Journal of Economics and Sustainable Development www.iiste.org
ISSN 2222-1700 (Paper) ISSN 2222-2855 (Online)
Vol.2, No.3

Revenue Allocation Formula and Its Impact On Economic Growth Process In Nigeria

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Abstract
This study attempts to analyze the impact of allocation formula on the Nigeria growth process. The analysis reveals the extent to which revenue allocation formula adopted in the past has affected the path of economic growth and development in Nigeria. The data is purely secondary data and was sourced from the world bank publication, CBN, Journal and other published and unpublished materials.

There is need, therefore to address the problem by formulating a move efficient revenue allocation wastage and mismanagement of founds. Also effort should be geared towards articulation of policies that will enhance capital formulation, employment of the abundant and measures may include attachment of more weight to the share of local government from the federal collected revenue, placing more emphasis on the internal revenue generation, redefinition of the concept of definition and sustaining the present effort of government as regards budget monitoring and implementation.
Keywords: Revenue, Allocation, Economic Growth, Nigeria

1. Introduction

Nigeria as a nation operates a federal structure of government federalism refers the existence in one country of more than one level of government, each with different expenditure responsibilities and taxing powers. This shows that fiscal federalism, a consequence of federalism, is all about the relationship among the different units of functions and tax powers to the constituent units. The existence of imbalance between functions and resource base makes it expedient for the higher level of government to transfer revenue to the lower level. This is referred to as 'efficiency transfer or balancing'

The sharing of funds from the federation account is one of the contentious and sensitive issues in the Nigeria polity this has remained a central element of interfiscal relations. In Nigeria revenue allocation is taken as the distribution of national revenue among the various tiers of government in the federation in such away as to reflect the structure of fiscal federalism. This issue is so important that in some other countries it has become a national question (mbanefoh 1993, emenuqua, 1993). For instance kayoed (1993) observed that a satisfactory solution to the question and its solution"

This shows that in any nation the stability as a political entity depends to a large extent on revenue location. A democratically elected government can be sustained if only there is an appropriate distribution of nation revenue among state governments themselves.

1.1 Statement of The Problem

The return of democratic government is expected to lead to the practice of a more balanced system of fiscal federalism, more transparency, fiscal accountability and more devolution of power to lower units of government and hence more fiscal decentralization. While a greater degree of decentralization would, no doubt, contribute to greater

grassroots participation, generate more local development, increase efficiency and equity, create employment opportunity and promote poverty alleviation, it must not be done in such a way as to conflict with the national objective or unduly complicate it.

The change in the Internal geographic structure of the nation as a result of strong and continuous agitation for state creation has led to distortion in the revenue allocation formula and this has weakened the fabrics of federalism. For example, 12 states were created out of four regions in 1967. in 1976, the number of state rose to 19 while local government and in 1996, the number of state rose to 36 with 774 local governments. Till date we still have 36 states and 774 local governments. Given the associated rising cost of running that is provision of secretariats, staff salaries and allowances rental and buildings, provision of utilities and increasing outlays on maintained and new projects, statutory allocations to state and local government together with internal revenues have become grossly inadequate. It is in the light of the economic growth process in Nigeria has not been utilized. Hence the need to examine empirically whether revenue allocation formular adopted in the past has had any meaningful impact on the economic growth process in Nigeria. The issue of revenue allocation in Nigeria is a fundamental one that border on promotion of national unity and rapid economic growth. It is however sad the despite continious increase in revenue generation in Nigeria over the years, the expected impact on economic growth in Nigeria has not been realized. Hence the need to examine empirically whether revenue allocation formula adopted in the past had any meaningful impact on the economic growth process in Nigeria.

1.2 Objectives of the Study

The major aim of the study is to assess the impact of revenue allocation on economic growth in Nigeria. This is important in view of the fact that the exists a link between revenue allocation formular and economic growth when one considers the position of government is gross fixed capital above, the specific objectives of this study are to;

1. Examine the extent to which the revenue allocation formula adopted in the past has affected the path of economic growth and development in Nigeria.
2. Proffer solution to the teething problem of revenue allocation formula in view of macro economic aspiration of rapid economic growth and development. The important of this is that whatsoever revenue formula that is being canvassed for or is adopted; the important thing is whether or not it improves the quality of life of people in Nigeria.

