

REVENUE DISTRIBUTION FROM FEDERATION ACCOUNT AND MONEY SUPPLY: EVIDENCE FROM NIGERIA

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Abstract

Money supply in every economy is very vital for economic growth and stability. However, the role of revenue distribution in ensuring the success of monetary policies revolving around money supply in Nigeria cannot be over-estimated. The study examines the impact of revenue distribution to the three tiers of government on money supply (MSS) in Nigeria. Time series data used for the study estimation span from 1981-2016 and were obtained from CBN statistical bulletin, 2016 edition and World Bank website. The specific purpose of the study is to establish the extent to which revenue allocation to federal, state, local governments and derivation allowance to the mineral producing states affect money circulating in the Nigerian economy. Ordinary least square method (OLS) was employed with the aid of SPSS version 20 to test the impact of revenue distribution on money supply. The findings reveal that revenue allocation to federal government has a significant positive impact on money supply. Allocation to local government councils has insignificant positive impact on money supply. On the contrary, allocation to states and the derivation allowance to Niger Delta States exert significant negative influence on MSS in Nigeria. The study concludes that revenue allocation to states and derivation allowance contribute to inflation in the country and recommends stringent



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monetary policies that will determine the percentage of allocated revenue usage by all tiers of government in a particular period to avoid too much money in circulation.

Keywords: *revenue distribution; allocation; money supply; economic stability; derivation*

JEL Classification: E51, E64

1. Introduction

Revenues that flow into the federation account include crude oil sales which form major part of government revenue. The receipts from crude oil sales are usually in USD, as a result, the Central Bank of Nigeria (CBN) converts them to Naira (local currency) before transferring the fund into the federation account for sharing among the three tiers of government [CBN, 2016], after deduction of derivation allowance given to the mineral producing states. The conversion of crude oil receipts which is eventually released for sharing among the three tiers of government is an occasion for so much money to be circulated in the economy [Omodero & Worlu, 2018]. This economic scenario of the country on a monthly basis is capable of igniting inflation, if the fund is not strictly controlled by the CBN through its monetary policy to avoid excess money supply [CBN, 2016]. Money supply also referred to as money stock is the entire stock of currency and other liquid instruments circulating in a country's economy as of a particular time, which includes safe assets, such as cash, coins, and balances held in checking and savings accounts that business and individuals can use to make payments or hold as short-term investments [Chen, 2018].

Due to the fact that money supply is one of the economic policy tools used by a country's government to manage inflation and stabilize prices of goods and services, therefore, it is pertinent to note that government revenue affects it either positively or negatively [Yakubu et al., 2014]. Economists evaluate the money supply and came up with policies revolving around it through controlling interest rates and increasing or decreasing the amount of money in circulation in an economy. A country's government or central bank collects and records money supply data and publishes them periodically [Chen, 2018]. According to Tau (2017), money supply (which is the money stock) and interest rate are monetary

policy measures determined and monitored by the Central Bank of a nation. The purpose of this monitoring is to achieve economic efficiency which has close relationship with the use of resources in an economy [Rosca, 2017].

For the purpose of this study, money supply will be represented by the broad money (M2) which comprises currency in circulation, deposits with commercial banks, currency outside banks, quasi money and demand deposits which include foreign denominated deposits [CBN, 2006]. Revenue distribution includes fund allocations from the federation account to the federal, states and local governments, as well as derivation allowance to the mineral producing states. These revenues shared among the various levels of government are usually channelled to the economy for productive government economic and social activities that ultimately benefit the entire public.

1.1. Objective of the study

The major aim of this study is to determine the effect of revenue distribution from the federation account on money supply in Nigeria. The specific objectives the study seeks to achieve are:

1. To establish the impact of federation account allocated fund to the federal government on money supply;
2. To examine the influence of federation account allocated fund to the state governments on money supply;
3. To assess the extent to which revenue allocation to local government councils affects money supply;
4. To verify the extent of influence derivation allowance has on money supply in Nigeria.

1.2. Research hypotheses

The following null hypotheses have been formulated in order to pursue the above specific research objectives:

Ho1: Federation account allocated fund to the federal government does not have significant impact on money supply in Nigeria;

Ho2: Federation account allocated funds to states do not exert significant influence on money supply in Nigeria;

Ho3: There is no significant relationship between revenue allocation to local government councils and money supply in Nigeria;

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Ho4: Derivation allowance and money supply in Nigeria do not have significant relationship.

