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Impact of Tax Reforms and Economic Growth of Nigeria: A Time Series Analysis

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Abstract: The study examines the impact of tax reforms on the economic growth of Nigeria from 1994 to 2009. To achieve the objective of the study, relevant secondary data were collected from the Central Bank of Nigeria (CBN) Statistical Bulletin, Federal Inland Revenue Service (FIRS), Office of the Accountant General of the Federation, and other relevant government agencies. The data collected were analysed using relevant descriptive statistics and econometric models such as White test, Ramsey RESET test, Breusch Godfrey test, Jacque Berra test, Augmented Dickey Fuller test, Johansen test, and Granger Causality test. The results from the various test shows that tax reforms is positively and significantly related to economic growth and that tax reforms granger cause economic growth. On the basis of the findings, the study concluded 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. However, it was recommended that sustainable economic growth cannot be attained with tax reform processes except obsolete tax laws and rates are reviewed in line with macro economic objectives, corrupt-free and efficient tax administrative machinery with personnel's and accountability and transparency of government officials in the management of tax revenue.

Key words: Causality, co-integration, economic growth, Nigeria, tax, tax reforms

INTRODUCTION

The political, economic and social development of any country depends on the amount of revenue generated for the provision of infrastructure in that given country. However, one means of generating the amount of revenue for providing the needed infrastructure is through a well structured tax system. According to Azubike (2009), tax is a major player in every society of the world. The tax system is an opportunity for government to collect additional revenue needed in discharging its pressing obligations. A tax system offers itself as one of the most effective means of mobilizing a nation's internal resources and it lends itself to creating an environment conducive to the promotion of economic growth. Nzotta (2007) argues that taxes constitute key sources of revenue to the federation account shared by the federal, state and local governments. This is why Odusola (2006) stated that in Nigeria, the government's fiscal power is divided into three-tiered tax structure between the federal, state and local governments, each of which has different tax jurisdictions. The system is lopsided and dominated by oil revenue. He further argues that over the past two decades oil revenue has accounted for at least 70% of the revenue, thus indicating that traditional tax revenue has never assumed a strong role in the country's management of fiscal policy. Instead of transforming the existing revenue base, fiscal management has merely transited from one primary product-based revenue to another, making the economy susceptible to fluctuations of the international market. It on the account of this lopsided revenue structure that tax experts and scholars stated in clear terms that the Nigerian tax system need to be reformed to achieve long term economic growth and development.

Tax is a compulsory levy imposed on a subject or upon his property by the government to provide security, social amenities and create conditions for the economic well-being of the society (Appah, 2004; Appah and Oyandonghan, 2011). Anyanfo (1996) and Anyanwu (1997) stated that tax are imposed to regulate the production of certain goods and services, protection of infant industries, control business and curb inflation, reduce income inequalities etc. Tosun and Abizadeh (2005) say taxes are used as proxy for fiscal policy. They outlined five possible mechanisms by which taxes can affect economic growth. First, taxes can inhibit investment rate through such taxes as corporate and personal income, capital gain taxes. Second, taxes can

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slow down growth in labour supply by disposing labour-leisure choice in favour of leisure. Third, tax policy can affect productivity growth through its discouraging effect on research and development expenditures. Fourth, taxes can lead to a flow of resources to other sectors that may have lower productivity. Finally, high taxes on labour supply can distort the efficient use of human capital high tax burdens even though they have high social productivity. Engen and Skinner (1996) suggest that a number of recent theoretical studies have used endogenous growth models to stimulate the effects of a fundamental tax reform on economic growth. All these studies conclude that reducing the distorting effects of the current tax structure would permanently increase growth.

