Journal of Emerging Trends in Economics and Management Sciences (JETEMS) 3(4): 361-366
© Scholarlink Research Institute Journals, 2012 (ISSN: 2141-7024)
jetems.scholarlinkresearch.org

Globalization and the Precarious State of Public Finance in Nigeria

Fakile, Adeniran Samuel and Adegbie, Folajimi Festus

Department of Accounting,
College of Development Studies,
Covenant University, Ota. Ogun State, Nigeria.

Corresponding Author: Fakile Adeniran Samuel

Abstract

As globalization eviscerates national borders, governments in both developed and developing countries are discovering that their tax base is eroding, especially their ability to tax the proceeds and profits from corporate investment and finance Domestic revenue mobilization is key to sustainable development finance – only self-sufficiency will allow the development of fully-functioning states with flourishing systems of political representation and economies reflecting societies' expressed preferences in regard to, for example, inequality. The significant of this paper therefore is that it will enable the revenue authority take necessary steps to prevent tax avoidance and tax evasion so as to increase the level of domestic revenue for development. It concluded that claims of corporate social responsibility are undermined when low corporate tax payments are exposed and a process of tax competition at the global level undermines the social contract previously set within the national arena, as states compete to offer tax exemption to capital. The paper suggested that with effective tax administration, adequate taxation of transnational corporations, tax compliance as part of corporate accountability, international tax cooperation, fight against bribery and corruption, arm length international trade negotiations and reduction in military expenditure, the problems are more likely to be solved.

Keywords: globalization, tax, revenue mobilization, public finance, sustainable development.

INTRODUCTION

Historically, tax policies have been developed primarily to address domestic economic and social concerns. The forms and levels of taxation were established on the basis of the desired level of publicly provided goods and transfers, allocating, stabilizing and redistributive aims thought appropriate for a country. Whilst domestic tax systems of essentially closed economies also had an international dimension in that they potentially affected the amount of tax imposed on foreign source income of domestic residents and typically included in the tax base the domestic income of non-residents, the interaction of domestic tax systems was relatively unimportant, given the limited mobility of capital. The decision to have a high rate of tax and a high level of government spending or low taxes and limited public outlays, the mix of direct and indirect taxes, and the use of tax incentives, were all matters which were decided primarily on the basis of domestic concerns and had principally domestic effects. While there were some international spillover effects on other economies, those effects were generally limited.

The accelerating process of globalization of trade and investment has fundamentally changed the relationship among domestic tax systems, the removal of non-tax barriers to international commerce and investment and the resulting integration of national economies have greatly increased the potential impact that domestic tax policies can have on other economies. Globalization has been one of the driving forces behind tax reforms, which have focused on base broadening and rate reductions, thereby minimizing tax induced distortions. It has encouraged countries to assess continually their tax systems and public expenditures with a view to making adjustments where appropriate to improve the "fiscal climate" for investment, increased mobility of capital, promotion of development, financial markets, and encouraged countries to reduce tax barriers to capital flows and modernize their tax systems to reflect these developments. This process has improved welfare and living standards around the world by creating a more efficient allocation and utilization of resources. Globalization has had a positive and negative effect on the development of tax systems such as capital flow across national boundaries and exploitation of countries in the area of tax avoidance. The study therefore looks at globalization and the precarious state of public finance in Nigeria.

Sources of Revenues in Developing Countries

Government capacity to tax depends on its ability to maintain its tax jurisdiction, although, factor mobility such as capital and labor erode this. As a result globalization has forced a fourth criterion on government: taxing the factor of production, land that is less mobile. The United Nations Millennium Project (2005) in its report points out that in order to

