

TAX INCENTIVES AND FOREIGN DIRECT INVESTMENT: THE PARADOX OF REVENUE GENERATION IN NIGERIA

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Abstract

The study examines paradox of revenue generation in the quest to attract FDI through tax incentives. The paper takes a literature review and empirical approaches. Prior literatures were reviewed with a view to outlining the outcomes and positions of existing related studies. In addition, data for sectoral performance measured as a ratio of sector contribution to GDP against Foreign Direct Investment (FDI) trends over a period of approximately 45 data points (1981-2023) were sourced from World Development Indicator (2024) and Central Bank of Nigeria (2024) Statistical Bulletin and charted on a graph with view to highlighting some key sectors contribution to GDP against FDI trends. The findings reveal that indiscriminate tax incentives in Nigeria have led to significant fiscal losses; with limited returns. In the same vein, the graph chart highlights that while tax incentives appear to significantly influence FDI inflows, their impact on sectoral GDP contributions is uneven. Some sectors demonstrate moderate responsiveness, while others remain stagnant despite generous fiscal incentives. This underscores the need for a more integrated approach combining tax incentives with infrastructure development, regulatory reforms, and institutional stability to drive sustainable sectoral growth and diversify Nigeria's economic base. Theoretical frameworks, such as the Neoclassical Theory of Investment and the Eclectic Paradigm, underscore the need for performance-based incentives and alignment with broader economic strategies. Policy recommendations include enforcing stricter oversight, conducting periodic reviews, and incorporating sunset clauses for time-bound incentives. A shift toward addressing non-tax barriers, such as infrastructure deficits and governance inefficiencies, is essential for sustainable development. Selective, evidence-based tax incentives integrated into a comprehensive economic framework can enhance Nigeria's investment climate and foster long-term growth without compromising revenue generation.

Key words: revenue, tax, incentives, investment

1. Introduction

The global economy thrives on investments, which serve as the backbone for fostering economic growth, employment creation, and technological advancement. Among the various forms of investments, foreign direct investment (FDI) plays a pivotal role in enhancing economic dynamism, particularly in developing economies.

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FDI represents an enduring interest by an entity resident in one economy and an enterprise resident in another (UNCTAD, 2023).

Developing countries, including Nigeria, have recognized the potential of FDI as a catalyst for economic growth, providing access to international capital, advanced technologies, and global markets. To harness these benefits, governments employ various strategies to attract FDI, including offering tax incentives (Adeleye et al., 2017). These incentives are designed to make the investment climate more appealing, energizing the economy and facilitating sustainable growth.

Tax incentives are widely used as a policy tool to stimulate FDI in key sectors of the economy, such as manufacturing, agriculture, and information technology. They come in various forms, including tax holidays, reduced tax rates, and exemptions from import duties on capital goods. For instance, in Nigeria, the Pioneer Status Incentive grants qualifying industries and products corporate income tax exemptions for up to five years (Federal Inland Revenue Service, 2021). These measures aim to alleviate the initial burdens investors face financially and create an enabling environment for business operations. However, while tax incentives have proven effective in attracting FDI in certain contexts, their implications extend beyond mere investment inflows.

Prior studies, such as those by James (2019) and Zolt (2022), highlight that the effectiveness of tax incentives often depends on factors such as the stability of the regulatory environment, the transparency of fiscal policies, and the strategic alignment of incentives with national economic priorities. Moreover, tax incentives can sometimes lead to revenue losses for the government, sparking debates about their overall efficacy. This leads to the paradox of revenue generation in the quest to attract FDI through tax incentives.

On the one hand, these incentives are crucial for stimulating investments that can drive economic growth and generate employment opportunities. On the other hand, they result in significant revenue forfeitures, which may undermine the government's fiscal capacity to fund essential public services and infrastructure development. For instance, empirical evidence from Nigeria indicates that while tax incentives have contributed to increased FDI inflows, they have also led to a considerable decline in tax revenues, raising concerns about their long-term sustainability (Babatunde & Laoye, 2018). This paradox states the complexity of balancing the objectives of investment promotion and revenue mobilization in a resource-constrained economy like Nigeria.

Against this backdrop, this paper explored the nexus between tax incentives and foreign investments, examining their dual impact on Nigeria's economic growth and revenue generation. The broad objectives of the study are threefold: first, to evaluate the effectiveness of tax incentives in attracting FDI; second, to assess their implications for government revenue; and third, to propose policy recommendations for optimizing the use of tax incentives without compromising fiscal sustainability.

2. Literature Review

Foreign Direct Investment in Nigeria

Foreign Direct Investment (FDI) has emerged as a critical instrument for economic growth, particularly in developing economies such as Nigeria. FDI involves the inflow of long-term capital investments into a country by foreign entities, typically through establishing subsidiaries, joint ventures, or acquiring significant stakes in local businesses. Unlike portfolio investments, FDI signifies an active interest in the management and operations of a business, thereby facilitating deeper economic engagement (Siddiqui & Merchant, 2022).