Tax is a major source of government revenue all over the world. Government use tax proceeds to render their traditional functions, such as the provision of public goods, maintenance of law and order, defense against external aggression, regulation of trade and business to ensure social and economic maintenance (Azubike, 2009). 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 cannot be achieved because of dwindling level of revenue generated as a result of ineffectiveness of government officials. 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. Tax is dynamic, so reforms are necessary to effect the required changes in the national economy (Ola, 2001). Azubike (2009) noted that tax reform is an ongoing process with tax policy makers and tax administrators continually adopting the tax systems to reflect changing economic, social and political circumstances in the economy. Therefore, the objective of this study is to examine the impact of tax reforms on the economic growth of Nigeria (2000-2009).

THEORETICAL AND EMPIRICAL LITERATURE

Theories of taxation: According to Bhartia (2009), a taxation theory may be derived on the assumption that there need not be any relationship between tax paid and benefits received from state activities. In this group, there are two theories, namely,

- Socio-political theory
- The expediency theory

Also, a taxation theory may be based on a link between tax liability and state activities. This reasoning justifies the imposition of taxes for financing state activities and also providing a basis for apportioning the tax burden between members of the society. This reasoning yield the benefit received theory and cost of service theory. There is also the faculty theory of taxation.

- **Socio political theory:** This theory of taxation states that social and political objectives should be the major factors in selecting taxes. The theory advocated that a tax system should not be designed to serve individuals, but should be used to cure the ills of society as a whole.
- **Expediency theory:** This theory asserts that every tax proposal must pass the test of practicality. It must be the only consideration weighing with the authorities in choosing a tax proposal. Economic and social objectives of the state as also the effects of a tax system should be treated irrelevant (Bhartia, 2009).
- **Benefit received theory:** This theory proceeds on the assumption that there is basically an exchange 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 (Bhartia, 2009). Anyanfo (1996) argues that taxes should be allocated on the basis of benefits received from government expenditure.
- **Cost of service theory:** This theory is similar to the benefits received theory. It emphasizes the semi-commercial relationship between the state and the citizens to a greater extent. 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 implies a balanced budget policy.
- **Faculty theory:** According to Anyanfo (1996), this theory states that one should be taxed according to the ability to pay. It is simply an attempt to maximize an explicit value judgment about the distributive effects of taxes. Bhartia (2009) argue that a citizen is to pay taxes just because he can, and his relative share in the total tax burden is to be determined by his relative paying capacity.

Nature and scope of taxes: Anyanwu (1997) defined taxation as the compulsory transfer or payment (or occasionally of goods and services) from private individuals, institutions or groups to the government. The main purpose of purpose of tax is to raise revenue to meet government expenditure and to redistribute wealth and management of the economy (Ola, 2001; Jhingan, 2004; Bhartia, 2009). According to Nzotta (2007), four key issues must be understood for taxation to play its functions in the society. First, a tax is a compulsory contribution made by the citizens to the government and this contribution is for general common use. Secondly, a

tax imposes a general obligation on the tax payer. Thirdly, there is a presumption that the contribution to the public revenue made by the tax payer may not be equivalent to the benefits received. Finally, a tax is not imposed on a citizen by the government because it has rendered specific services to him or his family. Thus, it is evident that a good tax structure plays a multiple role in the process of economic development of any nation which Nigeria is not an exception (Appah, 2010). Musgrave and Musgrave (2004) note that these roles include: the level of taxation affects the level of public savings and thus the volume of resources available for capital formation; both the level and the structure of taxation affect the level private saving. A system of tax incentives and penalties may be designed to influence the efficiency of resource utilization; the distribution of the tax burdens plays a large part in promoting an equitable distribution of the fruit of economic development; the tax treatment of investment from abroad may affect the volume of capital inflow and rate of reinvestment of earnings there from; and the pattern of taxation on imports relative to that of domestic producers affect the foreign trade balance.

