E-ISSN 2281- 4612
ISSN 2281-3993

Academic Journal of Interdisciplinary Studies
Published by MCSER-CEMAS-Sapienza University of Rome

Vol 1 No 2
November 2012

Tax Revenue and Economic Development in Nigeria: A Macroeconometric Approach

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Doi:10.5901/ajis.2012.v1n2p211

Abstract

The study examines the impact of tax revenue on the economic growth of Nigeria, judging from its impact on infrastructural development from 1980 to 2007. To achieve this objective, relevant secondary data were collected from the Central Bank of Nigeria(CBN) Statistical Bulletin, Federal Inland Revenue Service (FIRS) and previous works done by scholars. The data collected were analyzed using the three stage least square estimation technique. The results show that tax revenue stimulates economic growth through infrastructural development. That is, it highlights the channels through which tax revenue impacts on economic growth in Nigeria. The study also reveals that tax revenue has no independent effect on growth through infrastructural development and foreign direct investment, but just allowing the infrastructural development and foreign direct investment to positively respond to increase in output. However, tax revenues can only materialize its full potential on the economy if government can come up with fiscal laws and legislations and strengthen the existing ones in line with macro economic objectives, which will check-mate tax offenders in order to minimize corruption, evasion and tax avoidance. These will bring about improvement on the tax administration and accountability and transparency of government officials in the management of tax revenue. Above all, these will increase the tax revenue base with resultant increase in growth.

Key words: *Tax Revenue, Infrastructural Development, Foreign Direct Investment, Economic Growth.*

I. Introduction

A Tax is a fee charged or levied by a government on a product, income, or activity. If it is levied directly on personal or corporate income, it is called a direct tax. If it is levied on the price of a good or service, then it is called an indirect tax. The main reason for taxation is to finance government expenditure and to redistribute wealth

which translates to financing development of the country (Ola, 2001, Jhingan, 2004, Musgrave and Musgrave, 2004, Bhartia, 2009). Whether the taxes collected are enough to finance the development of the country will depend on the needs of the country and, countries can seek alternative sources of revenue to finance sustainable development(Unegbu and Irefin, 2011). Tax revenue is the receipt from tax structures. Revenues accruing to an economy, such as Nigeria, can be divided into two main categories, which are; Oil Revenue (includes revenue from royalties, Petroleum Profit Tax (PPT), gas tax) and Non-Oil revenue(includes trade, loans, direct and indirect taxes paid by other sectors of the economy, Aids, agriculture etc).

However, tax revenue mobilization as a source of financing developmental activities in less developed economies has been a difficult issue primarily because of various forms of resistance, such as evasion, avoidance corrupt practices attending to it. These activities are considered as sabotaging the economy and are readily presented as reasons for the underdevelopment of the country. Government collects taxes in order to provide an efficient and steadily expanding non-revenue yielding services, such as infrastructure-education, health, communications system etc, employment opportunities and essential public services (such as the maintenance of laws and order) irrespective of the prevailing ideology or the political system of a particular nation. Tax is also the nexus between state and its citizens, and tax revenues are the lifeblood of the social contract. The very act of taxation has profoundly beneficial effects in fostering better and more accountable government (Tax Justice Network(TJN), 2012). Musgrave and Musgrave (2004) also stated that the economic effects of tax include micro effects on the distribution of income and efficiency of resource use as well as macro effect on the level of capacity output, employment, prices, and growth. However, the use of tax as an instrument of fiscal policy to achieve economic growth in most less develops countries cannot be reliable because of dwindling level of revenue generation. Consequent upon this, changing or fine-tuning tax rates has been used to influence or achieve macroeconomic stability. A critical examples of governments that have influenced their economic development through revenue from tax are; Canada, United States, Netherland, United Kingdom. They derive substantial revenue from Company Income tax, Value Added Tax, Import Duties and have used same to create prosperity (Oluba 2008).

