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Tax Expenditure in Sub Saharan Africa: The Nigerian Experience

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Abstract
The Nigerian government established the National Economic Empowerment and Development Strategies (NEEDS) in 2003 to achieve its trade policy of which the reform of Nigeria Custom Services is one of the major functions. Over the years, custom and excise duties have been major sources of revenue apart from crude oil. However, the problems of corruption, fraud and malpractices together with inefficiencies and ineffectiveness in operations have hindered the desire to contribute maximally to the economic development of the nation. The central objective of trade policy was to provide protection for domestic industries and reduce the perceived dependence on imports; reduce level of unemployment and generate more revenues from the non-oil sector, hence tariffs on raw materials and intermediate capital goods were scaled down. Duty exemptions and concessions remain some of the quantitative policy instruments for attracting investment and boost domestic production. This paper will review; discuss Tax Expenditure and the Nigerian experience, especially on loss of revenue from customs.
Keywords: Custom duties, Revenue, Duty exemptions, Domestic production, Development.

Introduction

The provision of public services and infrastructure is a key factor for economic development and growth. Many developing countries fail to raise the tax revenue required to finance their public sectors. Domestic revenue mobilization in sub-Saharan Africa (SSA) is generally weak in comparison to other parts of the world. Excluding revenues from natural resources such as oil, which are cyclical, tax revenues in SSA averaged about 14 percent of GDP in 2005, only slightly higher than the 13 percent of GDP in 1980 (Keen and Mansour, 2009).

Tax expenditures, in the form of tax provisions, are government expenditures. They are conceptually and functionally distinct from those tax provisions whose purpose is to raise revenue. Tax expenditure programs are comparable to entitlement programs. Therefore, tax expenditures must be analyzed in spending terms and integrated into the budgetary process to ensure fiscal accountability. Tax expenditures affect (1) the budget balance, (2) budget prioritization in allocation, (3) the effectiveness and efficiency of fiscal resources, and (4) the scope for abuse by taxpayers, government officials and legislators.

Tax incentives are popular policy measures used in both high- and low- income countries, but there are differences in how high-income and low-income countries deal with them. The high- income countries (most of them Organization for Economic Cooperation and Development (OECD) member states) recognize that a tax incentive is a type of government spending in the form of a tax expenditure. A tax expenditure, a component of the tax system, functionally provides government financial assistance by not collecting tax revenue otherwise due. High- income countries have introduced tax expenditure accounting and subject tax expenditures to normal budgetary controls. (Swift, 2006)

Many low-income countries, even those with high public debt and those in which the majority of the population is below the poverty line (less than US$1 a day), have embraced tax incentives. Their spending in tax expenditures has decreased their revenue received, reducing these countries' capacity to assist the needs of the poor. Ironically, the poor do not benefit from tax incentives because their income is usually below the tax thresholds. None of these countries, so far, use tax expenditure accounting or subject tax expenditures to normal budgetary control. Many other transition economies and developing nations also use tax incentives, but in most cases they have not taken sufficient steps to make tax incentives accountable (Swift, 2006).

Definition

While tax revenue mobilization can be weak due to tax evasion or tax avoidance, it may also be negatively affected by policy measures like the introduction of tax expenditures, which deliberately reduce the tax burden on certain economic activities or taxpayers. Tax expenditures are usually defined as deviations from a benchmark tax system which give rise to tax revenue losses, tax expenditures are simply misclassified. They appear to be reduction in taxes, but they are equivalent to cash spending.

Political Economy of Taxation in Africa

The political economy of the countries of SSA is complex and heterogeneous, but to a greater or lesser extent, the distribution of patronage by political elites using public resources is integral to the political process in most countries. Resources for patronage can be obtained from both sides of the budget; from public expenditures or revenues. The most important channels through which resources for patronage are obtained from the tax system are twofold. First, tax concessions, such as income tax holidays or import duty exemptions, are granted to politically favoured companies on a selective basis, in circumstances where there is no strong objective rationale for granting tax incentives. Although this is often not illegal, it is usually done in a very untransparent manner. In many countries, large taxpayers, such as major companies, are more likely to bargain directly with government for tax concessions which favour them individually, rather than for groups of taxpayers representing common interests (e.g. the business sector) to bargain for changes in taxes which would benefit themselves collectively, and which would be transparent (Fuest and Riedel, 2009).

Visibility and control

One way of looking at tax expenditures is to see them as public expenditures. Just as 'normal' public expenditures, tax expenditures may or may not be justifiable by economic policy objectives like income redistribution or the correction of market failures. However, tax expenditures differ from direct government expenditures in a number of ways. In particular, they are frequently less visible and less clearly integrated into the budgetary process. For these reasons, there is widespread concern that tax expenditures are more difficult to control, more vulnerable to capture by lobby groups or even corruption and therefore more likely to lead to budget imbalances and governance problems than direct government expenditures. Since issues of fiscal transparency and political accountability are particularly pressing in developing countries, tax expenditures may be particularly problematic in these countries. Moreover, since tax expenditures lead to more complicated tax systems, there is a concern that tax expenditures might encourage tax avoidance and tax evasion.

