IMPACT OF INTERNALLY GENERATED REVENUE ON TOTAL REVENUE ACCRUING TO STATE GOVERNMENT IN NIGERIA

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ABSTRACT

This study assessed, in empirical terms, the roles that internally generated revenues play in the administration of state governments in Nigeria, using Ogun State in the South Western part of the country, as case study. It adopted the econometric tool of Ordinary Least Square (OLS) Regression method to analyse the relationship between internally generated revenues and subventions from the federation over a period of 10 years. The study found a positive relationship between the independent and dependent variables, indicative of the fact that internally generated revenue has a major influence on total revenue of the state government. The study therefore recommends that the state government should intensify its efforts in deepening the sources of its internally generated funds, thereby depending less on federal government statutory allocations and other external funds.

Keywords: internally generated revenue; taxation; subvention; federal allocation; state government.

1.1 Introduction

There are many sources of revenues available to state government out of which taxation plays the leading role. Historically, man is bound to pay tax in one form or the other, whether in cash or in kind. The three tiers of government recognized in Nigeria are the federal, the state and the local government and all these tiers generate revenues to prosecute their statutory functions from time to time. The government at each level is expected to perform its duties to the citizens, hence there must be funds to carry out those duties and these funds must be obtained from somewhere. Such funds include, but not limited to taxes, fees, fines, intergovernmental revenues, licenses and permits charged on goods and services, gifts and donations.

Each tier of governments has its revenue source limitations as for example, a state government cannot collect federally collectible revenues, like import and export duties. The list of revenue applicable to each tier is however available and every tier is expected to comply strictly to the list as contravention may lead to penalty from the superior tier.

Broadly speaking, the resources of the Federal Republic of Nigeria can be classified into oil and non oil revenues. Prior to oil boom of the 1970s, agriculture has been the mainstay of the economy, as the sector's contribution to the GDP was above 70%, which later fell to about 25% with the coming of oil. Now oil revenue accounts for the lion share of the federally collectible revenue, up to 90% of the total revenue. Whereas the oil revenue includes petroleum earning and petroleum profit tax, non-oil revenue comprises of other sources of revenue, namely: company income tax; custom and excise duties; fees; license; rent of government property etc. It is to be observed that most of the revenue collectible by the other tiers of government, aside from the federal government, are non-oil related revenues. It is therefore the objective of this study to look at the impact of internally generated revenue of Ogun state government on the total revenue that accrue to the state over a decade and recommend how the state government can improve on such revenue so as to be able to prosecute its laudable projects without recourse to external sources.

1.2 Literature Review

State government has been described as the second tier of government after the federal government. It is an independent political community within a well defined territorial limit whose members are bound together for a mutual protection and help. It uses official administrative agencies to correct external aggression, repress internal instructions and maintain law and order within its territorial limit, Taiwo and Ojo (1968). In order for it to be able to effectively carry out its statutory obligations to the citizenry, every state government recognizes three levels of governance: the legislature; the executive and the judiciary. Each of these levels is independent of the other. Nevertheless, they both derive their functions from the constitutions of the Federal Republic of Nigeria. The various functions of the state government are financed by both the externally and internally generated revenues. Government revenue, which is sometimes called public revenue, can therefore be described as the incomes that accrue to the government in order to finance its numerous economic activities. Since revenue is the blood of existence of every organization, it is pertinent to consider the various of sources of revenue accruing to the state government in broader perspective rather than just mentioning external and internally generated revenues, but before this is done, we would like to restate some of the functions of the state government on which the revenue sourced are being funded.

1.21 Function of state government

As earlier mentioned the state government derives its functions through the dictate of the Constitutions of Federal Republic of Nigeria. The major functions highlighted by the constitutions are:

- provision and maintenance of market;
- collection of taxes and rate;
- construction and maintenance of road;
- naming of streets;
- maintenance of law and order;
- provision and maintenance of public building;
- development of agriculture;
- provision of intra state transport services to the citizens of the state;
- provision and maintenance of health facilities;

- provide advice to the federal government on matter that can lead to economic development of the nation.

It is to be noted that most of the functions are major sources of internally generated revenues for the state government as emphasized below.