2. Literature Review

2.1. Conceptual Review

2.1.1. Broad Money (M2)

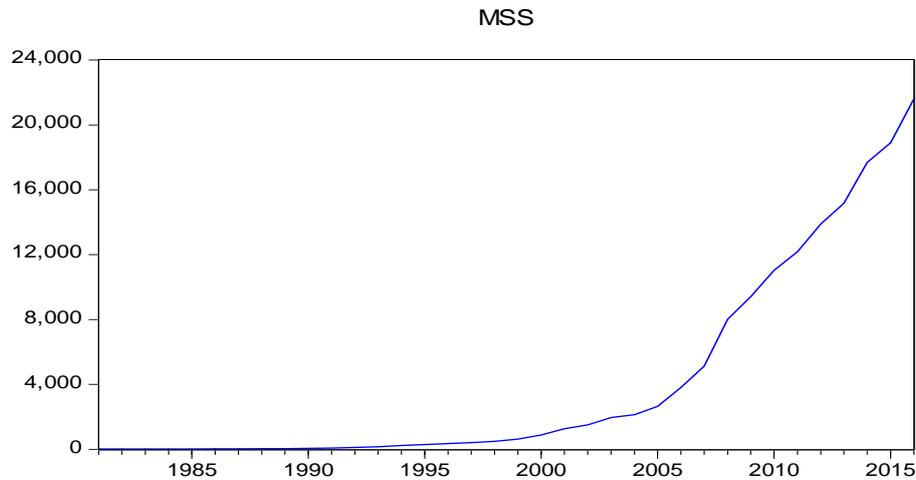


Fig. 1. Trend of MSS in Nigeria (1981-2016)

Source: Data from the Central Bank of Nigeria Statistical Bulletin, 2016

According to CBN (2016), broad money (M2) consists of narrow money plus savings and time deposits, as well as foreign denominated deposits. Narrow money comprises currency in circulation (bank notes and coins) with non-bank public and all bank account balances (demand deposits or current accounts) which can be easily used for a transaction. Therefore, broad money measures the total volume of money supply in the economy. When the amount of broad money is over and above the level of total output in the economy, it gives rise to excess money supply in the economy [CBN, 2016]. It becomes highly imperative to regulate money supply to ensure a stable relationship between money supply and economic activity. In order to maintain an equilibrium and match money supply with productive activities of



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both the public sector and private firms, regulation of money supply is necessary to prevent the devastating effect of inflation on the economy when money supply exceeds economic activities. The figure 1 below shows the broad money supply in Nigeria from 1981-2016. The vertical axis shows the money supply in billions of Naira while the horizontal area depicts the time which is on a yearly basis.

From figure 2 above, the trend of MSS revealed that, in 1980s up to 1990, MSS was not noticeable until 1991, when there was a little trace of it. Nevertheless, there has been a steady increase in MSS as it could be observed in the graph, though the increase and decrease in money supply is purely based on the discretion of the Monetary Policy Authority (CBN) in the country. It is a responsibility they carry out with strict consideration of its inflationary effects on the economy. However, government revenue, to a certain extent, influences the supply of money in the economy.

2.1.2. Derivation Allowance

Derivation allowance is the fund given to the mineral producing states which is deducted from the oil revenue before transferring it into the federation account for sharing among the three tiers of government in Nigeria. In line with S.162 (2) of the 1999 Constitution of the Federal Republic of Nigeria as amended, the derivation allowance is 13% of oil revenue and it is given on a monthly basis. Derivation principle suggests a matching between benefits received from the central pool and the percentage of contribution to the pool by states [Abubakar, 1986; Ashwe, 1986; Okunroumu, 1999]. The idea behind this principle is that the inhabitants of the area where a particular revenue is being generated must have suffered one form of economic and environmental loss or the other as a result of pollution and other health hazards. Such people deserve compensation as a way of enabling them benefit from the revenue from their area [Abubakar, 1986]. The figure 2 below shows derivation allowance to the Niger Delta States from 1981-2016. The vertical axis shows the derivation allowance in billions of Naira while the horizontal area depicts the time which is annually.

The derivation allowance to the Niger Delta States did not take effect until 1994. From 1994 to 1999 it was on the low side, but gradually increased in 2005 and came down again in 2009. The derivation allowance has been dwindling, but rose very high in 2013 and 2014 before the drop in oil prices also affected it and there was a serious decline in 2016.

