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Taxation as an Instrument of Economic Growth (The Nigerian Perspective)

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Abstract
This paper examines taxation as an instrument of economic growth in Nigeria. Using annual time series data sourced from the Central Bank of Nigeria (CBN) Statistical Bulletin during the period 1980 through 2013, a linear model of Corporate Income Tax (CIT), Value Added Tax (VAT) and Economic Growth (GDP) was estimated using the Ordinary Least Square (OLS) technique. The empirical resultsuggests that the hypothesized link among corporate income tax, value added tax and economic growth indeed exist in the Nigerian context. Thus the result offer tantalizing evidence that taxation is an instrument of economic growth in Nigeria. This conclusion points to the need for additional measures by government in ensuring that taxpayers do not avoid and evade tax so that income can be properly redistributed in the economy. In addition, regulatory authorities charged with the sole responsibility of collecting tax should further be strengthened to enforce compliance by taxpayers. Above all, the tax collected should be properly distributed so that economic growth can be properly harnessed.
Keywords: Taxation; Economic Growth; Development; Time Series Data;Nigeria

I. Introduction

Nigeria as a nation has the vision of becoming one among the world's 20 largest economies in the year 2020; this obviously is the brain behind the priority attention the present administration is directing at infrastructural development which is essential for economic growth. A developed economy is one with the ingredient to stimulate investment and create wealth, this by implication offers an atmosphere that is business friendly and has the potentials for the actualization of the vision 202020.The desired outcome requires a lot of money to put the economy in a position that stimulates investment, therefore,tax policies need to attract potential investors, and therevenue from tax should be sufficient enough to meet the infrastructural expenditures of the government.Apere (2003) notes that taxation is a microeconomic and fiscal policy instrument; it involves the transfer of resources from the private to the public sector for the accomplishment of economic and social goals.It is an instrument the government uses to measure, access and control the informal sector that dominate developing economies of the world (Wambaiand Hanga, 2013). This paper contends that taxation is an instrument of economic growth. Towards this end, this study examinestaxation as an instrument for economic growth using Nigerian data. The remaining part of this paper is divided into five (5) sections: II. Theoretical Underpinning, III. Empirical Studies,IV.Methodology, V.Results and Discussion and VI.Conclusion and Recommendations.

II. Theoretical Underpinning

The theory of taxation could be based on the activities between tax liability and the state, the primary purpose of taxation is to generate revenue for the government to settle its expenditures and for the provision of social amenities and welfare for the populace.According to Ogbonnaand Appah(2012), this reasoning justifies the imposition of taxes for financing state activities and for the provision of a basis for apportioning the tax burden between members of the society. They see the socio political theory of taxation as a theory that advocates for a tax system which is not designed to serve individuals but one that cures the ills of the society as a whole. The society is made up of individuals but is more than the sum total of its individual members; consequently, the tax system should be directed towards the health of the society as a whole, since individuals are integral part of the broader society (Chigbu, *et.al*, 2012).

Bhartia(2009) asserts that the expectancy theory of taxation is such that every tax proposal passes the test of practicality and must be the sole consideration before the tax authorities in a bid for tax proposal. It strongly emphasizes that the economic and social objective of the state is considered irrelevant since it is meaningless to have a tax that cannot be levied and effectively collected. The benefits-received theory assume an exchange or contractual relationship between the state and the tax-payers, certain goods and services are provided by the state and the cost of such goods and services are contributed in the proportion of the received benefits, thus, the benefits received present the basis for distributing the tax burden in specific manner. This theory overlooks the possible use of the tax policy for bringing about economic growth or stabilization (Chigbu, *et.al*, 2012).They see the cost of service theory as very similar to the benefits-received theory, the theory emphasize semi commercial relationship between the state and the citizens to a greater extent.

