

Tax Revenue and Economic Development in Nigeria

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ABSTRACT

This study investigated the impact of taxation on economic development of Nigeria from 2003 to 2017. Vector Error Correction Model (VECM), Augmented Dickey-Fuller (ADF) unit root test, Autoregressive Distributed Lag (ARDL) bounds test, Jarque-Bera Normality Test and Eigenvalue stability condition were utilised in this study. The study revealed that companies' income tax, petroleum profit and value added tax have a long run impact of -0.225 (p-value=0.000), -0.0005 (p-value=0.699), and 0.211 (p-value=0.000) respectively on the economic development of Nigeria. It was concluded that taxation has a significant long run relationship with Nigeria's economic development. The study recommended that the government should not increase companies' income tax rate because it is detrimental to the economic development of the country in the long run, instead the government should increase the value added tax because it has the potentiality to improve economic development of Nigeria. Also, the government should not concentrate effort on petroleum profit tax as it not significant on economic development of the country.

Keywords: Tax accounting system, revenue, Nigeria

JEL Classification: H20, H21, H22, H24, H27

INTRODUCTION

The rate of economic development creates an inequality among the countries of the world. Economic development ensures an increase in output together with a change in technical and institutional arrangement involved in production (Satope & Akanbi, 2014). Countries that are developed economically have an advancement in factors that brings about transformation in culture, social, educational, political and economic standards (Mick, 2007). Belshaw and Livingstone (2002) noted that improvement in economic development provides a livelihood for the majority of the population. In order to achieve a sustainable economic development, government ensures regular inflow of revenue into its treasuries, one of which is taxation which is used by government as an instrument to raise the necessary funds for public expenditure, to redistribute income, to stabilize the economy, to overcome externalities, to influence the allocation of resources, while at the same time should be supportive to the economy (Stoilova & Patonov, 2012). There can be little doubt that the nature of the economy, and its structural characteristics, influence the ability to tax and the types of taxes that can be imposed. The standard economic approach to taxation and development focuses on how economic change influences the evolution of the tax system (Besley & Persson, 2013). This in

turn allows tax revenue to grow and new taxes to be introduced, favours investments in the administrative ability to collect taxes, and fuels demand for infrastructure and redistributive taxation and spending among the population (Bräutigam, 2008; Lindert, 2004; Musgrave, 1969).

Literature have it that there is an interaction between tax revenue and economic development, because the revenue derived from administering taxes is as a result of complex interactions between economic, political and institutional factors (Besley & Persson, 2013; Kaminsky, Reinhart, & Végh, 2004). In Nigeria, despite the fact that taxation is the second largest sources of revenue to the government, there still abject poverty in which there is a wide gap between the rich and the poor, high unemployment (Chigbu & Njoku, 2015), poor health and wellbeing for all. These are against the indicators of economic developments which includes increased living standards, improved health, access to knowledge, water conditions; nutrition and sanitation (Santos & Alkire, 2010; Belshaw & Livingstone, 2002; Thomas, 2000; Moris, 1978), these among other issues necessitated this study.

Even though studies have been carried out on the implication of taxation on economic development, there is an existence of gap in the literature, as existing literature on these two variables focused on Gross National Product (GDP) per capital as the measures of economic development, whereas there are other proxies of economic development such as; human development index (Belshaw & Livingstone, 2002), inequality-adjusted human development index (Alkire & Foster, 2010), physical quality of life index (Moris, 1978); multidimensional poverty index (Santos & Alkire, 2010) and per capital real income. Based on the above gap, this study examines taxation and its implication on economic development in Nigeria, taking into consideration of human development index as the proxy of economic development in the country.