2. Literature Review

2.1 Fiscal Revenue and Economic Growth

In line with most growth theories, natural resources, human resources, capital enterprises and technonlogy are all important for rapidly economic growth. Expenditures on human resources development via spending on education and research, provision of infrastructural facilities health care, housing and urban development, environment, quality of national statistics, securities and administration of justice are made possible or better still financed through the revenue gotten from the nation's resources. These invariably lead to economic growth. This therefore posits that an efficient revenue allocation is of great importance in the equation of growth.

Similarly, successive governments do make provisions for human capital development and technological improvement through improvement in educating funding and expenditure on research because of the fact that these are necessary ingredients for economic growth and development it is often said that economic growth is possible even when an economy is deficient in natural resources. As pointed out by Lewis, (1990) "a country' which is often considered to be poor in resources today may be considered very rich in resources at some later time, not merely because unknown resource are discovered, but equally because new users are discovered for the known resources" Japan is one such country which is deficient in natural resources but it is one of the advanced countries of the world because. It has been able to discover new uses for limited resources. Moreover, by importing certain raw materials and minerals from other countries, it has been successful in over coming the deficiency of its natural resources through superior technology, new researches and higher knowledge.

It is also important to note that capital accumulation is one of the factors than enhance economic growth. Capital means the stock of physical reproducible factor of production. When the capital stock increases with the passage of time this is called capital accumulation (or capital formation). The process of capital formulation is cumulative and self-feeding and includes three inter-related stages.

1. The existence of real saving and rise in them

2. The existence of credit and financial institutions to institution to mobilize savings and to divert them in desired channels, and
3. To use these savings for investment in capital goods

There are various possibilities of increasing the rate of capital accumulation. Since the prospensity to save IS low in most LDCs, Voluntary savings will not be forth coming in sufficient quantities. Therefore, the consumption and thereby release resources for capital formation.

The various methods of forced saving are taxation, deficit financing and borrowing. These now brings out the role of revenue allocation formula because of the simple fact that in LDCs, the government does the above. It is obvious that how the fund/resources from this forced saving is been shared and the expenditure pattern is of great importane when the talk of rapid economic growth. Moreso, capital formation helps in providing machines, tools and equipment for the rising labour force. The provision for social and economic overheads like transport, power, education etc in the country is through capital formation. It is also capital formation that leads to the exploitation of natural resources, industrialization and expansion of market, which are essential for economic progress.

For an economy that is open like ours, the issue of economic growth cannot be discussed without bringing in particular. It is important to note that international free trade has been regarded as the "Engine of growth" that propelled the developed of today's economically advanced nations during the nineteenth and early twentieth centuries. Rapidly expanding export market provided an additional stimulus to growing local demands that led to the establishment of large manufacturing industries. Together with a relatively stable political structure and flexible social institutions, these increased export earning enables the developing country of the nineteenth century to borrow funds in the intenration capital market at very low interest rates. This capital accumulation, which is very important to growth in turn stimulated further production, made possible increased imports and led to a more diversified industrial structure.

Having gone through some of the importance economic actors of growth, it is important to note that there are some non-economic factors that are also crucial to rapid economic growth and development. It is sufficie to say that the final distinction between the historical experience of developed countries and the situation faced by contemporary developing nations relates to the nature of social and political institutions. One very obvious different between the now developed and the under developed nations IS that well before their industrial evolutions, the former were in dependent consolidated nations states able to pursue national policies on the basis of consensus toward modernizations.

2.2 Theoretical Framework

2.2.1 Traditional Neoclassical Growth Theory

According to Dernburg-IMcdougall (1980), economic thinking of the 1930s concentrated almost exclusively on labor as a factor of production. Conversely, the early post World War II growth theorist pushed the pendulum to tile opposite extreme and concentrated on, the role of capital in the growth process. More recently economist have tried to develop an integrated view that combines the effects of labour force Growth, capital growth, and improved technology in explaining economic growth. Many very interesting questions have bee raided. If output per capital tends to grow at a particular rate in a full employment economy, what is the magnitude of the growth rate, and what are their determinant? What fraction of growth is due to the fact that each worker has more capital to work with? What fraction is due to the fact that the capital is improved? And, finally, what fraction is due to the fact that labour itself might be becoming' more productive as standards of health, education and training improve?

