



# Taxation and Economic Growth in Nigeria

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## Abstract

Taxation is an economic strategy employed by government to enhance economic growth within the economy. Government in all tiers continue to lose substantial revenue through tax avoidance strategy which tax payers employ to cut short the amount of tax payable. In some cases, some tax payers adopt the criminal option of tax evasion. This practice completely deny government the tax accruable revenue. Against this backdrop, this study became necessary as it examines the connection between taxation and growth of the economic. The impact of different kinds of tax methods, namely; value added tax, petroleum profit tax, company income tax, education tax amongst others on the economic growth were also carried out in the study. Secondary data employed were collected from the Central Bank of Nigeria (CBN) statistical bulletin. The study employed canonical cointegrating regression to test the data and the objectives of the study. Results of the regression analysis show a positive relationship between taxation and the growth of the economy. It thus concluded that, taxation is a determining factor in economic growth. Premised on this finding, it recommended that government should take proactive step to ensure that time limit be set for collection of all taxes due it. The study further recommended that aggressive campaign be mounted by government to sensitize the citizens, especially potential tax payers on the need to promptly and honestly pay taxes appropriately. However, it advocated that proper utilization of tax revenue should be ensured.

**Keywords:** Taxation, Tax Avoidance, Tax Evasion, Economic Growth.

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## INTRODUCTION

The reliance on income from oil by the government and the need to change the revenue base has led the federal government to embark on reformative laws in taxation. Alli (2009), in his aims for tax reforms in Nigeria stated that, they were to close the gap between the Nation's Development (ND) initiatives and the funding of those several initiatives. There were also the desires to make taxation a fiscal policy instrument, and mobilize adequate fund in order to achieve and shore up service delivery to the citizens. The urgent need to leverage upon the level of financial inflow from non-oil activities, as well as revenue from oil engagements

were part of the reason for tax reform. Above all, to ensure efficiency in tax collection and reduce complaints and other taxation issues which include but not limited to double taxation.

Ogbonna and Ebimobowei (2012) opined that, the Nigerian tax reform has witnessed tremendous changes between 1904 and now. The consequences of which are the emergence of the following:

- Introduction of Income Tax in Nigeria between 1904 and 1926;
- Grant of autonomy to the Nigerian Inland Revenue (NIR) in 1945;
- The Raisman Fiscal Commission (RFC) of 1957;
- Formation of the Inland Revenue Board (IRB) in 1958;
- The promulgation of the Petroleum Profits Tax Ordinance (PPTO) No 15 of 1959;
- The promulgation of Income Tax Management Act (ITMA) 1961;
- Establishment of the Lagos State Inland revenue Department;
- The promulgation of the Companies Income Tax Act (CITA) 1979;
- Establishment of the Federal Inland Revenue Services (FIRS) between 1991 and 1992 and
- The tax policy and administration reforms amendment Act 2001 and 2004.

The government embarked upon tax reform process by instituting Study Group (SG) for the reformation of the Nigerian Tax System (NTS) consisting of persons from business cycle, government and the academia to study the existing tax laws and recommend appropriate reform with the examination of their impact to the overall economy.

Ogbonna and Ebimobowei (2012), observed that, consequent upon the reform, 9 bills in that respect were passed which later became law solely for enforcement and administration of tax. The laws were Federal Inland Revenue Service Act 2004, Companies Income Tax Act 2004, Petroleum Profits Tax Act 2004; Personal Income Tax Act 2004, Value Added tax Act 2004; Education Tax Act 2004, Customs, Excise Tariffs etc. (consolidation) Act 2004, and National Automotive Council Act 2004. Ogbonna and Ebimobowei (2012), further opined that, the tax institute was established in Nigeria to regulate tax practice and regulate the exercise which has made the body a major stakeholder in the Nation's tax system.

The body of literature reviewed indicates that extensive works have been done on taxation activities and the growth of the economy. Most of these studies were on taxation and economic growth in Nigeria (Tosun & Abizadoh 2005; Olusanya et al., 2012, Adereti et al., 2011; Nwakanma & Nnamdi 2013; Ihenyem & Mieseigha 2014; Izedonmi & Okunbor 2014; Anoremi & Ajala, 2013). However, none of these scholars examined the entire components of taxation, hence, the reason to look at the nature of the relationship between taxation and the growth of the economy.