A significant share of the tax revenue increase in Africa stems from natural resource taxes. This included income from production sharing, royalties, and corporate income tax on oil and mining companies (Pfister, 2009). Nigeria is a developing country whose major export is mainly crude oil. Also endow with other natural resources such as; natural gas, tin, iron ore, coal, limestone, lead, zinc and arable land (Economy Watch, 2011). As a sovereign nation, Nigeria has a land mass that covers about 923, 768 sq km and have a population of about 149,229,090. According to

Tran (2008), emerging economies are nations that have large territories and populations, and they are undertaking extraordinary development projects that call for new infrastructure, such as power-generating plants and telecommunications systems. Also, United Nations (2005) asserts that, achieving the Millennium Development Goals(MDGs), for instance, low-income countries (LICs) are required to increase their domestic revenues by around 4 percent of the GDP. Also, to meet the MDGs, OECD countries have been urged to raise their level of aid to LICs to about 0.7 percent of their Gross National Income – but this is as nothing when compared to potential tax revenues. The infrastructural developments demand a lot of resources and funding. In many rich countries, tax constitutes 30-40 percent of the GDP (Golit, 2008 and TJN, 2012). Nigeria with a budget of N4.97 trillion for the year 2011, representing 12% increase of 2010 annual budget(Unegbu and Irefin, 2011) shows that tax revenue is one of the ways of funding infrastructural developments specified in the budget. The tax base in Nigeria since had been on the increase in order to mobilize the resources needed to execute infrastructural projects. According to Kaldor(1963), those who believe that insufficient growth and investment is mainly a consequence of a lack of resources are chiefly concerned with increasing the resources available for investment through additional taxation. The availability and mobilization of revenue is the fundamental factor on which an economic development is sustained and managed. As noted by TJN(2012), tax is the most important, the most beneficial, and the most sustainable source of finance for development. Tax revenue in Africa, for example, is worth ten times the value of foreign aid. The long-term goal of poor countries must be to replace foreign aid dependency with tax self-reliance.

However, in Nigeria the contribution of tax revenue has not been encouraging, thus expectations of government are being cut short. Corruption, evasion, avoidance and tax haven indicators are strongly associated with low revenue (Attila, Chambas, and Combes, 2008) and indeed, corruption functions like a tax itself. According to Adegbie and Fakile, 2011), the more citizens lack knowledge or education about taxation in the country, the greater the desire and the opportunities for tax evasion, avoidance and non-compliance with relevant tax laws. In this respect, the country will be more adversely affected because of absence of tax conscience on the part of individuals and the companies and the failure of tax administration to recognize the importance of communication and dialogue between the government and the citizens in matters relating to taxation.

In the face of resource deficiency in financing long term development, Nigeria has heavily resorted to foreign capital, such loans and aid as the primary means to achieve rapid economic growth. Thereby accumulate huge external debt in relation to gross domestic product and serious debt servicing problems in terms of foreign exchange flow and, as such majority of the populace live in abject poverty. Government

has expressed concern over these and has vowed to expand the tax revenue in order to meeting its mandate. Kiabel and Nwokah (2009) argue that the increasing cost of running government coupled with the dwindling revenue has left all tiers of government in Nigeria with formulating strategies to improve the revenue base. Also, Ndekwu (1991) noted that, more than ever before, there is now a great demand for the optimization of revenue from various tax sources in Nigeria. This probably influenced the decision of the Federal Government of Nigeria (FGN), which in 1991 set up a Study Group on the Review of the Nigerian Tax System and Administration. Also, that an accurate estimation of the optimal level of expenditure requires knowledge of the productivity of the tax system and that it will assist in identifying a sustainable revenue profile for the country. As noted by IMF (cited in TJN, 2012) :

"*Developing countries must be able to raise the revenues required to finance the services demanded by their citizens and the infrastructure (physical and social) that will enable them to move out of poverty. Taxation will play the key role in this revenue mobilization. . . . .*

As a means of meeting their expenditure requirements, many developing countries undertook tax reforms in the 1980s. However, most of these reforms focused on tax structure rather than on tax administration geared towards generating more revenue from existing tax sources (Osoro, 1991).

Given this background, the objective of this study is to examine the impact of tax revenue on the economic development in Nigeria, judging its impact on relationship between infrastructural development and growth.

The paper is organized into five sections. Following this introduction is section two which reviews related relevant literatures. Section three deals with data and methodology, while section four dwells on empirical results and analysis. Section five provides the conclusion of the paper.

2. Literature Review

There are very few studies which have been conducted to see the impact of tax revenue on economic development. Some of the relevant related studies with regard to the subject matter were reviewed below.

