Empirical Analysis of Vertical Imbalance of Revenue Distribution in Nigeria between: 1985-2010.

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Abstract
In contemporary society, the surviving economy depends on the volume of tax response of her citizenry as it helps in frastructural development which in turns contributes to economic development in the country. Against this background, the paper examined the empirical analysis of vertical imbalance of revenue distribution in Nigeria between the periods of 1985 to 2010. Data sourced from the CBN and NBS Statistical Bulletin were subjected to empirical analysis and result showed that the findings confirmed an evidence of negative and inversely relationship between VIMBs and UNED while VIMBf indicated direct and positive relationship with UNED in Nigeria. This is suggestively true because federal has very wide coverage of revenue generation than the state government. In term of predicative capability of cases within the years of study, the state can predict 84 percent 21 out of 25 cases while the federal predict only 80 percent 20 out of 25 cases of UNED. However, VIMBs is not statistically significance while VIMBf is significant based in the overall parameter comparison with the UNED. Although both VIMBs and VIMBf are respectively significance in terms of the model estimates result. The VIMBf is fund to have the highest strength of explaining the variation in UNED by 7.7 percent than the VIMBs of only 1.7 per cent. It is therefore wise to recommended that effort should be made by the National Economic Commission, National Planning Commission and Policy Makers to regulate and restructure the Federal character commission policy of development to reflect true implementation and federalism in governance.
Keywords: Vertical Imbalance, Revenue, Gretl, Policy, Uneven Development, Dummy variables.

1. Introduction

Tax assignment indicates the level of government that should be in control of a particular tax and how this should be administered. In public finance, there is no ideal system of tax assignment; rather it varies from jurisdiction to jurisdiction, under three options namely: the assignment of all tax bases to sub-national government only, the assignment of all tax bases to the central government only, and the assignment of the bases to each level of government (Martinez-Vasquez et al, 1995).

It is recognized that both distributional and macroeconomic management considerations are against the type of arrangement when all tax bases are assigned to the sub-national government only (such as practiced in the former Yugoslavia). Under this system, the centre imposes surcharges on taxes collected by the sub-national governments. As such, this arrangement cannot facilitate income co-distribution through the tax system, while it also deprives the central government of the tax tool as a fiscal policy instrument for macroeconomic management. However, the major advantage is that spending decisions are compatible with tax decisions and, therefore, it encourages tax competition among the sub-national governments (Ter - Minassian, 1997).

The assignment of all tax bases to the central government only is consistent with the pursuit of macroeconomic objectives, while it generates more revenue owing to economies of scale and prevents revenue losses and high cost of administration (Rapu, 2006). This presupposes that the central government is obliged to transfer some of the revenue collected to the sub-national governments. Nevertheless, it is noted that this method separates spending authorities from revenue - raising responsibilities. Thus, the arrangement removes the links between the benefits derived from public expenditure and their prices (taxes).

There is also the horizontal fiscal imbalance, since the revenue -raising capacities of each of the sub - national governments vary and they face different costs, revenue - shocks and demand pressure as they attempt to meet their assigned expenditures. In this context, Broadway and Hobson (1993) note that a horizontal fiscal imbalance is measured by the portion of which a sub - national government's expenditure is financed by the assigned revenues, compared to its counterparts. Thus, revenue - sharing in a federal system to a large extent is aimed at not only to redistribute resources within the nation, but also to effectively control the borrowing capacities of the regions/local councils.

Revenue - sharing in a federal system is implemented usually through two main options, namely: a tax - to - tax sharing system or pooling the entire tax receipts before sharing. Tax to tax revenue sharing system (as practiced in Germany, Argentina and Brazil) has some problems. The system could provide incentives for the central government to concentrate efforts more on those taxes that are either not shared or to a lesser degree shared and those, which can achieve its stabilization policies. If no headway is made, the entire national tax system may be distorted. This explains why many federal systems are attracted to sharing systems whereby the entire proceeds are paid into an account and the pooled resources distributed to all tiers of government through agreed vertical and horizontal sharing procedures (Onah, 2006).

