques and technology - horizontal drilling and hydraulic fracturing (Hitchens, 2013).

Another major development recently in the global energy market is the move by China (the second largest oil-consuming nation) to commence production of shale oil (Powell, 2013). The imminent commencement of shale oil exploration in China has sent shock waves around the global energy market. China is estimated to have roughly 240 billion tons of accessible oil shale reserves. According to estimates by the Organization of Petroleum Exporting Countries (2013), about 10 million tons of oil can be produced from these reserves annually. In obvious panic, OPEC has constituted a committee to study the likely impacts of the shale oil exploration on the price of oil in the international commodities market and the likely economic impacts on oil producing countries. Although shale oil extraction is more costly than the production of conventional crude oil, it is nonetheless a substitute for conventional crude oil. There are also concerns about the environmental impact of shale oil production but this also is unlikely to deter China as the country is determined to embark on the project. For China, developing indigenous energy is a high priority. China's continuous reliance on oil imports somewhat ties its prosperity to political turmoil in the Middle East, and Africa. China also reckons that for strategic national interest, it is expedient to limit its energy needs from sources susceptible to interdiction and disruption.

Should these optimistic scenarios in the United States and China crystallize Nigeria and a host of other countries that export crude to the US and China would have to look for other markets. This could have grave consequences for the price of crude oil and it is feared that some oil producing countries could face the threat of becoming failed states (Herbst, 2013). The United States has been the largest importer of Nigeria's crude oil over the years but this is changing very fast. In the last decade, Nigeria accounted for between 9 and 11 percent of US total crude oil imports. However, Nigeria crude oil has recently dropped to below 5 percent share of total US crude imports. According to US Energy Information Administration (EIA, 2013) data, over the past five years the United States' reliance on Nigerian crude imports has dropped 63 percent, falling from a peak of 1.084 million barrels per day in 2007 to just 405,000 barrels per day in 2012.

This development underscores the need for the country to quickly decouple its revenue earnings exclusively from oil to other non-oil sectors. The needed diversification however, will be difficult to achieve if the country retains the current revenue sharing model which has encouraged rent seeking behaviour and over dependence on oil revenue by all the federating units in the country. It is therefore, imperative that the country tinkers with a new revenue sharing model that will encourage fiscal independence among the federating units.

Resolving Nigeria's oil dependency – The derivation model

To resolve Nigeria's dependence on oil as major revenue

source, the authors propose a revisit and re-enthronement of the derivation model. This proposal is not made lightly as the authors acknowledge that it is fraught with controversies. Indeed, one of the most controversial debates in Nigerian political-economic discourse is the way government revenue is shared amongst the components tiers of government in the country, otherwise known as revenue allocation (Ndongko, 1981; Osemwota, 1984; Mbanefoh, 1989; Mbanefoh and Anyanwu, 1990; Osedolor, 1998; Nyong, 1998; Onimode, 1999; Nwokedi, 2009; Uche and Uche, 2004). Revenue allocation or the statutory distribution of revenue from the Federation Account among the different levels of government has generated so much debate since the country's independence in 1960 and is today one of the contentious issues for discussions before the National Conference (sitting at the time of this write-up). As remarked by Uche and Uche (2004), the focus on revenue sharing, as opposed to revenue generation, is the primary cause of economic dependence of Nigeria on oil proceeds.

As earlier stated, from 1970 until very recently, revenue from oil constituted over 80 percent of the country's total earnings. Thus, the importance of the federal center has increased substantially over the years and as a consequence, a desperate struggle to win the state power at the centre ensued since this control meant for all practical purposes, being all powerful and owing everything (Uche and Uche, 2004). This agitation to control the centre has led to abandonment of other income earnings potentials that abound in the federating units. It is in this wise that the authors call for a rethink of the current revenue allocation criteria in Nigeria and a reversion to the system of revenue sharing based substantially on derivation.