In Nigeria, FDI addresses domestic investment deficits, fostering industrial growth, and enhancing global economic integration. However, the Nigerian economy has historically relied on FDI to bridge domestic savings and investment gaps, especially in the oil and gas, telecommunications, and manufacturing sectors. FDI inflows provide access to external capital, advanced technologies, and managerial expertise, which contribute to the modernization of industries and infrastructure improvement. Furthermore, FDI fosters employment creation, enhances productivity, and facilitates Nigeria's integration into global value chains, boosting export competitiveness (Adams & Opoku, 2020). However, the extent to which these benefits are realized depends on various factors, including the regulatory environment, infrastructure quality, and macroeconomic stability.

Moreover, several determinants of FDI are particularly relevant to Nigeria. Nigeria's market size and growth potential, driven by its population of over 200 million people, make it an attractive destination for market-seeking investments. However, macroeconomic instability, characterized by exchange rate volatility, high inflation, and policy uncertainties, poses significant challenges. The country's infrastructural deficits, particularly in energy and transport, further limit its capacity to attract and sustain FDI. Despite these challenges, targeted policy reforms, such as the liberalization of key sectors and incentives introduced like tax holidays, have bolstered Nigeria's FDI attractiveness (Farooq et al., 2022; Iamsiraroj & Ulubaşoğlu, 2020).

The oil and gas sector remains the primary recipient of FDI in Nigeria due to the country's abundant natural resources and strategic position as a global energy supplier. However, this reliance on resource-seeking FDI has led to a concentration of investments in extractive industries, often at the expense of economic diversification. The over-dependence on oil revenues has exposed Nigeria to external shocks, such as fluctuations in global oil prices, undermining the stability of FDI inflows. In recent years, focusing on diversifying the economy by attracting FDI to non-oil sectors such as agriculture, technology, and renewable energy. These sectors hold significant potential for fostering inclusive growth and reducing the country's vulnerability to external shocks (Kang & Jiang, 2020).

While the benefits of FDI in Nigeria are well-documented, its associated risks warrant critical examination. Profit repatriation by foreign investors often diminishes the long-term economic benefits of the host country retained. Moreover, excessive reliance on foreign investments can hinder the development of domestic industries, creating economic dependencies that limit Nigeria's self-reliance. Environmental concerns are also significant, particularly in the oil and gas sector, where FDI projects have often contributed to pollution and resource depletion. For instance, oil spills and gas flaring in the Niger Delta have had devastating effects on local ecosystems and communities (Zhu et al., 2021).

Furthermore, the global FDI trends, influenced by geopolitical and economic factors, shape Nigeria's FDI landscape. The COVID-19 pandemic, for example, caused a substantial decline in global FDI flows, dropping to \$929 billion in 2020 from pre-pandemic levels of \$1.5 trillion in 2019. Nigeria experienced a similar decline as global investors adopted a cautious approach amid uncertainty. However, the post-pandemic recovery has presented new opportunities for Nigeria to attract investments in emerging sectors such as digital infrastructure, healthcare, and renewable energy, aligning with global shifts toward sustainable and technology-driven development (Baier et al., 2023).

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Tax Incentives in Nigeria

Tax incentives in Nigeria are critical instruments employed to attract foreign direct investment (FDI) and stimulate economic growth. These incentives aim to reduce the tax burden on businesses, enhance the country's competitiveness, and promote industrial and infrastructural development. They have been widely applied across various sectors, including oil and gas, manufacturing, agriculture, and mining. However, the oil and gas sector benefits significantly from tax incentives, particularly through the Petroleum Profits Tax Act. This legislation grants tax holidays, accelerated depreciation, and capital allowances to companies engaged in exploration and production activities. Similarly, the mining sector enjoys tax exemptions for the first three years of operation, especially for firms involved in the extraction of solid minerals (Amadi, 2020; PricewaterhouseCoopers, 2024).

In the manufacturing industry, companies involved in high-priority areas such as steel production and fertilizer manufacturing receive tax exemptions for up to five years, enabling them to lower operational costs and expand their activities (Oladejo et al., 2019). Agriculture is another focus area for tax incentives, particularly for small and medium-sized enterprises (SMEs) engaged in primary production. These businesses are often granted an initial tax-free period of four years, which may be extended based on performance. Furthermore, companies located in export processing zones (EPZs) and free trade zones (FTZs) enjoy additional incentives such as 100% tax exemptions and unrestricted access to foreign exchange, provided their activities are primarily export-oriented (Chukwuma et al., 2021).

Conceptually, tax incentives are designed to attract FDI by reducing investment costs, thereby improving the host country's appeal to international investors. The Neoclassical Growth Model highlights the role of reduced taxation in lowering capital barriers, which stimulates economic growth. Tax incentives create a competitive advantage by making a country's fiscal regime more favorable, particularly in regions where infrastructure and other factors remain underdeveloped (Phillips, 1996).

