ASSESSMENT OF TAXATION AS AN INSTRUMENT OF ECONOMIC DEVELOPMENT IN NIGERIA

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ABSTRACT

This study examined the impact of taxation on economic development in Nigeria, and also examined the relationship between taxation and economic development in Nigeria from 1980 to 2018. Secondary data were obtained from Central Bank of Nigeria statistical from 1980 to 2018. Multiple Regression analysis and Pearson pairwise correlation mechanism were employed to analyze the relationship between taxation and economic development. The findings showed that Direct Tax (DIRTAX), Indirect Tax (INDTAX) had positive significant impact on economy stability in Nigeria. It is recommended that for the taxation policy to have a more significant impact on economic development of Nigeria, government should develop more strategies to increase tax revenue collection in the country, and the income realized from this tax should be judicious expended on the fulfillment of the government fiscal responsibilities.

Key Words: Taxation; Indirect tax; direct tax; Economic growth; Exchange rate; Nigeria

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 (Adegbite and Usman, 2017). 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).

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. 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.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). According to Musgrave and Musgrave (2004) 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 development. 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). The tax base in Nigeria since had been on the increase in order to mobilize the resources needed to execute infrastructural projects. 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 (Adegbite and Usman, 2017). The long-term goal of poor countries must be stated to replace their foreign aid dependency with tax self-reliance in terms of realizing immeasurable and enormous revenue from taxation.

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 the 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. Tax payment is not for the direct exchange of good and/or services but a transfer of resources and income from the private sector to the public sector in order to achieve some of the nation's economic and social goals (Okpe, 2000). Such goals may be for high level of employment, stable prices, rapid growth of gross national product, favourable balance of payments position, promotion of a free market economy, satisfaction of collective demands, equitable income redistribution, promotion of infant industries, the encouragement of priority sector, encouragement of balance population development and promotion of labour and capital development (Onoh, 2013).

Government also judges the basis, rates, the category of citizens, and the time period to pay the tax, on the direction of the economy's desires and government's perception of the standard of living of the citizens. Taxes therefore affect the expenditure size of government, the productivity and level of activities of businesses, the consumption pattern of individuals, the propensity to save and invest and the growth path of the economy.

The primary responsibility of every government all over the world is to ensure security, freedom and welfare of its citizen. It was stated in the Constitution of the Federal Republic of Nigeria (2011) states that government has the responsibility of ensuring the maximum welfare, freedom and happiness of its citizens". To effectively carry out its primary function and other subsidiary functions, governments need adequate funding. Unfortunately, Government responsibilities continue to increase over time especially in developing countries; as a result of growing population of citizens, and technological development. In Nigeria, the government has depended so much on oil revenue for execution of its primary functions and economic development. Recently, government depended on the income from both direct and indirect tax in order to cushion the effect of economic recession on the execution of the project and fulfilling of their fiscal responsibilities. In this sense, the effect of tax revenue on economic development cannot be underestimated. Therefore, this study assessed the effect of taxation on economic development in Nigeria.

Research Hypotheses

The following hypotheses were stated in null form:

HO_1: Taxation has no significant impact on economic development in Nigeria

HO_2: Taxation has no significant relationship witheconomic development in Nigeria

LITERATURE REVIEW

Taxation and its importanceon Economic Development in Nigeria

Taxation is an instrument employed by the government for generating public funds (Anyaduba, 2004). It is a required payment imposed by the government on the income, profit or wealth of individuals, group of persons, and corporate organizations. According to Adegbite and Usman (2017) a well-designed tax system can help governments in developing countries prioritize their spending, build stable institutions, and improve democratic accountability. The main purpose of a tax is to enable public sector finance its activities so as to achieve some nation's economic and social goals. It can also be for the purpose of redistribution of wealth to ensure social justice (Ola, 2001). Therefore, taxes can be used as an instrument for achieving both micro and macroeconomic objectives especially in developing countries such as Nigeria. However, Musgrave and Musgrave (2004) comment that the dwindling level of tax revenue generation in the developing countries makes it difficult to use tax as an instrument of fiscal policy for the achievement of economic development. Economic development can be substantially influenced through tax revenue generated from Company Income Tax, Value Added Tax, and Personal Income Tax, and Petroleum profits tax (Adegbite and Usman, 2017).

