THE IMPACT OF INDIRECT TAX REVENUE ON ECONOMIC GROWTH: THE NIGERIA EXPERIENCE

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ABSTRACT

This study examines the impact of indirect tax revenue on economic growth in Nigeria. The study uses value added tax revenue and custom and excise duty revenue as independent variables and economic growth was proxy with real gross domestic product as the dependent variable. The study employ secondary data collected from Central Bank of Nigeria statistical bulletin for the period covering 1993 to 2013 for the empirical analysis using the convenient sampling techniques. The research design is time series and the data were analyzed using descriptive statistics, correlation, unit root test, co-integration test and error correction model regression. The result revealed that value added tax had a negative and significant impact on real gross domestic product. In the same

vein, past custom and excise duty had a negative and weakly significant impact on real gross domestic product. The Error Correction Model (ECM (-1)) coefficient had a correct negative and statistically significant sign. This shows that short-run deviation can be quickly corrected. The Durbin-Watson positive value indicates the absence of autocorrelation in the model. The study therefore recommended that tax administrative loopholes should be plugged for tax revenue to contribute immensely to the development of the economy since past value added tax and custom and excise duty had a significant impact on economic growth.

Keywords: **VAT, CEXD Revenue; Gross domestic product**

1.0 INTRODUCTION
1.1 Background to the Study

Taxation is a way of raising revenue for the day to day running of government activities. Government activities involve generating funds and using same to provide security, social amenities, infrastructural facilities, etc, for the inhabitant of the country. Base on this, it is worthy of note that the objective of taxation is in tandem with the functions of government (Akhor, 2014). However, over the years, it has been observed that the Nigerian tax system has inherent problems in its structure. Odusola (2006) opined that the Nigerian tax system is concentrated on Petroleum Profit Tax (PPT) and Company Income Tax (CIT) while broad-based indirect taxes like the

Value-Added Tax (VAT) and Custom and Excise Duty (CEXD) are neglected. Thus, the tax system lacks the potential of diversifying the revenue portfolio for the country to safeguard against the volatility of crude oil prices and to promote fiscal sustainability and economic viability at lower tiers of government (Azaiki & Shagari, 2007).

In Nigeria, revenues have been allocated according to the formula recommended by Ad-hoc Fiscal Commissions or based on a principle chosen by the state. According to Taiwo, 2008, from 1946 to date, a total of thirteen revenue allocation Commissions had been set up. Each Commission recommended a formula for revenue sharing depending on the economic fortunes and purposes, which the government wanted the revenue sharing formula to serve. More so, the revenues are raised mainly through taxation to finance government expenditure and to influence other activities in the economy. In addition, tax revenue mobilization as a source of financing developmental activities in less developed economies has been a difficult issue primarily because of various forms of resistance, such as evasion, avoidance and other corrupt practices can easily be perpetuated within the direct taxes bracket. These activities are considered as sabotaging the economy and are readily presented as reasons for the underdevelopment of the country. Government collects taxes in order to provide an efficient and steadily expanding non-revenue yielding services, such as infrastructure, education,

health, communications system, employment opportunities and essential public services like the maintenance of laws and order, irrespective of the prevailing ideology or the political system of a particular nation. The very act of taxation has profoundly beneficial effects in fostering better and more accountable government (Tax Justice Network [TJN], (2012).

Akhor (2014) 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. Therefore, the use of tax as an instrument to achieve economic growth in most less develops countries cannot be reliable because of dwindling level of revenue generation.

Consequently, changing or fine-tuning tax rates has been used to influence or achieve macroeconomic stability. Critical examples of governments that have influenced their economic development through revenue from tax are: Canada, United States, Netherland and United Kingdom. They derive substantial revenue from Value Added Tax, Import Duties and have used same to create prosperity (Oluba, 2008). A significant share of the tax revenue increase in Africa stems from natural resource taxes. This included income from production sharing, royalties, and corporate income tax on oil and mining companies (Pfister, 2009). Nigeria is a developing country whose major export is mainly crude oil. Also endow with other natural resources such as; natural gas, tin, iron ore,

coal, limestone, lead, zinc and arable land (Economy Watch, 2011). Most economists, especially development and international economists have argued that over dependent on the direct taxes revenue (e.g PPT; due to the fluctuation in the oil price and CIT; because of the sharp practices like evasion, avoidance, etc, that can easily be perpetrated) may adversely affect a nation's economic growth and development (Okafor,2012).