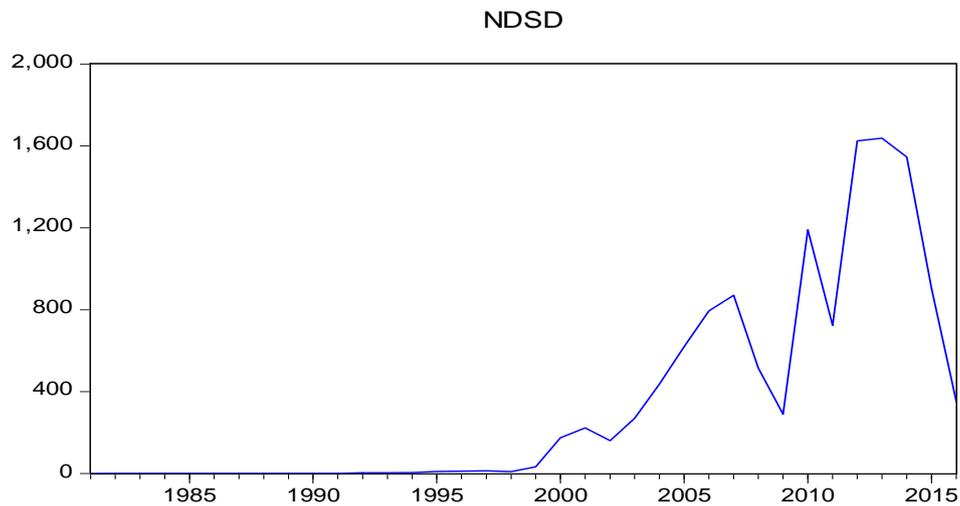


Fig. 2. Trend of NDS in Nigeria (1981-2016)

Source: Data from the Central Bank of Nigeria Statistical Bulletin, 2016

2.1.3. Federation Account

Federation account is a special account into which shall be paid all revenue collected by the government of the Federation, except the proceeds from the PAYE of Armed Forces Personnel, Police Personnel, Foreign Services Officers, Residents of the Federal Capital Territory (FCT) Abuja and other Federal Government Independent Revenue (FGIR) which include: licenses and internal revenue, mining, fees, earnings and sales, rent of government properties, interest and repayment (general and states), reimbursement of Audit fees, revenue from sales of Armed Forces Property, miscellaneous (Federal Republic of Nigeria (FRN) Constitution, 1999). All monies that flow into this account are distributed among the three tiers of government: federal, state and local governments in Nigeria.

The figure 3 below shows the interaction of money supply, allocation to the three tiers of government in Nigeria and derivation allowance to the Niger Delta States from 1981-2016. The vertical axis shows the amount in billions of Naira while the horizontal area depicts the time which is on annual basis.

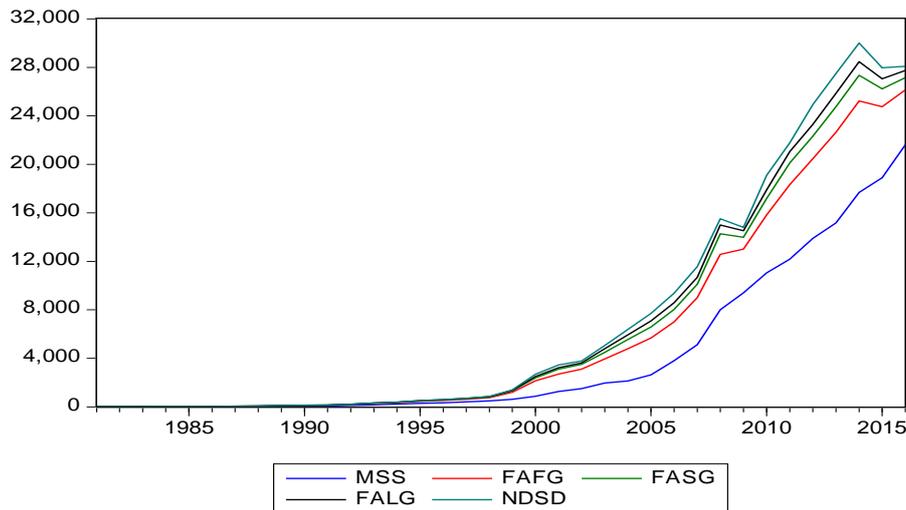


Fig. 3. Trend of MSS, FAFG, FASG, FALG and NDS in Nigeria (1981-2016)

Source: Data from the Central Bank of Nigeria Statistical Bulletin, 2016

From figure 3 above, all the explanatory variables rose from 1999 above the MSS. This is a proof that government revenue directly influences MSS. They rose very high in 2013, but decline in 2014 and picked up again in 2015 and 2016. Although, MSS was on a steady increase.