Todaro (2003) stated that another cornerstone of the neoclassical free market argument is the assertion that liberalization of national markets draws additional domestic and foreign investment thus increasing the rate of capital accumulation in terms of GNP growth. This is equivalent to raising domestics savings rates, which enhances capital – labour ratio and pr capital incomes in capital poor developing countries, Traditional neoclassical models of growth are a direct out growth of the Harrod Domar and Solow models, which both. Stress the importance of savings.

The RLM. Solow neoclassifical growth model in particular expanded on the Harrod-Domar formulation by adding a second factor, labour and introducing a third independent variables technology to the growth equation. Unlike the fixed –coeficnet, constant-returns-to-scale as assumption of the Harrod – Domar model, Solow's neoclassical growth model exhibited diminishing returns to labour and capital separately and constant returns to both factors

jointly. Technological progress become the residual factor explaining long-term growth and its level was assumed by Solow and other growth theorists to be determined exogenously, that is, independently of all other factors.

More formally the Solow growth model uses a standard aggregate production function in which $Y = k^{\propto} (J (AL)^{1-\propto}$ ……(1)

Where Y is gross domestic product, k is the capital stock (which may include human capital as well as physical capital), L is labour, and A represent the productivity of labour, which grow at an exogenous rate. In equation (1) $^{\propto}$ represents the elasticity of output with respect to capital (the percentage increase in GDP resulting from a % increase in human and physical capital). It is usually measured statistically as the share of capital in a country's national income accounts. Since $^{\propto}$ is assumed to be less than 1 and private capital is assumed to be paid it marginal product so that there are no external economies, this formulation of neoclassical growth theory yields diminishing returns to capital and labour

In line with the traditional neoclassicial growth theory, Output growth results from one or more of three factors: Increases in labour quantity and quality (through population growth and education in which public fund is been expanded upon), and improvement in technology. This underscores the importance of revenue allocation formula and other factors that are crucial to rapid economic growth and development.

2.3 National Revenue Mobilization, Allocation And Fiscal Commission (NRMAFC)

The Babangida government decided to revisit the Dina revenue allocation commission of 1968 which had recommended the setting up of a permanent revenue planning and fiscal commission but which was at that time rejected by government. Decree no 49 of 1989 provided for the setting up of a permanent commission to review revenue allocation formula. The decree established the national revenue mobilization, allocation and fiscal commission (NRMAFC), which was also charged with the responsibility of revenue mobilizations, and promotion of fiscal efficiency.

Some of the specific functions of the commission include the design and mobilization on all sources of public revenues, the periodic review of revenue allccation formulae, the prescription and application of revenue allocation formulae as well as monitoring the accruals form the federation account and other joint accounts. In carrying out this task, the commission gave more emphasis to the local government as it allocated an all time high allocation of 15% to local government administration as shown below.

APPROVAL	**RECOMMENDATION**	**GOVERNMENT**
Federal Government	47%	50%
State Government	30%	30%
Local Government	15%	15%
Special Fund	8%	5%

For the sharing aomong the states, the commission recommended the following:

APPROVAL	**RECOMMENDATION**	**GOVERNMENT**
Equality of state	40%	40%
Population	30%	30%
Internal revenue effort	20%	10%
Health, water, land mass and difficulty of terrain		10%
Land mass and terrain		10%

2.3.1 June 1992 Revenue Allocation Formula

Between 1990 and June 1992 there were about four revisions to the revenue allocation formula. However the June 1992 was more important because of the inability of local government to effectively administer primary education. Consequently the vertical renveue allocation formula was revised and the armed forces ruling council (AFRC) accepted the following revenue arrangement

Federal Government	48.5%
State Government	24%
Local Government	20%
Special Funds	7.5%

