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FISCAL FEDERALISM AND REVENUE GENERATION CAPABILITY OF STATES IN NIGERIA

SEGUN WALE OLAYINKA; & OMOTAYO AJIBIKE ADEKOLA

Department of Accountancy, the Polytechnic, Ibadan.
Corresponding Author: *walesamuel52@yahoo.com*, *kolatayo2003@yahoo.com*

Abstract

The study examined the effect of fiscal federalism on revenue generation capability of the states in Nigeria. The study was based on descriptive survey using data gathered from Nigeria Bureau of Statistics and Central Bank of Nigeria Statistical Bulletin covering the periods of 2011 to 2017. It was revealed through the findings of the study that the internally generated revenues of the states have not witnessed the desired improvement over the years. The revenues generated internally are growing at arithmetic progression while the financial commitments of the states are growing at geometrical progression. Based on these findings, it could be concluded that fiscal federalism has encouraged over-dependence of states on revenues from the federal and thereby weakened their ability to generate internal revenues. It is therefore recommended that the fiscal federalism practiced in Nigeria should be reviewed to diffuse too much power concentrated at the centre and encourage the states to learn from the private sector on how to source for revenue internally.

Key Words: Federation Account, Federalism, Fiscal, Internally Generated Revenues, Government.

Introduction

For any country to exist there must be rulers (Government) and the ruled (citizens). Between these exists a social contract. Social contract binds citizens together and with their government. The contract requires the government to tap all the economic and natural resources of the country and provides social amenities such as educational facilities, good roads, hospitals, pipe-borne water etc. to the citizens. Maintaining this social contract is particularly important and difficult in the midst of the social upheavals that frequently accompany the development transformation of the nations of the world and most especially the growing nations. Coupled with these, is that the resources available to the government are extremely limited to enable the government to fulfil her obligations appropriately. As a result of this, the essence of revenue generation for the maintenance of the society regardless of its economic structure maybe centrally planned, free-market or mixed has become indispensable. Just as revenue generation is crucial towards the existence of individuals and companies, so also it is to the survival of any government. No wonder revenue generation has become a critical issue in this present dispensation. This is even more pronounced in the developing economies like Nigeria where diversity is the order of the day as a result of different ethnics, languages, cultures, religious etc.

Sequel to this, issue of revenue generation has become a great concern in Nigeria over the years. According to AFDB, UNECA, and OECD (2010) as stated by Salami (2011), the major sources of public revenue for the past three decades in Nigeria are proceeds from taxes, sales of crude oil, levies, fines, tolls, penalties and charges. Out of all these revenue sources, oil revenues average 27% of GDP while tax revenues averaged 6.4% during

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2001-2009 periods. Oil revenues have been volatile, ranging from 35.6% in 2001 to 19.6% in 2009 when oil prices dropped as a result of the global recession. Despite this deterioration in revenue generation at the centre, the three tiers of government still rely heavily on it with little or no passion to strive for internally generated revenue. Especially, the alarming rate of feeble, fragile and crawling states that only wait for federal allocation rather than being creative in generating revenue internally has been a hard nut to crack. These states came into being to please specific set of people or some ethnic growths. As a result, they are always inactive and non-productive in terms of economic growth and development. Their inactivity has continued to be a serious threat to national development (Chujor & Dickson, 2017).

According to Odoko and Nnanna (2009), the internally generated revenue of states and local governments between 2001 and 2005 accounted for a paltry 11.9 and 4.8percent of the total revenue of states and local governments respectively. This development raises a lot of concerns as the nonchalant attitudes of these institutions towards internally generated revenue could be traced to their over-dependence on allocation from the central government. This over-dependence on allocation from the Federation Account weakens these institutions responsible for internal revenue generation, such as the Board of Internal Revenue (BIR) and overtime, the capacity to generate more revenue diminishes. This problem boiled and rooted down in the centre pedal of federalism which the country called true federalism. Akindele and Olaopa (2002) in their study exclaimed that the twin issues of revenue rights and fiscal jurisdiction have remained the most dominant and contentious in the relationship between local governments, as the third-tier of government and the other two tiers - the federal government and the states - within the parameters of Nigerian federalism.