2.2. Theoretical Framework

Fiscal Federation Theory championed by Musgrave (1959) and Arrow (1974) is the theory underlying this study. Arrow's activities of the public and private sectors (1974) and Musgrave's public finances (1959) provided the structure for the appropriate role of government in the economy. There are three roles expected from the government sector within the framework and they include: the role of government in correcting various forms of market failure, the role of ensuring equitable distribution of income and the role of maintaining stability in the macroeconomy at full employment and stable prices. This study is anchored on the

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role of the government in ensuring equitable distribution of income and maintaining stability in the macroeconomy through stable prices. This could be achieved through adequate support of all monetary policies aimed at maintaining proper relationship between money supply and productive activities (CBN, 2016). Government strong backing of all monetary policies is the tool that will enable the CBN to exercise control over the distributed revenue among the three tiers of government through its well-structured monetary policy. When revenue from the federation is distributed, so much money goes into circulation through government functions and activities, if these activities (which unavoidably involve money supply) are not regulated by the Monetary Authority in the country, there could be inflation which will adversely affect the economy generally.

2.3. Empirical Review

Ogbonna and Ebimobowei (2012) employed a survey research design to investigate the impact of petroleum revenue on the economy of Nigeria for the period spanning from 1970 to 2009. The study was carried out in Nigeria using both primary and secondary data. The secondary data were obtained from the CBN statistical bulletin in line with the dependent variables representing the economy (GDP, per capita income and inflation rate) and the independent variable (Petroleum revenue). The primary data were sourced by using a structured questionnaire administered to 240 respondents which include accountants, financial managers/controllers, management staff and chief executives of major oil and gas industry in Rivers and Bayelsa States. The study adopted descriptive statistics, Pearson product moment correlation coefficient and ordinary least square regression with the aid of statistical package for social sciences for the analysis. The result revealed among others that oil revenue does not significantly affect inflation ($0.412 > 0.05$). The findings also showed a weak relationship ($r = 0.33$) between oil revenue and inflation. Furthermore, the study revealed a strong correlation ($r = 0.839$) between petroleum revenue and GDP. The t-test revealed that petroleum revenue significantly affects GDP (that is $0.000 < 0.05$) at 5% level of significance. Similarly, the findings also indicated a positive relationship ($r = 0.908$) between Per Capita Income (PCI) and the oil revenue. The t-test indicated a significant positive impact of oil revenue on PCI. The study therefore suggested that the Nigerian government should invest major part of the oil revenue on the economy which will help to reduce inflation, as well as improve the value of GDP and Per Capita Income.

Muriithi (2013) examined the relationship between government revenue and economic growth in Kenya. The study was conducted in Kenya in 2013. Descriptive research design was adopted while the time series data from 2003 to 2011 were collected from Central Bank of Kenya (CBK), Kenya National Bureau of Statistics (KNBS) and Ministry of Finance Kenya. The independent variables studied were import duty, excise duty, income tax, Value Added Tax and Non-Tax Revenue, all representing government revenue. The dependent variable used was the economic growth. Both the dependent and independent variable were all expressed in Million of Kenya Shillings. The data were presented in table and graphs and then analysed with the aid of Statistical Package for Social Sciences (SPSS) using Multi-regression analysis. From the results that emerged, economic growth had a strong relationship with the independent variables. The study further revealed a significant negative impact of import and excise duties on the economic growth while income tax, Value Added Tax and non-tax revenue showed a positive and significant impact on the economic growth. The study therefore suggested that policy makers should take keen interest in ensuring that both import and excise duties imposed promote the economic growth in Kenya.

Ayinde, Bello, and Ayinde (2013) evaluated the Nigerian Government revenues and total expenditure using error correction model approach with a secondary data covering a period of 39 years (that is from 1970-2008). The study made use of descriptive research design and multiple regression technique for analysis of data obtained from the CBN statistical bulletin and Nigerian National Bureau of Statistics. Total government expenditure was the dependent variable while the independent variables are: oil revenue, non-oil revenue, federation account and federal government retained revenue. The result showed that all the revenue variables (independent variables) which included the federation account contributed significantly to Nigeria total expenditure. The study suggested more efficient use of revenue to match government spending.