## **THEORETICAL LITERATURE ON THEORIES OF TAXATION**

### **Ability to Pay Theory**

Ahuja (2011) opined that the willingness to pay is one measure of equality or fairness in taxation. This theory expects that tax payers should pay according to their ability. The higher earners have higher ability to pay, hence, should pay higher tax to the authority than the lesser earners. Therefore, the ability to pay approach or fairness in taxation demands that the tax burden on the various tax payers should be the same. This theory is supported by socialists, which believes that it promotes equity and fairness.

## **Peacock-Wiseman's Theory**

Wiseman and Peacock (1961) studied the time pattern of public financial commitment in the United Kingdom (UK) from 1890 to 1955 taking a political economy approach. Among their conclusions were that, public financial commitment does not laterally affect expenditure but at series of distinct stages. Their further findings were that, government like to expend more money whereas, citizens are tax averse. Thus, concluded that government needs to show interest on the wishes and aspirations of her citizens. It is therefore apt to say that there is appreciable increase in the level of tax payment which stimulates government behaviour. Nevertheless, as the economy and income grow, tax revenue also grows, thereby promoting public financial commitment proportionally to Gross National Product (GNP).

## **Expediency Theory**

This theory believes that tax proposals should ensure practicability and that state should give attention to this when considering tax policies. Therefore, practicability of tax policies enhances its efficiency and effectiveness. The cardinal point for taxation therefore will be sustained much as it is expedient to observe this principle.

It should be reasonable, wholly, exclusive and necessary for the social interest of the government. It should also identify a set of strong tools to the authorities to ameliorate any social and economic ills thus addressing income gap, inequalities and unemployment, etc. (Chigbu, Eze & Ebimobwei, 2011).

## **Empirical Literature**

Some investigations have been carried out on the relationship concerning tax policies and economic growth which many have suggested have positive and impactful role to play on the level of growth and productivity whereas, some felt to the contrary between the two variables. Ramot and Ichihashi (2012) panel data study of 65 countries from 1970 to 2006, examined the impact of tax structure on the growth of the economy and income inequality. The study observed that company income tax (CIT) rates have an adverse effect on economic growth and income inequality. They further observed that, personal income tax rate does not reasonably impact on economic growth and income inequality. It therefore, recommended a modest structure in the tax system since countries with broad-based tax structures, efficient tax administration and enforcement, will enjoy increased growth rate than those with lower efficiency.

Ehigiamusoe (2013) studied the connection between the Nigerian tax system and economic growth deploying correlation method and Granger Causality to determine their relationship. The study covered the period from 1980 to 2011. The study expounded that, Nigerian tax system has no substantial and impactful effect on economic growth because of the several challenges militating against the tax system. Again, the analysis of the tax ingredients indicates that Custom Duties have significant economic impact on the growth than Company Income Tax (CIT), Value Added Tax (VAT) and Petroleum Profit Tax (PPT). The study further revealed the draw back in the link between Petroleum Profit Tax (PPT) and Company Income Tax (CIT) on the one side, and Petroleum Profit Tax (PPT) and Value Added Tax (VAT) on the other side. Premised on this, it advises that Nigerian tax system structure should be reviewed to enable its impact be greatly felt on the economy.

Okoye and Gbegi (2013) studied the influence of revenue generation through Value Added Tax (VAT) on wealth creation in Nigeria. In order to satisfy the objectives of the study, secondary data were obtained from the Federal Inland Revenue Service as well as

Federal Bureau for Statistics. The data were subjected to analyses using table and simple percentages. Pearson Product Moment Correlation Coefficient (PPMCC) and T-test were adopted in the testing of the study hypotheses. Findings therefrom, revealed that the amount of revenue generated through VAT has a significant impact on wealth creation and also influences significantly, the total tax revenue generated in each fiscal year. The study recommended that, the Federal Inland Revenue Service (FIRS) should pay more attention to the informal sector to enhance growth in the economy. Therefore, it should create Tax offices at various localities in the country. This will ensure more revenue generation and fully achieve the objectives of wealth creation.