LITERATURE REVIEW

Taxation

Appah (2004) conceptualized taxation as a compulsory levy which is payable by economic units and subjects to the government with or without any corresponding entitlement to receive a definite and *direct quidpro quo* from the government. Chigbu and Njoku (2015) argued that taxation is intended to raise the necessary funds for public expenditure, redistribute income, stabilize the economy, overcome externalities and as well to influence the allocation of resources, while at the same time should be supportive to the economic growth (Stoilova & Patonov, 2012). Harelimana (2018) noted that taxation are all types of involuntary levies, from income to capital gains to estate taxes collected by a levying authority, usually a government. Anyafo (1996) defined taxation as a compulsory payment by individuals and organizations to the relevant inland or internal revenue authorities at the federal, state and local government levels. Taxation is a fiscal policy in terms of inhibiting investment rate and labour supply (Tosun & Abizadeh, 2005).

Moore (2008) viewed taxation as one of the few objective measures of the power and legitimacy of the state, this is because it provides a primary platform for political negotiations amongst the country's stakeholders. This implies that the revenue derived from administering taxes depends on the complex interactions between economic, political and institutional factors (Besley & Persson, 2013; Kaminsky, Reinhart, & Végh, 2004).

Based on the above, taxation can be referred to as the process of administering a compulsory levy backed by law on the subject, his or her activities and property by the government so as to provide for socio-economic amenities needed by the society.

The Nigerian tax system is based on the three-tiered government in the country, this implies that Nigeria operated tax structures between the Federal, State and Local governments, with each tier of government possessing and coordinating a separate tax jurisdiction (Adudu & Simon, 2015). Olaoye, Ayeni-Agbaje and Ogundipe (2016) noted that the taxes administered in Nigeria includes companies income tax petroleum profit tax, personal income tax, value added tax, education tax, customs, excise tariffs, national information technology development tax, withholding tax.

This inexhaustible taxes are made legal based on the following tax laws; Education Tax Act No 7 LFN 1993 & 2004, Stamp Duties Act CAP 41 LFN 1990, Company Income Tax Act (CITA) CAP 60. LFN 1990 & LFN 2004, Capital Gain Tax Act CAP 42 LFN 1990, Federal Inland Revenue Service Act 2004, Customs, Excise Tariffs, etc (Consolidation) Act 2004, National Sugar Development Act 2004; Petroleum Profit Tax Act (PPTA) 2004 & 2007, Personal Income Tax Act (PITA) CAP P8 LFN 2004, Value Added Tax (VAT) Act No 102 LFN 1993 & 2004, and National Automotive Council Act 2004, Information Technology Development Act 2007 (Olaoye, *et al.*, 2016; Ogbonna & Appah, 2012; Ayodele, 2006).

Economic Development

Economic development and economic growth are two distinct economic terms which are often misuse for one another. Harelimana (2018) refers to economic development as the process by which Gross National Product(GNP) per capital of a country increases qualitatively and quantitatively over a very long period of time. According to Satope and Akanbi (2014) economic development involves an increase in output together with a change in technical and institutional arrangement involved in production. They further argued that economic growth is a subcomponent of economic development because a nation cannot achieve economic development without having achieved economic growth. Mick (2007) noted that economic development is the combination of economic growth and factors, which may bring about general cultural, social, educational, political and economic transformation. Wyngaard (2006) stated that economic development is heterodox, because it is a complex phenomenon that involves a variety of social and economic processes due to the fact that it happens in different ways in different countries and regions of the world.

Manuel (2004) disclosed that economic development is the sustained increase in income of all members of society so as to be free from material want.

This view relates with Belshaw and Livingstone (2002) that opined economic development as the progress in providing livelihood on a sustainable basis, access to education and basic healthcare for the majority of the population. Malizia and Feser (2000) noted that both economic growth and economic development are complements, because one makes the other possible. They further stated that growth is an increase in output and expands the economy, whereas economic development entails a structural change that must lead to more equal distribution of income and wealth. United Nations Development Programme (1992) disclosed that economic development should at least create a conducive environment for people, individually and collectively, to develop their full potential and to have a reasonable chance of leading a productive and creative life according to their needs and interests.

