
State government taxation: empirical evidence from Nigeria

Cletus O. Akenbor

Department of Accounting and Finance
Federal University Otuoke, Baylesa State, Nigeria

Love Obiani Arugu

Department of Political Science and Strategic Studies
Federal University Otuoke, Bayelsa State Nigeria

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Abstract

This paper investigated state government taxation in Nigeria with a view to determine its impact on economic growth. To achieve this purpose, it was hypothesized that state government taxation has no significant impact on economic growth in Nigeria. In line with the above, related literature were critically reviewed. The data for this study were generated from the Central Bank of Nigeria (CBN) Statistical Bulletin for a period of 13 years (1999-2012). The data were analyzed with multiple regression analysis. The findings revealed that state government taxation has a significant impact on economic growth in Nigeria. Based on the above, it was recommended that state government should rise to the challenge of boosting its revenue base by ensuring that all available sources of revenue are adequately tapped and also ensure that tax administration and collections become more effective and efficient.

1.0 Introduction

Within the last decades issues of domestic resource mobilization has attracted considerable attention in many developing countries including Nigeria. In the face of unbated debt difficulties, coupled with the domestic and external financial imbalances confronting them, it is not surprising that many developing nations have been forced to adapt stabilization and adjustment policies and increase revenue which demand better and more efficient methods mobilizing domestic financial resources with the view of achieving financial stability and promoting economic growth. Taxation plays a significant role in achieving this purpose. According to Opuene (2006), in Ofurum and Ferry (2009), taxation is the imposition by the government of a compulsory levy on the income, profit, property, or the expenditure (consumption) of an individual, family, community, firms or corporate bodies so as to enable the government carryout its economic and social responsibilities to the citizenry.

In a federation like Nigeria, the concept of inter-governmental fiscal relations subsists, and the government's fiscal power is based on three-tier tax structure – federal, state, and local governments, each of which has different tax jurisdiction for the enactment of tax laws, formulation of tax policies, and tax administration (Oduola, 2006). In 2002, about 40 different taxes and levies are shared by all three levels of government. Each tier of government has the sphere clearly spelt out in the Taxes and Levies (approved list for collection) Decree, 1998. The most veritable tax handles are under the control of the federal government while the lower tiers are responsible for the less buoyant sources, which imply that the federal government tax corporate bodies while the state and local governments tax individuals.

In recent times, the revenue allocation to states from the federation account is not only dwindling but also grossly inadequate. This coupled with the ever increasing financial needs of states compelled state governments to imbibe the culture of improving internally generated revenue as alternative means of meeting and sustaining the various competing financing needs. To achieve this purpose, State governments diverse various means of improving their revenue base and the most popular means is through taxation. Laffer (2012) claimed that state income tax levels have impact on economic growth. It has also been reported that taxation enhances the economy of a nation as a means of achieving financial stability and promoting economic growth. The tax system in most states of the federation is seen as an embodiment of contention and controversy whether in its policy formulation, legislation or administration. Based on the above, our point of departure is to provide empirical evidence of the impact of state government taxation on economic growth of Nigeria. It was therefore hypothesized that state governments' taxation has no significant impact on economic growth in Nigeria.

2.0 Literature Review

2.1 Conceptual Issues on Tax Structure

A country's tax system is a major determinant of other macroeconomic indices. Specifically, for both developed and developing economies, there exists a relationship between tax structure and the level of economic growth and development. Indeed, it has been argued that the level of economic development has a very strong impact on a country's tax base (Hinricks, 1999; Musgrave, 1996), and tax policy objectives vary with the stages of development. Similarly, the (economic) criteria by which a tax structure is to be judged and the relative importance of each tax source vary over time (Musgrave, 1996). For example, during the colonial era and immediately after the Nigerian political independence in 1960, the sole objective of taxation was to raise revenue. Later on, emphasis shifted to the infant industries protection and income redistribution objectives.

In his discussion of the relationship between tax structure and economic development, Musgrave (1996) divided the period of economic development into two, the early period when an economy is relatively underdeveloped and the later period when the economy is developed. During the early period, there is limited scope for the use of direct taxes because the majority of the populace resides in the rural areas and are engaged in subsistence agriculture. Because their incomes are difficult to estimate, tax assessment at this stage is based on presumptions prone to wide margins of error.