1.2 Statement of the Problem

In Nigeria, people, especially the rich and the elites, deliberately dodge this civic responsibility of paying tax and sometimes employ the service of tax specialists in order to pay less tax to the government. There is also the problem of falsification of ages and the number of children and dependents one has in order to reduce the amount of tax payable. Emanating from these factors, the sub-national governments (state and local governments) contend that their currently assigned taxes are poor in terms of their bases and, therefore, accruable revenues are not enough to meet their expenditure targets. Also the statutory allocation from the federation account has been grossly inadequate as a result of a fall on gross domestic product. This invariably reduces their overall performance, considering their expenditure profiles.

Taiwo (2008) observed that the distribution of government revenue is skewed in favour of one tax base or the other (eg oil

revenue) in Nigeria. Nevertheless, the overwhelming evidence of positive impact of oil revenue on economic growth in Nigeria cannot be overemphasized (Odusola, 2006). However, the first question is, are other forms of taxes not important for consideration? Emanating from the above, there are some questions to ask: what relationship exists between Nigeria's tax revenue and her economic growth? And what is the contribution from other tax base to the overall tax revenue of a nation. Against these backdrops, this research seeks to find answers to the following research questions:

    (i)   What is the impact of value added tax on economic growth in Nigeria?

    (ii)   What is the impact of custom and excise duties on economic growth in Nigeria?

1.3 Objectives of the Study

The broad objective of this study is to provide empirical evidence on the impact of tax revenue on economic growth in Nigeria. The specific objectives include; to:

    (i)   determine the impact of value added tax on economic growth in Nigeria; and

    (ii)   evaluate the impact of custom and excise duties on economic growth in Nigeria.

1.4 Research Hypotheses

In line with the research problems and objectives, the following hypotheses were formulated and tested.

(i) HO_1: There is no significant relationship between value added tax and economic growth in Nigeria.

(ii) HO_2: There is no significant relationship between custom and excise duties and economic growth in Nigeria.

2.0 LITERATURE REVIEW

2.1 Economic Growth in Nigeria

Fiscal policy is one of the most important tools that have significant effect on all economic sectors and have real effect on economic variables like Gross national product, inflation, unemployment and so on. Credit flows and the fiscal stance are found to play a significant role in determining the trade balance. Nigerian government has gradually expanded its controls over the private sector, levying differential taxes and subsidies, increasing industrial prices relative to farm prices, favoring investment in key sectors, providing tariff and tax incentives to vital sectors, protecting favored industrial establishments from foreign competition, awarding import licenses to selected firms and industries, and providing foreign exchange to priority enterprises at below-market exchange rates in order to bring about economic growth and development. Emmanuel (2010) observe that the realization was dawned on Nigeria's government at a very critical period when its main source of revenue (oil) for decades witnessed an

unprecedented crisis and decline due to general fall in the prices of oil at the international market. This affected the overall revenue of the country and the general performance of government at various levels, especially as it concerns execution of capital projects, which to a large extent, is key to national development.

Muriithi and Moyi (2003) observe that a good tax system should be able to generate the needed revenue for government; redistribute income; and investment infrastructure that will provide the guarantee for business to strive and economic growth. The enabling environment created by government encourages the establishment of new business; survival of existing business and the infrastructures provided is a key determinant of political, economic and social well structured tax system provides government the needed fund for capital (infrastructure) and recurrent (administrative) expenditure that would greatly lead to economic growth and development. Therefore, tax can be seen as a fiscal policy, macroeconomic and internal revenue mobilization tool for the attainment of economic growth.

Ogbonna and Ebimobowei (2012) examine the Impact of Tax Reforms and Economic Growth in Nigeria using relevant descriptive statistics and econometric analysis. They found that various tax reforms are positively and significantly related to economic growth and that tax reforms granger cause economic growth. This means 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.

Anichebe, (2013) conduct a study on the impact of tax on economic growth in Nigeria for the periods 1986 to 2010. He found out that a significant relationship exist between tax composition and economic growth.