Despite the complexity in the concept of economic development literature have it that, increased living standards, improved health and wellbeing for all, and the achievement of whatever is regarded as a general good for the society as a whole (Thomas, 2000); Human Development Index which is of combinations of a measure of income, a health indicator and an access to knowledge indicator (Belshaw & Livingstone, 2002); Inequality-adjusted Human

Development Index (IHDI) which adjusts HDI for inequality in distribution of each dimension across the population (Alkire & Foster, 2010); Physical Quality of Life Index (PQLI) which discloses the wide range of indicators such as health, education, water conditions, nutrition and sanitation (Moris, 1978); Multidimensional Poverty Index (MPI) which identifies multiple deprivations at the individual level in health, education and standard of living (Santos & Alkire, 2010); Per Capital Real Income (PCRI) which deals with income based on population, are measures of countries' economic development.

Empirical Literature

With the use of panel co-integration modelling Andersson and Lazuka (2019) examined the long-term drivers of taxation in francophone West Africa. Their study revealed that long-term relationship exist between tax revenue and local economic development. In South Africa, Dladla and Khobai (2018) investigated the impact of taxation and economic growth with the use of Auto-Regressive Distribution Lag (ARDL) approach.

The study disclosed that in South Africa, there exist a negative relationship between taxes and economic growth. Using, correlation analysis, Harelimana (2018) examined the role of taxation on resilient economy and development of Rwanda and found out that there is a significant relationship between taxation and economic development in Rwanda. Using a panel of 30 OECD countries, Durusu-Çiftçi, Gökmenoğlu and Yetkiner (2018) studied heterogeneous impact of taxation on economic development with the use of panel cointegration. Out of the explanatory variables utilized in their study, only consumption taxation has a statistically significant impact on the steady-state level of GDP per capita.

Thom (2018) studied impact of tax incentive series on economic development, with the use of panel data analysis the study showed that there is no significant effect of sales and lodging tax waivers on any of four different economic indicators. Also, transferable tax credits was shown to have had a small, sustained effect on motion picture employment levels but no effect on wages, while refundable tax credits had no employment effect and only a temporary wage effect. Using 16 Africa countries, Onakoya, Afintinni and Ogundajo (2017) investigated the impact of taxation on economic growth. Using generalized least square, the study indicated that tax revenue is significant on economic growth in Africa. Using 32 countries in sub-Saharan Africa, Gbato (2017) studied the impact of taxation on the long-term growth and revealed using error correction model that there exist a zero effect of taxation on long term growth, whereas in the short run there exist a significant effect of the explanatory variable on the explained variable.

Chigbu and Njoku (2015) studied taxation and Nigerian economy with the use of cointegration test. The study showed that even though that long run relationships exist between the variables, there is no significant effect of taxation on the economy of the country. Adudu and Simon (2015) studied tax policy on economic growth in Nigeria with use of Granger causality cointegrations framework and disclosed that efficient tax reforms are necessary conditions for enhanced sustainable economic growth. Fjeldstad (2013) reviewed taxation and development with focus on experiences of donor support to strengthen tax systems in developing countries. The study revealed that the challenge for many developing countries is not only to increase the tax to GDP ratio but to tax a larger number of citizens and enterprises more consensually and to encourage constructive state-citizen engagement around taxation.

Stoilova and Patonov (2012) studied taxation and economic growth of European Union countries with the means of the regression analysis. They found out that direct taxes are more efficient in supporting economic growth in EU countries. In China, Man, Zheng and Lang (2011)

studied the effects of taxation on economic performance using cross sectional regression. The study showed that overall tax burden and tax structure affect economic performance. It was also revealed that tax burden has a negative correlation with economic activities. Auray and Danthine (2010) focused on bargaining frictions, labor income taxation, and economic performance in a subset of OECD countries. The study indicated that labor income taxation alone is not enough to account for cross-country differences in economic performance in OECD countries. Budryte (2005) studied corporate income tax in Lithuania in relation to other European Union countries. The study revealed that Lithuania’s profit tax burden is the lowest when compared to other EU countries.