2.3.2 The Revenue Mobilization Allocation And Fiscal Commission (RMAFC)

on the inception of the new democratic dispensation after several years of military rules and in accordance with section 162 (2) of the 1999 constitution, the Obasanjo led administration set up a commission in September 1999 headed by Engr. Hamman Tukur. It would be necessary to stated that the 1992 revenue allocation formular backed by decree 106 was in place and used into the new era of democracy. But this could not address changing realities like the increase in numbers of states (6) local government councils (185) and the constitutional provision that increases derivation principle form 1% to 13%

By the time collations were made and analysed, a critical study on constitutional responsibilities of each tier was done to assign commensurate indices through percentages to the beneficiaries. It was therefore not surprising that it look the commission almost a whole year to submit its first proposal to the president in August 2001, which was subsequently passed to the National Assembly in its original form. The proposed revenue formula remained the National Assembly for almost eight months before the Supreme Court verdict of April 2002 on resource control nullified special fund in the existing formula, which invariable affected the fate of the pending formula with the legislators.

Since an executive order, as authoritative interim measure which legalized by a subsequent ruling of Supreme Court was in place, the commission had to device another strategy in making sure that the revised formula is fair and just without emotion or sentiments. It therefore with drew the early submission and asked for fresh inputs from stakeholders and general public on how to apply the special fund. The commission came up with the final sharing formula with federal government having 46.63% states 33% and local government 20.37%. it further recommended that FCT should be treated like state so also the municipal councils. The implementation of institution, compulsory contributory pension scheme to address the problems that are common and peculiar sources of discontent among tiers and provision of fund that will take care of ecology, technology research, solid mineral development, national reserve and agricultural development (Shauib 2003)

2.3.3 Vertical Revenue Allocation Balance In Nigeria

As earlier stated in the beginning of this chapter, Nigeria been a country that practices federalism provides the primary basis for the inter-governmental fiscal problems of the Nigeria public sector. Normally each tier of government should be given adequate resources to be able to discharge its constitutional responsibilities, which is very important for the preservation of the autonomy of the constituent units. However, this is practically impossible in practice instead we notice that some may not have enough to meat their expenditure responsibilities from their own revenue source.

In Nigeria, fiscal imbalances have followed a distinctive pattern where the federal government is in a superior position and sub-national levels in the inferior position. This means that the central government engages in functional expenditure obligations than both the state and local government does.

An anomaly observed in the Nigerian situation is the inclusion of derivation as a part of vertical revenue allocation under a special fund instead of the universal practice of including it as a principle in horizontal revenue allocation. This explains partly the measure percentage allocated to it. (Tijani and Godowoli 1992) observed that the apparent oscillation in the use of the principle is responsible for the state apparent oscillation in the use of the principle is responsible for the state of affairs. In Particular, certain sections of the country (especially the oil producing states) felt circumvented that the principle of derivation was lightly emphasized in revenue sharing arrangements from the 1940s through the 1960s when the nations economic mainstay was agriculture, but the emphasized when oil became the major revenue earner from the early 1970s. The issue was further politicized with argument over on shore and off shore oil until the recent time.

Thus, while some people argued that derivation should be used to compensate those areas where buljk of the revenue that goes to the federation account comes from because of the associated costs (of pollution, distruption of socio-economic life of the communities etc), other are the view that unbridled use of derivation as a principle for revenue allocation will accentuate regional inequalities. Indeed, the Aboyade commission (1979) had argued along the line of (Scott 1964) that the derivation principle has little or no place in cohesive fiscal system for economic growth, national unit and social development.

3. Research Methodology

3.1 Model Specification

In theory, economic growth is influenced by miscellaneous factors. But in the study will shall adopt the neoclassical growth moedel, which stresses the important of labour, capital and technology. Thus the expanded version of Harnod-Domar model by Robert Solow stated more formally the growth of model as follows:

Y = K (AL) 1 - ……(i)

Following Iyoha (1968, we include the shares of state, local and federal government revenue from federation account into our model. This is because revenue enters the growth equation through expenditure on capital formation and employed. This is particularly important when one consider the fact that the roles of the private sector in Nigeria, until recent time is not pronounced like the private sector.