Umoru and Anyiwe, (2013) examine the effect of tax structure on economic growth in Nigeria. They employed co-integration and error correction methods of empirical estimation with an empirical strategy of disaggregation. They found out that direct taxation is significantly and positive correlated with economic growth while indirect taxation has insignificant negative impact on economic growth.

2.2 Taxation in Nigeria

Taxation in Nigeria following the extant laws is enforced by the 3 tiers of government, that is, federal, state, and local governments with each having its sphere clearly spelt out in the Taxes and Levies (approved list for collection) Decree, 1998. However, Nigeria runs a largely centralized revenue collection system, with the federal government collecting the major revenue (petroleum revenue – profit taxes, royalties, crude oil sales; company income tax, value added tax, customs and excise duties) on behalf of the constituent governments (Emmanuel, 2010).

According to Anyanwu (1997), a tax is a compulsory levy imposed by the government on individuals, companies, goods and services to raise revenue for its operations and to promote social equity through the redistribution of income effect of taxation. In line with this frame of thought, taxation is a source of government revenue by which individuals and corporate bodies are mandatorily required to pay certain proportion of their earnings to the government for the course of development. In addition, Bhatia (2003) defined tax as a compulsory levy payable by an economic unit to the government without any corresponding entitlement to receive a definite and direct benefit from the government. Note, the word direct here does not mean a price paid by the tax payer for any definite service rendered or a commodity supplied by the government. Rather it means that the benefits received by tax payers from the government are not related to or based upon the tax paid by the tax payers. This in effect implies that tax is a generalized exaction, which may be levied on one or more criteria upon individuals, groups, or the legal entities.

2.3 Value Added Tax and Economic Growth

Value added tax is another form of indirect tax applied at each stage of production to the value added. VAT is a consumption tax levied at each stage of the consumption chain and borne by the final consumer of the product or service. Each person is required to charge and collect VAT at a flat rate of 5%

on all invoiced amounts on all goods and services produced in Nigeria. VAT was introduced by The Federal Government of Nigeria in January, 1993. It was believed by many Nigerians that the tax was introduced as a means of avoiding taking loans from international agencies and came into effect on January 1, 1994 to replace the Sales Tax (Ochei, 2010). Taxable persons are obliged to register under VAT Act. The tax is at a single rate of 5 percent of taxable goods and services. Supply of all goods and services except those specifically exempted are subject to VAT. Nonresident companies, which transact business in Nigeria, are also required to register for VAT and render VAT returns using the address of the company in Nigeria with whom they have subsisting contract. A taxable person, whether Nigerian resident outside Nigeria, who fails or refuses to register for VAT administration within six months of engaging in any economic activity in the territory of Nigeria is liable to pay a penalty of $67.00 for the first month that the failure occurs and a further penalty of $34 for each subsequent month in which the failure continues (Emmanuel, 2013).

Owolabi and Okwu (2011) examined the contribution of Value Added Tax to Development of Lagos State Economy, using simple regression models as abstractions of the respective sectors considered in the study. The study considered a vector of development indicators as dependent variables and regressed each on VAT revenue proceeds to Lagos State for the study period. Development aspects considered included

infrastructural development, environmental management, education sector development, youth and social development, agricultural sector development, health sector development and transportation sector development. The results showed that VAT revenue contributed positively to the development of the respective sectors. However, the positive contribution was statistically significant only in agricultural sector development. On the aggregate, the analysis showed that VAT revenue had a considerable contribution to development of the economy during the study period. In addition, Unegbu and Irefin (2011) examine the impact of value added tax (VAT) on economic and human developments of emerging Nations from 2001 to 2009 , using regression, discriminant analysis and ANOVA, found out that VAT allocations have a very significant impact on expenditure pattern of the state during the same period. They found that, the perceptions citizens across the administrative areas of the state suggest that VAT has minimum impact level on the economic and human developments of Adamawa State from 2001 to 2009. Emmanuel (2013) examined the effects of VAT on economic growth and total tax revenue in Nigeria using data ranging from 1994 to 2010. He formulated two hypotheses that VAT does not have significant effects on GDP and also on total tax revenue. He found out that VAT has significant effect on GDP and also on total tax revenue. This indicates that increase in value added tax would to increase in tax revenue and economic growth (GDP).