METHODOLOGY

The data for the relevant variables of this study were exatrated from the statistical bulletin of the Central Bank of Nigeria and human development report of United Nations Development Programme for the year under condisderation in this study. The dataset starts from 2003 to 2017.

The models of this study as stated in equation(i) were estimated with descriptive statistic and Vector Error Correction Model (VECM). Preliminary estimations test are Augmented Dickey-Fuller (ADF) unit root test, Autoregressive Distributed Lag (ARDL) bounds test, while the post estimation test areJarque-Bera Normality Test and Eigenvalue stability condition.

The model for this study is specified in *equations* below;

$$ECDEV = f (TAXN_t, \mu) \dots \dots \dots (3.1)$$

$$HDI_t = \alpha_0 + \beta_1 CIT_t + \beta_2 PPT_t + \beta_3 VAT_t + \varepsilon_t \dots \dots \dots (3.2)$$

$$\Delta HDI_t = \delta + \tau_i + \tau_j + \tau_m + \tau_v + \lambda_1 ECT_{t-1} + U_{1t} \dots \dots \dots (3.3)$$

Where ECDEV represents economic development which is measured with human development index-HDI. TAXN represents tax revenue was proxied with CIT-companies income tax revenue, PPT-petroleum profit tax revenue, and VAT-value added tax revenue. ε_t is the stochastic error term/ disturbance factor, $\beta_1 - \beta_3$ are the shift parameters, while α_0 is the constant parameter. $K-1$ is the lag length reduced by 1, $\beta_i, \phi_j, \gamma_m, \varphi_v$ are the short run dynamic coefficients of the model’s adjustment long run equilibrium, λ_1 is the speed of adjustment parameter with a negative sign. ECT_{t-1} is the error correction term which is the lagged value of the residuals obtained from the cointegrating regression of the dependent variable on the repressors’. It contains lon run information derived from the long run co-integrating relationship, while U_{1t} is the residuals.

A Priori Expectation

It is expected that revenue derived from the administration of tax by the federal government of Nigeria have a positive impact on the economic development of the country.

DATA ANALYSES AND INTERPRETATION OF RESULTS

Descriptive Statistics

The results in Table 4.1 shows that HDI has a mean value of 0.49 and ranges between 0.53 and 0.443 during the period under review. CIT has a mean value of ₦625.54 billion and has a minimum and maximum value of ₦114.8 and ₦1,215.06 billion respectively between 2003 and 2017. The mean value of PPT is ₦1,885.26 billion with a minimum value of ₦683.5 billion and a maximum value of ₦3,201.32 billion for the period 2003-2017. VAT stood at an average of ₦513.82 billion during the period under review and fall between ₦136.4 billion and ₦972.348 billion. Based on the skewness statistic all the variables except the explained variable

are positively skewed, while Kurtosis statistic indicates that both the dependent and explained variables have a thin-tailed distribution.

Table 4.1: Descriptive Statistics

	HDI	CIT	PPT	VAT
Mean	0.4947333	625.5373	1885.257	513.8154
Maximum	0.532	1215.06	3201.32	972.348
Minimum	0.443	114.8	683.5	136.4
Skewness	-0.1355785	0.0730154	0.2231317	0.0514938
Kurtosis	1.894392	1.666511	1.810412	1.69815

Source: Authors' Analysis (2019)

Unit Root Test

The study utilizes the Augmented Dickey-Fuller (ADF) unit root test to determine the stationarity of the variables in order to avoid spurious regression result. The test hypothesis is that the variable contains unit root. The result in Table 4.2 reveals that only CIT is stationary at level while other variables (HDI, PPT, and VAT) become stationary after first differencing.