The procedures for the distribution of central revenue among the tiers of government are enforced through approved laws or by the constitution, reflecting the formula/indices for both vertical and horizontal sharing procedures. Thus, the formula - based system provides for the predictability of revenue particularly by the sub-national governments, which is an essential ingredient for budget planning. It also removes the intensive lobbying associated with revenue - sharing when the formula/indices are not specified and also erases the fear of domination of the minorities.

2.0 Review of Related Literature

2.1 The Meaning of Taxation

Taxation is defined by Anyanwu (1997) as a compulsory levy by the government on individuals, companies, goods and services to raise revenue for its operations and to promote social equity through the redistribution of income effect of taxation. In line with this frame of thought, taxation is a source of government revenue by which individuals and cooperate bodies are mandatorily required to pay certain proportion of their earnings to the government for the course of development. Viewed from this perspective, Bhatia (2003) defined tax as a compulsory levy payable by an economic unit to the government without any corresponding entitlement to receive a definite and 'direct' *quid pro quo* from the government. Note the word direct here. It is not a price paid by the tax payer for any definite service rendered or a commodity supplied by the government. The benefits received by tax payers from the government are not related to or based upon their being tax payers. A tax is a generalized exaction, which may be levied on one or more criteria upon individuals, groups or individuals, or the legal entities. "*quid pro quo* means something given or taken as equivalent to another" (Bhatia, 2003).

Little wonder that Eshiobo, Idomeh, and Eshioste (2000) assert that all sums levied by a government or through its accredited agents on the people residing in a country either as individuals or organizations (direct tax) or on goods imported or home produced (indirect tax) to enable the government meet its expenses and for the provision of general benefits are regarded as taxation. On his part, Olorunleka (1985), defines taxation as the process or machinery by which a community or group of people is made to contribute part of their income in some agreed quantum and method for the purpose of the administration and development of the society. It, therefore, follows that a tax is a financial charge or other levy imposed on an individual or a legal entity by a state or a functional equivalent of a state (for more details, see eniwikipandia org/wiki/tax). It can also be regarded as an enforced charge exerted on persons, corporations and organizations by the government to be used to support government services and programs (for details, see www.bohmcre.cm/glossary of terms/t. htm).

Alasan (2003) further points out two characteristics that are important in the imposition of taxes. First, its payment is compulsory as the government can coerce people to pay it. And second, non-payment of taxes usually attracts penalties. This implies that it is only the government that can levy taxes and this is done through various government agencies like the Board of Inland Revenue, the Joint Tax Board, the State Board of Internal Revenue, Local Government Revenue Committee and Joint State Committee (Ojo, 2003).

2.2 Taxes and their Components

In economic literature, the distinction is usually made between direct and indirect taxes. Direct taxes are taxes on income or receipt and the incidence of such a tax falls directly on the payer in that it is not possible for the person who pays the tax to shift the burden to someone else. Examples of direct taxes are personal income tax, capital gains tax, corporate income tax, company and payroll tax (Bawa, 2009).

Musgrave and Musgrave (2004) define direct taxes as those which are imposed initially on the individual or household that is meant to bear the burden while the indirect taxes are taxes which are imposed at some other point in the system but are meant to be shifted to whoever is supposed to be the final bearer of the burden. Personal taxes, such as the individual income tax are thus direct and most in rem taxes such as sales and excise taxes are indirect.

As a fiscal instrument, direct taxes are used to adjust people's disposable income and to reduce the parameter of unearned incomes. At the macroeconomic level, direct taxes are used to redistribute income (Alasan, 2003).The income distribution tenets of taxation lead us to the different forms of direct taxes, which are progressive tax, neutral (or proportional) tax and regressive tax. Under the progressive tax system, the higher the tax base, the higher the tax rate. The rate of taxation is graduated progressively as income increases. The regressive tax is the exact opposite of progressive tax. The tax rate diminishes as the income level or tax base increases so that low rate of tax is paid at higher level of income. The neutral tax is a method of setting tax rates so that the taxes paid as a fraction of income remain constant as actual income rises (Bawa, 2009).