Enokela (2010) conducted a study to explore the relationship between Value Added Tax and economic growth of Nigeria using secondary data and multiple regressions. He found out that Gross Domestic Product (GDP) is positive and statistically significant to Value Added Tax, Government Capital Expenditure (GCE) is positive but insignificant to Value Added Tax, and Gross Domestic Product per Capita (GDPPC) is negative and statistically significant to Value Added Tax. This in other words means that increase in value added tax would lead to a significant increase in economic growth.

2.5 Custom and Excise Duties and Economic Growth

An indirect tax is a tax on expenditure or outlay and it is possible to shift the tax burden (partly or wholly) to someone else (Anyanwu, 1997). Custom duty is an example of indirect tax and it consists of both the export and import duties although the latter is usually emphasized in countries where import predominates. Custom Duties constitute one of the oldest kinds of modern taxation in Nigeria been introduced in 1860 as import duties. They are taxes on Nigeria's imports charged either as a percentage of the value of the imports or as a fixed amount contingent on quality.

Export Duty is a tax on the goods exported to other countries, while import duty is a tax on the goods coming into a country from other countries. Anyanwu (1997) argues that taxes are imposed to regulate the production and consumption

of certain goods and services, protection of infant industries, control business and commerce, curb inflation, reduce income inequalities etc. However, increased taxation on imported goods and services have affected the level of such goods and services that industrialist within the country are encouraged to produce (Nnadozie, 2003). Due to high import duty on dairy products, textiles, materials, food drinks etc our economic potential are encouraged through industrial investment locally and the multiplier effect on employment and national growth. Meanwhile, excise duties are an ad-valorem tax on the output of manufactured goods and are administered by the country's custom services (Ekeocha, Ekeocha, Malaolu & Oduh, 2012).

3.0 METHODOLOGY

The design of this study is structure to use time series data. In fact, this enables the researcher to determine the impact of indirect tax revenue on economic growth in Nigeria for the period ranging from 1993 to 2013. In addition, the principal method common to this kind of research is empirical method. This method entails the use of quantitative, statistical or regression techniques in evaluating the research issues or problems.

The population of the study covered the period of 1980 to 2013 and the sample size covered the period of 1993 to 2013 based on the convenient and systematic sampling techniques. This period is adopted because of the non-availability of data on value added tax before 1993.

The major sources of these data are the publications of the Central Bank of Nigeria, Nigerian Investment Promotion Commission (NIPC) and Securities and Exchange Commission (SEC)

3.1 Model Specification

In light of the above research methodology and theoretical framework deduced to adequately capture and empirically examine the impact of tax revenue on economic growth in Nigeria, a multiple econometric model for this study was specified. Multiple econometric regression model is one that seek to explain variation in the values of the dependent variable on the basis of changes in the independent variables. The assumption is that, the dependent variable is a linear function of the independent variables. This study adapted the model of Okafor (2012). This is specified as follows;

$$\textbf{RGDP}_t = \beta_0 + \beta_1 \textbf{VAT}_t + \beta_2 \textbf{CEXD}_t + \mu \quad \textbf{.................... (1)}$$

Where:

RGDP = Real Gross Domestic Product

VAT = Value Added Tax

CEXD = Custom and Excise Duty

μ = Error Term

β = Beta Coefficient

Since the data to be used for the analysis is time series, we employ co-integration tests to avoid spurious regression. Then, diagnostic test of each of the variables for stationarity

was carried out using the Augmented Dickey - Fuller test for unit root. Where any of the series was found to be integrated, a cointegration test was conducted using Johansen Cointegration Test. In order to determine if there exists a long run relationship between the dependent and independent variables. An Error Correction Method is use to tie the short run behaviour to its long run value (Gujarati & Porter, 2009). The Error correction model examines the long-run and short-run dynamic relationship in equation (1). This therefore necessitates the need to re-specify equation (1) into an error correction model. This is shown in equation (2) below;

$$\Delta RGDP = \beta_0 + \beta_1 \sum_{i-0}^{n} VAT_{t-1} + \beta_2 \sum_{i-0}^{n} CEXD_{t-1} + \beta ecm_t + \mu_t \ \text{....................} \ (2)$$

