 P-ISSN: 2659-1561
E-ISSN: 2635-3040

Research Article

Improved Taxation and the Question of Fiscal Deficit on the Economy of Benue State: A Theoretical Assessment

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Received: Aug 25, 2019 **Accepted:** Sep 23, 2019 **Published:** Oct 24, 2019

Abstract: This study focuses on the role of improved taxation in counteracting the negative impact of fiscal deficits in the economy of Benue state. From the perspective of an improved tax system, there is now a renewed impetus and a consensus among stakeholders to increase revenue generation as witnessed in the current administration of the Benue State Internal Revenue Service (BIRS). The literature suggests three approaches for the purpose of tackling the challenge of budget deficit which includes: increase in revenue, reduction in expenditure, or a combination of both. An appraisal of the budgetary process in the state shows that annual expenditure proposals are always anchored on projected revenue, thus the accuracy of revenue projection is a necessary condition for devising an appropriate framework for fiscal deficit management. Its improvement or reduction depends on the tax systems and its vibrancy in revenue generation. This study, therefore, evaluates the productivity of the tax system in addressing the revenue deficits in Benue state. Its source of data is secondarily harnessed and revolved around books on taxation, government official documents on the performances of tax revenue generation. This is done in the bid to devise a reasonably accurate idea of Benue state's sustainable revenue profile side by side government's efforts towards the welfare of the state. Overall, the study reports a satisfactory level of productivity of the tax system in recent times.
Keywords: Economy, fiscal deficit, administration.

Introduction

Fiscal deficit has become a recurring feature of public sector financing all over the world. Its widespread use is partly influenced by the desire of various governments to respond positively to the ever-increasing demands of the populace and to enhance accelerated economic growth and development (Ariyo, 1993). This tendency toward deficit financing is more pronounced in developing countries where the populace looks to the government for the satisfaction of most needs. In as much as it behaves on the government to provide the needs of the society, the quest to meet those obligations have plunged many economies into the web of unsustainable fiscal deficits particularly the less vibrant ones and the Benue state experience serves as reference point in this study.

The magnitude of government surplus or deficit is probably the single most important statistic measuring the impact of government fiscal policy on an economy (Siegel, 1979).

In view of its phenomenal growth, it is now widely accepted that public sector finances and related policies constitute a central aspect of economic management. The quality of this management in no small measure influences overall macroeconomic performance as well as the distribution of resources between the public and private sectors.

On that note, conceptual issues around the notion of taxation, fiscal deficit and economic development are accorded some primacy here.

Conceptual Definition

A fiscal deficit is a shortfall in a government's income compared with its spending. The government that has a fiscal deficit is spending beyond its means. A fiscal deficit is calculated as a percentage of gross domestic product (GDP), or simply as total money spent in excess of income.

The difference between total revenue and total expenditure of the government is termed as fiscal deficit. It is an indication of the total borrowings as well.

Taxation on the other hand is defined by (Worlu and Emeka, 2012) as a fee charged or levied by a government on a product, income, or activity. In Nigeria taxation based on 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.

Economic development on its own 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 trades 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 (1969) 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 as a way to revamp an ailing economy. He further argued that there would be a tendency to shift from indirect to direct taxes. His 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. Nevertheless, the theory still represents a benchmark against which country specific empirical evidence may be compared.

Historical Overview;

This section presents a brief review of Nigeria’s tax-based revenue profile since 1960. The analysis will throw light on the shifts in the relative importance of each revenue source over time and the extent to which the Nigerian tax-revenue profile conforms with Musgrave’s theory. In the 1960s, emphasis was on accelerated economic growth and development, and the main goal of tax policy was maximum revenue generation to finance public sector programmes. Similarly, policy makers emphasized import substitution to underlie the industrial development strategy (Ekuarhare, 1980). Attention was directed toward increasing the existing tax rates (especially import duties) in the form of high protective tariffs, and as a consequence for balancing a deficit budget.