realize the MDGs, Official Development Assistance (ODA) would need to increase to $195 billion by 2015. According to the report, the transfer of resources from industrialized countries only constitutes a fraction of the aggregate income of the developing and transitional countries. In 2004, the net ODA share of the Gross Domestic Product (GDP) of all developing countries stood at just 0.5% (UNDP, 2006). In countries like China, Argentina and India the share lies at 0.1%, in Malaysia at 0.2%. Nevertheless, there are numerous exceptions: next to the small island developing states, crisis-ridden countries in Africa are particularly reliant on development aid. In the majority of developing and transitional countries, the share of public revenue to GDP lies well below the average of that of the industrialized countries. According to World Bank (2006) estimates, the share of central government revenues to GDP in low-income countries was only 13% in 2004. In contrast, in high-income countries it was 26.0% and in the European Economic and Monetary Union it was 35.7% (World Bank, 2006). The financial capabilities of governments in many developing countries are thus not only severely limited in absolute numbers, but also in relation to the GDP – and so are their abilities of providing reasonable quality public goods and services, particularly in education and health care.

Globalization and Public Finance

Taxes only constitute a fraction of national budgets in developing countries. Significant and additional sources of revenue are import and export duties, revenues from public enterprises, royalties for the extraction of natural resources (particularly crude oil), foreign aid, loans and government bonds. In developing countries, only 16% of state revenues come from taxing income, business profits and capital gains, while 32% is collected through taxes on goods and services, particularly through the value-added tax (World Bank, 2005). In the global competition for foreign investment, many governments attempt to attract transnational corporations through low taxes, subsidies and other incentives. In the past few years, a virtual 'tax race to the bottom' has emerged on a global scale. To attract foreign investment capital, governments have established Export Processing Zones (EPZs) worldwide. The International Labour Organization (ILO) estimates their numbers at over 3000 (ILO, 2003). Transnational corporations producing for export are granted numerous concessions in these zones, which include the unrestricted transfer of capital (including the repatriation of profits to countries of origin), reduced labour rights, low environmental and social standards as well as diverse tax incentives. Often governments guarantee investors full tax exemptions ('tax holidays') for a minimum of five to ten years. Thereafter, corporations in EPZs are charged substantially lower taxes than local businesses that produce for domestic consumption. This is the case for EPZs in Ghana, where foreign companies do not have to pay more than 8% tax on profits after the 10-year period has expired. Kenya, too, grants 'tax holidays' for a time span of ten years, after which it imposes a flat tax of 25 percent (KPMG, 2006).

The spectrum of investment incentives used by governments to win the favour of foreign investors is summarized by an advertisement for Export Processing Zones in Nigeria: "The regulatory regime for EPZs in Nigeria is liberal and provides a good environment for profitable operations. The incentives available to operators in Nigeria's EPZs compare favourably with the most attractive elsewhere in the world and are the best in the region. They include one hundred per cent foreign ownership of investments, "one stop" approvals, no import or export licenses, duty free import of raw materials, unrestricted remittance of capital profits and dividends, tax holidays and no strikes." (Martens, 2007) All these incentives run at the expense of state budgets, which consequently have to make up for considerable losses in income. This is despite the fact that for many corporations, financial incentives do not constitute the only criteria for investment decisions. Other important factors are good infrastructure, the availability of a qualified work force, the extent of state regulation, low transport costs and, where production is not for export, domestic market opportunities. The consulting firm McKinsey, surveying 30 corporations that had moved their production to India, found that financial incentives were at the bottom of the list of factors that influenced investment decisions (Farrell et al, 2004).
Over the course of the globalization of the production chain, transfer pricing has become one of the most important instruments for tax avoidance. The significance of transfer pricing is evident by the fact that, more than 50% of worldwide trade in goods and services occurs within transnational corporations (WTO, 2004).

Capital flight to tax havens leads to substantial revenue losses in developing countries. The term 'capital flight' is not clearly defined. Capital flight refers to the illegal, undocumented transfer of capital out of a country by corporations and private individuals, and is primarily done to evade government regulation and tax. Capital flight is the transfer of assets abroad in order to reduce loss of principal, loss of return, or loss of control over one's financial wealth due to government-sanctioned. The funds embezzled and exported by corrupt heads of state alone amounted to many billions of dollars in the past few decades (see the list compiled by Transparency International on some of the worst cases of embezzled public funds in Table 1). The European Commission estimates that in Africa, the

illegal transfer of money amounts to more than half of the foreign debt of that continent (CEC, 2003). This adds up to nearly USD 200 billion (World Bank, 2006).