Emmanuel (2013) studied the effects of Value Added Tax (VAT) on the economic growth and total tax revenue in Nigeria. The study being of Time series, were between 1994–2010. The formulated hypotheses of the study included VAT and its effect on GDP and total tax revenue. The regression analysis result of the study revealed a positive VAT effect on the overall tax revenue and the Gross Domestic Product of Nigeria.

Nwakanma and Nnamdi (2013), in their study examined taxation and National Development. The Least Square Method was adopted in their study which findings indicate that Petroleum Profit Tax, Company Income Tax and Excise tax have positive impact on National Economic Growths.

Ihenyen and Mieseigha (2014), examined taxation as an instrument of economic growth; the Nigerian Prospect. The study adopted time series data from 1980 to 2013 in a linear model, the findings from the study indicate that taxation is a tool for economic growth in Nigeria. Similarly, Izedonmi and Okunbor (2014), in their study on the contribution of Value Added Tax on economic growth of Nigeria, adopted time series data from 1994 to 2010. It applied Multiple Regressions in the analysis of the data which show a meaningful relationship with the employed variables and economic growth.

In the study of Anoremi and Ajala (2013), which explored the VAT and revenue generation using the stepwise regression analysis. Their findings statistically indicate a significant correlation between taxation and economic growth.

Bakare (2013), evaluated the impact of Value Added Tax and economic growth rate in Nigeria. Ordinary Least Square technique applied in the study reveal a correlation between the tax system and the domestic growth in Nigeria. The study of Olatunji (2009), also established a positive economic growth of the Value Added Tax. The data applied in the study was the simple percentage and chi-square.

Ayuba (2014), empirically studied the effect of non-oil tax revenue on the economic growth of Nigeria. It employed the time series approach in the work which spanned from 1993 to 2012. The analysis of the statistical data which applied the OLS, indicate positive relationship between the non-oil taxes and economic growth.

The work of Salami et al (2015), investigated the effect of taxation on the growth of Nigerian economy from 1976 to 2006. OLS was employed as the technique to analyze the result obtained and a significant impact of taxation on the economy was established.

Soyode and Kajola (2006), opined that tax evasion and tax avoidance are fundamental problems of tax administration in a developing country including, Nigeria. They indicated that all types of taxes imposed in Nigeria by the Government are to some extent either avoided or evaded due largely to the weak administrative machinery that would have monitored compliance. This could also be attributed to the complexity and the diverse nature of tax payers; it becomes difficult to capture all the odds in the formulation of tax laws. Loopholes will always exist and can only be reduced but not completely eliminated. Therefore, Tax evasion and tax avoidance must be viewed seriously. This is important as its perpetuation leads to loss of revenue for the government even honest tax payers lose faith in tax system. The large tax payers indulged in evasion, the worst it becomes for the

government and to the economy. Ultimately, the citizens become worse for it and are tempted to join the league of tax evaders.

## METHODOLOGY

Quasi experimental method of research design is adopted in the study. Secondary data adopted for the study were got from the Central Bank of Nigeria (CBN), Statistical Bulletin, from the period, 1981-2017. Estimation techniques applied were premised on the type of data received in the study. Canonical Cointegrating Regression (CCR) method was also adopted to arrive at the objectives of the study. In assessing the outcome of the regression, econometric and statistical tests were made use of.

