Inflation Rate and Tax Revenue Performance: A Time Series Assessment of Nigeria's Four Decades Experience

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ABSTRACT

There have been hyper inflationary trends in Nigeria going side by side with efforts of government to jack up its revenue generation. The broad objective of this study is to investigate the relationship between inflation rate and tax revenue in Nigeria in the past four decades. The study adopted a quantitative approach to the analysis of the impact of inflation on tax revenue performance in Nigeria using time series secondary data on Tax revenues, inflation rate, Foreign Direct Investment and Real Exchange, generated between 1981 and 2022, from the National Bureau of Statistics (NBS) and the Central Bank of Nigeria. Descriptive Statistics and Linear regression was carried out to establish the relationship between Inflation and tax revenue. The regression output was obtained using STATA, which is commonly used for time series data. The Laffer Curve Theory, which explains the theoretical relationship between the tax rate and government revenue obtained via taxing provided the theoretical framework on which the findings of this study leans on. The results of the study showed that there is a significant and positive relationship between inflation and Company Income Tax (CIT) in Nigeria; and between inflation and Petroleum Profit Tax (PPT) in Nigeria. However, the results of the study showed no significant relationship between inflation and Value-Added Tax (VAT) in Nigeria. From the findings, the study recommends that policymakers and tax authorities should take into consideration the impact of inflation when designing and implementing tax policies on CIT and PPT. Also, the lack of significant relationship between inflation and VAT suggests that policymakers and tax authorities should focus on other factors that affect VAT such as the level of economic activity, tax administration, and tax incentives.

Key Words: Inflation Rate, Value-Added Tax, Company Income Tax, Petroleum Profit Tax, Tax Revenue, Nigeria.

INTRODUCTION

Governments all over the world in attempt to meet its fiscal obligations levy taxes on its citizens and corporate organizations within its territorial control. However, there seems to be a macroeconomic problem called inflation, confronting most nations in their drive to meet their fiscal policy goals. Thus, raising question as to whether there is any form of relationship between inflation and revenue generation drives.

Mashkoor, Yahya, and Ali (2010), confirmed that, in as much as governments often use various methods of raising resources, taxation is the key and most important source of government revenue. (OECD, 2020), stressed on strengthening the utilization of domestic revenue for public expenditure financing as well as the

core role of taxes in the field of development and redistribution.

Regionally, many developing African countries have problems generating public revenue. In Africa, most government budgets have shortages that impede policy expenditures, which are essential to economic growth and human and capital projects. Foreign monetary fund support programs in African sub-Saharan countries have included steps for tax revenue growth and fiscal reform in these countries in recent years. Countries with relatively high tax revenues tend to have high tax indices.

Several sub-Saharan African countries have recently succeeded in reforming their tax systems; for example, Benin has implemented a substantial tax and administrative reform plan, leading to changes in the framework of the tax system and a rise in the GDP-to-tax ratio. Similarly, countries such as Ghana, Burundi, Liberia, Morocco, and Algeria were classified as high-tax countries in the study recently undertaken by the World Bank in Africa (World Bank, 2018), whilst central African countries (e.g., Sudan, the Central African Republic, and Nigeria) are rated as low-tax performers and have been associated with higher death tolls in armed conflict and violence (OECD, 2020).

Taxation is the primary source of government spending funds in Nigeria, like most developing nations. In the 2022 national budget, tax contributed 58% of non-oil revenue (Nkiruka, 2021). A report by the National Bureau of Statistics (NBS) reveals that tax revenue accounted for 6.5 percent of total Nigerian GDP between 2018 and 2019 (NBS, 2021, 2022), and in Q2'22, tax revenue accounted for 67 percent of government revenue as oil contribution to revenue continued to nosedive due to oil theft and pipeline vandalism.

One of the goals of modern government is to control inflation and ensure price stability in the economy.Fiscal policy is the government's management of the economy through the manipulation of its income and spending power to actualize some desired macroeconomic objectives, amongst which are price stability and economic growth (Adaramola 2020). It is also a deliberate alteration of government spending and taxation to help achieve desired macroeconomic objectives by changing the level and composition of aggregate demand (AD). This simply means that fiscal policy works through the manipulation of subsidies, exchange rates, checks on the external reserve, and borrowing that may be used to finance deficits where projected expenditures exceed revenues to check the price level.