Table 1: The worst cases of embezzled funds

	Head of State	Embezzled Funds (USD)
1	Mohamed Suharto, President of Indonesia (1967-1998)	15-35 billion
2	Ferdinand Marcos, President of Philippines (1965-1986)	5-10 billion
3	Mobutu Sese Seko, President of Zaire (1965-1997)	5 billion
4	Sani Abacha, President of Nigeria (1993-1998)	2-5 billion
5	Slobodan Milosevic, President of Serbia/Yugoslavia (1989-2000)	1 billion
6	Jean Claude Duvalier, President of Haiti (1971-1986)	300-800 million
7	Alberto Fujimori, President of Peru (1990-2000)	600 million
8	Pavio Lazarenko, Prime Minister of Ukraine (1996-1997)	114-200 million
9	Arnoldo Aleman, President of Nicaragua (1997-2002)	100 million
10	Joseph Estrada, President of Philippines (1998-2001)	78-80 million

Source: Transparency International, 2004

State of Public Finance in Nigeria

The federal government is responsible for collecting taxes on income, profits, and property, as well as import and export taxes and excise duties. It also runs the national transportation system. The petroleum sector provides over 83% of budgetary revenues. A large share of these revenues is redistributed to state governments. The budget is consistently in deficit. Public investment flourished during the oil boom years of the 1970s. When the oil market prices collapsed in the 1980s however, the Nigerian government maintained its high level of spending, thus acquiring substantial foreign debt. Although privatization efforts began in 1986, increased government spending outside the official budget since 1990 has damaged public finance reform. Taxes only constitute a fraction of national budgets in Nigeria. Significant and additional sources of revenue are import and export duties, revenues from public enterprises, royalties for the extraction of natural resources (particularly crude oil), foreign aid, loans and government bonds. In Nigeria, only 16 % of state revenues come from taxing income, business profits and capital gains, while 32 % is collected through taxes on goods and services, particularly through the value-added tax (World Bank, 2005).

In terms of income and wealth distribution, the prominence of indirect taxes in Nigeria as in many developing countries is highly problematic. This is because the value-added tax places a burden primarily on the poor and low-income families, who must spend most of their money on consumption. In contrast, for wealthier groups these taxes hardly carry any weight in relation to their incomes. To the benefit of affluent elites, governments often exempt entire sections of the economy from effective taxation, and in doing so forego revenues that amount to billions of naira. This is the case for profits from transnational corporations in export processing zones and taxation on property. According to UNDP (1999), property tax on large landowners could lead to significant additional revenues for governments in this sector (UNDP, 1999). In Nigeria, the mobilization of public revenues is made more difficult by the growing informal or ‘shadow’ economy. The shadow economy includes all economic activities that are not within the control of the state, and therefore also outside its tax jurisdiction. The following three types of activities are elements of the shadow economy: Informal economic activities in household productions and small enterprises, mostly to meet subsistence needs; Criminal activities that are tied to financial transactions, for example drug trafficking, corruption or child prostitution and Illicit work and similar activities which are generally legal, but deliberately concealed from public authorities in order to avoid the payment of taxes and avoid having to meet certain legal standards such as minimum wages. Schneider, in a comprehensive study on the shadow economy in 145 countries, comes to the conclusion that in 2003 the informal sector made up 41.2 % of GDP in Africa, 41.5 % in Latin America, and 26.3 % in Asia (Schneider, 2002).

Cobham (2005) estimates that tax revenues in developing countries would yield an additional USD 252 billion per year if the shadow economy were to be fully integrated into the formal economy.