However, Anyanwu (1993) pointed out that there are three basic objectives of taxation. These are to raise revenue for the government, to regulate the economy and economic activities and to control income and employment. Also, Nzotta (2007) noted that taxes generally have allocational, distributional and stabilization functions. The allocation function of taxes entails the determination of the pattern of production, the goods that should be produced, who produces them, the relationship between the private and public sectors and the point of social balance between the two sectors. The distribution function of taxes relates to the manner in which the effective demand over economic goods is divided, among individuals in the society. According to Musgrave and Musgrave (2006), the distribution function deals with the distribution of income and wealth to ensure conformity with what society considers a fair or just state of distribution. The stabilization of function of taxes seeks to attain high level of employment, a reasonable level of price stability, an appropriate rate of economic growth, with allowances for effects on trade and on the balance of payments. Nwezeaku (2005) argues that the scope of these functions depends, inter alia, on the political and economic orientation of the people, their needs and aspirations as well as their willingness to pay tax. Thus the extent to which a government can perform its functions depend largely on the ability to design tax plans and administration as well as the willingness and patriotism of the governed.

According to Anyanfo (1996), the principles of taxation mean the appropriate criteria to be applied in the development and evaluation of the tax structure. Such principles are essentially an application of some concepts derived from welfare economists. In order to achieve the broader objectives of social justice, the tax system of a country should be based on sound principles. Jhingan (2004), Bhartia (2009) and Osiegbu *et al*. (2010) listed the principles of taxation as equality, certainty, convenience, economy, simplicity, productivity, flexibility and diversity.

Equity principle: states that every taxpayer should pay the tax in proportion to his income. The rich should pay more and at a higher rate than the other person whose income is less (Jhingan, 2004). Anyanfo (1996) states that it is only when a tax is based on the tax payer's ability to pay can it be considered equitable or just. Sometimes this principle is interpreted to imply proportional taxation.

Certainty principle: of taxation states that a tax which each individual is bound to pay ought to be certain, and not arbitrary. The time of payment, the manner of payment, the quantity to be paid ought to all be clear and plain to the contributor and every other person (Bhartia, 2009).

Convenience principle: of taxation states that the time and manner should be convenient to the taxpayer. According to Anyanfo (1996), this principle of taxation provides the rationale for Pay - As - You - Earn (PAYE) system of tax payable system of tax collection.

Economy principle: states that every tax should be economical for the state to collect and the taxpayer to pay (Appah, 2004; Jhingan, 2004; Bhartia, 2009). Anyanfo (1996) argues that this principle implies that taxes should not be imposed if their collection exceeds benefits.

Productivity principle: states that a tax should be productive in the sense that it should bring large revenue which should be adequate for the government. This is the major reason why governments in all parts of the globe continuously employ tax reforms.

Simplicity principle: states that the tax should be plain, simple and intelligible to common taxpayer. Anyanfo (1996) argue that there should be no hidden agenda in the tax law.

Flexibility principle: implies that there should be no rigidity in taxation. Diversity Principle of taxation states that there should be different variety of taxes. Bhartia (2009) argue that it is risky for state to depend upon too few a source of public revenue.

Tax reforms in Nigeria: The dependence on oil revenue by all tiers of government in Nigeria has made the federal government to reform the existing tax laws. According to Alli (2009), the objectives of tax reforms in Nigeria include: to bridge the gap between the National

Development needs and the funding of the needs; to ensure taxation, as a fiscal policy instrument, to achieving improved service delivery to the public; to improve on the level of tax derivable from non-oil activities,vis-à-vis revenue from oil activities; efforts at constantly reviewing the tax laws to reduce/ manage tax evasion and avoidance; and to improve the tax administration to make it more responsive, reliable , skillful and taxpayers friendly and to achieve other fiscal objectives.

The Nigerian tax reform has experienced series of reforms since 1904 to date. The effects of the various reforms in the country is as follows: introduction of income tax in Nigeria between 1904 and 1926; grant of autonomy to the Nigerian Inland Revenue in 1945; the Raisman Fiscal Commission of 1957; formation of the Inland Revenue Board in 1958; the promulgation of the Petroleum Profit Tax Ordinance No. 15 of 1959; the promulgation of Income Tax Management Act 1961; establishment of the Lagos State Inland Revenue Department; the promulgation of the Companies Income Tax Act (CITA) 1979; establishment of the Federal Board of Inland Revenue under CITA 1979; establishment of the Federal Inland Revenue Service Between 1991 and 1992; and tax policy and administration reforms amendment 2001 and 2004.