In the whole world, there are only twenty-four countries out of the one hundred and ninety-three countries practising federalism. There are four African countries such as Nigeria, Comoros, South Africa and Ethiopia in this practice. Fiscal Federalism therefore is the inter-government fiscal relation as enshrined in a federal constitution provided for the functional responsibilities to be performed by the multi –levels of government and the financial resources that can be raised for provision of collective goods and services. This means that this system of government depicts that the management of economy in a country is the responsibility of three governments and not one central government. This system of administration is unique in the sense that it places the economy at a higher level of utility compared with the centralized system (Salami, 2011).

However, several opinions have been expressed by different scholars on whether or not fiscal federalism has impact on revenue generation. Also, a lot of studies carried out in Nigeria so far examined fiscal federalism and revenue allocation while only few studies took revenue generation into consideration. Hence, this study will dig deep to unveil the relationship between fiscal federalism and revenue generation in Nigeria.

Literature Review

Studies on fiscal federalism and revenue as a concept have been given a considerable attention both in the developed and developing countries by different scholars. However, the focal point of a lot of these scholars usually revolves around examining fiscal federalism and revenue allocation with little or no emphasis on revenue generation.

In the study of Olofin, Olubusoye, Bello, Salisu and Olalekan (2012) where two items of revenue (statutory and VAT) shared among the states including FCT and all the Local Government Areas (LGAs) between May 1999 and December 2008 were analysed using Cluster analysis, it was discovered that a small number of states constituting each of the clusters in terms of statutory allocation, VAT and net statutory allocation occupied the range of values for highest and lowest allocations. Specifically, the SE zone was found to be the least beneficiary of statutory allocation. In the case of VAT, NW zone benefited more than other zones while NC dominates the cluster of least beneficiary states. It was further disclosed that the oil producing states received the largest net statutory allocation even above the most industrialized state in Nigeria – Lagos simply because of the derivation fund enjoyed solely by them. Ubi and Iyang (2017) through historical descriptive approach x-rayed fiscal federalism and its associated changes as it was (and is currently) practiced in Nigeria before and after independence. The paper went further to show how Nigeria's current operation of fiscal federalism has robbed off negatively on the country's national development. The study then recommended,

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among other things, that there should be co-ordination of intergovernmental fiscal activities that would ensure that public spending at both state and local levels is in reality related to revenue generation efforts at the state and local levels.

In the empirical work of Salami (2011), it was disclosed that Nigeria's expenditure assignment, tax jurisdiction and revenue allocation is disproportionately in favour of federal government despite the recent tax reforms and constitutional amendments and that the internal revenue sources of local and state government have not been fully exploited. It was therefore recommended that concerted effort should be made to boost the internal revenue of the local and state government. Each level of government should be made to be autonomous. The local government should not be made to depend on state and federal government. The State Joint Allocation Committee should be abolished.

In the same vein, Odoko etal (2009) raised an alarm that Nigeria's fiscal federalism is in crisis as the persistent agitation for resource control by the oil-rich states and ethnic minorities of the South-South geopolitical zone can be ignored only at great cost to national unity. Against this background, a revisit to the old revenue-sharing and expenditure assignment formula was called for. In particular, there is a need to assign less weight to criteria such as 'land-mass' because of its inherent inequality and redistributive distortions. In the course of the study of Chujor etal (2017), it was found out that since the discovery of crude oil in Nigeria and the subsequent exploration of the commodity, virtually all other sectors of the economy have been neglected. Oil today seems to be the only foreign exchange earned. The economic life of the country rotates around oil. This neglect of other sectors and dependence on oil has led to the present economic crisis we are now facing. The oil glut of the early 80(s) almost brought a total collapse to the Nigerian economy. To date we are yet to come out of the problem. This has led to the introduction of various measures to redeem the economy. Most of these measures appear not to be working because of the general recession in the world economy. During the era of oil boom, government did not take serious measure to lay a solid foundation for the development of the economy.

Also, Iwayemi (2013) as stated by Ubi etal (2017) opined that the revenue sharing formula to assist sub-national governments had adverse effects which include inefficient fiscal and economic outcomes, significant rent seeking and corruption and weak or lack of political accountability at the different tiers of government. The study further stated that the poor and unattractive fiscal performance specifically at the sub-national levels is partly responsible for the inefficiencies in the transfer design embodied in the current revenue sharing framework. In the same vein, Akujuobi and Kalu (2009) as stated by Olofin etal (2012) with the aids of OLS technique found that Federal allocation and stabilization fund are significant in the financing of real asset investments at both 5% and 1% levels of significance. In addition, Internally-generated revenue (IGR), loans (LNS), Grants (GT) and value added tax (VAT) are found insignificant in the financing of the real asset investments of Nigerian state governments for the period 1984-2008.