What makes tax expenditures different from other forms of government spending?

The government uses tax expenditures and direct spending for the same purposes, but tax expenditures receive different treatment in two key ways. Most tax expenditures are not subject to the same annual appropriations process as other forms of spending. This means they are less likely to be scrutinized. Second, tax expenditures appear to be tax cuts instead of spending because they transfer funds to businesses and individuals through tax subsidies. It is therefore generally easier to win votes for tax expenditures than direct spending.

Tax Incentives for Foreign Direct Investment

Among the various types of tax expenditures existing in developing countries, tax incentives for foreign direct investment, have received most attention. Many developing countries use special tax incentives like tax holidays, investment allowances, free enterprise zones or tax sparing provisions. Again, little statistical information on the level of existing investment incentives and their development over time is available. But a dataset recently collected by Keen and Mansour (2008), which covers 40 Sub-Saharan African countries does suggest that the use of tax incentives for investment has increased over the last decades. For instance, in 1980, only one among the 29 countries for whom data is available for this year offered free zones, i.e. zones where special corporate income tax treatment is offered. In 2005, almost half of the countries covered by the dataset offered this type of incentives. Table 1 gives an overview over the different types of tax incentives reported by Keen and Mansour (2008) and their change over time. In the literature, the growing use of tax incentives for investment in developing countries is criticized for various reasons. One issue is that these tax incentives reduce corporate income tax revenue (Bird (2008), Klemm (2009)).

Table 1

Investment Tax Incentives in sub-Saharan African Countries 1980 and 2005						
	1980			2005		
	Number of Countries Offering Incentives (I)	Total Number of Countries (2)	Ratio (1)/(2)	Number of Countries Offering Incentives (I)	Total Number of Countries (2)	Ratio (1)/(2)
Tax Holidays	13	29	0.45	27	39	0.69
Reduced CIT Rates	3	29	0.1	20	39	0.51
Investment Allowances	17	29	0.59	22	39	0.56
Incentives for Exports	3	29	0.1	11	39	0.28
Free Zones	1	29	0.03	18	39	0.46
Investment Code	9	29	3.1	29	39	0.74

Source: Keen and Mansour (2008)

Tax expenditures in Nigeria

Nigerian government considers trade as the main engine of its development strategies because of the implicit belief that trade can create jobs, expand markets, raise incomes, facilitate competition and disseminate knowledge. According to world trade organization, the main trust of trade policy is the enhancement of competitiveness of domestic industries, with a view to stimulate local value-added and promoting a diversified export trade. Trade policy also seeks to create an environment that is conducive to increased capital inflows, and transfers and adoption of appropriate technologies. The Nigerian Government has put in place a number of investment incentives for the stimulation of private sector investment from within and outside the country. While some of these incentives cover all sectors, other are limited to some specific sectors. The nature and application of these incentives have been considerably simplified. Duty exemptions and concessions remain some of the quantitative policy instruments for affecting trade policy in favour of domestic industries and to achieve the aim of diversifications.

The Nigerian Customs was established in 1891 whose powers and functions are spelt out in the customs and management Act (CEMA) cap 84 of the laws of the Federation, 1990.The main function of the service is the collection of customs and excise duties on goods. It is in charge of trade facilitation and generation of trade statistics for planning purposes as well as the main coordinator of anti-smuggling operations at the sea port, airports and border stations. The service works closely with other institutions like the Central Bank of Nigeria, the Nigerian Ports Authority, the Military and the Economic Community of West African States (ECOWAS) secretariat. The Nigerian Custom Services ensures the security of International trade supply chain and combat international crime in conjunction with other members of the World Customs Organization (Buba,2007). The Customs is indeed very important to the economy as it collects import duties, excise duties, fees, tariffs and other levies imposed by the Federal Government on imports, exports and statutory rates. After oil, the customs provide the largest single chunk of revenue accruing to the federation account.

The Nigerian Customs Service is much criticized for alleged corruption and inefficiency and its upper echelon is often with intrigue and in fighting. Nigeria is an import-dependent nation and the country is awash with imports from all parts of the world. There is problem of sharp practices that collectively deprived the government of revenue and enriched some corrupt customs men and their collaborators (Adegbie and Fakile, 2011). There is under-assessment of payable duties, unauthorized transfer of funds, abuse of waivers, concessions and exemptions as well as non-remittance of government revenues.

The table 2 below shows the summary of duty loss to all concessions between January 2004 and November 2006.From the table, revenue loss in 2004 was N56.8billion which increased to N71.2billion in 2005 and reduced to N54.9billion in 2006.This is an evidence to show that the government is losing much revenue annually which will definitely affect negatively, provision of necessary needs for the growth and development of Nigerian economy. With so much outflows of income in billions of naira, the policy adopted by the government in the concession needs to be reviewed more so if the sectors that enjoy the concessions are not given much back to the economy. Most of the manufacturing companies that enjoy the waivers are not operating at full capacity while some are closing businesses for neighboring West African Countries. Some have actually been liquidated for inability to continue in business (Adegbie, 2011). If these have characterized the manufacturing industry, then where are the companies that enjoyed the waivers and concessions?