Yakubu, Umar and Aminu (2014) examined the relationship between money supply and government revenue in Nigeria. The study was conducted in 2014 and used Nigeria as a study place. The research employed Autoregressive Distributed Lag (ARDL) co-integration test which is also referred to as bound test. Time series data from 1970 to 2010 were collected from CBN statistical bulletin to test long run relationship, while the short run relationship test used data for 2009 and 2010 only. The variables investigated were total government revenue and money supply. Two

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models were specified, thereby using both variables as dependent and independent variables in two different equations. Results of the error correction model indicated that government revenue had a positive significant impact on the money supply as a macroeconomic indicator in the Nigerian economy, both in the long run ($0.00 < 0.05$) and in the short run ($0.00 < 0.05$).

Alexander (2015) employed least square multiple regression to investigate the relationship between GDP (the dependent variable) and the tax revenue which comprised Direct Taxes, Indirect Taxes and taxes collected by the Customs Division in Ghana. The time series data collected spanned from 1999 to 2014. The GDP deflator was used to get variables in real form and the use of logarithms were made to form the equations. The E-views 7 Statistical Software was employed for the computation of all the variables. The findings revealed a positive relationship between tax revenues and economic development. The test for the individual explanatory variables showed that direct taxes had a negative impact on GDP but not significant. Meanwhile, both the indirect tax and revenue from Custom Division had a significant positive impact on economic development. The study recommended more efforts to be made to ensure tax transparency and information sharing between Ghana and other countries. This will help the Ghana Revenue Authority to prevent tax evasion and avoidance by companies and individual taxpayers whose business operations extend beyond Ghana.

Oti and Odey (2016) evaluated Nigeria's revenue profile and development mesh. The study thoroughly investigated the extent to which the federally collected revenue, oil revenue, non-oil revenue, federation account and federal government retained revenue affect the Nigerian economy. Time series data gathered covered the period of 1980–2014. The statistical tools used for the econometric investigation were Augmented Dickey Fuller (ADF) test, granger causality test, Johansen test and error correction model (ECM). The result showed that total federally collected revenue contributed 0.0009% to the economic growth, oil revenue – 0.003%, non-oil revenue – 7.6%, federation account – 5.59% and federal government retained revenue – 0.016%. The Johansen co-integration test confirmed that a long run dynamic equilibrium relationship exists between economic development and various revenue sources and the granger causality result shows that the various revenue sources granger caused economic development in Nigeria. The study suggested among all that non-oil sectors should be encouraged to avoid over reliance on oil revenue for economic development.

Omodero and Worlu (2018) used pre- and post-effect of CBN interest rates adoption to evaluate the impact of monetary policy on oil revenue in Nigeria. The change from minimum rediscount rate (MRR) to monetary policy rate (MPR) which took effect from December 11, 2006 'till date motivated the study. The findings revealed among others that while MRR was still in use of money supply impacted positively and significantly on oil revenue, but from the adoption MPR which was used to replace MRR, money supply had a significant negative impact on oil revenue. Based on the result, the study concluded that MPR could not be preferred to MRR and suggested a review of baseline interest rate by the Monetary Authority.

2.4. Research Gap

Many studies on government revenue and economic growth have emerged in the past and recent times in diverse ways, although studies on the effect of revenue distribution on money supply have not been common. Scholars like Ogbonna & Ebimobowei (2012), Ayinde *et al.* (2013), Yakubu *et al.* (2014), Oti & Odey (2016) did a similar study but did not consider the effect of revenue allocated to the three tiers of government from the federation allocation (including the derivation allowance) on money supply. Revenue distribution among various level of government is very pivotal in the Nigerian economy as well as its interaction with total money in circulation in the economy. This study has been intended to determine the extent to which revenue allocation to each tier of government affects money supply as an economic indicator. Therefore, the study provides empirical evidence to fill this important gap.

3. Research Method

3.1. Design, Data Collection and Analysis

The study made use of ex-post facto research design because all data employed are already in the public domain and as such cannot be manipulated by the researcher. The data for this research were all secondary form of data and were obtained from the Central Bank of Nigeria (CBN), 2016 edition and the World Bank website. The data on money supply (MSS), federation account allocation to the federal (FAFG), state (FASG) and local (FALG) governments were sourced from the CBN, 2016 edition, while data on derivation allowance to the Niger Delta States were collected from the World Bank website. These data spanned from 1981 to 2016. The choice of this long period of time was to actually determine the effect

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of revenue sharing on money supply which is part of government’s role to ensure price stability through the Monetary Authority in the country.