It must be restated that before the discovery of oil in commercial quantity in 1956 agriculture was the mainstay of the Nigerian economy. Till date, a greater proportion of the population – about two thirds of the total labour force of the nation, depends on the sector for their livelihood and the rural economy in particular is propelled by agriculture. It is the main source of food for most of the population and also the dominant economic activity in terms of employment and linkages with other sectors of the economy, serving as a major source of raw materials for the agro-allied industries and a potent source of foreign exchange. The sector has been the highest contributor to the nation's GDP over the years – accounting for 42.07 percent in 2008, 35.8 percent in 2009 and 2.2 percentage points to the growth in real GDP in first quarter of 2010 (Uzor, 2011). Agriculture was also the major source of foreign exchange for the economy. For instance, the groundnut pyramids of the Northern region, cocoa farms of the Western region and palm plantations of Eastern Nigeria were the major sources of foreign exchange that sustained the respective regions (Phillips, 1971; Mbanefoh, 1977; Suberu, 1998; Onimode, 1999). The level of decay and neglect of agriculture in Nigeria is often highlighted by the story of Malaysian farmers learning the rudiments of palm cultivation in Nigeria but now exporting palm products to Nigeria. Oil palm is currently Malaysia's leading agricultural export and the country is the world's largest producer of the commodity. The success story of the sector in the pre-oil boom era has been relegated to the footnote of history following the emergence of crude oil as the prime mover of the nation's economy. This, in turn, created a false sense of affluence which impacted negatively on agriculture culminating in low productivity and relegation of the once vibrant sector. The decline in the share of agriculture in foreign exchange earnings is an apt illustration of negative correlations with oil revenue earnings.

Nigeria is currently a net importer of food, including staples such as rice where local production accounts for just 500,000 tonnes, whereas annual consumption stands at over 2.3million tonnes, leaving a huge deficit of about 2 million tonnes which has to be met with imports. It is estimated that the country spends over US$300 million annually on rice imports alone. In fact, in the heat of the food crisis in 2008, it was reported that the federal government of Nigeria spent N80 billion in one instance for the importation of rice and also slashed duties on rice imports from 100 to 2.7 percent to cushion the effects of food shortage on the citizenry (Sanni, 2010). The large volume of rice import has over the years sustained rice farmers in business in other countries (e.g. Malaysia) while domestic opportunities abound and has remained largely untapped. The massive importation of agricultural produce is dangerous in that it does not only drain the nation's scarce reserves, it also exposes the economy to external shocks and vagaries especially inflation.

It is worth re-stating the fact that Nigeria's golden years in agriculture was before the discovery of oil in commercial quantity and consequent consignment of agriculture to the backyard. The golden years of agriculture was also when the regions were fully involved in agriculture; each of the regions specializing on products where it has natural comparative advantage (Obi, 1998; Mabogunje, 2001). The export earnings from these produce made the regions financially and fiscally independent from the centre. All these were to change with the discovery of oil and accretion of oil revenues to the federation account for distribution to the various tiers of government.

The decline in crude oil earnings and the resultant drop in revenue accruing to states from the federation account have once again brought the reality of looking beyond the federation account to bear on many states and local governments in Nigeria.

It is pertinent at this point to go back the memory lane on the subject of revenue derivation and allocation in Nigeria and the crisis it has generated over the years. The agitation over revenue derivation and sharing began with the creation of a Central Account for the Federation to which the Regional Governments contributed and

received their allocation of revenue under the scheme of the Amalgamation of the Northern and Southern Protectorates in 1914 introduced by Lord Lugard, who was the first Governor-General of the amalgamated Nigeria. The Scheme placed administrative areas of the Northern and Southern Nigeria under two Lieutenant Governors, each with his responsibility for the area and departmental organization, while these departments, which were practically indivisible, and whose functions were common to both, were centralized under the direct control of the Central Government (Mbanefoh and Anyanwu, 1990; Nwokedi, 2009). Each of the regions submitted separate budgets proposals, which were incorporated in a centralized annual budget.

At the time of the amalgamation of the two regions, the principle of derivation was in operation. Each of the regions collected revenue of its internal resources mainly from agriculture – cash or export crops, taxation, import and excise duties. The mineral sector, which was the responsibility of the central government had not yet been developed to become a major national income earner. Consequently, the Southern Region, which had sea ports and consumed much liquor, and had abundant agricultural cash crops, generated more revenue from taxation, import and excise duties, etc. The Southern Region had far more revenue than was required to meet the budgetary requirements for the administering the region, while the Northern region had not enough revenue to meet its administrative and developmental costs. It had, therefore, to rely on the Colonial Government to defray its annual budget deficit (Colonial Office, 1953).