Thus, our model become: GD.PR = F(K, L, Fed Stat, Locl)……..(2)

Although in Iyoha (1998) model, he failed to incorporate political instability but the role of this factor was stress by Borno and Lee, (1993); Gillian (1993). Hence a dummy variables is introduced to capture the influence of political instability in our model. GDPR = FCK, L, Fd, Stat, Loc, Dum……..(3)

Finally, inflation rate is included just like Iyoha did to capture macroeconomic instability during this period. It is postulated to be detrimental to economic growth and development for the familiar economic reason. These include uncertainty about the profitability of long term investment and tendency toward speculative activities.

Thus, our model to be estimated takes the form of a single equation in economic growth as GDPR= FCK, L, Fed, Sta, Loc, un, infl)…….(4)

More formally, the model is specified as

GDPR = ab + a, Poc + a2 inv + a3sta + a4Loc + a5INF + a6DUM + ut….(5)

3.2 Data Sources And Characteristics

GDPR = Real gross domestic population growth rate.

POG=Population growth rate in Nigeria. Rising population connotes cheap labour and large market for product of enterprises, which expected to promote the economic growth (Green and Villanueva 1991; Fry 1991; Oyedije 1994; as sited ein james 1998).

INV = Gross fixed capital formation/GDP ratio

FED=Growth rate of share of federal government from the federation account.

STA = growth rate of share of rate of state government from the federal account

LOC = growth rate of shares of local government from the federal account

INF= inflation rate

DUM= Dummy variable presenting political instability

Ut= stochastic error in with usual while noise properties

Hint? a_0 ……..a^7 are the regression coefficient or impact multipliers to be estimated and a_0……a_5 and a_7<0.

Data used in this study is purely secondary data and was sourced from the World Bank publication (gdpr, inf). CBN, (Fed, sta and Loc), Journal and other published and unpublished material

3.3 Estimation Technique

For the purpose of this project we shall use the ordinary least square method to estimate its properties and correlation coefficient which measure the goodness of fit of the regression line shall also be employed. This goes further to explain the percentage of total variable of the dependent variable that can be explained by the explanatory variables gdpr = Y(K,L, fed. Stat, Loc…..)

4. Data Analysis

Analysis of variance (ANOVA) conducted in this study to test the overall significance relationship between the economic growth process in Nigeria and the existing revenue allocation formular and other factors captured in the model. The decision rules is that we accept Hi if F^X>F 0,05 or vise versa. The test that F^x = 4.42 while F 0.005=2.51 at 5% with V_1 = K-1 = 7, and V_2 = N-k=24.

The R^2 which is the coefficient of multiple determination, tell us the percentage of the total variation in the dependent variable (GDPR) as explained by the regression line. The higher the R^2, the greater the percentage of the variation in GDPR as explained by the explanatory variables and the better the goodness of fit of the regression line

to the sample observations. The R^2 in the estimated regression Is 0.66 and this means that about 66% of changes in the Nigeria growth process is explain by changes in the explanatory variables in the model.

The result also shows that the signes and the magnitude of the coefficient confirm to a prior expectation with the coefficients of inflation rate, Loc and FED been significant while others are not significant. The value of the Durbin Watson (2010) shows that there is no serial auto correlation.

4.1 Presentation of Regression Result

The result of the regression of equation is presented in table 1.0 below

TABLE 1.

The results in table 1 above shows that all the parameters conformed to prior expectation. It is also clear from the table that LOC, INF, FED are all significant based on the standard error and T-values of this coefficients. However, others are not significant even though they appear with the right signs. The F-value of 4.42 reveal that the result is relatively stable an to bust while 2(0.66) shows that about 66% of the systematic variation in GDPR is caused by the variables in the model. Lastly the DW value of 2.010 shows that there is no serial auto correlation in our model.

4.2 Discussion of Result

Table 1.0 shows that there exists a direct relationship between the revenue allocation formula as prioxies by the share of federal, state and local government from the federation account and economic growth process in Nigeria. This implies that the revenue allocation formula is a catalyst for economic growth and development. The sign of these variables onform to economic growth and development. The sign of theses variable conform to the aprior expection that is positive and except for the sharte of the state that is not statically significant, other were significant at 10%. The magnitude of the coefficient especially FED and LOC further conform the need improve the finding of local government considering the elascticity of these variables as regards economic growth process. This interpretation should be consider under a condition of equal absorptive capacity between states and local government.