Romanus and Monday (2014) examined the revenue generation efforts of the three tiers of government and how the application of true fiscal federalism will boost the Internally Generated Revenue (IGR) which will lead to rapid economic growth and development. The study is descriptive in nature and also employed secondary method of data collection. The results of the study showed that there is near total dependence on the revenue from federation account among the three tiers of government and total abandonment of internal revenue generation efforts. This neglect of IGR efforts have been seen to be responsible for the slow economic growth in the country. Berthold, Drews and Thode (2001) in Germany carried out the analysis of impact in which horizontal fiscal equalization between states and supplementary federal grants will have on economic development of the 16 Lander in a panel analysis with annual data from 1991 to 1998. In their findings, it was revealed that higher grants in horizontal and vertical fiscal relations significantly reduce the growth of nominal GDP per capita of the Lander. In a similar work but different country, Jimoh (2003) using regression analysis examined the impact of the extent of decentralization of government expenditures and/or revenue collection on the levels of economic activities in Nigeria. The study unveiled that more decentralized governance, especially in terms of increased local governments and increased transfer of revenues to lower tiers of government would stimulate economic activities and/ or economic growth. It further stated that the major

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determinants of the prevalence of poverty in Nigeria are economic and population growths. The work of Enikolopov and Zhuravskaya (2003) revealed that the effects of fiscal decentralization depend to a large extent on the structure of the party system as well as on the degree of "subordination" of sub-national levels. In their view, the age of the most important political parties is favorable to the positive effects of decentralization on economic growth most often in developing and emerging economies.

Sequel to the above, it could be noted that different studies have been done on the dynamics of fiscal federalism in both developed and developing countries. However, few studies have been carried out especially in Nigeria on the impact of fiscal federalism on revenue generation. This is the lacuna that this study intends to fill.

Theoretical Framework

The need to anchor the concepts of fiscal federalism and revenue generation within the framework of certain theory cannot be underestimated. The theory upon which this study was anchored was restricted to; "Maximum Social Advantage Theory".

According to Dalton and shared by Smriti, the principle of maximum advantage is the most fundamental principle lying at the root of public finance. Hence, the best system of public finance is that which secures the maximum social advantage from its fiscal operations. Maximum social advantage is the maxim for the states. The optimum financial activities of a state should therefore, be determined by the principle of maximum social advantage.

It is obvious that taxation by itself is a loss of utility to the people, while public expenditure by itself is a gain of utility to the community. When the state imposes taxes, some disutility or dissatisfaction is experienced in the society. This disutility is in form of sacrifice involved in the payment of taxes- in parting with the purchasing power. Similarly, when the state spends money, some utility is created in the society. Some satisfactions is experienced by a group of people in the society on whom, or for whom, the public expenditure is incurred by the state. This is the social benefit of welfare of the public expenditure.

As such, the maximum social advantage is achieved when the state in its financial activities maximise the surplus of social gain or utility (resulting from public expenditure) over the social sacrifice or disutility (involved in payment of taxes). The principle of public finance, thus, required the state to compare the sacrifice and benefit of the society in its fiscal operations.

The relevance of this theory to this study is seen in Nigerian case where some states are poor in revenue generation but very superb in incurring expenditure beyond their financial capability. Based on this, they impose more tax on the citizens than the benefits the citizens enjoyed through them. The only major two sources of revenue to them are federal allocation and imposition of taxes on the poor citizens. The creativity of devising other means of generating revenues to cushion the burden of the taxes levied on the citizens is never there. Sequel to this, the states are urged to be more creative in generating revenue internally so that the sacrifice made by the citizens can equal to the benefit derived from the government which is the focal point of "Maximum Social Advantage Theory".

Methodology

This study is based on descriptive survey using data gathered from Nigeria Bureau of Statistics and Central Bank of Nigeria Statistical Bulletin covering the periods of 2011 to 2017. The choice of the range of these periods is to be able to capture some periods before Nigeria witnessed chronic economic meltdown and periods during the meltdown. During this era, Nigeria is over-stretched in order to meet its immediate needs. This then exposed how fiscal federalism is a factor to consider in the attitude of different tiers of government to improve on their revenue generation potentials.