1.22 Sources of state government revenue

The major sources of revenue accruable to state governments, as explained above, are the internally generated revenue and externally generated revenue. The ability to generate revenues maximally is dependent on the ingenuity of the state government and the wisdom it employs in driving its resources towards harnessing more revenue avenue into its revenue nets from time to time. This is why state like Lagos is able to accrue more revenue into its nets more than any other states in the federation. Nevertheless, the following sources are available to all states in Nigeria:

- taxes;
- fines, fees and rates;
- licenses;
- earnings and sales;
- rent from government property;
- interest repayment and dividend;
- reimbursement;
- statutory allocations and
- grants.

These broad classification of revenues sources are broken into internal and external sources of revenue for the state government.

1.23 Internally Generated Revenue (IGR)

These are revenues that accrue to the State government from its internal activities without recourse to external sources. State government needs this to avoid embarrassment or disappointment from non-remittance of allocation from federal government, as often time federal allocation is being delayed and state government cannot wait endlessly for the allocation before it can perform its statutory obligations to the citizenry. As we have said before, the internally generated revenue varies from state to state as it is influenced by the culture, politics and economic setting of the residents of the state. It is however, summarized as follows:

- Taxes: The constitution specifies the type of taxes that could be collected by the state as distinct from the ones available to the either the federal government or the local government councils. For the state government the under-listed taxes are available:
- Personal income tax (PAYE): of individual excluding those of armed forces, external affairs officers, foreign nationals, residents of federal capital territory, Abuja and Nigeria Police Force;
- Withholding tax of individual and business name;
- Capital gain tax of individual and business name;
- Stamp duties;
- Pools, betting and lotteries, gambling and casino taxes;
- Road taxes or vehicle licenses;
- Business premises registration and renewal levy;
- Development levy, individual levy not more than N1,000 per annum on each taxable individual;
- Naming of street registration fee in state capital;
- Right of occupancy in state capital;
- Market fee, where the market is being maintained and financed by the state.
- Licenses, fees and fines: which include but not limited to motor and drivers' licenses; land registration and survey fees; fines imposed on offices as well as fees received for international mail convey boxes and bags;
- Rent from state government properties: these are revenues accruing to the state government from the hire of state equipment and leasing to the public of landed properties belonging to the state government;
- Reimbursement: revenues accruing from loan and services to officers and any other organization including collected fund from services earlier rendered to federal, local

government and any other organization;

- Interest repayment and dividends: like interest on loan given to the local, federal government and others as well as investment earnings;
- Miscellaneous: such as refund of amount overpaid to contractors; deposits; environmental and other fines, hires and lease rental payments.

1.24 Externally Generated Revenues (EGR)

Most people believe that state government functions are being financed by federal allocation and internally generated funds, not remembering the fact that there are some other externally generated revenues aside from federal allocation. To this end, external revenues accruing to state government are:

- Federal allocation: which is also called statutory allocation. It is the allocation from the federation account and each state of the federation is entitled to this allocation depending on agreed percentage. Each state government is entitled to monthly allocation horizontally. This has been put at 24% of total amount of federal account with effect from January 1, 1992. This 24% is shared among the 36 states on the basis of:

- 40% equity between the state;
- 40% population;
- 15% social development represented by primary school enrolment and
- 5% internal revenue efforts (the ratio of total internal revenue to recurrent expenditure).

- Value Added Tax: VAT replaced the erstwhile Sales tax, which was the exclusive reserve of the state government. To compensate the state government from moving VAT to federal collectible source, state governments were given 80% of the proceed from VAT at its inception in 1994. Nevertheless, this has been reduced to 50% of the proceed;
- Grants: These are grants accruing to state government, directly or indirectly, in form of donations from foreign countries and non-financial institutions as UN, UNICEF, UNESCO etc;
- Loans: could be internally sourced or externally sourced. Internal ones could be from individuals, organization, commercial banks and federal government, while the external

ones come from World bank, IMF and other foreign organizations. Nevertheless, external loans are to be approved by the Federal government;

- Financial aids: funds from foreign countries and charitable organizations to execute certain humanitarian programs like children immunization control of epidemic diseases or to control a disaster that befalls a particular community;
- Donation and gifts: this can come from sister state governments or from friendly foreign countries.