Table 2: The magnitude of the shadow economy in selected countries

Country	Shadow economy in % of GDP 1999/2000	Shadow economy in % of GDP 2002/2003
Nigeria	57.9	59.4
Zambia	48.9	50.8
Zimbabwe	59.4	63.2
Tanzania	58.3	60.2
Argentina	25.4	28.9
Brazil	39.8	42.3
Mexico	30.1	33.2
China	13.1	15.6
India	23.1	25.6
Germany	16.0	16.8
Great Britain	12.7	12.2
Japan	11.2	10.8
USA	8.7	8.4

Source: Schneider 2004

In addition to the problems of developing a comprehensive and effective tax system in Nigeria, government is unable to make full use of the income potential that already exists. In the global competition for foreign investment, the Nigerian government attempt to attract transnational corporations through the establishment of Export Processing Zones, where

Transnational corporations producing for export are granted numerous concessions, which include the unrestricted transfer of capital (including the repatriation of profits to countries of origin), reduced labour rights, low environmental and social standards as well as diverse tax incentives. The incentives available to operators in Nigeria's EPZs compare favourably with the most attractive elsewhere in the world and are the best in the region. They include one hundred per cent foreign ownership of investments, "one stop" approvals, no import or export licenses, duty free import of raw materials, unrestricted remittance of capital profits and dividends, tax holidays and no strikes" (Martens, 2007). All these incentives run at the expense of state budgets, which consequently have to make up for considerable losses in income. This is despite the fact that for many corporations, financial incentives do not constitute the only criteria for investment decisions. Other important factors are good infrastructure, the availability of a qualified work force, the extent of state regulation, low transport costs and, where production is not for export, domestic market opportunities.

What Are Public Revenues Used For?

How governments spend their money is central to the social and economic development of a society. The political priorities of governments are reflected more clearly in public budgets than in government declarations and action programmes. However, the responsibility for failed budget policies does not only lay with government, often, conditional ties imposed by the International Monetary Fund and the World Bank has substantially constrained the decision-making power of government over their national budget and the use of public revenues.

Health and Education Expenditures

Public investments in education and health are essential for alleviating poverty and realizing the MDGs. In Nigeria, spending on these sectors in both absolute and relative terms is entirely insufficient. Whereas the governments of rich countries allocate, on average, 13 to 23 percent of state revenues to public health provisions, the share in many developing countries remains stagnant at fewer than 10% (see Table 3). In the last few years, the Nigerian governments have shifted the burden of healthcare provision onto the shoulders of private households (WHO, 2006).

Table 3: Public and private expenditures on health

Country	Public expenditure in % of total expenditure on health		Private expenditure in % of total expenditure on health		General government expenditures on health in % of total government expenditure	
	1999	2003	1999	2003	1999	2003
Angola	45.3	84.2	54.7	15.8	2.4	5.3
Argentina	56.5	48.6	43.5	51.4	15.0	14.7
Botswana	54.3	58.2	45.7	41.8	6.7	7.5
Burkina Faso	44.0	46.8	56.0	53.2	10.0	12.7
Burundi	19.9	23.3	80.1	76..7	2.8	2.0
Congo	63.8	64.2	36.2	35.8	4.9	4.3
Egypt	33.9	42.6	66.1	57.4	5.6	8.2
Gabon	68.4	66.6	31.6	33.4	10.9	12.8
India	24.6	24.8	75.4	75.2	4.5	3.9
Mozambique	63.0	61.7	37.0	38.3	12.1	10.9
Nigeria	29.1	25.5	70.9	74.5	5.4	3.2
Eritrea	70.3	45.5	29.7	54.5	2.9	4.0
Pakistan	32.6	27.7	67.4	72.3	4.0	2.6
Uruguay	34.8	27.2	65.2	72.8	10.6	6.3

Source: WHO, 2006

Federal Government expenditures on education are below 10 percent of its overall expenditures. Table 4 presents these shares, and separately for recurrent and capital expenditures, based on actual expenditures between 1997 and 2002. Overall, the shares have varied between 9.9 and 7.6 percent and the trend has been largely downward.