Empirical studies demonstrate that tax incentives can significantly boost FDI inflows into priority sectors such as manufacturing and resource extraction (Adebayo & Udeh, 2020). However, the effectiveness of tax incentives in Nigeria has been subject to debate. While these measures have succeeded in attracting foreign capital to specific industries, issues such as poor implementation, limited transparency, and weak institutional frameworks undermine their full potential. Critics argue that the overuse of tax incentives often leads to revenue losses without significant reinvestment by foreign firms in local communities. Additionally, the scale of incentives granted to foreign companies sometimes creates an uneven playing field for domestic businesses, which do not receive equivalent support (Odunuga, 2019; Amadi, 2020).

Empirical evidence suggests that the long-term success of tax incentives in attracting FDI depends on complementary factors such as political stability, reliable infrastructure, and the enforcement of property rights. While tax incentives reduce financial barriers for investors, broader structural reforms are essential to sustain growth and development. A study by Chukwuma et al. (2021) emphasizes that tax incentives alone cannot offset the challenges of an unstable investment climate, further underscoring the need for integrated economic policies. So, tax incentives in Nigeria remain vital to fostering sectoral growth and attracting FDI.

Tax Incentives in some key sectors in Nigeria

The Petroleum Profit Tax Act (PPTA) is a cornerstone of Nigeria's fiscal framework for the oil and gas sector. It mandates a tax rate of 85% on profits from petroleum operations for joint ventures and 50% for companies operating under the new

Petroleum Industry Act (PIA) regime. However, companies involved in deep offshore and inland basin operations benefit from significantly reduced PPT rates of 30%, aimed at fostering investments in less-explored regions (Federal Inland Revenue Service, 2022). To encourage capital inflows, the Nigerian government offers investment tax allowances (ITA) and tax credits for qualifying expenditures. For instance, under the PIA, companies can claim up to 50% ITA on qualifying expenditure in the first year of production.

These incentives are designed to offset initial project costs, thereby reducing the financial burden on investors and promoting the development of marginal fields (NEITI, 2021). Companies engaged in exploration and productions are entitled to generous capital allowances under the PPTA. These include a 20% annual allowance for five years on qualifying capital expenditures and a 1% retention allowance for ongoing operations. The introduction of accelerated depreciation under the PIA further incentivizes exploration, particularly in frontier basins such as the Chad Basin and the Benue Trough (Deloitte, 2022).

In order to attract investments and promote mining, the government has implemented various tax incentives in the mining sector. One of the most notable is the three-year tax holiday available to mining companies, which can be extended for two additional years. This policy enables firms to reinvest their earnings, supporting their growth and operational sustainability. Additionally, companies enjoy substantial capital allowances on mining equipment, with up to 95% of the capital costs deductible in the first year. This allowance significantly reduces taxable income, providing financial relief to operators (PwC, 2023).

Furthermore, exemptions from customs and import duties on mining equipment reduce costs associated with acquiring advanced technology, improving efficiency and profitability (World Bank, 2021). These incentives have led to an increase in both local and foreign investments in the sector. Between 2019 and 2023, foreign direct investment in mining grew by 23%, attributed largely to the fiscal advantages provided. The resulting investments have not bolstered production, created employment opportunities, and spurred the development of related industries, contributing to Nigeria's long-term economic diversification objectives (Laporte & de Quatrebarbes, 2022).

The Pioneer Status Incentive (PSI) is one of the most prominent tax relief mechanisms targeting the manufacturing sector. Under this scheme, eligible companies enjoy a tax holiday of up to five years for newly established enterprises or those engaging in industries considered critical to economic development. This incentive is aimed at reducing the financial burden during the nascent stages of operations and encouraging the establishment of new businesses (Adegbite & Olayemi, 2021).

To lower production costs and boost industrial productivity; governments often exempt manufacturers from import duties on raw materials and intermediate goods. This policy enables manufacturers to acquire essential inputs at reduced costs, enhancing their global competitiveness. Duty-free imports help mitigate the financial constraints faced by local manufacturers, especially in import-dependent economies (Okonjo & Adebayo, 2019). Moreover, value-added tax exemptions on essential goods and manufacturing inputs further incentivize production in the sector. These exemptions reduce the cost of final goods, thereby making locally manufactured products more affordable to consumers. Additionally, VAT exemptions serve as a buffer against inflationary pressures, promoting greater access to essential commodities (Ogunleye, 2020).

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Tax incentives have significantly bolstered the manufacturing sector's capacity to compete in domestic and international markets. By lowering the cost of doing business, these measures facilitate investment in modern technologies, improved infrastructure, and workforce training, which are critical for enhancing productivity. Countries that have effectively implemented such incentives have witnessed increased foreign direct investment (FDI) inflows and accelerated industrialization (Beck et al., 2021).

Agriculture serves as a cornerstone of food security and employment, particularly in developing economies, where it supports livelihoods and sustenance for millions. Corporate tax exemptions enable agricultural businesses to reinvest earnings, fostering expansion and innovation. For example, in Nigeria, companies engaged in agricultural production benefit from initial tax-free periods, with extensions available in some cases (Abdullahi et al., 2021). Import duty waivers facilitate the acquisition of modern farming equipment at reduced costs, driving mechanization and efficiency. This approach has proven essential in many developing economies, where mechanization is closely linked to increased agricultural yields (Beck & Smith, 2021).