In his discussion of the relationship between tax structure and economic development, Musgrave (1969) 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 reside 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, 1969). 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.

On that premise, this study suggests a correlation between taxation, increased revenue generation and fiscal deficit as taxation and increase revenue generation are major determinants of the budget system and economic vibrancy. The literature suggests three issues that should guide decisions on the fiscal deficit profile for an economy.

The first issue relates to the usefulness of fiscal deficit as a tool for enhancing accelerated growth and development. This is an issue on which there is as yet no consensus among economists, given the divergent findings of reported studies. While some studies (Thornton, 1990) indicate a net positive effect, others (Baily, 1980; Feldstein, 1980; Landau, 1983) suggest a net negative effect. Mixed results have also been reported by some studies (e.g., Ariyo and Raheem, 1991).

The second issue relates to the mode of financing the deficit. Some of the financing options include the running down of government accumulated cash balance, net borrowing from the banking system or from abroad (Ariyo and Raheem, 1990). However, the peculiarity of the Benue state situation is the streamlined pattern of economic financing premised on increased revenue generation basically through taxation. Each mode of financing could have a differential impact on the economy (Chibber and Khalizadeh-Shirazi, 1988; Yellen, 1989). Third, and most importantly, a fiscal deficit profile must be sustainable (Buiter, 1983). Otherwise, the country or state will become perpetually insolvent (Wickens and Uctum, 1990).

Of concern to economists and interested observers in recent times is the rising magnitude of deficits by various governments. There is therefore a growing recognition that the formulation and implementation of macroeconomic management proposals most especially for economic reforms, should explicitly recognize the implications of fiscal deficit on the economy.

These reforms should cover not only the size and financing patterns of government deficits but also the structure of taxation and the level and composition of public expenditure (Chibber and Khalizadeh-Shirazi, 1988).

The findings of recent studies suggest the need for concern about the problem of fiscal deficit in Benue state. For example, the findings of a study by Ariyo and Raheem (1990) show that fiscal deficit has become a recurring feature of Nigeria's fiscal policy and by extension explains the challenges sub units within the system are faced with. They also note the absence of any identifiable macroeconomic objective to justify this deficit-prone behaviour. Further, Ariyo (1993) reports that the level of fiscal deficit in Nigeria has become unsustainable since 1980 and can only be managed through increased revenue generation in form of taxes. In furtherance of that, there are three options open to government for addressing the problem of non-sustainable fiscal deficits also.

According to Zee (1988), these include (1) the determination of the optimal tax rate for a given level of expenditure; (2) the determination of the optimal level of expenditure for a given tax rate; and (3) the simultaneous determination of the optimal level of expenditure and the tax rate. This study focuses on the first option as a determinant of a sustainable level of revenue as a basis for evolving a sustainable deficit profile in Benue state and in Nigeria at large. This choice was influenced by the following considerations. First, this study is essentially a follow-up to related studies by Ariyo and Raheem (1990) and Ariyo (1993), which indicate that the level of fiscal deficit in Benue state is no longer sustainable and it is not desirable to continue to incur budget deficit for financing public expenditure. The crisis of unsustainable fiscal deficit replicates itself in endless continuum but more pronounced in the aspect of non-payment of salaries of workers premised on unsustainable wage bill. Rather, efforts should be made to reduce expenditure or raise additional revenue.

Second, it is preferable to focus on revenue enhancement in view of the current situation in Nigeria as a panacea for counteracting the crises of fiscal deficit. Some scholars particularly those with financial economic ideas have explained the crises of fiscal deficit financing to be as a result of the country's implementation of a transition programme requiring large financial outlay on activities that are not directly productive, a situation that is expected to continue for some years. Hence, significant reduction or switching of public expenditure into directly productive real sectors of the economy is not a viable proposition in the short run. Third, Lipumba and Mbelle (1990) indicate that increasing tax revenue and reducing expenditure are the most important fiscal challenges facing a government entangled in the budget deficit problem. As such, this study proffers a combination of increased revenue and an adequate tax system as panaceas for fiscal deficits. Ndekwu (2014) also notes that more than ever before, there is now a great demand for the optimization of revenue from various tax sources in Nigeria.