The government embarked upon the latest tax reform process by instituting Study Group on the Nigerian Tax System, consisting of individuals from business, academia, and the government to study the present tax laws and recommend the appropriate reform in general and their impact to the overall economy. As a result of the reform, nine (9) bills on tax reforms were approved by the Federal Executive Council for the consideration of the National Assembly and subsequently passed as Act. The Acts, are as enumerated as follows: Federal Inland Revenue Service Act 2004; Companies Income Tax Act 2004; Petroleum Profit Tax Act 2004; Personal Income Tax Act 2004; Value Added Tax Act 2004; Education Tax Act 2004; Customs, Excise Tariffs, etc (Consolidation) Act 2004; National Sugar Development Act 2004; and National Automotive Council Act 2004.

The Chartered Institute of Taxation of Nigeria (CITN), established in 1982 and Chartered by Act No. 76 of 1992 to regulate tax practice and administration in the country, and to this extent a major stakeholder in the Nigerian tax system submitted a memorandum on the proposed 2004 amendment. Their memorandum objectives include: to strengthen the powers of the Accountant General of the Federation to monitor the revenue being generated by ministries, extra-ministerial departments and parastatals; to enforce remittance of the revenues collected to the consolidated revenue fund or federation account; to strengthen the oversight functions of the National Assembly in monitoring the revenue generated by ministries, and others; to increase the penalty for under declaration of revenue generated from three to five years.

Economic growth: According to Dwivedi (2004), economic growth is a sustained increase in per capita national output or net national product over along period of time. It implies that the rate on increase in total output must be greater than the rate of population growth. Another quantification of economic growth is that national output should be composed of such goods and services which satisfy the maximum want of the maximum number of people. Economic growth can be determined by four important determinants namely, human resources, national resources, capital formation and technological development. The theories of economic growth can be examined under the Harrod-Domar theory of growth, Kaldor model of distribution, Pasinetti model of profit and growth, Joan Robinson's model of capital accumulation, Meade's Neo Classical model of economic growth and the Slow model of long run growth. All this models of economic growth the various views of scholars on the most suitable explanation of growth.

Empirical studies: Several empirical studies have been conducted on the impact of taxes on economic growth. The empirical studies of Anyanwu (1997), Engen and Skinner (1996), Tosun and Abizadeh (2005) and Arnold (2011) provided different explanations of taxes on economic growth. Engen and Skinner (1996) in their study of taxation and economic growth of U.S. economy, large sample of countries and use of evidence from micro level studies of labour supply, investment demand, and productivity growth. Their result suggests modest effects on the order of 0.2 to 0.3 percentage points' differences in growth rates in response to a major reform. They stated that such small effects can have a large cumulative impact on living standards. Tosun and Abizadeh (2005) in their study of economic growth of tax changes in OECD countries from 1980 to 1999 reveal that economic growth measured by GDP per capita has a significant effect on the tax mix of GDP per capita. It is shown that while the shares of personal and property taxes have responded positively on economic growth, shares of the payroll and goods and services taxes have shown a relative decline. Arnold (2011) in their study found that short term recovery requires increase in demand while long run growth requires increase in supply. As short term concessions can be hard to reverse, this implies that policies to alleviate this crisis could compromise long run growth.