Similarly, rural investment allowances incentivize businesses to operate in underdeveloped regions, contributing to regional development while addressing income disparities and reducing urban migration (Ogunleye et al., 2022). Tax incentives have significantly contributed to sectoral growth and improved food production by reducing operational costs and enabling reinvestment in production activities. Studies from Sub-Saharan Africa demonstrate a direct correlation between tax policies and increased agricultural output, underscoring their importance in meeting food security goals (Adeyemi et al., 2020). However, these benefits are often hindered by challenges such as poor access to financing and inadequate infrastructure. Small-scale farmers frequently lack affordable credit, limiting their ability to capitalize on tax incentives or invest in advanced farming techniques (Abdullahi et al., 2021). While tax incentives remain a tool for fostering agricultural growth and ensuring food security, addressing structural barriers is essential to maximize their impact.

A coordinated approach that combines fiscal policies with investments in infrastructure and financial accessibility can unlock agriculture's full potential, driving sectoral and economic development. Export processing and Free Trade Zones (FTZs) are integral to Nigeria's strategy for promoting exports and facilitating international trade. These zones aim to attract foreign direct investment (FDI), create jobs, and enhance industrialization by providing an enabling environment for businesses. As part of its export promotion framework, Nigeria offers several tax incentives to companies operating in FTZs to encourage participation and boost competitiveness in the global market (Adeyemo et al., 2020).

Among the most prominent tax incentives is the full tax exemption for businesses operating within FTZs. This provision eliminates corporate income tax obligations, enabling businesses to maximize profitability and reinvest in their operations (Okon et al., 2021). Additionally, duty-free importation and exportation of goods within FTZs facilitate the seamless movement of raw materials and finished products, reducing costs and enhancing efficiency. The repatriation of profits without taxation further incentivizes foreign investors by providing financial flexibility and security, strengthening Nigeria's position as a competitive destination for FDI (Eze & Chukwu, 2019).

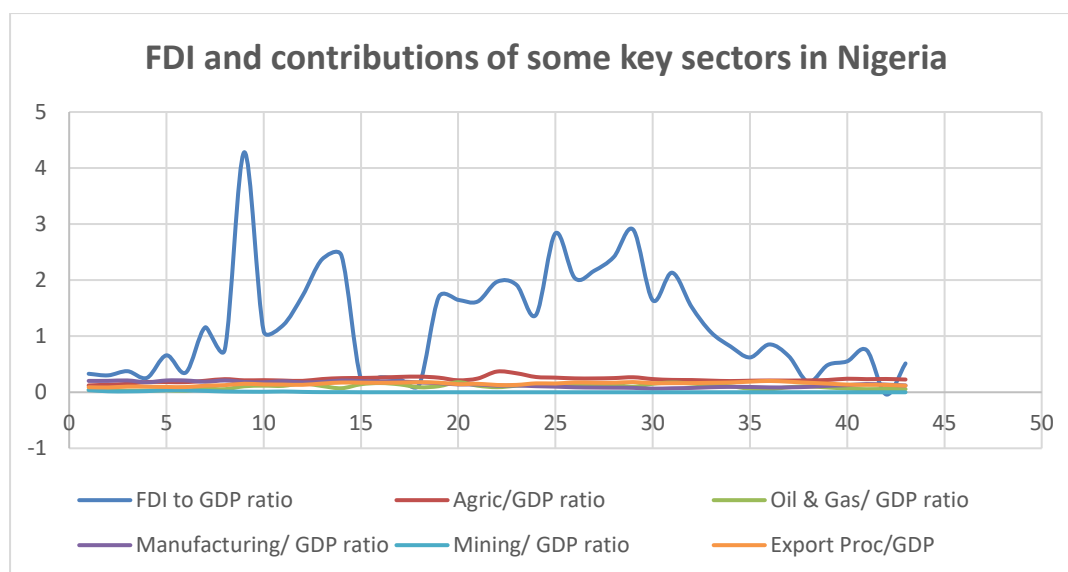


Figure 1

Source: Author's Research Output, 2025

In Figure 1, the chart presents a visual depiction of sectoral performance measured as a ratio of sector contribution to GDP against foreign direct investment (FDI) trends over a period of approximately 45 data points. The most noticeable trend is the FDI to GDP ratio, represented by the blue line, which exhibits significant volatility. These fluctuations suggest periods of intense capital inflows likely driven by shifts in tax policies, economic reforms, or global market conditions. Sharp spikes around the 10th, 25th, and 30th data points indicate when fiscal incentives may have successfully attracted foreign investments. However, the subsequent decline implies that such gains may not have been sustained, potentially due to policy reversals, insecurity, or macroeconomic uncertainties.

The agriculture sector, represented by the orange line, shows a relatively steady and marginal increase in its GDP ratio during the middle part of the observation period. This suggests a moderate response to tax incentives such as rural investment allowances, import duty waivers on agricultural inputs, and other sector-specific support mechanisms. The oil and gas sector, depicted in gray, maintains a consistent contribution to GDP, with slight increases following FDI spikes. This stability reflects the sector's maturity and the possible effectiveness of tax provisions under the Petroleum Industry Act (PIA), including reduced Petroleum Profit Tax rates and investment tax allowances.