Analysis and Findings

Fiscal Federalism and Revenue Generation

There have been several issues associated with Nigeria's fiscal federalism either directly or indirectly. Nigeria is one of the countries practising federalism with 36 states coupled with federal capital territory forming its

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federating units. All these states are different in terms of resources at their disposal to meet their various needs. Meanwhile, fiscal federalism being practised gives room for allocation of the centralised revenue to cushion the effect of this inequality among states in terms of natural endowments. However, it is observed that this has not yielded positive result despite the increment over the years. Instead, it has led to over-pamper and lack of creativity in generating internal revenue on the part of the states. Many states could not even survive without this allocation encouraged by federalism while there are a lot of potentials in their immediate environment for their survival. No wonder, the states continue to clamour for increment in the federal allocation without intensifying on internal sources of revenue. The findings of this study is furthered entrenched with the below tables 1 to 4.

Table 1: Federal Account Allocation to States (2011-2017)

YEARS	2011	2012	2013	2014	2015	2016	2017
AMOUNT (N' Billion)	1,921.61	2,084.69	2,251.34	2,062.63	1,597.64	1,347.23	1,681.47

Source: Central Bank of Nigeria Statistical Bulletin (2017)

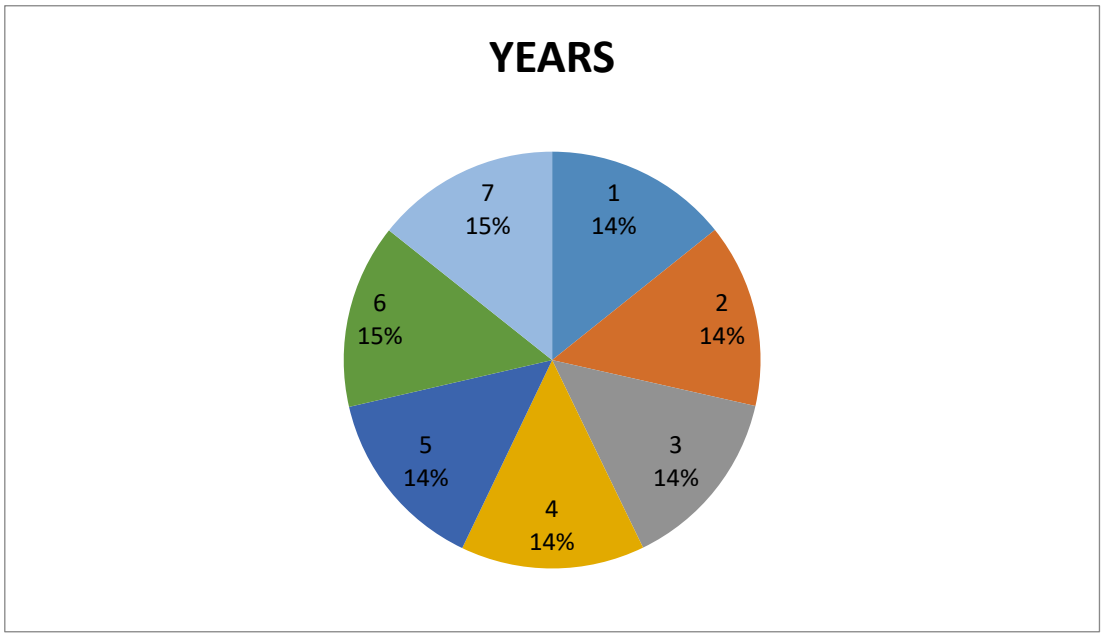


Figure 1: Federal Account Allocation to States (2011-2017)

Table 1 coupled with the chart revealed the trend of federal allocations to state covering the periods of 2011-2017. With these statistics, it could be shown that the allocation witnessed increase up till 2014 when deterioration set in. This is an indication of recession as a result of drop in price of oil in the world market. This badly affected a lot of states as shown in tables 3 and 4 as they are over-depended on this federal allocation. This is in line with the findings of Emeh (2010) as cited by Romanus etal (2014) where it was stated that increment in allocation to states has not provided the needed impetus that will usher in development and growth at the state level. The revenue increment over the years has further created an avenue for most of the state governors to loot the state treasury.