This implies that there is a mix of I(0) and I(1) series in the variables, as a result of this the bounds test proposed by Pesaran, Shin and Smith (2001) would be used to test for cointegration of the variables.

Table 4.2: ADF Unit Root Test Results

Variable	Level		First difference		Order of Integration
	Test statistic	p-value	Test statistic	p-value	
HDI	-0.604	0.2796	-2.478	0.0176**	I(1)
CIT	-4.376	0.0024*	---	---	I(0)
PPT	-1.851	0.6798	-2.996	0.0075*	I(1)
VAT	-2.555	0.3012	-2.292	0.0238**	I(1)

Note: * and ** indicate rejection of null hypothesis at 1% and 5% significance level respectively.

Source: Authors' Analysis (2019)

Cointegration Test

The Autoregressive Distributed Lag (ARDL) bounds test proposed by Pesaran, Shin and Smith (2001) is performed to test for the presence of cointegration due to the combination of I(0) and I(1) series in the model. The bounds test involves two asymptotic critical value bounds depending on whether the variables are I(0) or I(1) or a mix of I(0) and I(1). The two asymptotic critical value bounds are lower bound values and upper bound values. According to Pesaran, Shin and Smith (2001), the lower bound values assume that the forcing variables $\{X_t\}$ are I(0) only, and the upper bound values assume that $\{X_t\}$ are purely I(1). The null hypothesis for the bounds test is stated as:

$$H_0: \beta_1 = \beta_2 = \beta_3 = \beta_4 = \beta_5 = 0 \text{ (No co-integration)}$$

To reject the null hypothesis, the F-statistic must exceed the upper bound critical value. On the other hand, null hypothesis is accepted if F-statistic falls below the lower bound critical value. If the F-statistic falls between the lower and upper bounds critical values, the evidence of cointegration is inconclusive. The Schwarz information criterion is used to determine the optimal lag length for each variable in the ARDL model. Table 4.3 presents the result of the bounds test obtained from an ARDL (2, 2, 2, 2) model.

Table 4.3 shows that the F-statistic is greater than the upper bound critical values at 10%, 5%, 2.5% and 1% significance levels, thus indicating that the null hypothesis can be rejected. This indicates that there is cointegration (long-run relationship) among the variables in the model.

Table 4.3: Bounds Test Result

F-statistic	Significance level	Critical value bounds	
		Lower bound	Upper bound
8.611	10%	2.72	3.77
	5%	3.23	4.35
	2.5%	3.69	4.89
	1%	4.29	5.61

Source: Authors' Analysis (2019)

Model Estimation

Table 4.4 presents the long-run coefficients obtained from the ARDL model selected based on the Schwarz information criterion. As shown in Table 4.4, in the long run, revenue derived from companies income tax and value added tax are significantly related to economic development of Nigeria proxied with HDI, whereas they have different relationship, I_CIT is negative while I_VAT is positive. I_PPT is insignificantly negative on economic development, implying that a percentage change in revenue generated through the administration of petroleum profit tax in Nigeria would not lead to any significant impact on economic development of the country. A 1% increase in the revenue derived from companies in tax would result in 22% decrease in HDI while in terms of revenue derived from value added tax would increase economic development by 21%.

Table 4.4: Long-run Results

Variable	Coefficient	Standard Error	p-value
HDI	1.000	_____	_____
Constant	-0.343199	_____	_____
I_CIT	-0.2252533	0.0031148	0.000*
I_PPT	-0.0005416	0.0014015	0.699
I_VAT	0.2113539	0.003894	0.000*

$$ECT_{t-1} = 1.000HDI_{t-1} - 0.225I_CIT_{t-1} - 0.0005I_PPT_{t-1} + 0.21I_VAT_{t-1} - 0.34$$

Note: *denotes statistically significant at 1% significance level respectively.