Expert of group United Nations (2000) stated that, tax revenue contributes substantially to development and therefore, there is the need to streamline a nation tax system so as to ensure the realization of optimal tax revenue through equitable and fair distribution of the tax burden. The stark reality in most developing countries is that whilst there is severe budgetary pressure as a result of ever increasing demand for

government expenditure, there is a limited scope for raising extra tax revenues, as a result of Non-compliance with corporate persons result from technicalities and tax avoidance, poor record keeping and cash transactions. Keen and Mansour (2010), in analyzing the revenue mobilization in sub-Saharan-Africa found that, within sub-Saharan Africa, revenue has performed more strongly in resource-rich countries. In the same Desai, Foley and Hines (2004) stated that governments have at their disposal many tax instruments that can be used to finance their activities. These tax alternatives include personal and corporate income taxes, sales taxes, value added taxes, capital gain taxes and others. It is not uncommon for a country to impose all of these taxes simultaneously. Contrarily, in choosing what tax instruments to use and what rates to impose, governments are typically influenced by their expectations of the effects of taxation on investment and economic activity, including foreign direct investment (FDI). They stated that there is extensive empirical study that high corporate income tax rates are associated with low levels of FDI.

On the issue of the problem of tax revenue instability Lim (1983) in his study, instability of government revenue and expenditure in less developed countries observed that tax revenues instability was the major cause of expenditure instability in less developed countries in the period going from 1965 to 1973. Bleaney, Gemmel and Greenaway (1995) also, in their study, tax revenue instability, with particular reference to sub-Saharan Africa analyzed the sources and the consequences of revenues instability in developing countries. They found that tax revenue instability is more common in poor, more open and more inflationary economies. And evidence that countries with high tax revenue instability tend also to have high total expenditure instability. In line with this, Ebeke and Ehrhart(2010) in their work, the sources and consequences of the instability of tax revenue in Sub-Saharan African countries, using panel for 39 countries over the period 1980-2005, gave credence to Bleaney, Gemmel and Greenaway (1995), Guillaumont et al (1999), Fatas and Mihov, (2003), Talvi and Vegh (2005), Furceri (2007), Loayza et al (2007), Thorthon (2008) and Diallo (2009), that tax revenues instability in Sub-Saharan Africa is leading to public investment and government consumption instability which in turn generates lower public investment ratio and is therefore detrimental to the long term economic growth. This is of deep concern for Sub-Saharan African countries since it was found to be detrimental for growth and welfare.

Owolabi and Okwu (2011) examined the contribution of Value Added Tax to Development of Lagos State Economy, using simple regression models as abstractions of the respective sectors considered in the study. The study considered a vector of development indicators as dependent variables and regressed each on VAT revenue proceeds to Lagos State for the study period. Development aspects considered included infrastructural development, environmental management, education sector

development, youth and social development, agricultural sector development, health sector development and transportation sector development. The results showed that VAT revenue contributed positively to the development of the respective sectors. However, the positive contribution was statistically significant only in agricultural sector development. On the aggregate, the analysis showed that VAT revenue had a considerable contribution to development of the economy during the study period. Also Unegbu and Irefin(2011) in their paper, the impact of value added tax (VAT) on economic and human developments of emerging Nations from 2001 to 2009 , using regression, discriminant analysis and ANOVA, found out that VAT allocations have a very significant impact on expenditure pattern of the state during the same period. Also observed that, the perceptions by the citizenry across the administrative areas of the state suggest that VAT has minimum impact level on the economic and human developments of Adamawa State from 2001 to 2009.

Adegbie and Fakile(2011) concentrated on the Company Income Tax and Nigeria Economic Development relationship. Using Chi-square and Multiple Linear Regression analysis in analyzing the primary and secondary data respectively and concluded that there is a significant relationship between company income tax and Nigerian economic development. And that tax evasion and avoidance are major hindrances to revenue generation.

Lee and Gordon(2004) in their paper, Tax structure and economic growth, explore how tax policies affect a country's growth rate, using cross-country data during 1970–1997. Their findings revealed that statutory corporate tax rates are significantly negatively correlated with cross-sectional differences in average economic growth rates, controlling for various other determinants of economic growth, and other standard tax variables. And also, that in fixed-effect regressions increases in corporate tax rates lead to lower future growth rates within countries.

Ogbonna and Ebimobowei(2012) examined the Impact of Tax Reforms and Economic Growth of Nigeria using relevant descriptive statistics and econometric analysis and concluded that the various test shows that tax reforms is positively and significantly related to economic growth and that tax reforms granger cause economic growth. Also, that tax reforms improves the revenue generating machinery of government to undertake socially desirable expenditure that will translate to economic growth in real output and per capita basis.