### Model Specification

The Model of the study is specified as follows:

$$EG = f(VAT, PPT, CIT, ET, CED) \dots \dots \dots \text{equation (1)}$$

$$EG = \beta_0 + \beta_1VAT + \beta_2PPT + \beta_3CIT + \beta_4ET + \beta_5CED + \mu \dots \dots \dots \text{equation (2)}$$

Where:

- $\beta_0$  = Constant
- EG = Economic growth (Proxy with Growth Rate of Gross Domestic Product)
- VAT = Value Added Tax
- PPT = Petroleum Profit Tax
- CIT = Companies Income Tax
- ET = Education Tax
- CED = Custom Excise and Duties
- $\mu$  = Error term

### Data Analysis and Explanation of Results

Table 1: Stationary (unit root) Test

| VARIABLES | Augmented Dickey-Fuller (ADF) test statistic | 5% critical level | Phillips-Perron (PP) test statistic | 5% critical level | Order of integration |
|-----------|--|-------------------|-------------------------------------|-------------------|----------------------|
| ADF       |  |                   | PP                                  |                   |                      |
| EG        | -7.452010                                    | -3.587527         | -7.828417                           | -3.587527         | I(1)                 |
| VAT       | -4.869836                                    | -3.580623         | -5.568780                           | -3.580623         | I(1)                 |
| PPT       | -7.186737                                    | -3.580623         | -7.754512                           | -3.580623         | I(1)                 |
| CIT       | -5.271159                                    | -3.587527         | -8.405909                           | -3.580623         | I(1)                 |
| ET        | -4.791198                                    | -3.580623         | -5.767299                           | -3.580623         | I(1)                 |
| CED       | -4.181886                                    | -3.595026         | -12.25787                           | -3.580623         | I(1)                 |

Time series data are usually characterized by trends, in most cases they are non-stationary. Therefore, regression of a non-stationary variable on another non-stationary variable(s) applying the ordinary least square (OLS) leads to a false regression result. To avert this, the Augmented Dickey Fuller (AD)F and Philip-Peron (PP) unit root tests were employed and the obtained results were shown in table 4.1 above. The null hypothesis in the tests is that the variable is not stationary (has unit root). Therefore, rejection of the null hypothesis shows that the variable is stationary. To reject the null hypothesis, the computed value of the test statistic (t-statistic) must be greater than the critical value of the statistics at the assumed level of significance (i.e. 5% level of significance). When the null hypothesis is rejected at order of

integration zero,  $I(0)$ , the variables are believed to be stationary at level. It is only  $I(0)$  variables that are adjudged stationary series. Every other orders of integration such as integration of order one  $I(1)$  are considered non-stationary series in regression analysis. Both the ADF and PP test reveals that the series of all the variables are integrated of order one  $I(1)$  which implies that the series are non-stationary. So, adoption of OLS is inappropriate in such circumstance. This indicates we have no control for the non-stationary in the regression analysis  $I(1)$ .

Table 2: Cointegration Test

| Series: GDP, VAT, PPT, CIT, ET, CED          |               |        |                  |        |
|--|---------------|--------|------------------|--------|
| Sample: 1981 to 2017                         |               |        |                  |        |
| Null hypothesis: Series are not cointegrated |               |        |                  |        |
| Engle-Granger                                |               |        | Philips Ouliaris |        |
| Dependent                                    | tau-statistic | Prob.* | tau-statistic    | Prob.* |
| EG   | -3.096522     | 0.9108 | -3.604378        | 0.6547 |
| VAT  | -4.958522     | 0.2890 | -4.879649        | 0.2116 |
| PPT  | -7.302731     | 0.0166 | -6.482896        | 0.0259 |
| CIT  | -2.392732     | 0.9880 | -3.468944        | 0.7078 |
| ET   | -5.506888     | 0.1609 | -6.091574        | 0.0450 |
| CED  | -3.403907     | 0.8363 | -4.052576        | 0.4749 |

The outcome of Engle-Granger and Philips-Ouliaris cointegration tests for economic growth model are shown in table 4.2. Engle-Granger tests show one co-integrating equation whereas Philips-Ouliaris cointegration tests shows two co-integrating equation. This is signalled by the corresponding tau-statistics (-7.303) and the P-value (0.0166) of PPT and for Engle-Granger test as well as the tau-statistics (-6.483 and -6.092) and the P-value (0.0259 and 0.045) of PPT and ET respectively for Philips-Ouliaris tests. The P-values are less than 5% level of significance. Accordingly, the tests show that there is cointegration. This proves a long-run relationship between the dependent and independent variables.