In Nigeria, inflationary pressure has been a problem managed by the central bank. Nigeria's inflation in 2022 has defied all antidotes to continue its spiraling level since January. The inflation data released by the NBS in November indicates that the country's inflation was 21.37%, the highest in 17 years. This is happening despite the continuous hawkish stance of the Central Bank of Nigeria, which has raised the monetary policy rate by 500 basis points (5%) so far in 2022 (CBN Communique, 2022). The historical performance of the inflation rate indicates that the rate rose significantly to 17.01% year-on-year in August 2021 from 13.22% in the same month of the previous year (2020), missing market expectations of 6.40 percent. The main upward pressure came from food and non-alcoholic beverages in this period (20.1 percent vs. 16.0 percent in 2020), housing and utilities (15.07 percent vs. 12.1 percent), transport (16.96 percent vs. 13.08 percent), clothing and footwear (8.05 percent vs. 6.12 percent), furnishings and household equipment (6.12 percent vs. 5.46 percent), restaurants and hotels (5.68 percent vs. 4.96 percent), and miscellaneous goods and services (2.95 percent vs. 2.92 percent) On a month-to-month basis, consumer prices dropped 0.69 percent, the largest decline since October last year, following a 0.07 percent decline in May. Food and non-alcoholic beverages slumped by 1.60 percent, while other main components increased (NBS, 2021). Inflation is directly related to tax performance, as economist Milton Friedman said that, under certain circumstances, inflation can become an effective form of tax. If the government increases the rate of excise duty (tax on gasoline and alcoholic drinks), as we have seen in the past few years in Nigeria, the prices of goods tend to go higher. Hence, inflation has always caused axes to increase since people tend to pay more for goods and services than they should.

As the functions of government increase, especially in a modern economy, the government's revenue to finance its obligations must necessarily increase. Thus, the need for more certain, consistent, reliable, and diversified sources of government revenue in Nigeria (such as value-added tax revenue and company income tax revenue) cannot be overemphasized. According to the Federal Ministry of Economic Planning in their Economic Recovery and Growth Plan (ERGP, 2017), the government's financial position has decreased to low levels as a result of the crash in the price of crude oil in the international market, where crude oil sells for well below $120 per barrel, coupled with a decline in oil production due to militant activities in the Niger Delta, limiting the government's spending capacity on critical infrastructure.

One of the macroeconomic problems confronting Nigeria is the problem of inflation. Since the 1970s, there has been a continuous increase in the inflation rate. It is an economic cankerworm that has eaten deep into the fabric of the country's economy. Its effect on the economy is so calamitous that the real GDP of the country over the years has been stunted (Ezejiofor*et al*, 2021).

Inflation is a very popular phenomenon in an economy. The political fortunes of many political leaders and governments in Nigeria and abroad have been determined by how far they have succeeded in tackling the problem of inflation, so much so that some researchers called inflation "enemy number one". Inflation is the most hotly debated issue among the macroeconomic variables of the economy. The inflation rate has a great effect on the poor and makes their lives very miserable. It is therefore described as anti-poor. It redistributes income and wealth in favor of some and greatly harms others (Ezejiofor*et al*, 2021).

Given the literature gap, this study compared the different implications of inflation on tax revenue in Nigeria. Another remarkable contribution of this study to knowledge lies in the fact that a consumer price index was computed to link the inflation outcomes to poverty. The study further examines the theoretical rationale behind this index and also analyzes the socio-economic relationship between inflation and tax revenues.

However, the governments of Nigeria over the years has not folded its hands; they had adopted several fiscal policy measures to counteract this menace called inflation, but still, the problem has been on the increase, which means that despite the government's position to have minimal single-digit inflation, it seems nothing has actually been done. It is for this reason that this study investigated the effect of the inflation rate on tax revenue in Nigeria from 1981 to 2022.

The research questions derived from the study problem and objective are as follows:

1. Is there any relationship between inflation rate and Value Added Tax (VAT) in Nigeria?
2. Does inflation rate have any significant effect on Petroleum Profit Tax (PPT) in Nigeria?
3. Does inflation rate have any significant effect on Companies Income Tax (CIT) in Nigeria?