3.2 Method of Data Analysis

In the estimation of collected data an econometric technique known as the Error-correction models, unit root and co-integration test were adopted. Before estimation of equation (1), a correlation matrix was obtained to check for multicolinearity in the variables. A simple regression test was also conducted to predict the value of the dependent variable given a value of the independent variables. This study also supported the use of time series that are stationary since non-stationary time data are frequently subjected to spurious regression results. The properties of the time series data used were tested with the Dickey fuller (DF) and Augmented Dickey

Fuller (ADF) for unit root test. A co-integration test was used to examine the stable long run relationship between the dependent and independent variables. The co-integration test approach was the Granger-Engle two stage techniques. In examining the dynamic short-run behaviour of the variables and how the disequilibrium between the short and long run is adjusted for, the error correction model (ECM) was used. Then, the relationship in these variables over a long term was estimated. The software used in estimating the model and conducting other test was the EViews 8.0

4.0. DATA PRESENTATION AND ANALYSES

4.1 Descriptive Statistics

The descriptive statistics shows the description of the mean, standard deviation and normality test. The below is the descriptive statistics of the variables for the time period.

Table 1: Descriptive Statistics

Variable	Mean	Min	Max	Std. Dev	Jarque-Bera
RGDP	13593101	1132181	41181617	12547620	3.1621(0.20)
VAT	200.80	0.00	710.50	225.64	4.2419(0.11)
CEXD	98.13	15.50	398.10	87.01	34.6760(0.00)

Source: Author's Computation, 2016

The table above shows that on the average real gross domestic product (RGDP) value is 13593101, minimum value is 1132181, maximum value of 41181617 and standard deviation value of 12547620. Value added tax (VAT) is 200.80, minimum value of zero, maximum value of 710.50 and a standard deviation value of 225.64. Also, custom and excise duty (CEXD)

has an average value of 98.13, minimum value of 15.50, maximum value of 398.10 and a standard deviation value of 87.01. The Jarque-Bera statistics shows that custom and excise duty is normally distributed at 1% while real gross domestic product and value added tax are not normally distributed.

4.2 Correlation Matrix

Correlation measures the degree of linear relationship among the variables. Therefore, in Table 2 below, the result shows that real gross domestic product (RGDP) has a highly positive correlation with value added tax (VAT=0.99) but a high positive correlation with custom and excise duty (CEXD=0.58). Also, a highly positive correlation exists among the explanatory variables. This therefore means that there is a strong significant positive relationship among the variables under investigation. A closer look at the value of the correlation coefficient results revealed that a perfect positive correlation relationship exists between gross domestic product (RGDP) and the explanatory variables. The correlation matrix also revealed that no two explanatory variables were perfectly correlated. This means that there is the absence of multicolinearity problem in our model. Multicollinearity between explanatory variables may result to wrong signs or implausible magnitudes, in the estimated model coefficients, and the bias of the standard errors of the coefficients.

Table 2: Correlation Matrix Result

Variable	RGDP	PPT	CITA	VAT	CEXD

RGDP	1.00	0.88	0.94	0.99	0.58
VAT	0.99	0.87	0.95	1.00	0.59
CEXD	0.58	0.72	0.39	0.59	1.00

Source: Author's Computation, 2016

4.3 Unit Root Test

In testing for unit root for the variables, we use the Augmented Dickey-Fuller (ADF) unit root test and the results for the time series is presented in table 3.

Table 3: Augmented Dickey-Fuller Unit Root Test

		Lag	ADF Statistics	ADF (95%)	Remark
Level	RGDP	2	4.0195	-3.0403	Non-Stationery
	VAT	0	-1.4843	-3.0299	Non-Stationery
	CEXD	0	0.0439	-3.0206	Non-stationery
		Lag	ADF Statistics	ADF (95%)	Remark
	DRGDP	1	-6.3086	-3.0521	Stationery
	DVAT	0	-5.7439	-3.0403	Stationery
	DCEXD	0	-4.7850	-3.0403	Stationery

Source: Author's Computation (2016)

The empirical findings from the table above reveal that real gross domestic product (RGDP), value added tax (VAT) and custom and excise duty (CEXD) was not stationary at level. They all became stationary at first difference. This simply means that a regression model with

level and first difference for the variables would be used in testing our formulated hypotheses.