The early period of economic development is, therefore, characterized by the dominance of agricultural taxation, which serves as a proxy for personal income taxation, and in Nigeria the various marketing boards served as effective mechanisms for administering agricultural taxation. Agricultural taxation substituted for personal income tax given the difficulty in reaching individual farmers and the inability to measure their tax liability accurately. Further, the large percentage of self-employment to total employment makes effective personal income tax unworkable (Musgrave, 1996). This problem thereby necessitates the use of the ability-to-pay principle, effectively limiting personal income taxation to the wage income of civil servants and employees of large firms both of which account for an insignificant proportion of the total working population. During the early period of economic development, direct taxes in form of company income taxes cannot be important because there are few home-based industries. The same principle applies to excise tax (an indirect tax) on locally

manufactured goods. Both will increase in relative importance as economic development progresses, however, due to growth or non-static nature of the bases of these taxes. Several retail outlets also make a sales tax system difficult to implement, and a multiple-stage sales tax system even more so (Musgrave, 1996). Further, the rudimentary nature of the economy precludes retail form of taxes.

At this stage also, taxes are difficult to collect because of the lack of skills and facilities for tax administration (Hinricks, 1999). Given this, a complicated tax structure is not feasible and the amount of revenue from personal income tax will depend on taxpayers' compliance and the efficiency of the tax collector. An important source of government revenue during the early stage of economic development is the foreign trade sector because exports and imports are readily identifiable and they pass through few ports. However, revenue from export and custom duties is not stable because of periodic fluctuations in the prices of primary products. This tends to complicate plan implementation in many developing countries (Massel, Pearson and Fitch, 1992).

Economic development brings with it an increase in the share of direct taxes in total revenue. This is consistent with the experience of developed economies in which direct taxes yield more revenue than indirect taxes. For example, personal income tax becomes important as the share of employment in the industrial sector increases. Also, as the dominance of the agricultural sector decreases, sales tax may be broadened because a great deal of output and income will go through the formal market as the economy becomes more monetized. Musgrave (1996) noted that at this stage, taxes may be imposed on firms or individuals, on expenditures or receipts, and on factor inputs or products, among others. He further argued that there would be a tendency to shift from indirect to direct taxes. This theory relates to a normal development process, however. It does not consider a situation where the sudden emergence of an oil boom provides an unanticipated source of huge revenue. Hence, this stereotype may not be applicable to an oil-based economy like Nigeria. Nevertheless, the theory still represents a benchmark against which country-specific empirical evidence may be compared.

2.2 Nigerian Fiscal Federalism: Assignment of Tax Powers

Fiscal federalism refers to the existence in a country of more than one level of government, each with different taxing powers and responsibilities for certain categories of expenditure. Nigeria is a good example of a country operating a federal system of government through three tiers of government: the federal, the state and the local. The present slate of Nigeria's fiscal federalism has evolved overtime, starting with the Phillipson Commission of 1946. As Ekpo and Ndebbio (1992) note, this evolution has been influenced by economic, political, social and cultural considerations.

The present arrangement has also undergone several revisions since the initial report of the Phillipson Commission of 1946. Since then, there have been about eight commissions each revising the reports of their respective predecessors. The last revision exercise was undertaken by The National Revenue Mobilization, Allocation and Fiscal Commission in 1988. For further details about the terms of reference and recommendations of each commission or committee, interested readers are referred to Ekpo and Ndebbio (1992). One major characteristic of federalism is the constitutional separation of powers among the various levels of government.

Drawing upon the reports of the various commissions and revisions to previous constitutions, Section 4 (second schedule) of the 1989 Constitution of the Federal Republic of Nigeria (FGN, 1989b) specified three categories of legislative functions. The first is the exclusive legislative list of which only the federal government can act. The second is the concurrent legislative list on which both the federal governments can act, and the third comprise residual functions consisting any matter not included in the above first two lists. Of direct relevance to this study is the assignment of tax powers among the three tiers of government in Nigeria.