Source: Authors' Analysis (2019)

Short Run Results

The short run dynamics and the speed of adjustment shown in Table 4.5 reveals that only I_PPT has a contemporaneous positive and significant effect on HDI, while other variables are not significant on the significant on HDI in the short run. The adjustment term of (0.0091) is not significant suggesting that the previous year's errors (or deviation from long-run equilibrium) are not corrected within the current year at a convergence of 1%.

Table 4.5: Short Run Results

Variable	Coefficient	Standard Error	p-value
$\Delta(\text{HDI}_{t-1})$	-0.1246179	0.3381634	0.712
$\Delta(\text{I_CIT}_{t-1})$	-0.004635	0.0106232	0.663
$\Delta(\text{I_PPT}_{t-1})$	0.0084995	0.0049341	0.085***
$\Delta(\text{I_VAT}_{t-1})$	-0.0103699	0.0131523	0.430
Constant	0.0077585	0.0027187	0.004*
ECT_{t-1}	0.0091183	0.1075464	0.932

$$\Delta\text{HDI}_t = 0.0078 - 0.1246\Delta\text{HDI}_{t-1} - 0.0046\Delta\text{I_CIT}_{t-1} + 0.0085\Delta\text{I_PPT}_{t-1} - 0.0104\Delta\text{I_VAT}_{t-1} + 0.0091\text{ECT}_{t-1}$$

Note: * and*** denote statistically significant at 1% and 10% significance level respectively.

Source: Authors' Analysis (2019)

Residual Diagnostic Tests

Test for Normality

Table 4.6 reports the result of the Jarque-Bera normality test shows that the residuals in the model have a normal distribution.

Table 4.6: Jarque-Bera Normality Test

Equation	chi2	Df	Prob> chi2
D_hdi	1.170	2	0.55712
D_I_CIT	0.209	2	0.90078
D_I_PPT	0.244	2	0.88495
D_I_VAT	0.474	2	0.78908
ALL	2.097	8	0.97789

Source: Authors' Analysis (2019)

Test for Model Stability

Based on the result of Eigenvalue stability condition as presented in Table4.7, the VECM specification imposes 3 moduli.

Table 4.7: Eigenvalue stability condition

Eigenvalue	Modulus
1	1
1	1
1	1
-0.4700938	0.589002
-0.4700938	0.589002
0.2218474	0.501985
0.2218474	0.501985
-0.1792079	0.179208

Source: Authors' Analysis (2019)

DISCUSSION OF FINDINGS

This study examines the effect of taxation on economic development of Nigeria from 2003 to 2017. The long-run results is relied upon for the discussion of findings. The results show that revenue derived from the administering companies income tax is negatively and significantly related to economic development in Nigeria. This negative sign of the coefficient of companies income tax negates the *a priori*, therefore offers evidence to invalidate its *a priori* expectation. This depicts that increasing the companies' income tax of the country would results to reduction in the economic development of Nigeria. This also applies to the revenue derived by the federal government of Nigeria from petroleum profit tax, because it is insignificant on the

economic development of the country. The value added tax has a significant and positive impact on the economic development of Nigeria, this is in tandem with *a priori* expectation of this study and also with the findings of Durusu-Çiftçi, *et al.*, (2018) that consumption taxation (value added tax) is statistically significant on the economic development of OECD countries. This further implies that an increase in the value added tax of Nigeria would further improve the economic development of the country.

CONCLUSION AND RECOMMENDATIONS

This study empirically investigated the impact of taxation on economic development of Nigeria. Evidence from the Autoregressive Distributed Lag (ARDL) bounds test, it is concluded that taxation has a significant long run relationship with Nigeria's economic development. Also, companies' income tax and value added tax are long run determinants of economic development in Nigeria. The study recommends that the government should not increase companies' income tax rate because it is detrimental to the economic development of the country in the long run, instead the government should increase the value added tax because it has the potentiality to improve economic development of Nigeria. Also, the government should not concentrate effort on petroleum profit tax as it not significant on economic development of the country. Subsequent studies about taxation and economic development in the country should cover other measures of economic development.

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