It was principally to tap the surplus revenue of the Southern Nigeria in order to subsidize the budget deficit of the Northern Nigeria and also to provide most of the fund for Central Administration that the amalgamation process was contrived (Nwokedi, 2009). By 1946, a new constitution was introduced under the then colonial Governor, Sir Arthur Richards, which formally gave birth to a Federation of three Regions, the Northern and the Western and Eastern regions which were created from the old Southern region of Nigeria. The establishment of the three regions necessitated the allocation of the functions and revenues to the regions by the Central Government. To this end, the Phillipson Commission was appointed in 1946 to advise the Federal Government. The Commission recommended the adoption of the Principles of Derivation and Even Development for the revenue sharing amongst the Regions. This recommendation soon gave rise to agitation by some regions, which regarded the principles as unsatisfactory (Ekundare, 1973; Adebayo, 1993, Adesina, 1998, Nwokedi, 2009). The Hicks/Phillipson Commission appointed in 1951 reviewed the revenue allocation formula and recommended some new principles, which would also meet the constitutional changes of the new Macpherson Constitution of 1951. The 1951 Constitution enhanced the federal structure by increased legislative and financial autonomy to the Regional Governments.

Accordingly, the Federal Government adopted the new revenue sharing formula based on the four principles of Independent Revenue, Need, Derivation and National Interest. But it was not long that disputes amongst the regions over the implementation of these four principles of revenue sharing led to agitation for a review along with further constitutional reforms. With the adoption of revised constitution known as Oliver Littleton Constitution of 1954, which further devolved more legislative and administrative powers from the centre to the regions, the revenue allocation was also revised to reflect the constitutional changes. The Chicks Commission Report of 1953 was introduced. The Chicks formula placed more emphasis on the Principles of Need and National Interest. The Chick Report also recommended that mining should continue to be under Federal control while mining royalties should be allocated to the regions from where the minerals were extracted (Teriba, 1966; Tamuno, 1998).

Just before independence the Constitutional Conference held in 1957 commissioned another revenue review exercise. The Raisman Commission made its recommendations in 1958 (Colonial Office, 1958). The Commission's Report was significant in a number of ways. First, it was the report that was adopted for the Independence Constitution of 1960 by which a sovereign Nigeria was governed. Two, it re-enacted the provision of mineral resources in the Exclusive Legislative List under Federal Government control. Thirdly, it de-emphasized Derivation Principle by reducing from 100 to 50% the revenue derived from mining, rents and royalties to the regions of origin. It redistributed the other 50% as follows: 30% to the Centre and 20% to the newly designed Distributable Pool Account. The reason given by the Raisman Commission for abandoning the application of 100% derivation to region of origin was that at this time there was a great prospect of phenomenal rise in revenue derivable from mineral oil exploration in the Eastern Region and if the percentage derivation was not reduced now then in future, the revenue accruing to the Eastern Region would be awesome and far exceed those of other regions (Colonial Office, 1958).

It therefore recommended that funds from Distributable Pool Account to which the 20% revenue derived from mineral resources was to be paid, should be shared amongst the regions on the principles of "continuity" of existing levels of service and Minimum Responsibilities, as well as the Principle of Need. This implied the use of population as the indicator of need used in the application of previous revenue application formula.

There were subsequent revenue allocation review exercises (see FGN, 1967, 1970, 1971, 1975) but the basic principles adopted by Raisman Commission's recommendation for revenue allocation endured throughout the life of the First Republic as most of them were adopted under Independence Constitution of 1960

and also under the Republican Constitution of 1963, when a fourth region, that is the Mid-Western Region was created. The 1963 Constitution (FGN, 1963) provided in Section 141, the formula for sharing revenue from Distributable Pool Account to the regions as follows:

North	-	Forty Nine Fifths
East	-	Thirty One Ninety Fifths
West	-	Eighteen Ninety Fifths
Mid-West	-	Six Ninety Fifths

The Binn's Commission set up in 1964 to review the Raisman Commission's formula did not make any radical changes but merely added a new principle of Financial Compatibility in the distribution from the Distributable Pool Account (Binns Commission, 1964). This resulted in the redistribution of the fund from the Distributable Pool Account in the following percentage:

North	-	42%
East	-	30%
West	-	20%
Mid-West	-	8%

According to Nwokedi (2009) this new principle was deficient to the extent that it did not realistically and unequivocally determine in relative terms, the cash position of the regions, their tax efforts and standard of services provided by them. Nevertheless, the system remained in force until the military regime upset the fairly stable revenue allocation system under civilian rule and adopted a chaotic system that over-centralized revenue resources and control.