In Africa especially in Nigeria, natural resources such as income from production sharing, royalties, and corporate income tax on oil and mining companies yield the significant portion of tax revenue (Pfister, 2009). These tax sources are the basic and most reliable sources of government revenue because of their certainty and flexibility characteristics. Certainty characteristic implies that collection of taxes from taxpayers is assured, all other things being equal. Tax collection is not affected by the state of the economy; whether the economy is declining, stagnant or growing. Its flexibility

makes it possible for the government to adjust the tax system to suit her desired

According to Waidyasekera (2012), the role of taxation on economic development are as follows.

i The primary function of a tax system is to raise revenue for the government for its public expenditure. So the first goal in the development strategy as regards taxation policy is to ensure that this function is discharged adequately.

ii To reduce inequalities through a policy of redistribution of income and wealth. Higher rates of income taxes, capital transfer taxes and wealth taxes are some means adopted for achieving these ends.

iii To increase the level of savings and capital formation in the private sector partly for borrowing by the government and partly for enhancing investment resources within the private sector for economic development.

iv To protect local industries from foreign competition through the use of import duties, turnover taxes/VAT and excises. This has the effect of transferring a certain amount of demand from imported goods to domestically produced goods.

v To stabilise national income by using taxation as an instrument of demand management. Taxation reduces the effect of the multiplier and so can be used to dampen cyclical fluctuations on the economy.

Classification of tax in Nigeria

According to Ofe and Idrisu (2015), the main taxes in Nigeria can be classified into direct and indirect taxes as follows:

a) **Direct taxes**

These are charged on a taxpayer's income, profits or other gains. They are paid by the taxpayer directly to the tax

purpose.

authority. The direct taxes are personal income tax(payable by individuals), companies income tax(payable by companies other than those engaged in petroleum operations), petroleum profit tax is payable by companies engaged in petroleum operations. Education tax is payable by companies while capital gains tax is payable by both individual and corporate bodies.

b) **Indirect taxes**

Indirect taxes imposed on commodities (goods), professional services and instruments, before they reach the ultimate consumer, client or owner, not as taxes (that is not to the tax authorities but as part of the selling legalization price/cost of the commodity, service, instrument as the case may be. Examples of indirect taxes include value added tax, custom duties, excise duties and stamp duties. A simple guide do determining what tax is indirect is to acknowledge the fact that once the tax burden is not borne directly by the entity that remits the tax to the relevant tax authority, it is indirect tax (Ofe and Idrisu 2015).

Underpinning Theory

Theories of Taxation

a) **The benefits-received theory:** This theory proceeds on the assumption that there is basically an exchange or contractual relationship between tax-payers and the state. The state provides certain goods and services to the members of the society and they contribute to the cost of these supplies in proportion to the benefits received. In this quid pro quo set up, there is no place for issues like equitable distribution of income and wealth. Instead, the benefits received are taken to represent the basis for distributing the tax burden in a specific manner. This theory overlooks the possible

use of the tax policy for bringing about economic growth or economic stabilization in the country(Adegbite and Usman, 2017).

b) **The cost of service theory:** This theory is very similar to the benefits-received theory. It emphasis the semi- commercial relationship between the state and the citizens to a greater extent. The implication is that the citizens are not entitled to any benefits from the state and if they doreceive any, they must pay the cost thereof. In this theory, the state is being asked to give up basic protective and welfare functions. It is to scrupulously recover the cost of the services and therefore this theory, unlike the benefits received one, specifically implies a balanced budget policy. In the process, the state is not to be concerned with the problems of income distribution. No effort is to be made to improve income distribution; and no notice is to be taken if the policy of levying taxes according to the cost of service principles deteriorates it further (Bhartia, 2009).

Review of empirical studies on the Relationship between Taxation and Economic Development in Nigeria

Worlu and Emeka (2012) examined the impact of Tax Revenue on the economic growth of Nigeria between 1980 and 2007 using its effect on infrastructural development. They reported that tax revenue has direct and indirect relationships with the infrastructural development and the gross domestic product respectively (GDP). It was argued that the channels through which tax revenue affects economic growth in Nigeria are infrastructural development, foreign direct investment, and GDP. However, this study was restricted to 2012 not 2018, therefore the result cannot be given wider generalization.

Owolabi and Okwu (2011) examined the contribution of only Value Added Tax (VAT) to Development of Lagos State Economy from 2001 to 2005. The study regressed each development indicator (infrastructural, environmental management, education sector, youth and social welfare, agricultural, healthcare, and transportation) on VAT revenue proceeds generated by Lagos State during the study period. Their finding was that revenue generated from VAT positively contributed to the development of the respective sectors of Lagos State economy during the period studied. This study only examined a single component of indirect tax (VAT) on economic growth. However, the study failed to employed both direct and indirect taxes.