The implication according to Chigbu, *et.al*, (op.cit) was that the citizens are not entitled to any benefits from the state and if they do receive any, they must pay the cost thereof. In this theory, costs of services are scrupulously recovered unlike the benefits-received theory where a balanced budget is implied.Another theory of interest is the ability to pay theory, the principle in this taxation holds that taxes imposed on tax-payers should be based on the progressive tax approach which maintains that taxes should be levied according to a tax-payer's ability to pay. This system of taxation requires that higher earning persons pay taxes higher than those with lower income. The basic tenet of this theory is that the burden of taxation should be shared by the members of the society on the principle of equity and justice and that this principle necessitates that tax burden is apportioned according to their relative ability to pay.Adam Smith is the brain behind the principle of equity and justice, he advocates that the amount of tax payable should be equal, this by implication means that tax payable is in proportion to earned income. Equity and justice is assumed only when the tax system is based on the ability of the tax payer to pay the amount levied as tax liability.

Economic growth and development are backed by some theoretical frameworks, one of which is the Harrod-Domar model which was developed independently by Sir. Roy Harrod in 1939 and Evsey in 1946, it is a model that makes obvious the rate of economic growth in an economy, however, emergence of economic growth and development theories can be traced backed to Adams Smith's Wealth of Nations. Adams Smith opines that the wealth of a nation depends on division of labour and is limited by the limits of division of labour. However, a later postulation by Richardo, Milthus and Mill took definite shapes in correcting Adam Smith's expositionwith further analyses which took a decade eventually surpassed the Smithian view.The concept of taxation has been several viewed by academies differently though pointing toward same direction, Wambaiand Hanga, (2013) opine that taxation is a compulsory levy by the government through its agent on the profits, income, or consumption on its subjects or citizens. It is a compulsory contribution made by individuals and organization towards defraying the expenditure of government (Dandago and Alabede 2001).It plays a very important role in the economic life of a developing country.

Today, Nigeria is indeed in dire need of effective and efficient tax system in order to generate enough revenue that will stimulate economic growth (Oji, 2000). According to Olusanya, *et al* (2012), taxation may be seen as a threat to individual's proposed standard of living or even business proposed revenue generation, but to the government and the fiscal need for taxation, it is the pillar and facilitator of development. In national development, taxation is increasing, and the introduction of new technology has stimulated continuous economic growth and development. The real purpose of taxation is to take purchasing power from tax payers so that tax payers relinquish control over economic resources and make them available to the state. It is a fiscal policy instrument which the government manipulate to achieve macroeconomic objective. This objective could be an expansionary one directed at reducing the rate of national unemployment, government through tax incentives can stimulate investment as the tax liability on investors is reduced and more money becomes available for investment purposes thus, reducing the level of poverty as more unemployed people becomes gainfully employed, this for sure is a signal for economic development. Taxation ensures redistribution of income and wealth, thus, a tool for the achievement of socially desirable goal (Olakunri, 2000).

III. Empirical Studies

Several studies have examined taxation as an instrument of economic development in different countries with diverse techniques.The outcome of the investigations however, shows degree of relatedness in the results.The tax reform in Nigeria is spearheaded by the Federal Inland Revenue service which is geared to achieving greater revenue collection, voluntary and willing compliance and breaking the long piercing phobia between taxpayers and tax collectors. For instance in a study by Wambaiand Hanga, (2013) on taxation and social development in Nigeria: tackling Kano's hidden economy, they found that the attitude of the government on taxation need to change and recommends a tax system that concentrate on establishing simplicity, predictability, and neutrality.Chiumiaand Simwaka, (2012) studies analyses the effect of taxation in sub-Saharan Africa. They found that taxes levied on personal and corporate income reduces economic growth. From their study, one may be tempted to conclude that the tax structure is largely irrelevant in less developed economies, but embedded in an effective tax system are benefits for both the taxpayers and the government.Tosun and Abizadeh(2005) studied economic growth and tax charges in OECD countries from 1980 to 1999; their study reveals that economic growth measured by GDP per capital has significant effect on tax mix of GDP per capita. The study recorded a decline in shares of payroll, goods and services and positive growth from personal and property taxes.