However, inflation rate turn out to negatively related economic growth and statistically significant. Thus policy to maintain macroeconomic stability by controlling the rate of inflation within reasonable limit is required to promote economic growth and development. More importantly high and variable rate of inflation not only complicates the problem of government expenditure planning for economic growth and development, they also send wrong signals to private sector investors. However the case of political instability tends to be insignificant but we do not fail to establish the fact the negative relationship exist between economic growth and political instability because of the earlier reason given in this study.

5. Findings and Policy Implications

The policy implication of the study is that during the period under review, the share of local and federal government from the federation account contributed to the economic growth process of Nigeria. Hence the share of local government must be increased for improved performance. This is consistent with the findings of Iyoha (1998). However, the share of state from the Federation on account does not perform as expected. Hence, effort should be geared towards effective and efficient utilization of fund at the state level. The scenario at the state level may be due to mismanagement and embezzlement of fund.

In addition, high level of inflation rate in the country during this period reflects macroeconomic instability. This may be caused by the continuous importation of good especially consumable items. Thus putting pressure on the local currency and high cost of doing business in Nigeria.

With respect to the dummy variable the findings upport the review that political instability affects growth negatively. The results corroborate the conclusions of other studies (see Barro Lee (1993), Gillian 193).

The duo of labour and capital were as control variables here and the result confirms that labour and capital are growth catalyzing factors. Although they were not significant in this study and this may be partly due to the low growth rate of capital and the high level of unemployment, thus, showing that labour has not been fully utilized. Effort should be geared towards increase in investment through expansion in private sector investment. On the other hand, public sector investment which has been in the provision of inefficient social infrastructure, and moribund projects that fail to produce stimulating multiplier effects on the economy in long run should be discourage..

5.1 Conclusion

In this study, we have been able to review the existing revenue allocation formula from 1960 to date, determine the extent to which the revenue allocation adopted has affected the path of economic growth and development. We have also been able to identify the critical problems buffeting the current system of fiscal federalism in Nigeria.

The result reveal that beginning from 1960 till date Nigeria experimented with over fifteen revenue allocation formulae (horizontal or vertical). Greater changes were witness in the horizontal revenue allocation formula. The findings also reveal that the Aboyade and Okigho commission as well as NRMAFC provided objective basis for revenue allocating using measurable criteria. However, because of the technicality involved the Aboyade commission, his recommendations were rejected but government never the less accepted its vertically allocation formula.

The establishment NRMAFC as a permanent revenue allocation committee is found to have significantly reduced the adhoc nature in which previous revenue allocation schemes have been revised or modified. In the past many attributed financial problem of states of local government to the prevailing vertical revenue allocation formula. However, this study reveals that the major cause of declining proportion of federally collected revenue going to the sub-national government in recent years is the introduction of petroleum. Trust Fund, Dedicated Account and Stabilization Fund. This situation has made thing worse considering the ever-increasing needs of urban and rural population In education, water supply, health facilities and road etc.

Moreso, given it history and Evolution, and in particular the influence of military governance on its development, it was observed that the system of fiscal federalism is over centralized, especially with respect to revenue collection Although, inter-governmental grants are used to moderate the concentratin of financial resources at the centre, this does not vitiate the fact that the lower levels of governments are under funded and hence are relatively ineffective as agents of economic growth and development. The general condition is the increase is revenue allocation to the various units of government will lead to provision of more goods and services, higher investment and economic growth. Therefore, the revenue allocation system has been partly efficient in Nigeria. i.e it is sub-optimal.

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Table 1.:Relationship between Economic Growth and Revenue Allocation Formula's

Variables	Coefficient	Standard Error	T. Statistics
Constant	0.066	1.302	0.051
DPOG	0.984	1.351	0.728

DWV	5.076	4.716	1.076
DFED	1.063	0.738	1.441
DSTA	0.960	1.814	0.529
DLOC	2.724	2.030	1.341
DINF	-0.114	0.063	-1.804
DUM	-0.872	2.660	-0.328

R^2 = 0.66 dw = 2.010f=4.42 ADJ R^2 = 0.50 S.E.R. = 5.727
Source: author's computation