In Nigeria, two major factors influence the assignment of tax powers or jurisdiction to the three tiers of government. These are administrative efficiency and fiscal independence. The efficiency criterion requires that a tax be assigned to the level of government that is most capable of administering it as efficiently as possible. Fiscal independence on the other hand requires that each level of government should, as far as possible, be able to raise adequate funds from the revenue sources assigned in order to meet its needs and responsibilities. Very often the efficiency criterion tends to conflict with the principle of fiscal independence. The former entails a great deal of centralization concentration of tax powers at the higher level of government, due to the limited administrative capacity of lower levels of government. Conversely, the latter requires the devolution of more tax powers to the lower levels of government to match the functions constitutionally assigned to them. In the Nigerian context, the scale has always been tilted in favour of the efficiency criterion.

The first Fiscal Commission in Nigeria set very stringent conditions for declaring any revenue source as regional. It required revenue of taxes to be local in character for easy assessment and collection, to be regionally identifiable, and in general have no implication for national policy. Given such above conditions, very few revenue heads (taxes) could be considered as regional and assignable to either the state or the local government levels. There is also a distinction between the ability to legislate on a particular tax and the ability to collect a particular tax. The two powers can reside with the same level of government or be separated. Available evidence from the current jurisdictional arrangement summarized in the table suggests that both types exist in Nigeria. The table shows that all the major sources of revenue are left solely to the federal government in both respects. These are import duties, excise duties, export duties, mining rents and royalties, petroleum profit tax, and company income tax. This may be attributable to the bias for the efficiency criterion noted earlier.

The principal tax with shared jurisdiction is the personal income tax on which the Federal Government of Nigeria (FGN) legislates. In terms of its administration, the FGN collects the personal income tax from the armed forces personnel and the judiciary. Each state government administers and collects personal income tax from other categories of residents in its territory. Capital gains tax is also under shared jurisdiction in which the FGN legislates while state governments collect the tax. Given the bias for the efficiency criterion, the state and local governments have jurisdiction over minor, low-yielding revenue sources. For example, state governments have jurisdiction over football pools and other betting taxes, motor vehicle and drivers' license fees, personal income tax (excluding the judiciary and military), and sales tax. Local governments administer entertainment tax, radio and licensing, motor part fees and the potentially buoyant property tax. The table below shows the major Nigerian taxes.

No	Types of tax	Jurisdiction	
		Legislation	Administration and collection
1.	Import duties	Federal	Federal
2.	Excise duties	Federal	Federal
3.	Export duties	Federal	Federal
4.	Mining rents and royalties	Federal	Federal
5.	Petroleum profit tax	Federal	Federal
6.	Companies income tax	Federal	Federal
7.	Personal income tax, Armed forces, external affairs officers and federal capital Territory		
8.	Capital gains tax	Federal	States
9.	Personal income tax	Federal	States
10.	License fees on television and wireless radio	Federal	States
11.	Stamp duties	Federal	States
12.	Estate duties	Federal	States
13.	Gist tax	Federal	States
14.	Sales or purchases tax	Federal	States
15.	Foot ball tools and other betting taxes	States	States
16.	Motor vehicle tax and drivers' license fees	States	States
17.	Entertainment tax	States	States
18.	Land registration and survey fees	States	States
19.	Property tax	States	local
20.	Market and trading license and fees	States	local

Source: Phillips (1991) **Table 1: Nigerian's Major Taxes**

In summary the table shows that the federal government exercises legislative control over the first 14 tax sources, while the states are in charge of the remaining 6 sources. It is not worthy that the local government has no legislative power over revenue source, although it can initiate bylaws subject to the approval of the state government. The FGN also dominates tax administration and collection. For example, it directly collects revenue the first 7 items, which account for over 80% of total tax-based revenue in the country. The state government is responsible for the collection of revenue for items 8 to 18, which cumulatively account for an insignificant proportion of the total tax-based revenue. The local government controls only two items.

Tax sources at the federal, state and local government levels are as shown in the table below.