LITERATURE REVIEW AND THEORETICAL FRAMEWORK

Relationship between Tax bases and Inflation Rate

A nominally defined tax base will be affected in one of the following ways: For excise taxes, fees, fines, etc. where the payable amount is calculated in relation to the numRber of transactions rather than their value, the nominal tax liability remains unaffected by inflation. Thus, the real value of the tax decreases with rising price levels. The same is true for taxes with a historical tax base. Examples are wealth and inheritance taxes where the tax base is not or only infrequently unadjusted. In a similar fashion, inflation reduces the real value of historically defined or otherwise fixed deductions, allowances, and tax credits. In these cases, however, this causes real tax burdens to increase. If the tax is computed as a fraction of changes in nominal

values, inflation will also lead to increasing effective tax rates. The most important example here is the capital gains tax. A tax base is not affected by inflation if the tax is a fraction of a transaction's value at the time of the transaction (ad valorem taxes, VAT). For changing general price levels, the tax changes in line with the nominal value of the underlying transaction. Thus, the real value of the tax liability remains unchanged. This study focuses on the taxation of income as a direct result of the relative sensitivities of different tax bases with respect to inflation. In most industrialized economies, taxes on consumption either represent only a small part of total tax revenue (excise taxes) or are unaffected by inflation (value-added, ad-valorem taxes). Furthermore, the mechanics of the distortion of excise taxes are relatively straightforward while taxes on income are affected in a multitude of different ways (Adaramola, & Dada, 2020).

Petroleum Profit Tax (PPT) and Inflation Rate in Nigeria

Obinna (2020) documented that Petroleum Profit Tax (PPT) is a tax applicable to upstream operations in the oil industry. He continued that PPT is particularly related to rents, royalties, margins, and profit sharing elements associated with oil mining, prospecting and exploration leases. According to the definition of the Petroleum Profit Tax Act (PPTA), Petroleum operations essentially involve petroleum exploration, development, production and sale of crude oil.

The importance of the Petroleum Profit Tax (PPT) to Nigeria's economic growth cannot be over-emphasized. Oz-Yalaman (2019) documented that Nigeria's petroleum industry constitutes a major source of revenue to the government, and occupies a strategic position in the economic growth of Nigeria. According to Popoola*et al*, (2017), Petroleum Profit Tax (PPT) is the most important tax in Nigeria in terms of its share of total revenue, contributing 95% and 70% of foreign exchange earnings and government revenue; and the importance of foreign exchange to Nigeria's import-dependent economy cannot be over-emphasized. Popoola*et al*, (2017)continued that the petroleum industry is the largest generator of Gross Domestic Product (GDP) in Nigeria, which is Africa's most populous nation, and contributed to national economic growth in varied ways through employment generation, income generation, industrialization, as well as improvements in other economic variables. However, Ogbonna (2009) expressed the opinion that the administration of Petroleum Profits Tax in Nigeria has mainly been focused on revenue generation to the detriment of stimulating economic growth and development of the country.

Value Added Tax (VAT) and Inflation Rate in Nigeria

Oseni, & Sanni(2016), defined VAT as "an indirect form of taxation based on the general consumption behaviour of the people". This definition is in line with the Statements of Standard Accounting Practice (SAAP) number five (5), issued in the United Kingdom in 1974, to be a tax on the supply of goods and services which is eventually borne by the final consumers, but collected at each stage of production and distribution chain.

Omodero et al, (2021), believed that the impressive performance of VAT in all the countries it was introduced actually influenced the decision of the government to introduce VAT in Nigeria in 1994. The Federal Inland Revenue Service (FIRS) documented that VAT, which replaced the old sales tax, is a consumption tax which is relatively easy to administer, easy to collect and difficult to evade, thus increasing government revenue thereby aiding Nigeria's economic growth. The FIRS is responsible for the administration of VAT in Nigeria.

Companies Income Tax and Inflation Rate in Nigeria

According to Okwara, & Amori, (2017), CIT is a direct tax levied on the profits of companies. Companies Income Tax is derivable from the taxable profits of companies which are incorporated under the Companies and Allied Matters Act, 1990 as amended till date or any other law that may replace it dealing with the

incorporation of companies. In line with section 8(1) of the Companies Income Tax Act (CITA), CIT are payable upon profits of any company accruing in, derived from, brought into, or received in Nigeria in respect of any trade or business that may have been carried out. Currently, the rate of CIT is 30% of assessable profit.