The few literatures that exist are of the support that tax revenue impact positively on economic growth. However, the reviewed studies ignored the link between tax revenue and economic growth and provided evidence that may not provide an adequate guide for policy decisions. Also, most of the previous studies applied techniques that take into no account of the properties of the time series that were used in their analysis and possibly arriving at unrealistic estimates.

Ogbonna and Ebimobowei (2012) so far represents the most comprehensive assessment of the impact tax revenue on economic growth. In his he disaggregated tax revenue into its various components such as; excise duties, personal income tax, petroleum profit tax, companies income tax, value added tax and education tax. Our study improves upon Ogbonna and Ebimobowei (2012) in the following respects. First, this study covers the period 1980—2007. We therefore update the analysis. Second, our study captures the link between tax revenue and its impact on economic development. Third, Ogbonna and Ebimobowei (2012) examined a direct relationship. We believe that such may not provide an adequate guide for policy decisions since we cannot ascertain its impact on the infrastructure required by the citizens that will enable them to move out of poverty, which are of interest to this study. Hence, we utilizes annual time series data to develop a small macroeconometric model that captures the interrelationship among infrastructure, investment behaviour and economic growth given the tax revenue of the economy. This study therefore contributes to the literature on the significant or role of tax revenue in bringing about economic growth in Nigeria.

3. Data and Methodology

This section focuses on the data and analytical procedure adopted in this study.
The data for this study were obtained from secondary sources. Specifically, annual time series data of the variables were obtained. The data include; gross domestic product(GDP), infrastructure, petroleum profit tax(PPT), company income tax(CIT), custom and excise duties, foreign direct investment(FDI), domestic investment(DI), interest rate(INT) and consumer price index(CPI) are collected for the period of 1980 to 2007. This is as a result of non availability of data, except for the aforementioned period. The data are sourced from Central Bank of Nigeria(CBN) statistical bulletin and previous works done by scholars. .
In attempting to examine the impact of tax revenue on economic growth, study evaluate the time series features of the data by employed Augmented Dickey Fuller (ADF) and Philips-Perron(PP) to test for the unit root. After which the study analyze the short-run model system using the three stage least square(3SLS) regression framework. This is because of the simultaneity bias that usually associated with the use of ordinary least square in a framework where the right hand side endogenous variables are correlated with the error term. This leads to a misleading judgments.
Given the above, we develop a small macroecometric model below to capture the interrelationships between tax revenue and economic aggregates in Nigeria.

$$Log(INFD)_t = \gamma_0 + \gamma_1 log(PPT)_t + \gamma_2 log(CIT)_t + \gamma_3 log(CED)_t + \varepsilon_{1t} \ldots\ldots\ldots\ldots\ldots\ldots (1)$$

(+) (+) (+) (+)

$$Log(FDI)_t = \beta_0 + \beta_1 log(INFD)_t + \beta_2 log(INT)_t + \beta_3 log(RGDP)_t + \varepsilon_{2t} \ldots\ldots\ldots\ldots\ldots(2)$$

(+) (-) (+)

$$Log()RGDP)_t = \theta_0 + \theta_1 log(FDI)_t + \theta_2 log(INFD)_t + \theta_3 log(CPI)_t + \theta_4 log(FDI)_t + \varepsilon_{3t} \ldots\ldots(3)$$

(+) (+) (-) (+)

Equations 1-3 are stochastic equations used for estimation.
Where,
INFD=Infrastructure Development, proxy by electricity generation(mega watt per hour)
DI=Aggregate Domestic Investment, proxy by total domestic savings
GDP=Economic growth, proxy by Gross Domestic Product
PPT=Petroleum Profit Tax
CIT=Company Income Tax
CED=Custom and Excise Duties
FDI=Foreign Direct Investment
INT=Interest Rate(lending rate)
ε_t= *error term*

It would be recalled that accelerator investment principle suggests that an increase in the demand for output is accompanied by increase in the demand for investment(Olofin and Afangidel, 2009). The ability of investors to meet such an increase in demand for output depends on one side, the availability of infrastructure. The response of investment to output growth is likely to be higher in a country whose infrastructural development is high.

4. Empirical Results

Unit Root Test
The results are shown in table 1 below. All the variables are non-stationary at level but are all stationary at first difference.