Table 3: Canonical Cointegrating Regression (CCR) Result

| Dependent Variable: EG                           |             |                    |             |        |
|--|-------------|--------------------|-------------|--------|
| Method: Canonical Cointegrating Regression (CCR) |             |                    |             |        |
| Included observations: 34 after adjustments      |             |                    |             |        |
| Variable   | Coefficient | Std. Error         | t-Statistic | Prob.  |
| VAT  | 0.869050    | 0.093360           | 9.308550    | 0.0000 |
| PPT  | 0.624095    | 0.047524           | 13.13210    | 0.0000 |
| CIT  | 0.023443    | 0.074983           | 0.312638    | 0.7595 |
| ET   | -0.096366   | 0.031612           | -3.048411   | 0.0093 |
| CED  | 0.578248    | 0.056009           | 10.32411    | 0.0000 |
| C  | 32.23806    | 0.793484           | 40.62848    | 0.0000 |
| R-squared  | 0.874069    | Mean dependent var | 27.04852    |        |
| Adjusted R-squared                               | 0.815946    | S.D. dependent var | 0.342608    |        |
| S.E. of regression                               | 0.146984    | Sum squared resid  | 0.280856    |        |
| Durbin-Watson stat                               | 2.072444    | Long-run variance  | 0.000715    |        |

The above result which is for the canonical cointegrating regression was adopted in finding the impact of taxation on economic growth in Nigeria. The outcome variable is Economic Growth (EG) while the explanatory variables are VAT, PPT, CIT, ET and CIT. The result

indicates that VAT, PPT, CIT and CED are positively related to EG. Contrary to this, ET is inversely related to EG. This means that, EG falls with increase in ET and rises with increase in VAT, PPT, CIT and CED.

All the variables except company income tax (CIT), are statistically significant given their P-values that are less than 10% level of significance. Therefore, all the variables, except CIT are significant factors for the level of economic growth in Nigeria. By this level of impact, a unit increase in VAT, PPT, CIT and CED will bring about 0.869, 0.6241, 0.023 and 0.578 increase in EG whereas a unit increase in ET will lead to decrease or reduction in EG by 0.0964.

The adjusted R<sup>2</sup> means that significant proportion (87.4%) of the changes in economic growth resulted from the changes in the explanatory variables used in the model. The Durbin Watson test of 2.07 indicates absence of serial correlation while the long-run variance 0.000715 shows that there is long-run link between the variables. So, the model has a good fit and its parameters are valid for tenable conclusions. The study thus shows a long run relationship among the variables such as GDP, PPT, VAT, ET, CIT, and CED. It further proves that taxation is necessary in explaining the variation in economic growth (EG). It takes a positive relationship with EG, sign posting that an increase in taxes (such as PPT, VAT, CIT, and CED) will also increase economic growth in Nigeria and vice versa. Therefore, evincing from this, the null hypotheses in the study should not be accepted. The findings of this study conclude the findings in the study of Poulson and Kaplan (2008) and Jibrin, Blessing and Ifurueze, (2012) on similar background.

## **FINDINGS**

The analysis of the data of the study reveals a significant relationship between taxation and economic growth in Nigeria. It is further ascertained that potential tax payers employs tactical ways of reaching the amount of tax payable by them. In some circumstances, they want to completely evade the responsibility of tax payment thereby denying the Government and the citizens the benefits of tax revenue. Therefore, some decay in the state infrastructure and in most cases, its lack of provision was due largely to inability of Government to mobilise adequate funds for their provision which were lost in evasion and avoidance of tax.

## **CONCLUSION AND RECOMMENDATIONS**

Premising on the outcome of the study, it become necessary to conclude that taxation is an important determinant and plays a significant role in economic growth in Nigeria. It is therefore recommended that government should enact policies which will include the maximum time for collection of all taxes. This will ensure substantial collection of taxes as due. Similarly, government should step up and make aggressive sensitization and awareness campaign for improved taxation. Finally, there is need to encourage the payment of Value Added Tax by the people to ensure that Government provide to the citizens the desired public infrastructure thus improve welfare.

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