There were some lukewarm attempts with premeditated outcomes to review revenue allocation system under the military (FGN, 1967, 1970, 1971, 1975, 1984). The Gowon Military Regime set up the Dina Committee of 1968. Though the Committee made some useful recommendations, the government rejected its recommendation. Rather, the Gowon Regime preferred to make provisions for allocations by issuance of Decrees. The Decrees were punitive as they were disruptive of the Federal System. Though the country was in a civil war, there was no rational reason other than the militarist autocratic tendency that informed the Gowon Regime to over-concentrate the revenue resources in the Federal Government and to instantly disrupt the Federal System as all the states were severely starved of funds, deprived of independent sources of revenue generation and were constrained to crawl on their knees before the federal government to obtain funds for both their recurrent and capital expenditures. In fact, the advent of the military government under General Gowon marked the beginning of the tendency to disrupt the institutional framework and the principles on which the Nigerian Federation was established. Once the states were starved of the requisite funds to run their governments, and were deprived of independent source of revenue, they were downgraded to exist as glorified local governments or administrative units of the federal government. It is in this context that reference is made of the following Decrees promulgated by the Gowon regime.

(i) Decree No. 13, 1970, which reduced revenue accruing to the states on Export Duties from 100 to 60%; duty on fuel from 100 to 50%, mining rents and royalties from 50 to 45%. The reductions were to be paid into Distributable Pool Account, out of which 50% was retained by the Federal Government and the other 50% shared amongst the states, half of which, on the basis of equality of states and the other half on the basis of population.
(ii) Decree No. 9 of 1971, transferred rents and royalties of off-shore petroleum mines from states to the Federal Government while
(iii) Decree No. 6 of 1975 altered the existing formula of allocation from 45% to 20% of mining rents and royalties accruing to the states of origin. The same year,
(iv) Decree No. 7 of 1975 introduced standardized personal income tax throughout the Federation thereby undermining states powers to vary taxes and rates as they deemed fit within their jurisdiction (FGN 1970, 1971, 1975).

But while the Federation was staggering under the onslaught of financial strangulation of states by the Gowon Regime, the Mohamed/Obasanjo Military Regime that toppled the Gowon Regime dealt devastating blows to the fragile federal system. In 1979, the Obasanjo Regime commissioned the Technical Committee on Revenue Allocation under the Chairmanship of Professor O. Aboyade to formulate a revenue allocation formula preparatory to the military hand-over to civil administration in 1979 (FGN, 1979). The Aboyade Committee stabbed the Federation at its most vital organ by destroying the principle of derivation, which had been the basic tenet of true fiscal federalism. The Committee in its report urged the abrogation of the application of the principle of derivation in revenue allocation, which it erroneously attributed to be largely responsible for poisoning inter-governmental relations and for hampering the sense of national unity. The Committee went further to assert that the derivation principle had the effect of denying the Federal Government the powers to effect inter-state redistribution of income. The Committee's report must have created the basis for the virtual abandonment of the principle of derivation by successive military regimes, when revenues accruing to the states were drastically reduced to pitiable levels. But as later events have proved, the de-emphasis of the principle of derivation has caused more political tensions and threats to national unity in recent times than in the post-colonial era when states were allocated 50% of revenue derived from their natural resources (Oyediran and Olagunju, 1979; Rimi, 1980; Ehwarieme, 1999; Gurr et al., 2001, Uche and

Uche, 2004).