4.4 Engle Granger Co-integration Test

The co-integration test for the variables using Tau-statistics is presented in table 4.

Table 4: Engle Granger Co-integration test

Residuals	Tau-statistics	p-value
RGDP	-3.8184	0.3010
VAT	-1.9716	0.9469
CEXD	-3.1599	0.5638

Source: Author's Computation (2016)

The co-integration results were based on the Engle Granger using Tau-Statistics. The findings from the Tau-Statistics reveal that the selected variables are with one co-integrating vector. The existence of co-integration among the variables justified the use of error correction model in this study.

4.5 Error Correction Model

The Error Correction Model (ECM) model examines the impact of indirect tax revenue on economic growth. It also examines other controlled variables such as value added tax and custom and excise duty. The result is presented in table 5.

Table 5: Regression Result for Error Correction Model

Variable	Coefficients	t-statistics	P-value
C	777712.3	1.78	0.1026
DVATt(-1)	-89008.1	-3.34	0.0066
DCEXDt(-1)	-14577.6	-1.70	0.1155

ECM(-1)	-0.5902	-2.31	0.0412

R^2= 0.842183
Adjusted R^2= 0.741753
F-statistic= 8.385832(0.001147)
DW= 1.9328668
No of Observation=21

Source: Author's Computation (2016)

From the regression result above, it would be revealed that the adjusted R-squared value of 0.741753 shows that 74% of the systematic variation in the dependent variable is jointly explained by the independent variables. The F-statistics value of 8.385832 and its associated p-value 0.001147 show that the overall model is statistically significant. This means that there exists a significant linear relationship between the dependent and independent variables in the model.

Following the above, **value added tax (DVAT$_{t-1}$)** had a negative (-89008.1) and significant (-3.34) impact on real gross domestic product (RGDP) at 1% level of significance. This therefore means that increase in past value added tax would significantly decrease the value of real gross domestic product (RGDP) at 1% level of significance because the variable is significant.

The variable, **past custom and excise duty (CEXD$_{t-1}$)** had a negative (-14577.6) and weakly significant (-1.70) impact on real gross domestic product (RGDP) at even more than 10% level of significance. This therefore means that increase in past

custom and excise duty will lead to decrease in real gross domestic product (RGDP).

The Error Correction Model (ECM (-1)) coefficient of -0.5902 had a correct negative sign, it was statistically significant (-2.31). This shows that short-run deviation from (-0.5902) can be quickly corrected. This result clearly shows that long-run in real gross domestic product (RGDP) is quickly adjusted to equilibrium in the short-run. Also, we found that the Durbin-Watson value for model was 1.938668 which indicates that there is absence of autocorrelation in the model.

5.0. Summary of Findings and Conclusion

In this study, we examine the impact of indirect tax revenue on economic growth in Nigeria. The empirical analysis from the error correction model regression result revealed that **value added tax (DVAT$_{t-1}$)** had a negative and significant impact on real gross domestic product (RGDP) at 1% level of significance. This negates the finding of Enokela (2010) that current value added tax has significant positive impact on economic growth in Nigeria (RGDP). This therefore suggests that we should accept the null hypotheses (H2) which states that current value added tax has no significant positive impact on economic growth in Nigeria. In addition, **past custom and excise duty (CEXD$_{t-1}$)** had a negative and weakly significant impact on real gross domestic product (RGDP) at even more than 10% level of significance. This therefore suggests that we should

accept the null hypotheses (H3) which states that current custom and excise duty has no significant positive impact on economic growth in Nigeria.

The Error Correction Model (ECM) coefficient had a correct negative sign and it is statistically significant. This shows that short-run deviation can be quickly corrected. This result clearly shows that long-run real gross domestic product (RGDP) is quickly adjusted to equilibrium in the short-run. Also, we found that there is absence of autocorrelation in the Durbin-Watson model.

Recommendations

Based on the empirical findings;

(1) The study recommended that tax administrative loopholes should be plugged for tax revenue to contribute immensely to the development of the economy since past value added tax and custom and excise duty had a significant impact on economic growth.

(2) The study also recommended that the tax agencies/authorities should establish good relationship with the professional associations involved in tax matters in order to reduce tax malpractices perpetrated by tax payers with the connivance and often active support of external auditors and tax consultants.

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