Table 4: Federal Government Expenditure on Education as share of Federal Expenditure, 1997- 2002 (%)

	1997	1998	1999	2000	2001	2002
Recurrent	12.3	12.0	11.7	9.4	9.5	9.1
Capital	6.1	7.5	5.0	8.5	6.0	6.0
Total	9.9	9.6	9.0	9.0	7.6	8.0

Source: Federal Government of Nigeria Annual Budget (various years). Reported in Herbert (2002)

Military expenditures at the expense of the poor

Military expenditure and debt servicing account for a high proportion of total expenditure in many developing countries, including Nigeria and the two items are closely connected. Real military expenditures probably lay far beyond the official figures, as for many countries, particularly in Africa; there is no dependable data available. Some components of military expenditures and some sources of income – for example reimbursements for troop contributions to UN peacekeeping operations – do not appear in the official budget figures of

countries like Mali, Ethiopia, Ghana and Nigeria (Mitoogun, 2003). In 2004, developing countries spent an average of 15.6% of their budgets on the military, while wealthy countries spent an average of 10.5% (SIPRI, 2005).

Steps Toward Achieving Global Tax Justice

Every year, developing countries including Nigeria lose billions of dollars through tax evasion, tax avoidance and inefficient fiscal authorities. A large portion of the already scarce revenues goes toward military expenditures, harmful subsidies and debt repayment, none of which contribute toward alleviating poverty and promoting sustainable development. The responsibility for reform must be for all nations world-wide. It is the industrialized countries, particularly the EU, the USA and the institutions that they dominate (the IMF, the World Bank and the WTO) who are responsible for the erosion of revenue bases due to forced tariff reductions and the resistance to long overdue debt cancellations. They must reform their economic and trade policies accordingly. A basic requirement for strengthening public revenues is a broad based tax system. Taxation should be based on ability to pay, and rich individuals and large landowners should be taxed accordingly. Capital and resource consumption should be taxed instead of labour. A flat and undifferentiated value-added tax is regressive, burdens the poor, and cannot contribute to forming a just tax system. Development cooperation should actively support these reforms through capacity building and technical assistance.

Strengthen Tax Authorities and Financial Administrations

A tax system is only as effective as the administrative machinery that is responsible for implementing and collecting the taxes. In many countries, such a tax administration still needs to be developed, or at least strengthened. This involves a legal framework as well as necessary staff and technical infrastructure. Only in this way can shadow economies be reduced, tax avoidance overcome and tax evasion prevented. Development cooperation can provide the crucial technical and financial support for this.

Tax Compliance As: Part of Corporate Accountability

The debate on corporate social responsibility and accountability has so far concentrated on basic environmental and social standards, human rights and preventing corruption. It is important that enterprises contribute to the public finances of host countries by making timely payment of their tax liabilities. In particular, enterprises should comply with the tax laws and regulations in all countries in which they operate and should exert every effort to act in accordance with both the letter and spirit of tax laws and regulations. This would include such measures as providing to the relevant authorities the information necessary for the correct determination of taxes to be assessed in connection with their operations and conforming transfer pricing practices to the arm's length principle.

Fight Bribery and Corruption

In order to avoid the embezzlement of public funds and reduce revenue losses due to fraud, corruption and bribery, more decisive rules and procedures are necessary both in affected countries and at the international level. The United Nations Convention against Corruption, which came into force on 14 December 2005, plays an important role here. This comprehensive international set of rules has been signed by 140 countries and ratified by 78 (as at November 2006). The convention contains regulations for criminal proceedings, preventing corruption, improving international cooperation and the repatriation of embezzled funds from abroad.

Stop the Pressure to Liberalize Trade in International Trade Negotiations

As long as the budgets in many countries, particularly in Nigeria, depend on customs revenues, forced trade liberalization leads to substantial losses in income. Governments of affected countries cannot adequately compensate for these cuts in the short term. The EU and the USA should therefore stop pressuring developing countries to reduce their tariffs in negotiations at the World Trade Organization, as well as in negotiations for inter-regional trade agreements, instead, affected countries (in accordance with the principle of 'Special and Differential Treatment') should be able to determine the pace and the extent of further liberalization steps on their own.

Reduce Military Expenditures and Strengthen Peace Building

By reducing military budgets, large sums of money could be freed up for education and health. A precondition for this, however, is strengthened support of conflict prevention, peacekeeping and peace-building. The new UN Peace-building Commission can play an important role in this if it is equipped with the necessary financial resources. At the same time, the largest arms-producing countries (in particular the five permanent members of the Security Council) have a responsibility to improve the control and regulation of their arms exports and to support a Global Arms Trade Treaty.