As shown in yellow, manufacturing maintains a largely steady GDP ratio, indicating that tax incentives like the Pioneer Status Incentive (PSI), import duty exemptions, and VAT waivers may have helped cushion the sector from economic shocks without driving substantial growth. The mining sector, represented by the light blue line, shows minimal change throughout the period. Despite tax holidays and capital allowances on mining equipment, its low contribution may be due to the long gestation nature of mining projects and prevailing regulatory challenges. Export Processing Zones (EPZ), shown in green, also reflect limited gains despite benefiting from comprehensive tax exemptions and duty-free privileges. This suggests the presence of structural impediments such as poor infrastructure, bureaucratic inefficiencies, or weak global integration that undermine the effectiveness of such incentives.

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Overall, the chart highlights that while tax incentives appear to significantly influence FDI inflows, their impact on sectoral GDP contributions is uneven. Some sectors demonstrate moderate responsiveness, while others remain stagnant despite generous fiscal incentives. This underscores the need for a more integrated approach combining tax incentives with infrastructure development, regulatory reforms, and institutional stability to drive sustainable sectoral growth and diversify Nigeria's economic base.

Theoretical Perspectives Linking Tax Incentives to Foreign Direct Investment

Neoclassical Theory of Investment

The Neoclassical Theory of Investment, introduced by Jorgenson (1963), underscores the pivotal role of the marginal productivity of capital relative to its cost in shaping investment decisions. The theory suggests that firms allocate resources to investment opportunities when the expected returns on capital exceed its associated costs. Tax incentives, such as reductions in corporate income tax rates, tax holidays, and provisions for accelerated depreciation, play a critical role in reducing the effective cost of capital. Consequently, these measures amplify the expected net returns, thereby fostering an environment conducive to increased investment, including Foreign Direct Investment (FDI).

This theoretical framework also highlights the sensitivity of investment decisions to fiscal policies, particularly in capital-intensive industries where cost considerations are paramount. By lowering tax liabilities, host countries can effectively position themselves as more attractive destinations for investment. This is especially relevant in the global context of heightened tax competition, where nations strategically use tax incentives to secure capital inflows.

Empirical evidence supports this perspective. For instance, Wilson and Wildasin (2021) demonstrate that tax competition often results in reduced effective tax rates as countries strive to attract multinational corporations. Similarly, studies have found that tax policy reforms designed to reduce the marginal cost of capital can significantly increase the volume of FDI inflows (Bénassy-Quéré, Fontagné, & Lahrière-Révil, 2005). However, while tax incentives may serve as a crucial determinant of investment, they must be balanced against potential revenue losses and the risk of engaging in a "race to the bottom" that undermines fiscal sustainability.

The Eclectic Paradigm Theory

The Eclectic Paradigm, introduced by Dunning (1988), offers a comprehensive explanation for foreign direct investment (FDI) by integrating ownership, location, and internalization advantages. Ownership advantages relate to unique firm-specific assets such as proprietary technology, brand reputation, or economies of scale that enable firms to compete effectively in foreign markets despite the challenges of operating abroad. On the other hand, location advantages emphasize the role of geographical, economic, and institutional factors that make a host country attractive for investment. Tax incentives are particularly significant within the location component, as they can enhance the appeal of a host country, especially in developing economies where infrastructure or regulatory quality may be suboptimal. Instruments such as tax holidays, reduced corporate tax rates, and investment allowances are commonly used to offset these deficiencies.

Research by Zeng et al. (2020) underscores that tax incentives, when paired with other locational factors like market size, natural resource availability, and labor market characteristics, significantly influence the decision-making process of multinational corporations (MNCs). Furthermore, tax incentives can interact with other location

advantages to create a more compelling investment environment, facilitating long-term benefits such as technology transfer and job creation.

Internalization advantages, the third component, explain why firms prefer FDI over alternative entry modes such as licensing or joint ventures. By internalizing operations, firms can safeguard their proprietary assets, reduce transaction costs, and maintain production processes. Favorable tax regimes in host countries often complement these advantages by lowering the overall cost of entry and operation, making FDI a more attractive option for firms.

The interplay of these three components highlights the strategic importance of tax incentives in shaping FDI flows. However, for tax incentives to be effective, they must form part of a broader policy framework that addresses other critical factors, such as infrastructure development, market stability, and institutional quality. This comprehensive approach ensures that the benefits of FDI are sustainable, contributing to long-term economic growth and development in host countries. By aligning tax policies with the principles of the Eclectic Paradigm, governments can enhance their competitive position in the global market for FDI.

Public Choice Theory

The Public Choice Theory views tax incentives as negotiated outcomes between governments and potential investors, influenced by political, economic, and institutional factors (Buchanan & Tullock, 1962). This theoretical framework underscores the interplay of public and private interests, highlighting how governments strategically design tax incentives to achieve developmental goals, such as enhancing national welfare, promoting employment, or achieving industrial diversification.