This probably influenced the decision of the Federal Government of Nigeria (FGN), which in 2007 set up a Study Group on the Review of the Nigerian Tax System and Administration. Narrowing the situation to Benue state, an accurate estimation of the optimal level of expenditure requires knowledge of the productivity of the tax system. This will assist in identifying a sustainable revenue profile for the state and the country at large. It will also help in determining appropriate modifications to the existing tax structure and rates as well as areas for improving tax administration. It should be noted that in the broader Nigeria context, the advent of the oil boom in the 1973/74 fiscal year encouraged over-reliance on oil revenue to the neglect of the traditional revenue sources. As a result, some non-oil revenue sources were either abandoned or became of less concern to the government and no attention was paid to assessing the optimal revenue derivable from these non-oil sources and that has had a reverberating effect on the economies of most states in Nigeria and Benue state is not left out in this regard.

Further, there were episodic jumps in the country's total annual revenue and hence budget deficits (Ariyo and Raheem, 1990). This is a reflection of the vagaries of the oil market whose fortunes fluctuate widely and unpredictably. With this background, this study appraises the productivity of the Benue state tax system as well. This will assist in an objective assessment of the state's sustainable level of revenue as a basis for determining an optimal level of expenditure. It will also facilitate the design of fiscal policies to overcome the deficit in the long run since the causes and the attendant consequences of fiscal deficit are understood in this study especially from the broader Nigeria perspective. In this regard, the study:

- ✓ presents an understanding of the challenges of fiscal deficit to Benue state and;
- ✓ evaluates the productivity of the Nigerian tax system.

In an attempt to meet the ever-increasing demands of the populace, where the government is already in a condition of unsustainable fiscal deficit as depicted in the Benue state situation, the call for increased revenue generation is expedient. The need for this arises primarily from the perceived inadequacies of the revenue base to cope with the targeted level of economic activities. The underlying presumption is that the rate of growth achievable through reliance on public revenue alone would be inadequate for meeting the yearnings and aspirations of the populace hence the call for increased revenue generation through the broadening of the tax net to accommodate new taxpayers. In addition, Ariyo and Raheem (1991) indicate that this fiscal stance has generated mixed effects on several macroeconomic aggregates. To achieve this on the broader Nigeria context, the country needs to either generate more revenue or reduce the level of expenditure or embark on an appropriate combination of both. For reasons indicated earlier, this study investigates the revenue enhancement potentials of existing revenue sources, given the current over-dependence on oil revenue and hence the relative neglect of other sources. We also believe that the "ratchet effect" syndrome of an unsustainable fiscal deficit precludes a significant reduction in the aggregate level of expenditure in the near future.

Conclusively, it can be said with relative ease that a country or a states's tax system is a major determinant of other macroeconomic indexes. 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, 1966; Musgrave, 1969), 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, 1969). Our study therefore enables us to assess the extent to which the Benue state tax system conforms with this scenario. If applicable, such a characterization will enhance accurate tax revenue projection and targeting of specific tax revenue sources given an ascertained profile of economic development. It will also assist in estimating a sustainable revenue profile thereby facilitating effective management of a country's fiscal policy, among others.

Conflicts of interest: There is no conflict of interest of any kind.

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 P-ISSN: 2659-1561
E-ISSN: 2635-3040

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Citation: Andrew Terhemba Ayabam, Eugene Aliegba and Usman Abu Tom. 2019. Improved Taxation and the Question of Fiscal Deficit on the Economy of Benue State: A Theoretical Assessment. International Journal of Recent Innovations in Academic Research, 3(10): 40-45.