Table 1: Results of Unit Root Stationarity Test

Variables	Augmented Dickey Fuller test(ADF)		Philips- Perron test(PP)	
	Level	First Difference	Level	First Difference
Lnrgdp	-2.244336	-5.604378	-2.244336	-5.604378
Lninfd	-3.434385	-5.913238	-4.080133	-5.913238
Lndi	0.106179	-6.108517	0.106179	-6.108517

Lnppt		-1.401524	-6.382351	-1.401524	-6.382351
Lncit		-0.048278	-6.982531	0.016975	-6.982531
Lnced		--0.150467	-6.691870	-0.096982	-6.691870
Lnfdi		-0.205633	-5.117080	-0.245577	-5.117080
Lnint		-2.008267	-8.677968	-1.791522	-8.944514
Lncpi		-0.682699	-4.261452	-0.269825	-4.261452
Critical Values	1%	-3.621023	-3.626784	-3.621023	-3.626784
	5%	-2.943427	-2.945842	-2.943427	-2.945842
	10%	-2.610263	-2.611531	-2.610263	-2.611531

After the unit root test, we conducted a cointegration test and observed that E1-E3 are all cointegrated, but the results are not reported here. Consequently, we now estimate the system equation using the three stage least square(3SLS) regression framework without any serious problem of spurious relationship. The equations(E1-E3) are in the system are over identified. The results are reported in tables 2-4 below.

Table: 2 Dependent Variable: Infrastructure Development(LOG(INFD))

Variable	3SLS			
	Coefficient	Std. Error	t-Statistic	Prob
Constant	5.156715	0.283868	18.16588	0.0000
LOG(PPT)	-0.093815	0.054382	-1.725095	0.0876
LOG(CIT)	0.307719	0.090872	3.386277	0.0010
LOG(CED)	0.031817	0.094132	0.338000	0.7361

Table : 3 Dependent Variable: Foreign Direct Investment(LOG(FDI))

Variable	3SLS			
	Coefficient	Std. Error	t-Statistic	Prob
Constant	-13.05720	1.951231	-6.691777	0.0000
LOG(INFD)	6.977515	0.719851	9.692996	0.0000
LOG(RGDP)	-2.244851	0.315676	-7.111243	0.0000
LOG(INT)	0.173869	0.217913	0.797880	0.4268

Table : 4 Dependent Variable: Real Gross Domestic Product(LOG(RGDP))

Variable	3SLS			
	Coefficient	Std. Error	t-Statistic	Prob
Constant	-3.344180	0.625152	-5.349387	0.0000
LOG(INFD)	2.467792	0.107429	22.97135	0.0000
LOG(FDI)	-0.218834	0.027339	-8.004419	0.0000

The results in tables 3-5 show that tax revenues is directly related to infrastructure, though only company income tax exerts a significant effect on infrastructural development. This gives support to Adegbie and Fakile(2011). This shows the stringent measures of the corporate affair commission in making sure that companies deal with them show evidence of tax return. Hence, making company income tax to exerts huge relative influence on total tax revenue in Nigeria. Petroleum profit tax is significant but with a wrong sign while custom and excise duties is not significant. The effects of Petroleum profit tax and custom and excise are not encouraging. The reason being that in the case of petroleum profit tax the resources are not channeled to infrastructural development which is the drive of development and, also corruption and administrative lapses in the administration of tax in Nigeria. These now affect the generation and effect of tax revenue.

One major findings from our results is that tax revenue is indirectly related to foreign direct investment and real GDP through its impact on infrastructural development. The real GDP is significant though the sign is against apriori expectation as it presents with a negative rather than positive relationship with foreign direct investment. Surprisingly also, foreign direct investment is with a contrary apriori sign and it is not significant. The interest rate, though with the wrong sign, is significant.

5. Conclusion

This study focuses on tax revenue and economic growth in Nigeria. In the analysis, the small macroeconometric model revealed that an indirect relationship between tax revenue and economic growth through infrastructural development. The results highlighted the channels through which tax revenue influences economic growth in Nigeria. These links involve infrastructural development, foreign direct investment and real gross domestic product. Sustained economic development would be possible by the availability of enhanced and, hitherto, low tax revenues. The will help the economy achieve the basic infrastructure that will stir up investment, which in turn will bring about economic growth. However, tax revenues can only materialize its full potential on the economy if government can come up with fiscal laws and legislations and strengthen the existing ones in line with macro economic objectives, which will check-mate tax offenders in order to minimize corruption, evasion and tax avoidance and, improve the tax administrative machinery with personnel's and accountability and transparency of government officials in the management of tax revenue. These will increase the tax revenue base. And this will help the economy to achieve greater self-reliance and avoid large debts.

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