Table 2: Internally Generated Revenue at State Level (2011-2017)

YEARS	2011	2012	2013	2014	2015	2016	2017
AMOUNT (N' Billion)	480.38	584.40	662.05	707.86	682.67	831.19	931.23

Source: National Bureau of Statistics/Joint Tax Board/State Boards of Internal Revenue

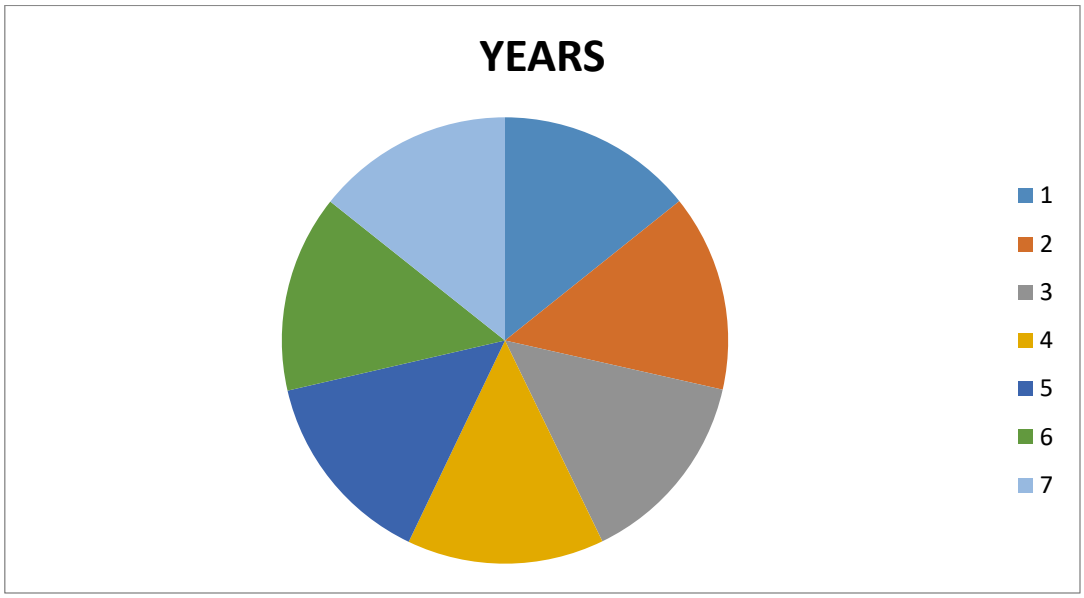


Figure 2: Internally Generated Revenue at State Level (2011-2017)

The internally generated revenue at the states level for the periods of 2011-2017 was depicted by table 2 and chart. These figures revealed the insensitivity of the states to their internal potentials. There is just meagre increase over the years compared with the huge responsibilities of the states requiring real financial commitment. There is just 21.65% increase between 2011 and 2012, 13.29% increase between 2012 and 2013, 6.92% increase between 2013 and 2014, 3.56% decrease between 2014 and 2015, 21.76% increase between 2015 and 2016 and 12.04% increase between 2016 and 2017. With these calculations, the increase percentage of internally generated revenue of states in the federation was deteriorating instead of increasing to complement the federal allocations. Sad enough, there was even a decrease between years 2014 and 2015. This poor performance at the states level has raised a serious concern about the practice of federalism. Many states only rest on their oars with the minds that the centre has harnessed to its self major avenues for revenue and they just have to wait for the goodies from the centre to flow.

In view of this, the states are weak financially and their financial base cannot strengthen or guarantee true federalism (Romanus etal, 2014). Hence, attention should be shifted from federal allocation which has always been a bone of contention and then focus on how the internally generated revenues of states can be improved for them to be independent. This is in support of the observations of Emenuga (2007), Dike and Iwuamadi (2005) where they stated that much attention should be given to the proper management of sates' available resource bases has given to intergovernmental fiscal relations and federal allocation so as to improve their internally generated revenues.

Table 3: Summary of State Government and Federal Capital Territory Finances (N' Billion) 2011-2017

	2011	2012	2013	2014	2015	2016	2017
Total Revenue	**3,410.10**	**3,572.52**	**3,905.38**	**3,672.03**	**2,859.02**	**2,471.81**	**3,578.48**
Recurrent Expenditure	2,055.70	1,664.40	1,948.43	2,120.48	2,267.34	2,399.24	1,930.33
Current Surplus (+)/Deficit (-)	**1,354.40**	**1,908.20**	**1,956.95**	**1,551.57**	**591.68**	**72.57**	**1,648.15**
Capital Expenditure	1,375.20	1,965.30	1,890.41	1,862.52	1,201.82	970.61	1,521.76