1.25 Factors affecting growth of IGR of State Government

As earlier pointed out IGR varies from state to state depending on the ingenuity of the state government and its ability to drive its resources to harness all the sources of revenue to its revenue nets from time to time. Most states that collect enough IGR tapped into this principle and the under-listed are some of the factors militating against growth of IGR in some states of the federation:

- Unclear demarcation of boundaries between one state and the other;
- Non existence of enabling law to capture some IGR sources;
- Non mobilization of adequate personnel to drive revenue collection;
- Environmental problem emanating from inaccessibility to certain areas of the state during the raining season or when there is communal dispute;
- Poor monitoring and supervision of revenue collectors;
- Poor knowledge of appropriate tax rate;
- Poor publicity and enlightenment on the benefit accruing for paying revenue voluntarily;
- Sharp practices on the part of revenue collectors for holding on to some of the revenues due to inadequate internal control systems;
- Inadequate motivation of the revenue collectors to really drive enough collections for the state;
- Absence of reliable database;
- Lack of enforcement capability of the State Inland Revenue.

1.26 Ways to improve State Government Revenue

Having stated the factors affecting growth of IGR of State Government, it is reasonable to look at some of the ways by which the state government can improve their revenue bases. Some of the suggested ways are:

- Seeking for more allocation from the federation account, though this would mean the withdrawal of certain concession the federal government is given to the citizens, like withdrawal of oil subsidy;
- Prompt reconciliation and auditing of state government accounts to block all possible avenue of embezzlements and misappropriation of government funds by officials;
- Prompt remittance of external grants to state government locked up in federal government accounts;
- Total overhauling methods of assessment and collection of revenues;
- Appointment of dedicated officials with proven integrity to take charge of revenue collection in the state;
- Provision of social amenities to the citizens, for them to know where their tax payments are being spent in the state;
- Government to embark on public enlightenment to educate the people on the need to fulfill their civil responsibility of paying taxes;
- The federal government to stop playing politics with state government and start being realistic by providing fund to states based on needs not by political affiliations.

1.27 Taxation as a major source of IGR

Governments, all over the world, are saddled with obligatory responsibilities and functions in the provision of basic and essential needs ranging from health, education, security, housing, road and bridges etc. In other words, they are to provide those things that make for economic growth and development which make life meaningful for the citizens. For the government to meet with these obligations, money have to be raised, part of which would have to be provided by the people. Taxation plays a major role as the money being raised from the citizens to prosecute all the obligatory functions to improve the economic growth and development of the society. Many authors have described taxations in many ways as summarised below:

Ogundele (1999) described taxation as the process or machinery by which communities or groups of persons are made to contribute in some agreed quantum and method for the purpose of the administration and development of the society. This definition was supported by Soyode and Kajola (2006), when they opined that tax is a compulsory exaction of money by a public authority for public purposes.

Nightingale (1997) in his own contribution described tax as a compulsory contribution imposed by government. All the authors concluded that it is possible for tax payers not to receive anything identifiable for their contribution, but that they have the benefit of living in a relatively educated, healthy and safe society. However, the infrastructure which tax payers are supposed to enjoy is in a deplorable condition (Fafunwa, 2005); education system in disarray (Obaji, 2005) and the health system is in a worrisome condition (Lambo, 2005), therefore our leaders have been clamouring that a huge sum of the resources which they are to use to provide these amenities find their way out of the economy through tax evasion. Tax evasion has been described to be a deliberate and willful practice of not disclosing full taxable income in order to pay less tax. It is found to be a violation of the law as compared to tax avoidance, which occurs when facts of transactions are admitted but are only arranged or presented in such a way that the resulting tax treatment differs from that intended by the relevant tax legislation, Kay (1980). As it was described by Sikka and Hampton (2005) and Olatunde (2007), tax evasion is one of the major social problems inhibiting development in developing countries and eroding existing welfare in developed economies in the world. It also leads to economic stagnation and socio-economic repercussions. It is therefore necessary for every society to understand the behavior of tax payers and the reasons that cause such specific behavior.