It is also to be observed that the Committee's report must have encouraged the Obasanjo military regime to abandon the usual practice of embodying the formula of revenue allocation in the Constitution as exemplified in Section 41 of the 1963 Constitution (FGN, 1963). Rather the Regime preferred to embody in the 1979 Constitution a set of guidelines for determining the mode of revenue allocation but transferred the responsibility of determining the formula for revenue allocation for the Federation to the National Assembly acting on the recommendation of a Revenue Allocation and Fiscal Commission established under the constitution (FGN, 1979). Furthermore, for the first time in the constitutional history of Nigeria, provision was made in the 1979 Constitution for the allocation of revenue from the Federation Account to the Local Governments which were specifically listed in Part 1 of the First Schedule of the Constitution (FGN, 1979). This provision is strange to Federal Constitution and was later to cause controversy between the Federal and State Governments. This controversial provision was replicated in the 1999 Constitution (FGN, 1999). To be specific, Section 162(2) of the 1999 Constitution vests on the National Assembly the power to determine the formula for revenue allocation on the recommendations of the proposals from the President of the Federal Republic of Nigeria based on the advice of the Revenue Mobilization Allocation and Fiscal Commission[6], provided that the National Assembly must ensure that the principle of derivation of not less than 13 percent of the revenue accruing to the Federation Account directly from the natural resources must be constantly reflected in any revenue allocation formula. And in accordance with Section 162(3) of the 1999 Constitution (FGN, 1999), the National Assembly has powers to distribute the amount outstanding to the credit of the Federation Account among the federal and state governments and the local government councils in each state. These provisions under the 1979 Constitution did not explode into open and bitter controversy between the federal and state governments, but resentments were noticeable amongst marginalized oil-producing ethnic communities during the civilian rule under the 1979 Constitution leading to the setting up of Presidential Commission on Revenue Allocation (see FGN, 1980a, 1980b, 1980c, 1980d, 1980e). But under the 1999 Constitution, the provisions of the Constitution on mode of revenue sharing caused violent social eruptions and disputes between the federal and state governments (FGN, 2001). The controversy between the federal and state governments reached its peak with each suing the other in the Supreme Court (FGN, 2001). The disputes centered on which tier of governments, federal or state has possession of off-shore mineral resources, deciding the effective date of payment of 13 percent derivation and direct allocation of revenue from Federation Account to the local governments and payment of primary school teachers in the local governments.

Because of the great significance of the Supreme Court ruling on April 5, 2002 (Supreme Court, 2002), on the contentious constitutional disputes between the federal and state governments and its far-reaching implications in re-defining the powers of the two tiers of government on resource control, revenue derivation and funding of local government, a comment on the salient points on the Supreme Court ruling is important here.

The Federal Government had asserted that it had exclusive right to the natural resources located within the continental shelf of Nigeria and therefore denied the right of any state in the Federation to any revenue derivable from that natural resource. The eight littoral states namely, Bayelsa, Akwa Ibom, Cross Rivers, Delta, Lagos, Ogun, Ondo and Rivers disputed the federal government claim and each contented that its territory extended beyond the low-water mark into its territorial water and even onto the territorial continental shelf and the exclusive economic zone. The littoral states therefore maintained that natural resources derived from both onshore and offshore are derivable from their respective territory and in respect thereof, each was entitled to the "not less than 13 percent" allocation as provided in the proviso to sub-section (2) of Section 162 of the 1999 Constitution.

In order to resolve the dispute, the Federal Government took out a writ of summons in the Supreme Court praying for "a determination of the seaward boundary of a littoral state within the Federal Republic of Nigeria for the purpose of calculating the amount of revenue accruing to the Federation directly from any natural resources derived from the state pursuant to Section 162 (2) of the Constitution of the Federal Republic of Nigeria, 1999" (FGN, 1999).

All the states of the Federation were joined in the suit. In their counter-claims (Proposal, 2001), some of the states mostly oil producing states, challenged the constitutionality of the Federal Government action in refusing to pay their 13 percent derivation in accordance with Section 162 (2) of the Constitution with effect from the date of coming into force of the 1999 Constitution, and also the non-inclusion of revenue derived from gas exploration from their states in their 13 percent derivation. They therefore sought the court injunction to restrain the federal government from violating the Constitution in the manner declared. They also disputed the Federal Government's claim on off-shore resources.

After hearing the arguments of both parties to the dispute, the Supreme Court (Supreme Court, 2002) ruled among others as follows:

i. That the seaward boundary of a littoral state within the Federal Republic of Nigeria for purposes of calculating

[6] Revenue Mobilization Allocation and Fiscal Commission is a commission set up by the 1999 Constitution to advise the president on the model for sharing revenue accruing to the Federation Account among the three tiers of government (FGN, 1999).

the amount of revenue accruing to the Federation Account directly from any natural resources derived from the state pursuant to Section 162(2) of the 1999 Constitution is the low-water mark of the land surface thereof or (if the case requires as in the Cross Rivers State with an archipelago of islands) the seaward limits of inland waters within the state.

ii. That the 1999 Constitution having come in force on 29th May, 1999, the Principle of Derivation under the proviso to Section 162(2) of the Constitution came into operation on the same day 29th May, 1999 and the Federal Government is obliged to comply therewith from that data

iii. That the under-listed policies and/or practices of the Federal Government are unconstitutional, being in conflict with the 1999 Constitution, that is to say:

a) Exclusion of natural gas as constituent of derivation for purposes of the proviso to Section 162(2) of the 1999 Constitution

b) Non-payment of shares in respect of proceeds from capital gains taxation and stamp duties

c) Funding of the Judiciary as a first line charge on the Federation Account

d) Funding of Joint Venture Contracts (JVCs) and the Nigerian National Petroleum Corporation (NNPC) priority projects as first line charge on the Federation Account.

e) Unilaterally allocating one percent of the revenue accruing to the Federation Account to the Federal Capital Territory of Abuja.