Abomaye-Nimeniboet al, (2018) posited that government often use CIT incentives such as tax exemptions to attract and retain local and foreign investors to engage in productive activities thereby increasing economic growth, and also influence a favourable balance of payment with other countries. Since companies income tax is progressive (the higher the earnings, the higher the CIT), it encourages economic growth. Okwara, & Amori, (2017), mentions the objectives of CIT which aids Nigeria's economic growth to include: Source of government revenue to finance infrastructural projects, equitable distribution of income/wealth, achievement of favourable balance of payment as an instrument of fiscal policy to regulate the economy and influence economic growth, and to discourage the manufacture and consumption of undesirable goods inimical to public health so as to maintain a healthy society and workforce to aid economic growth.

Theoretical Framework

The Laffer Curve Theory propounded by Arthur Laffer in 1974, which explains the theoretical relationship between the tax rate and government revenue obtained via taxing, provides the theoretical basis for the findings of this study. The bottom of the Laffer curve, which is depicted in the figure below, indicates that there are no taxes, which will result in no government revenue. Tax revenue increases initially when taxes are raised from zero, but as the government continues to raise taxes, tax revenue declines, giving the curve its steepness. Therefore, more taxes will have a significant negative impact on a country's ability to thrive economically. In the long run, the drop in the tax base will balance off the sharp gain in tax income since the high tax burden makes people spend more money and reduce demand. The Prohibitive Range, when the Laffer curve travels backward, is the darkened area of the curve. Government revenue will decrease as a result of a tax increase that is above the Prohibitive Range (Laffer, 2004).
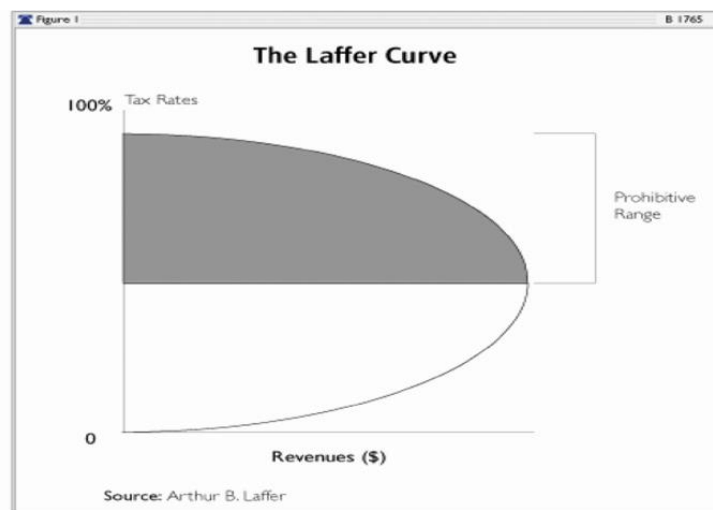
Figure 2. Source: Laffer (2004)

The Laffer Curve

100% Tax Rates

Prohibitive Range

0

Revenues ($)

Source: Arthur B. Laffer

Figure 2.1: Laffer's curve

METHODOLOGY

The current study adopts a quantitative approach to the analysis of the impact of inflation on tax revenue performance in Nigeria. The data used in this study come from secondary sources. The data generated are time series data on Tax revenues, inflation rate, Foreign Direct Investment and Real Exchange from the National Bureau of Statistics (NBS) and the Nigeria National Petroleum Corporation publications from

1981 to 2022. The study builds on existing research studies and methodologies using correlation research design and multiple regression analysis was conducted via the Stata Statistical Package.

Model Specification

The model specification of this study is adapted from the work of Oghenekevwe *al.,* (2014) who investigated the impact of inflation on tax revenue performance in Kenya over the period of 2005 to 2018. It was modified in order to achieve the objective of the current study.

To establish if there is any significant relationship between inflation rate and tax revenue performance in Nigeria. The researcher conducted a multiple regression analysis using the following model;

$$IFR = \alpha + \beta_1.X_1 + \beta_2.X_2 + \beta_3.X_3 + \beta_4.X_4 + \varepsilon$$

Where;

IFR = Inflation Rate was measured using tax revenue figures from the year 1981-2021 available on NBS website.