Table 2: Revenue Loss by Nigerian Customs Services from 2004 – 2006 in Naira

SN Exemption/Concession	2006 N	2005 N	2004 N
1. Revenue loss due to exemption /waivers	18,237,049,659.54	41,636,157,785.94	33,970,745,310.37
2. Revenue loss due to ETLS	1,494,223,772.13	2,548,734,595.82	2,104,089,331.98
3. Revenue loss due to concessionary Duty rate granted bonafide Manufacture/Assemblies	564,956,189.29	10,001,804,163.24	6,982,047,350.65
4. Revenue loss due to export Processing/excise factory	256,055,157.07	248,545,281.21	146,279,457.67
5. Revenue loss due to concessions to Manufacture-In-Bond-Schemes (MIBS)	3,819,378.39	820,147,347.45	1,115,233,719.64
6. NDCC	34,365,839,307.46	15,989,292,537.74	11,478,137,655.38
TOTAL	**54,921,943,464.88**	**71,244,681,711.40**	**56,796,532,825.67**

Source: Adapted from Buba, (2007)

Of interest is another case of $3 billion (N488 billion) waiver granted to a Chinese firm, WEMPCO, to encourage them set up a $250 million Cold Rolled Steel Plant, which was thoroughly abused. Tens of billions were lost to waivers for sugar, cement, and rice imports and what not, Daily Trust (2011). It was discovered that in 2011 alone, a colossal N37.2 billion was lost as a result of import waivers that were granted to importers of raw materials in that year alone. Nigeria Customs Service records have shown that the nation lost N276.9 billion between 2000 and 2008. House of Representatives investigation in 2009 into waivers granted by federal government said that the government was yet to abate the practice of granting "illegal and indiscriminate" waivers to "totally undeserving" firms and individuals, despite repeated orders from the House that the policy be discontinued Nigerian National News (2012).

The Effects of Tax Expenditures on the Budget

Tax expenditures, as spending items, affects fiscal budget balance, prioritizing resource allocation, efficiency and cost-effectiveness. The impact of tax expenditures on the budget is as discussed below.

(1) Tax expenditures have not been integrated into the budget process for appropriation. There is no requirement to coordinate them with respective budget allocations. As a result, some tax expenditures overlap, are redundant, or conflict with budget spending and objectives.

(2) Tax expenditures, in reducing tax revenue received (or net tax revenue), reduce the overall budget balance like direct expenditures. As a result, the overall budget deficit will increase or the overall budget surplus will decrease if direct expenditures are constant.

(3) Even though the main concerns in many developing countries are economic growth and poverty reduction, tax expenditures have a higher priority than direct expenditure programs for infrastructure, economic growth, education, health, poverty reduction, and so forth. Most poor people do not benefit from tax expenditures because their incomes are below tax thresholds.

(4) Tax expenditures may provide an opportunity for abuse by government officials and legislators either for self enrichment or to provide benefits to favored interests. Tax expenditures have a direct and often large cash value to potential recipients. Consequently, companies and business groups have a strong motivation to lobby for tax incentives by exaggerating the prospective economic or social benefits. These lobbying activities often lead to a proliferation of tax expenditures and undermine spending efficiency and fiscal accountability. Also, the direct cash value of tax expenditures can become an open inducement to bribery and corruption.

Conclusion

Integrating tax expenditures into the budget process and subjecting them (and all other spending) to effective legislative controls could improve the efficiency of government and soften the blow from the belt tightening that is necessary if we are to avoid a debt crisis. Reductions in tax expenditures could simplify the income tax and make it less prone to abuse, especially if part of the revenues from the trimmed tax expenditures were used to cut marginal income tax rates. That is, controlling tax expenditures might increase the chances of enacting badly needed tax reform.

One issue is that the cost of tax incentives may be greater than expected because of tax avoidance schemes set up to exploit them. Moreover, it is difficult to distinguish genuine Foreign Direct Investment from domestic-source investment because round tripping' may occur, where domestic capital is routed offshore and then brought back as foreign investment. Therefore government should discourage tax incentives granted to attract FDI, especially tax holidays. In addition, tax expenditures must be audited for performance and the information must be published (with comprehensive analysis) to ensure fiscal transparency.

In our view, the government should: (1) make public all the production sharing agreements (PSAs) in the oil sector and subject these to public review, with a view to eliminating the fiscal incentives provided, and to ensure that all future PSAs are shared and debated publicly. (2)Undertake the promised review, which should be made public, of all tax incentives with a view to reducing or removing many of them, especially those that involve the exercise of discretionary powers by ministers. Those incentives that remain must be simple to administer and shown by the government to be economically beneficial. (3) Provide on an annual basis, during the budget process, a publicly available tax expenditure analysis, showing annual figures on the cost to the government of tax incentives, and showing who the beneficiaries of such tax expenditure are.

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