The Supreme Court (Supreme Court, 2002) also ruled that it was unconstitutional for the Federal Government to allocate funds from the Federation Account to the local governments in the Federal Capital Territory as they should not be classified as local governments in the states under the Constitution. Furthermore, the Court considered it irregular for the Federal Government to allocate funds from the Federation Account direct to the local governments in the states and paying salaries direct to local government primary school teachers in the states thereby by-passing the state governments which have primary responsibility for local governments. It was argued that such funds should be paid into the State/ Local Government Joint Account for states to disburse to their respective local governments in accordance with sub-section 5 of Section 162 of the 1999 Constitution (FGN, 1999).

From the above Supreme Court ruling, it is evident that apart from the off-shore claims which went in favour of the Federal Government, that the states emerged from the suits happier and collectively richer than before because most of their funds that were arbitrarily held or disbursed by the Federal Government has been declared unconstitutional and the Federal Government was obliged to comply with the Supreme Court ruling. For instance, the funds hitherto taken out of the Federation Account as a first line vote by the Federal Government (before sharing the balance) to fund the Judiciary, Nigeria National Petroleum Corporation (NNPC) and the Federal Capital Territory, Local Governments, servicing of external debts and retention of derivation from gas exploration and capital gains tax, must now be returned and be paid into the Federation Account for sharing amongst the two tiers of government as provided in Section 162 of the Constitution. In the same vein, monies realized from sales of Federal Government-owned companies and parastatals hitherto kept in a separate and exclusive account of the Federal Government must now be paid into the Federation Account for disbursement in accordance with revenue sharing arrangements under the Constitution.

It must be mentioned that though the states, in general, gained by the Supreme Court ruling as more revenue accrued to them from a fuller Federation Account not tampered with, by first line deductions by the Federal Government, the littoral states were particularly sad and have been increasingly restive over the court ruling on off-shore derivation which deprived them of revenue from off-shore oil exploration. The most adversely affected states include Ondo, Akwa Ibom and Cross River States whose 13 percent derivation stem mostly from off-shore operations. Indeed, faced with mounting socio-political pressure and discontent from the littoral states against the Presidency for initiating the Supreme Court ruling on the resource control, the then President, Olusegun Obasanjo, after a cabinet meeting on July 17, 2002 (FGN, 2001) worked out in interim political solution by giving the most affected littoral states namely: Akwa Ibom and Ondo States, monthly allocations of N600 million and N210 million respectively.

Whatever informed the President's action and however laudable it would seem in some quarters, the fact remains that his action was a mere palliative and had not addressed the main question of evolving a satisfactory revenue allocation formula which would take into account the Supreme Court ruling and also the need to devolve more revenue and powers to the states in response to popular demand for a true fiscal federal system in Nigeria.

DISCUSSION AND POLICY IMPLICATION OF A ROLLBACK TO DERIVATION MODEL

What does a rollback to the derivation model portend for Nigeria in general and the federating units in particular? A fiscal federal system in Nigeria based essentially on derivation has enormous benefits to the states and the country in general. First, a revenue formula that gives greater weight to derivation will enable each state in the federation to look inwards and exploit the resources – human, mineral and others that abound in their localities. By so doing, the country would diversify her revenue base and decouple its fiscal operations from the vagaries associated with oil revenue. Secondly, apart from helping to douse the tension and feelings of injustice which is widespread in the oil producing states, it will also help to

encourage the non-oil producing states to develop other natural resources especially agriculture, which was the mainstay of the regions then and which have long been abandoned in their struggle for their share of the oil money. It should be noted that revenue allocation was never an issue in the country until crude oil became the mainstay of the economy. In fact, in the early years of independence, the then three regional governments controlled their resources and paid tax to the Federal Government. The Northern, Western and Eastern regions controlled 50 per cent of proceeds from the hides and skin, groundnut, legumes and other food crops from the North; cash crops like cocoa and kola nuts from the west; and palm produce from the east. The three regions had a clear vision of what they wanted. The vision, which was progressive and complementary, not only made the regional governments economic power bases, it also made Nigeria a major exporter of agricultural products (Arowolo, 2011).