1.3 Statement of Problem

Ability to generate enough revenue by states is dependent on the philosophy and the available human resources to drive it, hence each state relies on the human skills at its disposal as well as its constitution to mobilise as much revenue as possible. Much as the skilled revenue mobilisers are necessary, there must also be active legislative arms to promptly pass law that would empower the state government on any relevant revenue source that is just being discovered. The federal allocation to state governments to maintain their financial obligation is always inadequate, hence so much emphasis is placed on internally generated revenue. This is however been plagued by tax evasions, avoidance, poor record keeping and inability to cover all the tax nets available to the state government due to encroachment of sister states or federal government on what is legitimately due to the state under review. As the citizens expect the government to live up to expectation, the government, on the other hand, have some limitations through dwindling revenues, as the internally generated funds are always found to be inadequate.

1.4 Research Questions

The study was guided by the following research questions:

- To what extent is the internally generated revenue of significant effect to state government total revenue?
- To what extent has tax evasion affects government total revenue?
- What is the effect of internally generated revenue on government expenditure?
- To what extent has internally generated revenue stimulates development of infrastructure and welfare of the citizen in the state?
- What are the various sources of government revenue and their implications on the economy?
- What are the various classification of government expenditure?

1.5 Research Hypothesis

For the purpose of analysing the data, the following hypotheses were tested:

- Ho_1: internally generated revenue of the government is not significantly compared to externally generated revenue;
- Ho_2: internally generated revenue of the government is not significant when compared to total revenue;
- Ho_3: internally generated revenue of the state government is not significant when compared to government expenditure;

- Ho4: withholding tax has no significant relationship on total internally generated revenue of the state government.

1.6 Sources of data

The variables considered in this work are the Externally Generated Revenue (EGR), Total Revenue (TR), Government Expenditure (GExp) and Withholding Tax (WHT) as independent variables, while Internally Generated Revenue (IGR) is the dependent variable. Data on these variables were collected from Ogun State Treasury Office from 2004 to 2013.

1.7 Method of Data Analysis

Ordinary Least Square (OLS) technique of data analysis was employed to estimate the specified model equation. An econometric software, E-views, was used to facilitate the estimation process. Multiple Regression methods were adopted to quantify the effect of afore-listed independent variables on internally generated revenue of the state for the period under review. (R-squared); T-statistic, F-ratio, Durbin Watson (D-W) statistic, Standard error of coefficients (SER) were carried out to assess the relative significance of the variables. The evaluation were based on the statistical significance of the estimated coefficients using 5% level of significance.

1.8 Regression Result

Dependent Variable is Internally Generated Revenue (IGR)

Variables	EGR	TR	GExp	WHT
Constant	0.96759	0.89649	0.89935	0.999740
Standard Error	0.39745	0.36578	0.40037	0.440653
t-statistic	2.43449	2.45089	2.42463	2.268769
R-squared	0.956409	0.735631	0.697381	0.736594
Adj. R-squared	0.939653	0.709053	0.675069	0.710511
Durbin-Watson	1.64731	2.213007	1.79659	2.550053
F-statistic	159.7819	130.8591	86.80025	139.60839

1.9 Interpretation of Model Estimation Result

From the result obtained for hypothesis one, t-test calculated at 5% significant level shows that IGR is greater than the t-test table value implying that IGR is statistically significant. The fact that the standard error of coefficient of IGR is less than half of coefficient of independent variable, EGR, shows that IGR is statistically significant when there is increase in the size of state revenue. The R-square which is the coefficient of determination depicts that 96% of the variable in EGR is being explained by variations in IGR. The adjusted R-square of 0.939653 depicts that the model has a good fit, which is also confirmed by f-statistic of 159.7819; all indicative of the fact that the model, as a whole, is statistically significant at 5% level. In addition, the result revealed no serial auto-correlation problem as reflected in the value of D-W statistic of 1.64731. Conclusively, since calculated f-statistic is greater than the tabulated value at 5% level of significance, IGR of Ogun State Government is statistically significant when compared to EGR.