Success(2012) investigated the impact of Petroleum Profit Tax on the economic development of Nigeria from 2000 to 2010. Their findings reveal that petroleum profit tax positively impacts on gross domestic product (GDP) of Nigeria, and the impact is statistically significant.. They argue that the increase in the economic growth rate does not reflect in Nigeria's general economic development. However, the scope of this study is limited to 2010 not extended to 2018.

Adegbie and Fakile (2011) concentrated on the relationship between Company Income Tax and Nigeria Economic Development. Their conclusion based on finding was that there is a significant association between company income tax and economic development of Nigeria. Okafor (2012) investigated the impact of income tax revenue on the economic growth of Nigeria as proxied by the gross domestic product (GDP). The study adopted the ordinary least square (OLS) regression analysis technique to explore the relationship between the GDP (the dependent variable) and a set of federal government income tax revenue heads over the period 1981-2007. The

regression result indicated a very positive and significant relationship between the components of tax revenue and the growth of the Nigeria economy. However, the scope of the study is limited to the periods of 1981 and 2007 not prolonged to 2018.

Adereti, Sanni and Adesina (2011) studied value added tax and economic growth in Nigeria. Time series data on the Gross Domestic Product (GDP), VAT Revenue, Total Tax Revenue and Total (Federal Government) Revenue from 1994 to 2008 sourced from Central Bank of Nigeria (CBN) were analyzed, using both simple regression analysis and descriptive statistical method. Findings showed that the ratio of VAT Revenue to GDP averaged 1.3% compared to 4.5% in Indonesia, though VAT Revenue accounts for as much as 95% significant variations in GDP in Nigeria. A positive and significant correlation exists between VAT Revenue and GDP. Both economic variables fluctuated greatly over the period though VAT Revenue was more stable. No causality exists between the GDP and VAT Revenue, but a lag period of two years exists. this study only confined to a single component of taxation, therefore the results cannot be given wider perceptive.

Akwe (2014) analyzed the impact of Non-oil Tax Revenue on Economic Growth from 1993 to 2012 in Nigeria. To achieve this research objective, relevant secondary data were used from the 2012 Statistical Bulletin of the Central Bank of Nigeria (CBN). These data were analyzed using the Ordinary Least Squares Regression. The result from the test shows that there exists a positive impact of Non-oil Tax Revenue on economic Growth in Nigeria. Nevertheless, the study is restricted to Non-oil Tax Revenue on economic Growth not extended to taxation.

Onaolapo, Aworemi, and Ajala (2013) examined the impact of value added tax on revenue generation in Nigeria. The Secondary Source of data was sought from Central Bank of Nigeria statistical Bulleting (2010), Federal Inland Revenue Service Annual Reports and Chartered Institute of Taxation of Nigeria Journal. Data analysis was performed with the use of stepwise regression analysis. Findings showed that Value Added Tax has statistically significant effect on revenue generation in Nigeria. This study is on value added tax on revenue generation in Nigeria not on taxation and economic development, therefore the result cannot be generalized.

Ogbonna and Ebimobowei (2012) investigated the impact of petroleum profit tax on the economic growth of Nigeria. To achieve the objective of this paper, relevant secondary data were collected from the Central Bank of Nigeria (CBN) and the Federal Inland Revenue Service (FIRS) from 1970 to 2010. The secondary data collected from the relevant government agencies in Nigeria were analysed with relevant econometric tests of Breusch-Godfrey Serial Correlation LM, White Heteroskedasticity, Ramsey RESET, Jarque Bera, Johansen Co-integration and Granger Causality. The results showed that there exists a long run equilibrium relationship between economic growth and petroleum profit tax. It was also found that petroleum profit tax does granger cause gross domestic product of Nigeria. However, this study is also confined to a single component of taxation, therefore the results cannot be given wider perceptive.

Adesoji and Chike (2013) shown that there is a positive relationship between internally generated revenue and infrastructural development. The study also revealed the various methods of generating internal revenue, which are the enforcement of tax personnel, contribution, and creating awareness to the public. The findings of the study however show that revenue administration agencies need to be reviewed to generate more revenue in the country. Vincent (2001) Studies on tax and public revenue mobilization in Nigeria have shown a high degree of centralization. However, this study is

limited to internally generated revenue and infrastructural development not taxation.