Extra-budgetary Expenditure[4]	111.00	215.40	207.97	0.00	0.00	69.32	202.88
Total Expenditure	**3,541.90**	**3,845.10**	**4,046.80**	**3,983.00**	**3,469.16**	**3,439.17**	**3,654.96**
Overall Surplus (+)/Deficit (-)	**-131.80**	**-272.50**	**-141.42**	**-310.95**	**-610.14**	**-967.36**	**-76.48**

Source: Central Bank of Nigeria Statistical Bulletin (2017)

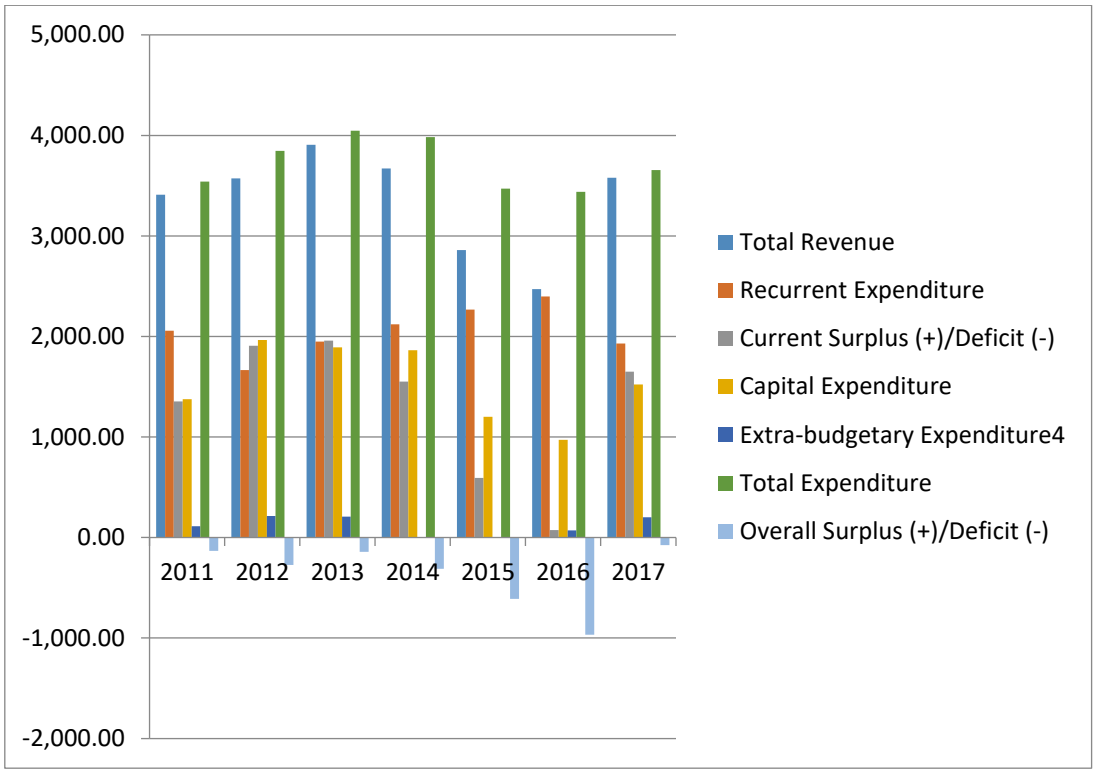


Figure 3: Summary of State Government and Federal Capital Territory Finances (N' Billion)

Table 3 captured the summary of the total revenues and expenditures of the states during the periods of 2011-2017. This is with the view to examine the financial capability of the states to meet their financial commitments. With the results in the table above, the states altogether have deficits throughout all the periods under consideration. This means the revenues realised internally coupled with the allocation could not even be enough to settle the expenditures of the states. No wonder, there have been financial crisis to the extent of swimming and dinning in high indebtedness as shown in table 4, not being able to pay salaries, provide basic amenities and embarking on projects to better the lives of the citizens at the states' level. However, there are few states if observed individually who are rich as a result of proper management of their internal sources of revenues. Though, these states have been said to be favoured based on their natural endowments and industrial opportunities but yet proper management is still the key to their richness. There are states that have a lot of untapped opportunities but still depend heavily on allocation.

Okwesili, Nwali and Orga (2013) concluded that there is need to ensure that the distribution of revenue should encourage each state and local governments to improve internal revenue generation, not to constantly and wholly depend on fund coming from the federation account and the issues of intergovernmental relations should be reviewed and respected so that functions to be performed by each tier of government could be explicitly stated.