Federal government	State government	Local government
<ul style="list-style-type: none"> • Companies income tax • Petroleum profit tax • Value added tax • Education tax (applies to companies, residents of the Federal Capital territory and non-resident individuals) • Capital gains tax (applies to corporate bodies and Abuja residents) • Stamps duties (applies to corporate bodies) 	<ul style="list-style-type: none"> • Personal income tax (applies to residents of the state) • Withholding tax (individuals only) • Capital gain tax (individual only) • Stamp duties (applies to instruments executed by individuals only) • Road taxes (e.g. vehicle licenses) • Taxes on pool bets, lottery and casino wins 	<ul style="list-style-type: none"> • Tenancy rates • Shops and kiosk rates • Fees for on-off liquor licenses • Fees for butcher slabs • Fees for marriage, birth and death registrations • Fees for the street name registration (except in the state capital)

<ul style="list-style-type: none"> • Withholding tax (applies to companies) • Personal income tax (applies to personnel of the armed forces, police, External Affairs Ministry, and residents of Abuja) 	<ul style="list-style-type: none"> • Business premises and registration fees in urban and rural areas • Urban areas as defined by each state, maximum of <ul style="list-style-type: none"> (i) N10,000 for registration, and (ii) N 5,000 per annum for renewal of registration Rural areas: <ul style="list-style-type: none"> (i) N2,000 for registration and (ii) N1,000 per annum for renewal of registration • Development levy (max. of N100 per annum applies to taxable individuals only) • Street name registration fees (state capital only) • Fees for right of occupancy on urban land owned by the state government • Market taxes and levels where stake finance is involved • Miscellaneous revenue (e.g. rent on property) 	<ul style="list-style-type: none"> • Motor park fees • Market taxes and levies (except in any market where state finance is involved) • Fees for domestic animal licenses • Fees for bicycles, trucks, canoes, wheelbarrows, carts and canoes • Fees for right of occupancy on land in rural areas (except those of federal and state government) • Cattle tax, applies to cattle farmers only • Entertainment and road closure levy • Fees for radio and television licenses • Vehicle parking and radio license fees • Charges for wrongful parking • Fees for public convenience, sewage and refuse disposal • Customary ground permits fees • Fees for permits for religious establishment • Fees for permits for signboards, bill boards and advertisements
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Source: Ariyo (1999) **Table 2: Nigeria's tax sources (taxes and levies approved for collection) Decree No. 21 of 1998**

Note: Other major taxes authorized under different tax laws include: (i) Mining, rents and royalties; (ii) Customs and excise duties (i.e., import and export duties), and (iii) Miscellaneous revenue (e.g., earnings from oil sales, rents on property, etc.).

2.3 An Overview of the Nigerian Economy

Nigeria gained her political independence from Great Britain in 1960 with high hopes for a society that would guarantee rapid economic, social and political progress. From 15th January, 1966 to September 31st, 1979, the nation had been under military dictatorship regimes. It is important to know that from October 1st, 1979, to December 31st, 1983, Nigeria practiced the American type of democracy. However, this democracy fell on January 1st, 1984 when Nigeria witnessed yet another era of military regime. A democratically elected Government

was sworn in on May 29th, 1999. It is the hope of Nigerians that the military will restrict themselves to their constitutionally defined roles. It was expected that the economy would usher in high standard of living for its citizens. To this effect, a lot of efforts were put into designing and establishing appropriate economic strategies through the various National Development Plans. Specifically, Government undertook huge investments in industries, social services and infrastructure in order to accelerate the pace of economic growth and development. At that time, expectations were heightened by exploration of huge oil reserves which included sharp increases in foreign exchange earnings and government revenue. The so-called oil boom produced profound changes in the investment, production and consumption patterns of the country. It also led to fundamental changes in the socio-cultural values, political arrangements, mode of economic management as well as the policies and programmes that were embarked upon in the period, (Central Bank of Nigeria, 1993).

The Nigerian economy is still agrarian. About 90 percent of the country's foreign exchange earnings is generated by the oil sector and about 70 percent of the Federal Government revenue is also derived from the oil sector. But the share of the agricultural sector in the GDP is 31 percent. This is about thrice of the sector. However, because of low productivity in agriculture, 59.65 percent of total labour force is employed in the sector. The relative shares of employment by other sectors are 14.98 per cent in Chemical-Petro-Chemicals, 4.01 percent in Construction, 3.13 percent in basic industries, 2.06 percent in public utilities, 6.04 percent in Government, and 10.27 percent others. The manufacturing sector, in spite of its less than 10.01 percent contribution to the GDP has the greatest potential for employment generation. One of the major manifestations of the gravity of the nation's economic depression is increasing lack of capacity to create new jobs or maintain existing ones. The continued inability of the economy to provide employment, the existence of a large number of unemployed unskilled labour and the resultant social and economic consequences has made it imperative that job creation and occurrence should be the primary objectives of economic recovery programmes. Unfortunately, the implementation of the policy objectives of job-creation in the past had been unsuccessful. Specifically, the IMF-World Bank Structural Adjustment Programme (SAP) embarked upon since 1986, instead of creating new employment has even reduced the existing low level of employment and output. Furthermore, the deregulation of both interest and exchange rates had led to high cost of production. This has resulted in high prices, thereby reducing the purchasing power of the population.