From the review of previous works, the gaps identified are scope, methodology and conceptual gap. This is because majority of the studies seen and reviewed are conducted in Nigeria with different scope, methodology and concepts, and the findings may not be generalized in wider perspectives. Thus, this study is exclusive and anticipates to contribute to knowledge by investigating the impact of both direct tax and indirect on economic development in Nigeria

METHODOLOGY

Secondary data were used in this study. The relevant data for the study were obtained from Central Bank of Nigeria (CBN) Statistical Bulletins and Federal Inland Revenue Services Bulletin from 1980 to 2018. Regression analysis technique was used to measure the effects ofindependent variableson dependent variable while Pearson pairwise correlation mechanism were employed to analyze the relationship between taxation and economic development in Nigeria.

Model Specification

Economic developmemt (proxied by GDP) is the dependent variable that is Gross Domestic product (GDP) is the explained variable while the explanatory variables are direct tax, (summation of petroleum profit tax, Company income tax, and Value added tax, Indirect tax were captured by adding Excise Duties, custom duties, and Value added taxes together).Exchange rate and Consumer Price Indexare the control variables. This can be specifically stated as;

$$GDP = f(DIRTAX, INDTAX, EXCH, CONPINX, \mu) \quad (1)$$

Note that the proxy for economic growth is GDP; hence it will be used for the study. The multiple regression equation based on the above functional relation is;

$$\sum_{i=1}^{n} GDP = a0 + \sum_{i=1}^{n} a1DIRTAX + \sum_{i=1}^{n} a2INDITAX + \sum_{i=1}^{n} a3EXCH + \sum_{i=1}^{n} a4CONPINX + \mu1 \quad (2)$$

Where;

GDP	=	Gross Domestic Product
DIRTAX	=	Direct Tax
INDTAX	=	Indirect Tax
EXCH	=	Exchange Rate
CONPINX	=	Consumer Price Index

RESULTS AND DISCUSSION

Table 1: Descriptive Analysis of the relationship between Taxation and Economic Development

Variable	Observation	Mean	Standard Deviation	Minimum	Maximum
GDP	38	716.009	143.1997	527.58	950.11
DIRTAX	38	1233.737	578.5552	400.41	2078.31
INDTAX	38	120143.5	76139.38	42802.99	249798.2
EXCH	38	30629.69	11518.5	20730.6	57990.2
CONPINX	38	206.3	8.628763	192	215

Source: Authors' Computation (2019)

The descriptive statistics of the analysis is presented in Table 1 above shows that economic development as the dependent variable. Economic development had a mean value of 716.009 with a standard deviation of 143.1997 it

had a maximum value of 950.11 and a minimum value of 527.58. Petroleum profit tax (PPT) had a mean of 1233.737 and standard deviation of 578.5552 with positive maximum and minimum value of 2078.31 and 400.41 respectively, which signifies that for every 1% increase in income realized from Direct Tax (DIRTAX), Economic development increases by up to 0.123%, this implies that there is a positive relationship between Economic development and Direct Tax (DIRTAX).

The impact of Indirect tax (INDTAX) and others can be seen as shown in the Table 1, Indirect tax (INDTAX), exchange rate (EXCH) and Consumer price index (CONPINX) with mean values of 120143.5, 30629.69 and 206.3 respectively and standard deviations of 76139.38, 11518.5 and 8.628763having positive maximum values of 249798.2, 57990.2 and 215, and positive minimum values of 42802.99, 20730.6 and 192. This implies that 1% increase in Taxation triggers a rise in Economic development. It can be deduced from the analysis that there is a positive relationship between Taxation and Economic development, therefore null hypothesis is rejected.

Table 2: Unit Root Test

Variables	ADF stat	1% critical value	5% critical value	10% critical value	Order of integration	Remark
GDP	3.322	-3.145	-2.764	-2.534	I(0)	Stationary
DIRTAX	3.467***	-3.145	-2.764	-2.534	I(1)	Stationary
INDTAX	3.896***	3.670	3.000	-2.450	I(1)	Stationary
EXCH	3.231***	-3.145	-2.764	-2.534	I(1)	Stationary
CONPINX	3.564	3.670	3.000	-2.450	I(1)	Stationary

(*) = 1%, (**) = 5% and (***) = 10% means stationary at respectively

Source :Author's computation (2019)

Table 2 showed that ADF stat of all variables are greater that all the critical vales (1%, 5% and 10% critical values which made all variables stationary at 5% level of significant, that is all the variables are cointegrated. All the variables are stationary at first level which exhibited that there is long run relationship between taxation and economic development in Nigeria.