Conversely, multinational enterprises (MNEs) exploit their bargaining power to negotiate favorable tax regimes that maximize their return on investment. However, the dynamic interplay between governments and MNEs often leads to tailored tax policies that align with both parties' interests. For instance, research by Klemm and Van Parys (2016) illustrates that tax incentives in Sub-Saharan Africa are frequently crafted to attract resource-seeking foreign direct investment (FDI), particularly in capital-intensive sectors like mining and energy. These incentives often include exemptions on import duties, corporate tax holidays, and reduced royalties, enabling MNEs to offset operational risks and high initial costs.

Governments, in turn, leverage these arrangements to secure infrastructure development, technology transfer, and job creation, albeit sometimes at the expense of forgone public revenue. Moreover, political stability and institutional quality emerge as determinants in these negotiations. Stable political environments create a conducive atmosphere for long-term investments, reassuring MNEs of reduced policy reversals or expropriation risks. For example, countries with robust governance frameworks and transparent legal systems tend to attract more sustainable FDI, as seen in Botswana's diamond mining industry. By contrast, weak institutions and corruption may result in poorly structured incentives that benefit politically connected entities over broader economic goals.

3. Methodology

The study took a literature review and empirical approach. Prior studies were reviewed with a view to highlighting the outcomes and positions of existing related works. In order to make an empirical validation in the Nigerian context, the study adopts a cross-section research design, secondary data for sectoral performance such as

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agriculture sector; oil and gas sector; manufacturing; mining sector and Export Processing Zones (EPZ), measured as a ratio of sector contribution to GDP against Foreign Direct Investment (FDI) trends over a period of approximately 45 data points (1981-2023) were sourced from World Development Indicator (2024) and Central Bank of Nigeria ([CBN], 2024) Statistical Bulletin and charted on a graph with view to highlighting some key sectors contribution to GDP against FDI trends.

4. Discussion

Implications of Tax Incentives on Revenue Generation

Tax incentives have a significant impact on revenue generation in developing economies like Nigeria. They aim to attract foreign direct investment (FDI) by reducing operational costs for investors but can also erode a country's revenue base if poorly designed. Theories such as the Neoclassical Theory of Investment, Market Imperfections Theory, Eclectic Paradigm, and Public Choice Theory provide valuable insights into balancing the benefits and drawbacks of tax incentives.

The Neoclassical Theory of Investment postulates that tax incentives lower the cost of capital, potentially boosting investment inflows. For instance, Nigeria's tax holidays and reduced corporate tax rates reflect efforts to align with this theory, but their effectiveness is undermined through institutional inefficiencies and weak infrastructure. Ogbonna and Ebimobowei (2021) highlight that these incentives often fail to yield sustained FDI inflows due to broader economic challenges. Furthermore, the Market Imperfections Theory argues that tax incentives can address structural barriers such as high entry costs and monopolistic practices. Nigeria's Pioneer Status Incentive exemplifies this approach, in capital-intensive sectors like manufacturing and telecommunication. However, empirical findings, such as those from Fasoranti (2013), reveal that without supporting infrastructure and transparent policy implementation, such incentives have a limited impact on long-term investment retention.

Also, the Eclectic Paradigm integrates factors like ownership, location, and internalization advantages, suggesting that tax incentives alone are insufficient to attract sustained FDI. Empirical evidence from Ajayi and Nwokedi (2022) shows that despite Nigeria's significant market size and resource base, its poor governance and economic instability discourage investors. This aligns with the paradigm's assertion that non-tax determinants, such as infrastructure and regulatory stability, play a more critical role in influencing investment decisions. Moreover, public Choice Theory critiques tax incentives emphasizing their susceptibility to rent-seeking behavior, where politically influential entities exploit these policies for preferential treatment. In Nigeria, this often leads to inequitable tax regimes, revenue leakages, and reduced efficiency in resource allocation. Brennan and Buchanan (1980) highlight how unchecked rent-seeking behavior undermines the effectiveness of tax incentive policies; a challenge Nigeria continues to face.

Empirical studies comparing Nigeria with other developing nations further illustrate the implications of tax incentives on revenue generation. Mauritius, for example, leverages transparent and stable tax regimes to attract FDI while maintaining fiscal discipline (Zhou & Chindanya, 2019). Similarly, Malaysia combines tax incentives with industrial policies to promote economic diversification and export growth (Salleh & Rajab, 2020). These experiences contrast sharply with Nigeria, where overreliance on broad-based incentives often leads to revenue losses without significant investment inflows. External factors also play a critical role in determining the effectiveness of tax incentives. Global competition for FDI often compels nations to

offer increasingly generous incentives, resulting in a "race to the bottom" that erodes fiscal revenues.