Olusanya*et al*, (2012) investigated taxation as a fiscal policy instrument for income redistribution among Lagos state civil servants using spearman's rank correlation oefficient, the study found a positive relationship between tax as a fiscal policy instrument and income redistribution. In the study on taxation and economic growth of the United State, Engenand Skinner (1996) found a modest effect on the order of 0.2 to 0.3

percentage point differences in growth rates in response to major tax reform. Their findings suggest that such minor effect cumulatively can have large impact on the standards of living.Adereti*et al*, (2011) explored value added tax and economic growth in Nigeria, their result found no causality existing between GDP and VAT revenue, and a positive and significant correlation between VAT revenue and GDP.Saez, (2004) studied direct or indirect tax instruments for redistribution: short-run versus long-run, the findings reveals that in a long-run context individuals respond to tax incentives through the occupational margin, which is in contrast to a short-run situation where individuals are stuck into their occupations and can only adjust labour supply on the job.Worluand Emeka (2012) examined tax revenue and economic development in Nigeria using the three stage least square estimation technique, this study found that tax revenue stimulate economic growth through infrastructural development, it highlight the channels through which tax revenue impacts on economic growth in Nigeria and also that tax revenue has no dependent effect on growth through infrastructural development and foreign direct investment but just allowing the infrastructural development and foreign direct investment to positively respond to increase in output.

Feredeand Dahlby, (2012) test the impact of the Canadian provincial governments' tax rates on economic growth using panel data covering the period from 1977 to 2006; the study found that higher provincial statutory corporate income tax rate is associated with lower private investment and slower economic growth. Their empirical estimation suggested that a 1 percent point cut in the corporate tax rate is related to a 0.1-0.2 percentage point increase in the annual growth rate. Their findings indicate that sales tax boosts provincial investment and growth when switched from a retail sales tax to aharmonized sales tax with federal value-added.Nwakanmaand Nnamdi, (2013) examined taxation and national development with the least square methodology and specification on the lin-log model of human development index. Their findings reveals that Petroleum Profit Tax, Company Income Tax and Excise Tax respectively exhibit a positive relationship with the level of national development, and a negative relationship between human development index and corporate tax.

Dackehagand Hansson (2012) studied how statutory tax rates on corporate and personal income affect economic growth using panel data from 1975 to 2010 for 25 rich OECD countries, they found a negative influence on economic growth from both taxation of corporate and personal income. Their study revealed a more robust economic growth in correlation with corporate income tax. Koester and Kormendi, (1989) construct measures on average and marginal income tax rates by regressing tax revenue on GDP, and they summed the measures in a growth regression, they detect no statistically significant relationship between taxes and economic growth. In their finding, tax rates seem to have a negative impact on the growth rate, though with marginal tax rate having negative effect on the level of activity. However, contrary to Koester and Kormendi findings, Padovanoand Galli, (2001) constructed a similar tax measures and included a dummy slope to allow changes in tax rates over time, they found tax rates as having negative and statistical significance on growth. Their study in 2002 eventually confirms a negative correlation between marginal tax rates and economic growth, and average tax taxes to have significant impact on economic growth and development.

Xing, (2011) in his study, does tax structure affect economic growth? He examine the effects of revenue-neutral tax structure and changes on the long-run level of income per capita using panel data for 17 OECD countries over the period 1970-2004. The study did not obtain compelling evidence in favour of consumption taxes over income taxes or personal income taxes over corporate taxes. The robust result appears to be that shift in tax revenue towards property taxes are associated with a higher level of income per capita in the long run.Poulsonand Kaplan, (2008) studied the impact of tax policy on economic growth in the states within the framework of an endogenous growth model. They applied the regression analysis to estimate the impact of tax on economic growth in the state from 1964 to 2004. They found a significant negative impact of higher marginal tax rate on economic growth. This analysis however, underscores the importance of controlling for regressivity, convergence, and regional influences in isolating the effect of taxes on economic growth in the states.