α = Constants.

β_1... β_4 = the slope which represents the degree with which tax revenue performance(dependent variable) changes as Inflation Rate (independent variable) change by one unit variable.

The dependent variable, X (Tax Performance) is measured by Value-added Tax, Company Income Tax (CIT) and Petroleum Profit Tax (PPT).

X_1 = Value-added tax (VAT) (dependent variable) was measured using annual figures for the years 1981-2022 retrieved from NBS website.

X_2 = Company Income Tax (CIT) (dependent variable) was measured using annual figures from the year 1981-2022 retrieved from NBS website.

X_3=.Petroleum Profit Tax (PPT) (dependent variable) was measured using Price Profit Tax Index for the year 1981-2022 available on NNPC website

DATA PRESENTATION, ANALYSIS AND DISCUSSION OF RESULTS

Descriptive Statistics

Tables 1 and 2 show the descriptive statistics which includes Data source, period, expected result meaning value, maximum value, mean and standard deviation.

Table 4.1 Data source and expected results

Variable	Data source	Period	Expected relationship
IFR	NBS	1981-2022	……………
PPT	NBS	1981-2022	(+)
CIT	NBS	1981-2022	(+)
VAT	NBS	1981-2022	(-)

Sources: Author's Computation (2023)

Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
PPT	48	176.7478	1059.1700	548.403434	209.4471988
CIT	48	112.3609	556.2703	293.427155	123.2319675
GI	48	.8390	83.2056	17.446288	20.5301580
CGT	48	.0565	72.5931	4.500326	11.117100
Stamp Duty	48	.4900	62.5830	5.333734	10.9236529
INFL	48	7.8223	18.4509	12.359678	3.1171109
Valid N (listwise)	48				

Source: Descriptive Statistics Results

From table 4.2, it is clear that there is high spread of data among variables. From its nature it was so anticipated since time series data, especially those with aggregates, follow a random or stochastic process. The PPT had an average of 548.403434, the least value of 176.7478, the maximum value of 1059.1700 and standard deviation of 209.4471988. CIT had an average value of 293.427155, the least value of 112.3609, the maximum value of 556.2703and standard deviation of 123.2319675. GI had an average value of 17.446288, the least value of .8390, the maximum value of .8390 and standard deviation of 20.5301580. CGT had an average of 4.500326, the least value of .0565, the maximum value of 72.5931and standard deviation of 11.1171007. Stamp Duty had the average value of 5.333734, the least value of .4900, the maximum value of 62.5830and standard deviation of 10.9236529. INFL had the average value of 12.359678, the least value of 7.8223, the maximum value of 18.4509and standard deviation of 3.1171109.

From table above, data for Inflation was widely spread than other variables 209.4471988. It also has large mean indication of the fact that the economy of Nigeria has grown rapidly over the past years. Among the dependent variables, data for PPT was widely spread than other variables 123.2319675. This is due to fluctuations in the manufacture of taxable goods and services caused by the unfavourable conditions in the economy such as corruption, politics among others.

Regression Analysis

Linear regression was carried out to establish the relationship between Inflation and tax revenue. The regression output was obtained using STATA which is commonly used for time series data. Tax revenue collected was regressed against the three predictor variables; Inflation, PPT, CIT, VAT.

Effect of Tax Revenue on Value Added Tax

Table 4.3 Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.395a	.156	.001	3.240
a. Predictors: (Constant), Inflation				

R=0.395 indicates that the correlation between Tax revenue and Inflation rates is a positive linear relationship.