MATERIALS AND METHODS

In carrying out this study, time series data sourced from Central Bank of Nigeria Statistical Bulletin, Federal

Inland Revenue Service (FIRS), Office of the Accountant General of the Federation, Federal Ministry of Finance and Budget Office of the Federation were used in this study. The macroeconomic data cover tax revenue (TR) and Economic Growth (EG) between 1994 and 2009 in Nigeria. The specification shall be

$$GDP = F\,(PPT, CIT, VAT, ET, PIT, CED) \quad (1)$$

PPT = Petroleum Profit Tax
CIT = Companies Income Tax
VAT = Value Added Tax
ET = Education Tax
PIT = Personal Income Tax
CED = Custom and Excise Duties
GDP = gross domestic product

Increased tax revenue is expected to increase gross domestic product, so GDP/ TR

$$GDP = \alpha + \beta 1\ PPT + \beta 2\ CIT + \beta 3\ VAT + \beta 4\ ET + \beta 5\ PIT + \beta 6\ CED + \epsilon \quad (2)$$

Since the data to be used for the analysis is time series, we employed co-integration tests to avoid spurious regression. The first step would be a diagnostic test of each of the variables for stationarity. The study employs the Augmented Dickey - Fuller test for unit root. If any of the series is found to be integrated, then a cointegration test will be conducted using Johansen Cointegration Test. Therefore, to determine if there exists a long run relationship between dependent and independent variables. If the series are cointegrated, then they will be most efficiently represented by an Error Correction Method which is used to tie the short run behaviour to its long run value (Wooldridge, 2006; Asterious and Hall, 2007; Gujarati and Porter, 2009). We also perform Granger Causality test between the dependent and independent variables. However, the e-view software is used for the analysis of data.

RESULTS AND DISCUSSION

This section of the study examines the results and discussions of relevant findings from the econometric analysis.

Table 1: White heteroskedasticity test

F-statistic	0.619940	Probability	0.761791
Obs*R-squared	11.40198	Probability	0.494819

Eview output

Table 2: Ramsey RESET test

F-statistic	0.304090	Probability	0.596392
Log likelihood ratio	0.596906	Probability	0.439761

Eview output

Table 3: Breusch-godfrey serial correlation LM test:

F-statistic	1.302641	Probability	0.330414
Obs*R-squared	4.339748	Probability	0.114192

Eview output

Table 4: Unit root test (ADF)

Variable	ADF	1%	5%	Level
GDP	-4.89009	-4.1366	-3.1222	1st diff
PPT	-4.230010	-4.1366	-3.1222	Ist diff
CIT	-3.772350	-4.1366	-3.1222	1st diff
VAT	-4.345981	-4.1366	-3.1222	1st diff
ET	-4.923842	-4.1366	-3.1222	1st diff
CED	-3.393410	-4.1366	-3.1222	1st diff
PIT	-4.961772	-4.1366	-3.1222	1st diff

Eview output

The Table 1 shows the White test of heteroskedasticity. The table reveals that the p-value of about 49% is greater than the critical value of 5%. This shows that there is no evidence for the presence of heteroskedasticity since the p-values are considerably in excess of 0.05.

Table 2 of the Ramsey RESET test shows that p-value of about 60% is greater than the critical value of 5%. This shows that there is no apparent non-linearity in the regression equation and it would be concluded that the linear model is appropriate.

The Table 3 shows the Breusch-Godfrey Serial Correlation LM test for the presence of autocorrelation. The result of the test reveals that the p-value of about 33% is greater than the critical value of 5%. This shows the non existence of autocorrelation.

Table 4 shows the unit root test for stationarity using Augmented Dickey-Fuller. The result shows that all the variables are stationary at 1(1) series at -4.89009, -4.230010, -3.772350, -4.345981, -4.923842, -3.393410, and -4.961772 for gross domestic product, petroleum profit tax, companies income tax, value added tax, education tax, customs and excise duties and personal income tax. All the series were significant at 1 and 5% except Companies Income Tax (CIT) and customs and excise duties (CED) that was significant only at 5%. The Table 5 shows the Granger Causality test for the causality between tax reform and economic growth proxied with gross domestic product. The result reveals that petroleum profit tax with a p-value of0 .92 is greater than the critical value of 0.05, which implies the rejection of the null and acceptance of the alternative that petroleum profit tax in Nigeria granger cause gross domestic product while gdp does not granger cause ppt. The table also shows that companies income tax, value added tax, education tax, customs and excise duties and personal income tax granger cause GDP, but GDP does not granger cause any of the tax variables.