Table 3: The effect of Taxation on Economic Development

Dependent variable	Independent variables	Coefficient	Standard Error	T	p>|t|	[95% conf. interval]	
GDP	DIRTAX	.2989558	.0689144	4.21	0.000	.1128057	.467106
	INDTAX	.2005996	.0003994	3.15	0.007	-.0009667	.0010865
	EXCH	-.1004484	.0025184	-4.15	0.000	-.0169223	-.0039746
	CONPINX	-.0863164	2.643678	-3.46	0.004	-10.65895	2.932626
	Constant	1468.087	551.2917	8.60	0.000	50.94668	2885.228
R-squared =0.6132		Adj. R-squared = 0.5434		Prob> F = 0.0000		F (4,5)= 60.43	

Source: Authors' Computation (2019)

Table 3 shows the effect of taxation on Economic development in Nigeria. 1% increase in the direct tax (DIRTAX) increases economic development (GDP) by 0.29%. This suggests a positive significant effect ofDIRTAX on GDP. The outcome is significant (β=.2989558, t = 4.21, P>|t| =0.000) 1% increase in Indirect

tax (INDTAX) increases GDP by 0.26 %.This means that INDTAX imparted GDP positively and significantly (β=.2005996, t = 3.12, P>|t| =0.007). That is if INDTAX increases GDP increases. Contrarily, 1% increase in the exchange rate (EXCH) reduces GDP by 0.1%. This suggests a negative significant effect (β=-.1004484, t = -4.12, P>|t| = 0.000) of EXCH on GDP. More so, 1% increase in Consumer price index (CONPINX) reduces GDP by 0.08%. This also reveals a negative insignificant effect of CONPINX on GDP (β=-.0863164, t = -3.46, P>|t| =0.004). This is suggesting that if CONPINX in Nigeria increases, GDP also reduces.

Given coefficient of determination (R^2) as 0.6132 (61%) with the value of adjusted R^2 as 54.3%, it shows that the independent variables explained 54.3% of the observed variation in economic development in Nigeria, the remaining 45.7% are for error terms. The F and probability statistics also confirmed the significance of this model. This hypothesis is to test whether or not there is significant effect of taxation on economic development in Nigeria. From the decision rule above, because the p-value equals 0.0000 which is less than 0.05, therefore the null hypothesis is rejected while the alternative hypothesis is upheld. Therefore taxation has significant effect on Economic development in Nigeria.

Table 4: The Relationship between Taxation and Economic Development

	GDP	DIRTAX	INDTAX	EXCH	CONPINX
GDP	1.0000				
DIRTAX	0.6604*	1.0000			
INDTAX	0.4038	0.7389*	1.0000		
EXCH	0.0148	0.7184*	0.5791	1.0000	
CONPINX	-0.5974	-0.2973	0.0301	0.0207	1.0000

Source: Authors' Computation (2019)

A pairwise correlation test between the variables indicates correlation between Gross Domestic Product (GDP) and other explanatory variables in Table 4. The coefficient of correlation (R) between Direct Tax (DIRTAX) and Gross Domestic Product (GDP) is (0.6604), an indication of significant and positive relationship. Indirect Tax (INDTAX) has a moderate positive correlation (0.4038) with Gross Domestic Product (GDP) and the variable Exchange Rate (EXCH) has a weak correlation (0.0148) with Gross Domestic Product (GDP). Consumer Price Index (CONPINX) shows a negative correlation coefficient (0.5974) with Gross Domestic Product (GDP).

SUMMARY AND CONCLUSION

This study examined the impact of taxation on economic stability in Nigeria, and also examine the relationship between taxation and economic development in Nigeria from 1980 to 2018. Secondary data were obtained from Central Bank of Nigeria statistical from 1980 to 2018. Multiple Regression analysis and Pearson pairwise correlation mechanism were employed to analyze the relationship between taxation and economic development. The findings showed that Direct Tax (DIRTAX), Indirect Tax (INDTAX), Exchange Rate (EXCH) and Consumer Price Index (CONPINX) do have a significant effect on the performance of economy stability. It is recommended that for the taxation policy to have a more significant impact on economic development of Nigeria, government should develop more strategies to increase tax revenue collection in the country, and the income realized from this tax should be

judiciously expended on the fulfillment of the government fiscal responsibilities.

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