From hypothesis two, the standard error of the coefficient of the explanatory variable is also less than half, which also indicates that the variable is statistically significant. The adjusted R-square of 0.709053 also depicts that the model has a good fit in addition to non serial auto correlation problem reflected in the value of D-W statistic of 2.213007. f-statistics calculated is also greater than f-statistic table at 5% level of significant, indicative of the rejection of Ho and acceptance of Hi which points to the fact that internally generated revenue is significant when compared to total revenue accruing to the state government.

From hypothesis three, the standard error of the coefficient of the explanatory variable is also less than half, which also indicates that the variable is statistically significant. The coefficient of determination R-square of 0.697381 depicts that about 70% of the variable in Gexp is being explained by variations in IGR. The adjusted R-square of 0.675069 also depicts that the model has a good fit in addition to non serial auto correlation problem reflected in the value of D-W statistic of 1.79659. f-statistics calculated is also greater than f-statistic table at 5% level of significant, indicative of the rejection of Ho and acceptance of Hi which points to the fact that internally generated revenue is significant when compared to total state government expenditure.

From hypothesis four, the standard error of the coefficient of the explanatory variable is also less than half, which also indicate that the variable is statistically significant. The coefficient of determination R-square of 0.736594 indicates that about 74% of the variations in IGR is being explained by variations in WHT. The adjusted R-square of 0.710511 also depicts that the model has a good fit in addition to non serial auto correlation problem reflected in the value of D-W statistic of 2.550053. f-statistics calculated is also greater than f-statistic table at 5% level of significant, indicative of the rejection of Ho and acceptance of Hi which points to the fact that withholding tax has significant effect on total internally generated revenue of the state government.

The positive correlations between the dependent variable and the independent variables confirm the fact that internally generated revenue has a major influence on the various independent variables: externally generated revenue; total revenue accruing to the state; total government expenditure and also the withholding tax income of the state and agrees with the submission of Pintrich (2005).

2.0 Conclusions

The study revealed that internally generated revenue plays significant role in growing the revenue of the state. It was even revealed, in the course of this study, that the internally generated revenue of Ogun State exceeds statutory allocation from the Federal Government. This assertion was supported by the coefficient of determination which states that about 74% of the variable in total government revenue (including statutory allocation from the federal government) is being explained by variations in IGR.

Secondary source of data was adopted for this study with time frame covering 2004 to 2013, the figures were analysed using regression method of analysis to facilitate the conclusion. It was therefore concluded that there is significant relationship between internally generated revenue and externally generated revenue; total government revenue; total government expenditure and withholding tax. This is also in line with the conclusion that the volume of internally generated revenue accruing to the state determines the extent by which the state government fulfils its statutory obligation of providing social amenities as road, bridges etc for the citizens without recourse to external aids and its ability to satisfy the citizens in providing these social amenities would translate to more patronages of the latter by way of voting en-mass for the ruling party during the next election period, that is around the corner.

2.1 Recommendations

Based on the finding of this study, it is recommended that:

- the state government should brainstorm on how to improve on its internally generated revenue base and also enact the necessary law to make such collections valid;
- all loopholes accounting for non or short remittance of government revenue should be blocked, by improving on the internal control and internal checks instituted on revenue collections;
- the government should train and re-train revenue collectors and encourage them to come up with suggestions on how to improve collection drives in the state;
- since residents of citizen determine the tax payment and the fact that some of Ogun state residents that work in Lagos state are paying income tax to Lagos state government, Ogun State government should carry out an enumeration exercise of such residents and seek for reimbursement of the those residents' income tax that have been remitted to Lagos State Internal Revenue Board. The state should also do the same thing in the state, where such practice is in vogue;
- government should publicise the fact that social amenities being provided are financed through the internally generated funds, to make people to be eager to pay tax voluntarily.
- the various factors that lead to tax evasion should be discouraged and if possible blocked. Such factors as imperfect tax administration; high tax rate; complicated tax law; information gap and porous economic border should be guided against.
- the process of paying taxes in designated banks should be more effective and convenient for tax payers who willingly want to pay their taxes in the banks;
- self assessment of tax should be encouraged by the state government;

- the tax system should satisfy the principle of economic justice so as to discourage tax avoidance and evasions.

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