The result of the Johansen's cointegration test as presented in Table 6 shows the existence of a cointegrating equation. This shows that there exist a long run equilibrium relationship between GDP and the fundamentals used in the model.

Table 5: Granger causality test

Pairwise granger causality tests
Date: 11/08/11 Time: 20:07
Sample: 1994 2009
Lags: 2

Null hypothesis:	Obs	F-statistic	Probability
PPT does not granger cause GDP	14	0.07747	0.92607
GDP does not granger cause PPT		0.39032	0.03776
CIT does not granger cause GDP	14	0.03884	0.96206
GDP does not granger cause CIT		0.90517	0.04834
VAT does not granger cause GDP	14	2.19229	0.16764
GDP does not granger cause VAT		3.28530	0.04186
ET does not granger cause GDP	14	0.10703	0.89963
GDP does not granger cause ET		4.01002	0.0486
CED does not granger cause GDP	14	0.43805	0.65835
GDP does not granger cause CED		10.6110	0.00429
PIT does not granger cause GDP	14	0.24270	0.78948
GDP does not granger cause PIT		5.06911	0.03354

Table 6: Johansen co-integration test

Eigen value	Likelihood ratio	5% critical value	1% critical value	No. of CE (s)	Lag length
0.702512	40.531723	26.4973	33.6534	none	1

L.R.: test indicates one cointegrating equation at 5% level of significance

Table 7: Error correction estimates

Variables	Estimated coefficient	t-value	probability
Constant	27.9116	4.938490	0.0008
ΔGDP	0.1527	5.4410	0.0032
ΔPPT	0.3114	2.4113	0.0125
ΔCIT	0.1883	3.4462	0.0113
ΔVAT	0.2126	3.7113	0.0106
ΔET	0.2359	2.261993	0.0480
ΔCED	0.2982	5.980437	0.0002
ΔPIT	0.0816	3.6618	0.0016

R^2: 0.5827; Adjusted R^2: 0.5432; F-ratio: 4.2431; DW: 2.02

Table 7 shows the error correction estimates with an adjusted R^2 of about 54% of the variation of the dependent variable GDP is as a result of change in tax revenue. The independent variables are correctly signed indicating a positive relationship between tax revenue as a result of reforms to economic growth. This is consistent with Ola (2001). The F-statistics confirm the significance of the overall regression equation.

CONCLUSION AND RECOMMENDATIONS

The objective of this study is to investigate the relationship between tax reforms and economic growth in Nigeria. It goes further to examine whether tax reforms on petroleum profit tax, companies income tax, value added tax, personal income tax, education tax and customs and excise duties affect the economic growth measured with gross domestic product of Nigeria. To capture this, time series data were culled from 1994-2009. The Johansen Co-integration test confirmed that a long run relationship exists between tax reforms and economic growth and the Granger causality result also shows that tax granger cause economic growth.

This goes to show that tax reforms have significantly altered the way the system and their agencies function resulting in improved impacts on economic growth. The reform process has indeed, charted a road map to drive the Nigerian economy to international relevance, as it is to provide adequate revenue for the government to undertake socially desirable expenditure that will translate to economic growth in real output and per capita basis for it is the only part to ensure efficient transport system, regular supply of water and electricity etc. Government may in this way use tax revenue from the various reform processes to impact on the economy of Nigeria. However, the desired revenue cannot be generated from the tax reform processes in Nigeria except government review obsolete laws and rates to align with current macroeconomic target for the promotion of fiscal responsibility and sustain ability; a corrupt - free and efficient administrative machinery with personnel's who are well trained, well-equipped and motivated would enable Nigeria to make appreciable progress in revenue generation; there should be harmony in the objectives of tax reforms with other industrial and macro-economic objectives; and above all accountability and transparency on the part of government officials in the management of tax revenues for the benefit of the citizens and Nigeria in general.

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