IV. Methodology

The plan of this paper follows an estimation of a linear regression model. The use of secondary data sourced from the Central Bank of Nigeria (CBN) Statistical Bulletin during the period 1980 through 2013 was employed. The study used Ordinary Least Square (OLS) technique with its Best Linear Unbiased Estimate (BLUE) Property in estimating the parameters of the model. The linear model for this study was estimated based on the empirical studies of Koester and Kormendi, (1989); Xing, (2011); Chiumia and Simwaka, (2012); Ferede and Dahlby, (2012); and Dackehag and Hansson (2012). In line with the above studies we examined taxation as an instrument of economic growth linking Corporate Income Tax (CIT), Value Added Tax with Gross Domestic Product (GDP) in a unifying model. The model for the study is given as:

$$GDP = F(CIT, VAT) \qquad \textbf{\textit{eq. 1}}$$

$$GDP_{it} = a_0 + b_1CIT_{it} + b_2VAT_{it} + \varepsilon_t \qquad \textbf{\textit{eq.2}}$$

Where:

GDP = Gross Domestic Product

CIT = Corporate Income Tax
VAT = Value Added Tax
a_0, b_1, b_2 = Regression Coefficient
ε_t = Error Term
it = Time dimension

The emphasis of this paper is to empirically test the relationship between some variables of taxation (corporate income tax and value added tax) and economic growth (GDP) in order to agree or disagree whether taxation is an instrument of economic growth in Nigeria.

V. Results and Discussion

A summary of the results of the Ordinary Least Square (OLS) regressions was presented in the below table.

Table I: OLS Results

Variables		**Key Statistical Indicators**				
GDP	**Pearson Correlation**	**f-statistics**	**t-statistics**	**R^2 Unadjusted**	**Adjusted R^2**	**Durbin Watson**
CIT	.762	41.666	6.455	.923	.891	.722
VAT	.495	9.7490	3.122	.845	.820	.121
Constant	1.00		-2.5888			

Dependent Variable: GDP
Independent Variables:CIT, VAT

From the results analyzed in table I above, the independent variables (CIT and VAT) were perfectly correlated and hence there is multi-collinearity in the result with the dependent variable (GDP) constant with 1, Corporate Income Tax (CIT) at .762 and Value Added Tax (VAT) at .495. In evaluating the goodness of fit in the model, the unadjusted R-Squared of .923 means that 92.3percent of CIT has been explained by the GDP and .845 of VAT means that 84.5 percent of VAT has been explained by the GDP. The values for CIT and VAT are high and impressive since the unexplained variation is just 7.7percent (1 – .923) and 15.5percent (1 – .845) respectively. With the adjusted R^2 of .89.1, it means 89.1 percent is the true value of CIT that constitute the GDP which is high and impressive since the unexplained variation is just 6.4 percent (1 – .936). Also, with the adjusted R^2 of .820, it means 82.0 percent is the true value of VAT that constitute the GDP which is high and impressive since the unexplained variation is just 18 percent (1 – .820). In computing the Analysis of Variance (ANOVA) in the regression model, the f-statistics test computed for CIT showed a figure of 41.666 and VAT showed a figure of 9.7490 at 5% level of significance. Therefore with all these aforementioned explanations and analysis, it therefore implies that CIT and VAT have significant relationship with economic growth in Nigeria. The Durbin Watson (Dw) test with values .722 and .121 for CIT and VAT respectively revealed that there is no existence of first order serial correlation in the model. Thus, the empirical results are suggestive; indicating that the hypothesized link between Corporate Income Tax (CIT), Value Added Tax (VAT) and Economic Growth (GDP) indeed exist in the Nigerian context. The finding of our study implies that taxation is an instrument of economic growth in Nigeria.

VI. Conclusion and Recommendations

This paper has explored the link between some parameters of taxation (Corporate Income Tax and Value Added Tax) and Economic Growth(Gross Domestic Product) using annual time series data spanning 1980 through 2013 in a unifying linear model. By focusing on a possible measure of taxation that has not been studied previously in other countries, this paper adds to literature in Nigeria that attempts to understand whether taxation is an instrument of economic growth. The empirical results offer tantalizing evidence that taxation is an instrument of economic growth in Nigeria. This conclusion points to the need for additional measures by government in ensuring that taxpayers do not avoid and evade tax so that income can be properly redistributed in the economy. In addition, regulatory authorities charged with the sole responsibility of collecting tax should further be strengthened to enforce compliance by taxpayers.Above all, the tax revenues should be properly distributed so that economic growth can be harnessed, especially in providing basic social amenities as well as infrastructures in Nigeria.

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