For Nigeria, challenges such as corruption, weak infrastructure, and economic volatility further diminish the impact of tax incentives. As Egger and Merlo (2019) argue, these non-tax factors often outweigh the benefits of tax reductions in attracting FDI. Ajayi and Nwokedi (2022) provide a concrete example, showing how FDI inflows into Nigeria declined during the 2020 oil price crash despite existing tax incentives, underscoring the limited role of tax policies in mitigating broader economic risks. Thus, the implications of tax incentives on revenue generation highlight the need for strategic policy design that integrates theoretical insights and empirical evidence.

Nigeria must adopt targeted, transparent, and performance-based tax policies to balance short-term investment attraction with long-term fiscal sustainability while addressing critical non-tax factors like infrastructure and governance. Insights from Mauritius and Malaysia underline the importance of aligning tax incentives with broader economic strategies to maximize their developmental impact.

Evaluating the Implications of Tax Incentives

Tax incentives stimulate economic growth and attract investment. However, their effectiveness must be rigorously evaluated to ensure they achieve their intended objectives without creating undue fiscal burdens. Metrics such as investment attraction, job creation, and revenue growth are commonly used to assess the impact of tax incentives (Okonjo-Iweala et al., 2021). These metrics provide insights into the extent to which tax policies drive economic activities and contribute to national development.

Tax incentives have notable advantages. They stimulate economic activities by reducing the financial burdens on businesses, thereby encouraging expansion and innovation. For instance, they significantly attract foreign direct investment (FDI), as investors are drawn to favorable tax regimes. Evidence from Nigeria demonstrates how incentives, such as corporate tax holidays and duty-free imports, have encouraged multinational corporations to establish operations in sectors like manufacturing and agriculture (Eze & Chukwu, 2020). Moreover, tax incentives contribute to job creation by fostering industrial growth and enhancing business competitiveness, particularly in developing economies.

Despite their benefits, tax incentives also have drawbacks. One major issue is revenue leakage, as governments forgo potential tax income in favor of incentives, often without guaranteed returns on investment. Additionally, inequities arise when incentives disproportionately benefit large corporations at the expense of smaller enterprises, creating an uneven playing field. Unintended consequences, such as tax evasion and abuse of incentive programs, further undermine their effectiveness (Adeyemi et al., 2021).

A comparative analysis with similar economies, such as Kenya and Bangladesh, highlights the challenges and opportunities of tax incentives. While Kenya has successfully utilized tax incentives to boost its technology sector, inefficiencies and governance issues have limited their impact in Nigeria. Bangladesh, on the other hand, has leveraged tax incentives in its garment industry, significantly increasing exports and employment. These examples underscore the importance of tailoring tax policies to local contexts while learning from international best practices (Rahman & Khan, 2020).

5. Conclusion and Recommendations

The role of tax incentives in Nigeria's economic framework remains deeply contentious. While they offer a strategic tool to attract foreign direct investment and

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counterbalance structural deficiencies like infrastructure gaps and regulatory inefficiencies, their broader impact on revenue generation and economic sustainability demands scrutiny. Nigeria's reliance on tax incentives has not consistently translated into substantial financial benefits, such as job creation, sectoral diversification, or technology transfer. Instead, the country has faced significant revenue leakages, exacerbated by weak institutional frameworks and limited accountability mechanisms.

From a theoretical perspective, tax incentives align with the Neoclassical Theory of Investment and the Eclectic Paradigm when they effectively lower the cost of capital and leverage location-specific advantages to draw investment. However, the practical application of these theories in Nigeria often falls short due to inefficiencies in governance, the absence of performance-based incentive structures, and a lack of alignment with broader economic priorities. Empirical evidence further supports the assertion that tax incentives alone cannot compensate for critical deficiencies in infrastructure, institutional stability, and human capital development.

The paradox of tax incentives is stark in Nigeria, while they aim to attract investment, their poor design and implementation frequently erode fiscal capacity, undermining long-term development goals. This study concludes that indiscriminate and overly broad tax incentives are not sustainable. Instead, Nigeria should pivot a model that integrates tax incentives into a broader economic strategy, focusing on infrastructure development, governance reform, and targeted investments. Measures like performance-based incentives tied to measurable outcomes, sunset clauses to limit indefinite tax holidays, and robust cost-benefit analyses are critical to maximizing their benefits.

In light of these considerations, the researchers do not encourage the continued reliance on broad-based tax incentives in their current form. Their fiscal costs outweigh their economic benefits and perpetuate a dependency cycle undermining budgetary resilience. While selective, well-designed incentives may play a role in strategic sectors, the emphasis should shift toward addressing non-tax barriers to investment. By adopting a more transparent, accountable, and evidence-based approach, Nigeria can attract sustainable investments and enhance its economic growth trajectory without compromising revenue generation.

To address the challenges associated with tax incentives and optimize their role in fostering sustainable economic development, the following recommendations are proposed, with a focus on balancing short-term investment attraction and long-term fiscal sustainability:

- i. The government should ensure tax incentives are targeted toward strategic sectors with high developmental potential. This aligns with national economic priorities and maximizes societal benefits through job creation, technology transfer, and local capacity building.
- ii. Policies should include sunset clauses and periodic reviews to assess their performance. The government must ensure incentives are adjusted or discontinued based on measurable impacts, preventing indefinite fiscal losses.
- iii. Government agencies must improve governance structures by establishing independent bodies to monitor and evaluate the use of tax incentives. This will enhance accountability, transparency, and efficiency in their administration.
- iv. Tax policies should align with long-term objectives such as industrialization, infrastructure development, and economic diversification. This integration ensures coherence across all government initiatives aimed at sustainable growth.