Moreover, derivation principle will naturally increase the revenue base of oil producing states tremendously in the short term but with time; other states will be encouraged to exploit other resources that abound in their areas as they too will be allowed to retain 50% of the proceeds of the revenues accruing from their areas. This will bring about the much needed diversification of the economy. The argument that re-distribution of resources from the much endowed states to less endowed states will promote even development is akin to weakening the strong to strengthen the weak. This is clearly counter-productive as Nigerian experience has shown. Since crude oil was discovered in commercial quantity in Nigeria about 58 years ago, the country has lapsed almost irretrievably into a mono-product economy. Successive governments in Nigeria has harped on the need to diversify the economy but none so far has been able to break out of what has come to be known as the ‘oil doom syndrome’ or ‘resource curse’. Nigerian governments at all levels seem content with merely gathering the enormous rent from crude oil exploration and sharing same without any value addition or developing other productive non-oil sectors of the economy.

Furthermore, derivation model will give each state of the federation a lot of fiscal space to compete with other states in areas of development and capacity building. As was the case in Nigeria’s history, the Western region used revenues from cocoa to sponsor free education in their region; the Eastern region also did the same with revenues from palm oil production while the Northern region also encouraged their region in education, manpower and capacity building through scholarship and other incentives. The regional governments then demonstrated that development can only move from the states to the centre and not the other way round.

Again derivation will stem the tide in incessant and unproductive state creations. Indeed, part of the sad history of military rule in Nigeria is in areas of state creation. The military governments hindered the practice of true federalism in Nigeria through incessant and unsystematic creation of new states. The outcome of this was an excessively bloated fiscal structure and many of the states created were not financially viable as they lacked the fiscal capacity to achieve any meaningful development. Although it was argued that creation of states and local governments by the military government was to produce a balanced federation, the emergence and proliferation of states and local governments have continued to pose new problems for intergovernmental fiscal relations. Presently, only about three states (namely Lagos, Kano and Port Harcourt) out of the 36 states in the federation are viable and could potentially maintain reasonable level of service from their internally generated revenue. The rest of the states including the federal capital territory exits in parasitic fashion – living and depending entirely and miserably from the proceeds of the federation account. And the call for more states to be created remains unmitigated and getting louder by the day. It is also one of the contentious issues before the constitutional conference sitting at the time of writing the paper. The only reason for those calling for more states to be created is to enable them have a greater share of the federation account – not that the new states to be created can stand alone fiscally and financially. Only a true fiscal federation will stem this tide.

Derivation will also help to bring about fiscal discipline and proper prioritization needed in the states and the federal government. The current revenue sharing formula places too much funds in the hands of the federal government which has little to do in addressing the yearnings of the people at the grassroots. These enormous funds in the hands of the federal government have led to wastages, wanton corruption and high cost of governance. Undoubtedly, the states need a greater percentage of revenue allocation. After all, the states and local government areas are closer to the people and are, therefore, in a better position to directly address the yearnings of the people at the grassroots. Derivation can help to bring down the cost of governance as each state in the federation including the federal government will learn to cut its coat according to the size of its cloth.

Finally, to ensure stability and avoid dislocation of existing services in states, the rollback to the derivation model could be by increments – perhaps, an accretion of 1.5% per annum for the next 24 years. This would amount to additional 36% percent to the present 13% bringing the total to 49%. It is envisaged that the 24-year period is enough for non-oil producing states to readjust to new fiscal discipline and long enough for the country to decouple from its near-total dependence on proceeds from oil.

Conclusion

Nigeria has depended precariously on revenue from oil

for too long. This dependence on a single product for the country's fiscal operations has been traced to the institution of a revenue sharing formula that de-emphasized derivation in favor of other principles. It is obvious that unless the country returns back to the era when derivation was a major index for revenue sharing, the current agitations by oil producing states will linger and the country's economy may never be diversified away from oil. This reversion will naturally affect most states in Nigeria that are not naturally endowed especially oil but there are abundant other resources that these states could exploit especially agriculture. In the long run, this may be a small price to pay compared to the impending catastrophe that the country could face in the world in the near future without oil.

Conflict of Interests

The authors have not declared any conflict of interests.

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