3.0 Methodology, Findings, Analysis and Discussion

This study focused on the impact of State Governments taxation on economic growth of Nigeria for the period of 1999-2012. While state government taxation was operationalized as state tax revenue, economic growth was measured by Gross Domestic Product (GDP) and these were obtained from the Central Bank of Nigerian Statistical Bulletin of various years. In analyzing the data generated from this study, the multiple regression analysis was adopted, which was computed with the aid of the Statistical Package for Social Sciences (SPSS) version 17.

The following model has been designed and specified for this study

$$GDP = f[\alpha_0 + \beta_1 \text{LogSTR} + \beta_2 \text{LogINV} + \beta_3 \text{LogSAV} + \dots \dots \dots \mu_i]$$

Where GDP=Gross Domestic Product, STR=Tax Revenue, INV=Investment, SAV =Savings,

α_0 = Regression Constant, $\beta_1 - \beta_3$ =Regression Co-efficient, and μ_i = error term.

In testing the stated hypothesis, Gross Domestic Product (GDP) was regressed against State Government Tax Revenue (STR), Investments (INV) and Savings (SAV), and the result obtained is shown in the table below.

Statistical Variables	Co-efficient	Std. Error	t-Statistic	P-Value
Intercept	235971.558	56920.186	4.146	0.003
STR	0.523	0.187	2.800	0.021
INV	0.639	0.433	1.475	0.174
SAV	-0.101	0.350	-3.119	0.012
Co-efficient of Correlation	0.980			
Co-efficient of Determination	0.960			

Source: SPSS Version 17 Window Output **Table 3: Multiple Regression Analysis with GDP against STR, INV and SAV**

The table above shows a multiple correlation co-efficient of 0.98, which is close to 1.0 from the positive side. This suggests that there is a strong relationship between GDP and STR, INV, SAV. The result shows that-

- (i) 1 % increase in STR, leads to 52.3% increase in GDP
- (ii) 1 % increase in INV, leads to 63.9% increase in GDP
- (iii) 1 % increase in SAV, leads to 10.1% decrease in GDP.

The multiple co-efficient of determination of 0.96, indicates that about 96% of the variance in GDP is associated with changes in STR, INV and SAV. In other words, about 4% change in GDP is due to other variables other than STR, INV, and SAV, hence the model is a good fit. Since the P-Value associated with STR (0.021) is less than 0.05, it indicates a significant relationship. Therefore, the null hypothesis is rejected. This implies that state governments' taxation has a significant impact on economic growth in Nigeria. This finding is in concordance with Laffer (2012), who claimed that state income tax levels have a positive impact on economic growth.

Conclusion and Recommendations

To rely on only one source of revenue is unwise. Most state governments in Nigeria rely so much on allocations from federation account, which is grossly inadequate to meet the needs of the people. It is therefore imperative that state government command independence sources of revenue to meet its obligations, and taxation serves as a veritable weapon for this purpose. State governments have jurisdiction on the administration and collections of such taxes as capital gains tax, personal income tax, license fees on television and radio, stamp duties, land registration and survey fees, motor vehicle drivers' license among others.

The result of our analysis indicated that state governments' taxation enhances economic growth in Nigeria. Such a characterization will enhance accurate tax revenue projection and targeting of specific tax revenue sources given an ascertained profile of economic growth. It will also assist in estimating a sustainable revenue profile thereby facilitating effective management of a country's fiscal policy, among others. However, the time period covered in this study (1999-2012) may not be robust enough for such characterization, which may therefore serve as a limitation to this study. Based on the above, it is recommended that state governments in Nigeria should rise to the challenge of boosting their revenue base by ensuring

that all available sources of revenue are adequately tapped and tax administration and collections become more effective and efficient.

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