Income from most sources including pay for work done, interest and dividend income, capital gains, rent and royalties and business or profit income are subjected to taxation. Income taxes are levied on taxable income, which is total income minus exemptions and deductions. Some of these adjustments, especially when used in ways unintended by legislations are sometimes called loopholes (Henderson and Poole, 1991). Viewed from this perspective, Ojo (2003) indicates that under the provisions of the capital gains tax act in Nigeria, tax liability arises on actual year basis when a chargeable asset is disposed. Capital gains arise where the sales proceed on the disposal of the changeable asset is more than the cost of organization. On the other hand, Henderson and Poole (1991) analyze a payroll tax as a fixed-rate tax on earnings (up to a specified level) with no deductions or exemptions, where the money is earmarked (set aside) as contributions to particular social insurance programmes.

An indirect tax is a tax on expenditure or outlay and it is possible to shift the tax incidence (partly or wholly) to someone else Alasan (2003). Custom duty is an example of indirect tax and it consists of both the export and import duties although the latter is usually emphasized in countries where import predominates. Export Duty is a tax on the goods exported to other countries, while import duty is a tax on the goods coming into a country from other countries.

Value added tax is another form of indirect tax rate applied at each stage of production to the value added. The sum of value added at all stages of production equals retail price, so the tax should be the same as a retail sales tax of the same rate (Ojo, 2003). Sales and excise taxes are levied on the consumption expenditure of a wide range of goods and services and tax levied on home made goods respectively.

The findings of Diaz-cayeros and Mcllure (2000) reveal that the implementation of assigned taxes to any level of government follows four methods, namely: independent legislation and administration, dual administration, surcharges on federal taxes and tax - sharing. Independent legislation and administration guarantees tax sovereignty, but sometimes inconsistent laws and administrative bottlenecks could create problems and increase the cost of administration. Dual administration means that both the centre and the units have legislative and administrative responsibilities. Tax - sharing implies that the central government relinquishes a fraction of revenue from some selected taxes collected from a sub-national government to the same government. Surcharge implies that the lower level of government may surcharge the central government for the taxes collected in its jurisdiction or vice-versa.

In this connection, Shar (1998) provides three basic considerations, which determine the type of taxes allocated to each level of government to include: administrative efficiently, the objective of the tax and the mobility of the tax base. Following these broad considerations, May (1996) notes the types of taxes that should be assigned to the different levels of government. In his view, progressive (redistributive) taxes should be centralized. These include personal income tax and corporate tax. Taxes for economic stabilization should be collected centrally. These include import and export taxes. Taxes on mobile factors of production should also be centralized and these include capital gain taxes.

Resident's taxes such as sales, excise and retail taxes can be decentralized; Distinction – based taxes are also subject to central collection. These include value added tax. Benefits tax/user charges such as toll fees, hospital and school fees, motor licenses and so on are assigned to the level of government that provides the services

Taxes distributed on unequal basis to jurisdictions are administered by the central government. These include taxes on natural resources and taxes on immobile factors of production such as land and buildings are assigned to the local jurisdictions. Property taxes are assigned to municipal councils.

Many federal systems of government attempt to achieve equity through revenue - sharing between the central government and regions/local bodies and among the regions/local bodies. This reflects the fact that often times the high - yielding revenue types are assigned to the central government, while substantial and growing expenditures are devolved to the sub - national governments, which connotes vertical fiscal imbalance. A vertical fiscal imbalance is measured by the extent to which a tier of governments' expenditures is financed by own assigned taxes (Marcele, 2000).

3.0 Research Methodology

In this study, secondary data are used and collected from Central Bank of Nigeria Statistical Bulletin, Central Bank of Nigeria Economic and Financial Review, Central Bank of Nigeria Annual Reports and Statement of Accounts. In all cases, the data are annual time series data and covered the period of 1985 to 2009. The analysis was done electronically using econometrics software-Gretl. Statistical Techniques such correlation, test of significance procedure and probit regression model were adopted in analyzing the data.