CONCLUSION

Large corporations and wealthy individuals are increasingly avoiding their obligation to contribute to society through taxation. With the aid of governments, they are shifting the tax burden further onto ordinary citizens and smaller businesses. Governments claim that revenues are too low to achieve social justice through decent public goods

and services; privatization and cuts in social expenditure are presented as the only solutions. Instead, we argue for tax justice: to restore the ability to tax the wealthy beneficiaries of globalization. Tax avoidance now occurs on a massive global scale. Assets held offshore, beyond the reach of effective taxation, are already estimated to equal one-third of total global assets. Around half of all world trade appears to pass through tax haven jurisdictions, as corporations shift profits to where they can avoid tax. Networks of banks, lawyers and accountants create complex and secret financial structures, reducing transparency and enabling tax evasion. Claims of corporate social responsibility are undermined when low corporate tax payments are exposed. Such behaviour is economically inefficient, socially destructive, and profoundly unethical. These trends threaten democracy and development. A process of tax competition at the global level undermines the social contract previously set within the national arena, as states compete to offer tax exemptions to capital. Tax havens grow more numerous, the world's richest financial centres get even richer, taxes paid by large corporations fall, and ordinary citizens bear the cost. We call upon all concerned to meet this challenge, by building global and national campaigns for tax justice.

REFERENCES

Cobham, A. (2005). Tax evasion, tax avoidance and development finance. Oxford: Queen Elizabeth House (QEH Working Paper Series).

Ernst and Young, (2005a). Transfer pricing global reference guide.

Ernst and Young, (2005b). 2005–2006 Global transfer pricing surveys – Global transfer pricing trends, practices, and analysis, November 2005. Ernst & Young.

Farrell, D., Remes, J.K. & Schulz, H. (2004). The truth about foreign direct investment in emerging markets. In: *McKinsey Quaterly* 2004: 1.

International Labour Office, (2002). Decent work and the informal economy. Geneva: ILO.

International Labour Office (2003). ILO Database on export processing zones. Geneva: ILO.

KPMG, (2004). Corporate tax rate survey for 2004 – rates still falling. Toronto: KPMG.

KPMG, (2006). Die Besteuerung in China. Berlin: KPMG;

Martens, J. (2007). The precarious state of public finance. Global policy forum: DGB Bildungswerk.

Mitoogun, W. (2003). The process of budgeting for the military sector in Africa. In: SIPRI Yearbook 2003. Oxford: OUP.

OECD, (2000). Die OECD-Guidelines for multinational enterprises. Revision 2000. Paris: OECD.

OECD, (2003). Articles of the model convention with respect to taxes on income and capital. Paris: OECD.

OECD, (2005). Environmental fiscal reform for poverty reduction. A DAC reference document. Paris: OECD.

Schneider, F. (2004). The size of the shadow economies of 145 countries all over the World: first results over the period 1999 to 2003. Bonn: For schungsinstitut zur Zukunft der Arbeit (IZA Discussion Paper 1431).

SIPRI, (2005). Stockholm International Peace Research Institute yearbook 2005. Stockholm.

SIPRI, (2006). Recent Trends in Military Expenditure. Stockholm: SIPRI

Social Watch Deutschland, (2005). Social watch report 2005. roars and whispers. gender and poverty: promises vs. action. Montevideo: Social Watch.

Tax Justice Network, (2005). Tax us if you can. London: Tax Justice Network.

United Nations, (2005). International financing system and development. Report of the Secretary-General New York: UN (UN Dok. A / 60 / 163, 27 July 2005).

UN Millennium Project, (2005). Investing in development. A practical plan to achieve the Millennium Development Goals. New York

UNDP, (1999). Human development report 1999. Globalization with a human face. New York.

UNDP, (2006). Human development report 2006. Beyond scarcity, power, poverty and the global water crisis. New York.

WHO (2006). The World Health Report 2006. Geneva: WHO.

World Bank, (2005). Global development finance. Washington, D. C.: World Bank.

World Bank, (2006). Global development finance. Washington, D. C.: World Bank.