Table 4: Domestic Debt of State Governments (N' Million) (2011-2017)

YEARS	2011	2012	2013	2014	2015	2016	2017
AMOUNT	1,233,294.65	1,551,650.13	1,537,471.45	1,655,178.71	2,503,260.42	2,958,517.43	3,348,774.26

Source: Central Bank of Nigeria Statistical Bulletin (2017)

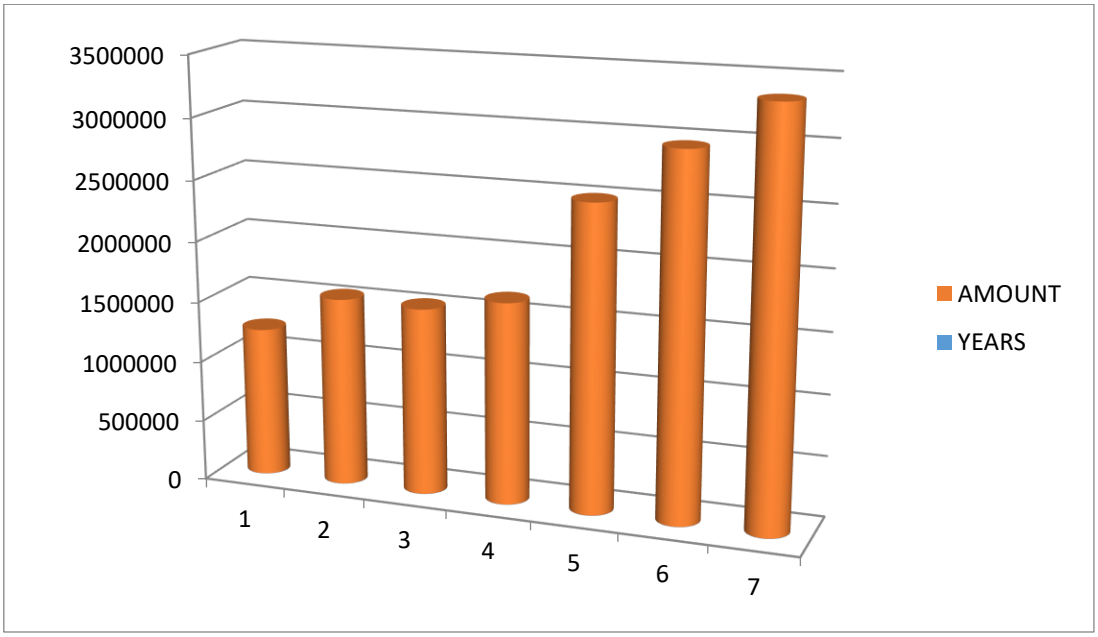


Figure 4: Domestic Debt of State Governments (N' Million)

The table above is an indication of lack of initiative to create enough wealth at the states level and over-reliance on the federation account. The percentage increase in the indebtedness of the states for the periods stated above is ever-skyrocketing. Between 2011 to 2012, there is an increase of 25.81%, 2012 to 2013 witnessed a decrease of 0.91%, 2013 to 2014 is with an increase of 7.66%, 2014 to 2015 witnessed an alarming increase of 51.24%, 2015 to 2016 with an increase of 18.19% and 2016 to 2017 13.19%. This is an indication that at the states level, there is lack of financial capability to cater for the immediate needs of the citizens. The rate of indebtedness continues to grow at geometrical proportion as a result of reckless spending by states due to their reliance on allocation from the federation account. However, if states are fiscally autonomous, the frivolous spending that has led to the huge debt overhang/burden would not be embarked on, knowing that there is no "free money" from federation account (Ubi & Inyang, 2017).

Conclusion and Recommendations

This study examined the effect of fiscal federalism on revenue generation capability of the states in Nigeria. Therefore based on the findings of this study, it could be concluded that fiscal federalism has encouraged over-dependence of states on revenue from the federal and thereby weakened their ability to generate internal revenues. States within the country have become lethargic since whether or not they generate revenue, there is a free flow of money that must surely come from the top. This has led to tremendous increase in the rate of indebtedness across the country in recent times.

Hence, it is recommended that the fiscal federalism practiced should be reviewed to diffuse too much power concentrated at the centre and encourage the states to learn from the private sector on how to source for revenue internally. Also, the excesses of the state governments in term of frivolous spending and white elephant projects should be curbed.

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