3.1 Model Specifications

The model for the study is specified as in the equations 1 and 2 to establish the relationship between uneven development (dependent variable) and vertical imbalance of both federal and sub national level (independent variables).

MODEL1

UNED = f (VIMB$_f$)

I.e. $UNED = \beta_o + \beta_1 VIMBf + €$ 1

$b_1 > 0$

MODEL2

UNED = f (VIMB)

I.e. $UNED = \alpha_o + \alpha_1 VIMB_s + €$ 2

$b_1 > 0$

Where:

β_o = constant term or intercept

α_o = constant term or intercept

β_1 = the coefficient for Federal Vertical imbalance (VIMBf)

α_1 = co-efficient of sub-national imbalance ($VIMB_s$)

€ = the error term

We seek in this work to determine whether these variables do or do not habitually move together. According to Koutsioyannis (1973), the coefficient of correlation is a measure of the degree of co -variability of the dependent and independent variables. Correlation coefficient may assume values from -1 to + 1 when r is positive, dependent and independent variables increases or decrease together. r = + 1 implies that there is perfect positive correlation between dependent (i.e. GDP and UNED) and independent ($VIMB_f$ $VIMB_s$) variables respectively. A dummy variable is introduced as a proxy for uneven development in model 1 and 2 takes the value of one (1) for uneven development and the value of zero (0) for even development in the model. When r is negative, dependent and independent variables move in opposite direction. If r = - 1 there exists a perfect negative correlation between dependent (GDP & UNED) and independent (CIT, CED, VAT & $VIMB_F$ $VIMB_S$) variables.

3.2 Techniques of Data Analysis

The content analysis research method, which is adopted in this study, is described by Balogun and Ojeikere (2004) as the examination of existing written documents. The data gathered are estimated using the simple linear regression technique, with microfit 4.0 and logit econometric software to authenticate and take decision on the outcome of the results obtained. Various statistical tests such as the F-statistics is used to test the overall significance of the regression equation. The T-test is adopted to test the significance of each variable. The Durbin-Watson test is also used to test the present or absence of autocorrelation among the explanatory variables in model 1. In model 2 and 3, Zcal is used to test for individual parameter, Likelihood Ratio Test (LRT) is used to test for the overall significance of the parameters which follows the chi-square distribution.

4.0 Empirical Approach and Discussion of Results

Model 1. UNED = f ($VIMB_f$)

Table 4.1 Logit Regression out-put of VIMBf on UNED

Regression	Coefficient	Standard Error	Z cal.	Slop
CONST	-1.56403	1.71154	-0.9138	
$VIMB_f$	0.0240977	0.0138119	1.754	0.00172

MacfeddenR^2 = 0.2587,Adj R^2= 0.076789,
R=0.5086
Number of cases “correctly predicted” =20(80%).
Likelihood Ratio Test (LRT): Chi-square (1) = 5.68809 [0.0171]
Source: Gretl 2.8 Version

The model estimate of UNED on VIMBf has an econometric expression of

UNED= αo+α1 VIMBf with the estimated model of UNED = -1.5640+0.0241VIMEf.

Model 1

Model of UNED on VIMBS

UNED = F (VIMBs)

Logit Model of vertical imbalance of sub-national and the uneven Development in Nigeria (UNED) Gretl result output is shown in the table below:

Table 2: Logit Regression model result of UNED on VIMBs

Regression	Coefficient	Standard Error	Z cal.	Slop
CONST	2.88317	3.99790	0.7212	
$VIMB_s$	-0.0131404	0.0419373	-0.3133	-0.00174

MacFadden $R^2 = 0.006073$, R =0.0779,Adj $R^2 = -0.175882$
Number of cases correctly predicted = 21(84.0%)
Likelihood Ratio Test (LRT); chi-square (1) =0.133496 [0.7148].
Source: Grelt Version
The estimated regression Logit model of UNED on VIMBs is expressed as:
UNED = β o + β $_1$VIMBs
UNED = 2.883 – 0.0131VIMBs.
Model 1