Table 4.4: ANOVA[a]

Model	Sum of Squares	df	Mean Square	F	Sig.
Regression	89.248	1	89.248	8.504	.005 b
Residual	482.752	46	10.495		
Total	572.000	47			

a. Dependent Variable: V_1

b. Predictors: (Constant), Inflation

Table 4.5: Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	2010.036	1.931		1040.867	.000
	Inflation	.442	.152	.395	2.916	.005

a. Dependent Variable: V_1

Results in Table above show a positive and significant relationship between Inflation and tax revenue rates ($\beta = 0.442$, $P = 0.005$). Hence the model for the relationship can be written as follows; $Y = 2.010 + 0.442 X$ (where x is Inflation, Y=log of tax revenue)

Effect of Infaltion Rate on Petroleum Profit Tax

Table 4.6: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics		
					R Square Change	F Change	df1
1	.292 a	0.085	0.065	202.5166	0.085	4.272	1

a. Predictors: (Constant), Inflation

R=0.292 indicates that the correlation between Tax revenue and Inflation rates is a positive linear relationship. R squared shows that only 6.5 percent of tax revenue is attributable to PPT. Table 4.4 results further show that the model F (1, 46) = 4.272, P >0.05 is valid in explaining the relationship that exists between the dependent and independent variables of the study.

Table 4.7: ANOVA[a]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	175204.8	1	175204.8	4.272	.044 b
	Residual	1886597	46	41012.98		
	Total	2061802	47			

a. Dependent Variable: PPT

b.   Predictors: (Constant), Inflation

Table 4.8   Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	790.495	120.722		6.548	0
	Inflation	-19.587	9.477	-0.292	-2.067	0.044

a. Dependent Variable: PPT

Results in Table above show a positive and significant relationship between Inflation and tax revenue rates (β = -1.9587, P =0.44). Hence the model for the relationship can be written as follows; Y = 7.90495 + -1.9587X (where x is Inflation, Y=log of tax revenue)

Effect of Inflation and Company Income Tax

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics		
					R Square Change	F Change	df1
1	.111[a]	0.012	-0.009	123.7889	0.012	0.578	1

a. Predictors: (Constant), Inflation

R=0.111 indicates that the correlation between Tax revenue and Inflation rates is a positive linear relationship. R squared shows that only 01.2 percent of tax revenue is attributable to CIT. Table 4.4 results further show that the model F (1, 46) = 5.78, P >0.05 is valid in explaining the relationship that exists between the dependent and independent variables of the study.

ANOVA[a]

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	8858.125	1	8858.125	0.578	.451[b]
	Residual	704889.4	46	15323.68		
	Total	713747.5	47			

a. Dependent Variable: CIT

b. Predictors: (Constant), Inflation

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	238.992	73.792		3.239	0.002
	Inflation	4.404	5.793	0.111	0.76	0.451

a. Dependent Variable: CIT

Results in Table above show a positive and significant relationship between Inflation and tax revenue rates (β = 4.404, P =0.451). Hence the model for the relationship can be written as follows; Y = 2.38992 + 4.404 X (where x is Inflation, Y=log of tax revenue)

Discussion of Findings

The findings of this study have significant implications for policymakers and tax authorities in Nigeria. The significant relationship between inflation and PPT on one hand and between inflation and CIT on the other hand, suggest that policymakers and tax authorities should take into consideration the impact of inflation when designing and implementing tax policies. They may need to adjust tax rates to keep pace with inflation, and also consider other measures such as tax exemptions or tax rebates to alleviate the impact of inflation on taxpayers.

The findings also suggest that there is no significant relationship between inflation and VAT in Nigeria. This implies that policymakers and tax authorities should focus on other factors that affect VAT such as production quantity, and tax administration. They may need to consider measures such as tax incentives or simplification of tax regulations to encourage the collection of VAT. This finding conforms to that of Iya, & Aminu, (2014) who carried out a study to examine the effect of VAT the revenue generation in Nigeria.

SUMMARY, CONCLUSION AND RECOMMENDATION

This study aimed at examining the impact of inflation on tax revenue in Nigeria through the time series data regression method covering the period from 1981 to 2022. The findings revealed that inflation has a significant negative impact on the Company Income Tax and Petroleum Profit Tax but did not have an impact on Value-Added Tax.

The study concludes that inflationary trends played a great part in influencing the performance of Nigeria tax revenue policies. The impact of high inflation is compounded by the consequences of policy measures taken in response to macroeconomic challenges of the economy, which included tax cuts and administrative leniency, leading to severe revenue losses.

From the findings, the study recommends that policymakers and tax authorities should take into consideration the impact of inflation when designing and implementing tax policies on CIT and PPT. Also, the lack of significant relationship between inflation and VAT suggests that policymakers and tax authorities should focus on other factors that affect VAT such as the level of economic activity, tax administration, and tax incentives.

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