In order to produce a flawless statistical result and empirical evidence, the study made use of ordinary least square method (OLS) for the regression analysis with the aid of Statistical Package for Social Sciences (SPSS) version 20. Multiple regression analysis was used and t-statistics applied to test individual null hypothesis (Ho) at 5% level of significance. The rejection criterion was that p-value less than 5%, the Ho will be rejected and if otherwise, Ho will be accepted.

3.2. Model Specification

The model comprises money supply (MSS) as the response variable while the explanatory variables include: revenue share of federal (FAFG), state (FASG), local (FALG) and derivation allowance to the Niger Delta States (NDSD). Koutsoyiannis’ (1977) model states that economic theory does not specify the practical form of any relationship. This connotes that a functional relationship may be linear, cubic or even in a quadratic form [Arowoshegbe, *et al.*, 2017].

Based on this premise, the model specification for this study is as follows:

$$MSS = f(FAFG, FASG, FALG, NDSD) \dots\dots\dots (1)$$

Where:

- MSS = Money Supply (M2)
- FAFG = Federation account allocation to federal government
- FASG = Federation account allocation to state government
- FALG = Federation account allocation to local government councils
- NDSD = Niger delta states derivation allowance from the oil revenue

This can be expressed in its explicit form as follows:

$$MSS = \alpha + \beta_1FAFG + \beta_2FASG + \beta_3FALG + \beta_4NDSD + \mu_i$$

Where:

- MSS = Money supply (M2)
- α = Determinant of money supply
- FAFG = FAFG (Federation Account Allocation to Federal Government)
- FASG = FASG (Federation Account Allocation to State Governments)
- FALG = FALG (Federation Account Allocation to Local Government Councils)

$\beta_1 - \beta_4 =$ Coefficients of the independent variables
 $\mu_i =$ Normally distributed error term

The A prior expectation is that the fund allocation used by the three tiers of government should be greater than zero implying positive contribution to money supply in Nigeria.

4. *Data Analysis and Interpretation*

Table 1. Model Summary of Results

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	0.958 ^a	0.918	0.907	1939.41708	1.443

a. Predictors: (Constant), NDSD, FASG, FAFG, FALG

b. Dependent Variable: MSS

Source: Authors' Computation, 2018, using SPSS Version 20

From table 1 above, the value of R is 95.8% which represents a very strong and positive correlation between revenue allocation and money supply in Nigeria. R-Square of 91.8% indicates the extent to which all the explanatory variables (FAFG, FASG, FALG, and NDSD) explain the variations in the money supply, which implies that only 8.2% is attributable to other factors not accounted for in the model. The Durbin-Watson is 1.443, which means it is within the acceptable limit. Values approaching 0 indicate positive autocorrelation, and values toward 4 indicate negative autocorrelation [Gujarati & Porter, 2009]. However, values under 1 or more than 3 are a definite cause for concern [Durbin & Watson, 1950, 1951; Field, 2009; Gujarati & Porter, 2009]. Therefore, the value of 1.443 as revealed in this study is above 1 and below 3.

The result on table 4.2 shows that the value of F-statistics is 86.459 with the p-value of $0.000 < 0.05$ level of significance. The result indicates that the predictor variables (FAFG, FASG, FALG, and NDSD) jointly and significantly influence the dependent variable (MSS). This is an indication that the model is statistically significant and appropriate for the study.

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Table 2. Anova

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	1300803571.730	4	325200892.932	86.459	0.000
	Residual	116601497.228	31	3761338.620		
	Total	1417405068.958	35			

a. Dependent Variable: MSS

b. Predictors: (Constant), NDS, FASG, FAFG, FALG

Source: Authors' Computation, 2018, using SPSS Version 20.

Table 3. Coefficients

Model	Unstandardized Coefficients		Standardized Coefficients	T	Sig.	
	B	Std. Error	Beta			
1	(Constant)	-639.900	445.681		-1.436	0.161
	FAFG	6.707	1.456	2.601	4.607	0.000
	FASG	-19.725	4.598	-2.192	-4.290	0.000
	FALG	15.943	13.281	0.932	1.200	0.239
	NDS	-6.099	1.910	-.481	-3.193	0.003

a. Dependent Variable: MSS

Source: Authors' Computation, 2018, using SPSS Version 20.