To investigate the significance of VIBMf to UNED, the slope of 0.00172 associated with the Zcal value of -0.9138 is less than the critical value of 0.05 shows that VIMBf is statistically significant to the level of UNED in Nigeria. VIMBf and UNED are statistically significant base on the significance of the overall parameters because, the probability (slope) of 0.00172 associated with LR-Test statistic with chi-square distribution value of 5.68809 is less than 5 per cent of significance.

Model 2

The probability value (slope) associated with the Zcal(-0.3133) is less than the critical value at 5 per cent level of significance i.e. slope (-0.00174) < 0.05 which implies that the VIMBs is statistically significant to the UNED. The overall significance of UNED and VIMBs is found to be statistically not significant as the probability (0.7148) of Likelihood Ratio Test (LRT) which follows chi-square distribution of 0.013346 is largely greater than the critical value of 0.05 at 5 per cent level of significance.

4.5 Discussion of Regression Result in the Models Above

Model 1

The R=0.5086 of UNED and VIMBf is 50.9 per cent and highly positively correlated. This implies direct relationship between VIMBf and UNED in Nigeria. In terms of magnitude of relationship the logit result revealed that a unit change or rise in VIMBf will result in 2.4 per cent correspondent increase in UNED in Nigeria.

To investigate the significance of VIMBf to UNED, the slope of (0.00172) associated with the Z cal value of -0.9138 is less than the critical value of 0.05 hence VIMBf is statistically significant to the level of UNED in Nigeria

`Base on the significance of the overall parameter of UNED and VIMBf, the probability (slope) of (0.0171) associated with LRTest statistic with chi-square distribution value of (5.68809) is less than 5 per cent level of significance. Therefore, VIMBf and UNED are statistically significant.

The logic model result indicated very high prediction value of 20 cases out of 25 between 1985 to 2009 actual uneven development reported cases by the data set making 80 per cent predicated cases and just 20 per cent unpredicted by VIMBf. R^2= 0.2587 show that the model is 25.9 Percent accurate and fitted though it presented a weak fit for predicting power but positive. The Adjusted R^2= 0.07678 tell the degree of variation in dependent variable (UNED) can be explained by VIMBf 7.7 per cent while 92.3 per cent is unexplained by VIMBf as a result of policy of federal character biased socio economic and political factors e.t.c.

Model 2

The model estimate indicated that there is negative relationship between VIMBs and UNED in Nigeria with very weak correlation value of 7.8 per cent. This inferred that there is positive but inverse relationship between UNED and VIMBs. However, a unit change or raise in the level of VIMBs will result to correspondent 1.3 per cent decrease in the UNED in Nigeria.

To test for the significance of VIMBs to UNED, the probability value (the slope) associated with the Ƶ cal (-0.3133) is less than the critical value at 5 per cent level of significance i.e. slope (-0.00174) < 0.5 which implies that the VIMBs is statistically significant to the UNED. Therefore, the overall significance of UNED and VIMBs is fund to be statistically not significant as the probability (0.7148) of likelihood Ratio Test (LRT) which follows chi-square distribution (0.13346) is largely greater than the critical value of 0.05 at 5 per cent level of significance.

Based on the binary nature of UNED classification (1-uneven and 0-even development) the analysis revealed very high predication value of about 21 out of the actual data set of 25 cases from 1985-2009 indicating 84 percent correctly predicated cases of uneven development in Nigeria by VIMBs.

The adjusted R^2= 0.1758 showed that the degree of variation in the dependent variable (UNED) can be explained by independent variable (VIMBs) inversely at 17.6 per cent. The variation in UNED cannot be inversely explained at 82.4% due to some factors such as policy, political reasons or error due to economic crises and implementation issues. In addition, the model is suggested to be fitted at just 0.61 percent which means it is very weak functional model. This could be a result of factors of non functional data set for the true reflection of happening in the real society (Nigeria).