- v. Beyond fiscal measures, the government should focus on improving critical investment enablers such as infrastructure, governance, and regulatory stability. Tackling these barriers will make Nigeria more competitive without over-relying on tax incentives.
- vi. Engaging diverse stakeholders, including local businesses, investors, and civil society, ensures tax incentive policies reflect collective interests. This participatory approach strengthens public trust and policy effectiveness.
- vii. The government should benchmark successful models, focusing on transparent and performance-driven tax regimes. This approach ensures policies are effective and aligned with global standards.

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Appendix

Year	FDI to GDP ratio	Agric/GDP ratio	Oil & Gas/ GDP ratio	Manufacturin g/ GDP ratio	Mining/ GDP ratio	Export Proc/GDP
1981	0.329732	0.12240409	0.042495	0.202637	0.038226325	0.08968415
1982	0.301613	0.1350269	0.033084	0.203323	0.01723728	0.08588984
1983	0.375338	0.14990733	0.026961	0.210983	0.015301383	0.10123955
1984	0.257422	0.18308361	0.031564	0.177364	0.021124009	0.10027008
1985	0.658453	0.1822764	0.035081	0.210545	0.034817953	0.09461223
1986	0.352544	0.18020425	0.027948	0.2101	0.033009151	0.09266697
1987	1.15907	0.20552106	0.063265	0.187835	0.024055437	0.11713377
1988	0.762696	0.23371649	0.054802	0.210196	0.013468675	0.12716877
1989	4.282088	0.21275597	0.106858	0.18354	0.010134016	0.15092731
1990	1.087951	0.21556263	0.117369	0.177826	0.008593904	0.1401534
1991	1.196726	0.20885283	0.114394	0.194946	0.0135376	0.13701108
1992	1.722383	0.20321159	0.157808	0.176545	0.006135448	0.1330075
1993	2.371903	0.2349113	0.111556	0.183763	0.002303762	0.15517862

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1994	2.436852	0.25173849	0.071757	0.209271	0.00227124 2	0.17322873
1995	0.238322	0.25486506	0.14322	0.199937	0.00046709 9	0.17091258
1996	0.268818	0.26199159	0.164152	0.191011	0.00043443	0.16903781
1997	0.233794	0.27416651	0.140136	0.191985	0.00044401 3	0.17176212
1998	0.137154	0.27908371	0.088821	0.174506	0.00041802 5	0.17893939
1999	1.699069	0.26028486	0.108245	0.162574	0.00040047 2	0.1713673
2000	1.648321	0.21357241	0.179345	0.139334	0.00035054 5	0.1444751
2001	1.618616	0.24475355	0.117408	0.139254	0.00027229 9	0.15098228
2002	1.971584	0.36965083	0.090597	0.118118	0.00012590 7	0.12991727
2003	1.914621	0.33827061	0.117142	0.120606	0.00010681 7	0.13158161
2004	1.380374	0.27230454	0.135762	0.108616	0.00	0.15843767
2005	2.836294	0.26089283	0.14192	0.100611	0.00	0.15630347
2006	2.035753	0.24734991	0.133167	0.088529	0.00	0.17461137
2007	2.169195	0.24662577	0.12584	0.084014	0.00	0.1698569
2008	2.413739	0.25279751	0.131901	0.081689	0.00	0.16961199
2009	2.900249	0.26748855	0.098871	0.078384	0.00	0.1817032
2010	1.642074	0.2352451	0.151483	0.064516	0.00	0.16211926
2011	2.133118	0.22032782	0.173267	0.07106	0.00	0.1620628
2012	1.523782	0.21785232	0.155855	0.076981	0.00	0.16313484
2013	1.069539	0.20758623	0.1271	0.089289	0.00	0.16915
2014	0.817478	0.19990255	0.106687	0.096358	0.00	0.17422513
2015	0.621502	0.20631893	0.062939	0.094284	0.00	0.18942345
2016	0.853396	0.2098311	0.052326	0.086797	0.00	0.2015674
2017	0.642183	0.20846571	0.090131	0.08742	0.00	0.18776214
2018	0.183821	0.21203774	0.103991	0.096489	0.00	0.16979603
2019	0.485778	0.21906296	0.085145	0.115224	0.00	0.15455505
2020	0.551894	0.24143306	0.066097	0.126673	0.00	0.13683025
2021	0.751578	0.23357059	0.054727	0.146107	0.00	0.1322639
2022	-0.03913	0.23691872	0.059164	0.135935	0.00	0.13148292
2023	0.514646	0.22724938	0.055907	0.12133	0.00	0.11691858

Sources: World Development Indicator (2024) and CBN Statistical Bulletin (2024)