From Table 3 above, the regression result is as follows:

$$MSS = (639.900) + 6.707FAFG - 19.725FASG + 15.943FALG - 6.099NDS.$$

From the regression equation on table 3, when FAFG, FASG, FALG and NDS are zero, the MSS will be -639.900. Therefore, a unit increase in FAFG while holding FASG, FALG and NDS constant will on the average increase the MSS by 6.707 in Nigeria. In the same manner, a change in FALG while keeping FAFG, FASG and NDS constant will lead to an increase in MSS by 15.943. A unit increase in FASG while keeping FAFG, FALG and NDS constant will reduce MSS by 19.725 in Nigeria. Similarly, a unit change in NDS while holding constant FAFG, FASG and NDS will lead to a reduction in MSS by 6.099.

4. Hypotheses Testing

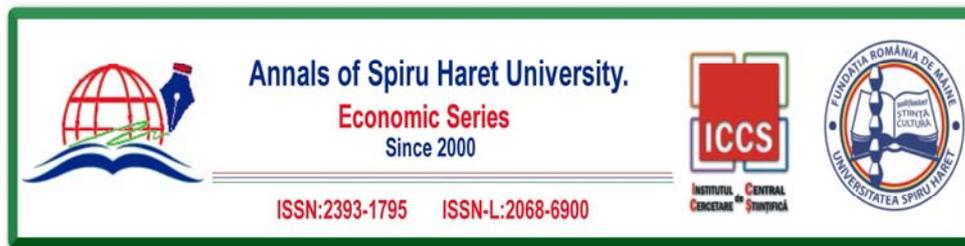
The study earlier suggested that FAFG, FASG, FALG and NDSG do not have significant impact on MSS. The null hypotheses H_{01} - H_{04} have been tested using the t-statistics, the results show that: FAFG has a robust significant and positive influence (P-value $0.000 < 0.05$; t-statistics = 4.607) on MSS. Therefore, H_{01} is rejected and the alternative which states otherwise accepted. This result agrees with Yakubu *et al.* (2014) whose study revealed that total government revenue has significant positive impact on money supply. The result further substantiates the findings of Alexander (2015) and Ayinde *et al.* (2013) but disagrees with Muriithi (2015). FASG has a significant negative impact (P-value $0.000 < 0.05$; t-statistics = -4.290) on MSS; H_{02} is established and the alternative which suggests otherwise overruled. FALG has insignificant positive influence (P-value $0.239 > 0.05$; t-statistics = 1.200) on MSS; H_{03} is accepted while the alternative suggestion is declined. NDSG has a significant negative effect (P-value $0.003 < 0.05$; t-statistics = -3.193) on MSS, H_{04} is also proven and the alternative which states otherwise rejected. Therefore, the results of H_{02} - H_{03} are in conflict with Yakubu *et al.* (2014) but agree with Muriithi (2015).

5. Summary of Findings, Conclusion and Recommendations

The purpose of this study is to provide evidence on the effect of revenue distribution from the federation account on money supply using broad money (M2) as proxy for money supply. From the t-statistics on table 3, the results revealed that revenue allocated to the federal government has positive and significant impact on money supply, the local government allocation has insignificant impact on MSS, while the state allocation and derivation allowance exerted negative influence on MSS. These findings have provided concrete evidence that apart from FAFG, allocation to state and Niger Delta States derivation allowance have adverse effect on money supply, though allocation to local governments does not have any impact. By implication, allocation to states and derivation allowance contribute to inflation in the economy due to weak institutional quality such as corruption. Gribincea (2017) submits that, corruption has undermined many countries' political and economic status.

The study therefore makes the following recommendations based on the findings:

- There should be made conscious effort by the central government to ensure equitability and fairness in income distribution. This will provide all levels of



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government the avenue to carry out their share of expenditure responsibilities without financial constraints.

- The government should ensure that it plays its role of maintaining price stability through adequate and strict monetary policies that will keep the rate of money supply and economic activities of both public and private sectors at a balance.
- Government laws and financial regulations governing public sector revenue usage should always align with monetary policies to avoid inflation.
- Monetary policies should include the percentage of allocated fund that all levels of government should not exceed within a particular financial period.
- The usage of derivation allowance should be well regulated and monitored through some stringent monetary policies as deemed necessary to keep the economy in equilibrium.

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