5.0 Conclusions

The findings confirmed that there is negative and inversely relationship between VIMBs and UNED while VIMBf has direct and positive relationship with UNED in Nigeria. This is true because federal has very wide coverage of revenue generation than the state government. In term of predicative capability of cases within the years of study, the state can predict 84 percent (21) out of 25 cases while the federal predict only 80 percent (20) out of 25 cases of UNED. However, VIMBs is not statistically significance while VIMBf is significant based on the overall parameter comparison with the UNED. Although both VIMBs and VIMBf are respectively significance in terms of the model estimates result. The VIMBf is fund to have the highest strength of explaining the variation in UNED by 7.7 percent than the VIMBs of only 1.70 per cent. From the analysis, we conclude that changes in the existing tax assignment and revenue sharing arrangement will go a long way in protecting our nascent democracy. It will also reduce agitation and unnecessary tension in the system while it will positively check uneven development and facilitate the stable provision of public services across the sub-national government.

6.0 Recommendations

Based on the findings of this research, some recommendations are made for improving the Nigeria economy. Firstly, increasing the Fiscal Capacities of the state and local governments (i.e. sub national government); the current debates is that sub national government in Nigeria, lack the financial capacities to carry out some of the assigned responsibilities and, therefore, the suggestion is to trim down these responsibilities. However, this will move Nigeria towards a unitary system of government. In this regard, the option has been to improve the sub-national government's fiscal capacities through partly, modification of assigned taxes and introduction of other more reliable taxes as follows.

The introduction of state excise taxes on alcoholic beverages and tobacco products is a good example for new tax assignment to the state government. The new tax system is expected to be a residence based tax and does not eliminate excise tax by the federal government. It recommends also that effort should be made by the National Economic Commission, National Planning Commission and Policy Makers to regulate and restructure the Federal character commission policy of development to reflect true implementation and federalism in governance.

Personal income taxes form a major component of tax assignment to the state governments. Evidence over the years has shown that yields from the personal income tax have been low. In this regard, it is suggested that the powers to set ratios, in addition to the existing administrative responsibilities should be transferred to the state governments. This will enable them to adjust ratios, depending on the economic circumstances and revenue needs. The administration of property tax should be placed under the purview of the state governments while the proceeds should be given to the local councils, with a surcharge of not more than 10 per cent to cover administrative costs. Thus, besides increasing revenue, it will also reduce tax evasion and avoidance. Another area in which the councils could increase their tax revenue is through entertainment tax on birthdays and burial ceremonies, taxes on advertisement in their localities, and cost recovery charges, such as tolls for use of local roads and other user changes

7.0 Policy Implication

6.1 Review of the vertical Distribution formula

To further boost statutory transfers to the sub national governments to reduce uneven development between the federal and the sub national governments the revenue-sharing formula should be reviewed. However, the percentage allocation to each tier of government can be determined by proper beginning, depending largely on the expenditure needs of each tier of government on social services, internal security and defense.

Compelling the State Governments to allocate the mandatory 10 per cent of their internal Revenue to the local Government, the Federal Government should establish a standard format to enable it monitor this aspect of the constitution and stiff penalty stipulated in the law. For instance, it could be recommended that failure to comply; the fiscal commission should deduct the outstanding amounts from individual state government's share of the Federation Account. Constitutional Amendment on the Distribution of proceeds from the federation Account

The Federal government through the Revenue mobilization, allocation and Fiscal Commission (RMAFC) should establish a good and accepted statistical base for the purpose of revenue-sharing across the sub-national governments. This is in terms of derivation, population and geographic area. This should also, be reviewed at regular intervals through independent surveys.

The political climate of Nigeria must be improved upon with strict adherence to the rule of law so as to stimulate economic growth. As observed, the Value Added Tax and the Fiscal Imbalances as reflected in the fiscal operations is not practically reflected in the economy due to no accountability, transparency and leakages in the system.

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