TAXATION AND NIGERIAN ECONOMY: BENCHMARKING VALUE ADDED TAX 2000 – 2020

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Abstract

The economic growth of any nation depends on government ability to generate adequate revenue to provide infrastructural facilities needed to strengthen the productive capacity of the economy. VAT seems to be one of the most effective means of mobilizing a nation's internal revenue and providing conducive environment for economic growth. The main focus of this study is to investigate the effect of VAT on Nigerian economy to discover the imperativeness *of the tax policy. Descriptive research design was adopted for this study. Data for VAT and RGDP were obtained from the CBN Statistical Bulletin and Federal Inland Revenue Service (FIRS) Publications for the period 2000-2020 and analyzed using SPSS 20 software. It was discovered that VAT has a significant effect and positively related to GDP. The study concludes that VAT revenue made a significant contribution to the Economic Growth of Nigeria within the period under review. Hence, the study recommended that Nigerian government should use VAT proceeds to improve standard of living of the populace and infrastructures in order to strengthen the productive capacity that will ultimately translate to economy growth.*

Keywords: Economic Growth, Gross Domestic Product (GDP) and Value Added Tax (VAT).

1. Introduction

The achievement of a high, rapid and sustained economic growth is one of the major objectives of government involvement in the economy. In order to achieve adequate economic growth in the economy, governments need to incur expenditures on internal security, economic services, social and community services, and amongst others, which in turn will lead to an improvement in the standard of living of the citizenry. However, the inadequate or lack of funds to embark on these projects, necessitates the need for increase in revenue generation by the governments through taxation.

According to Ajie, Akekere and Ewubare (2014), taxation is an instrument for transferring or diverting resources from the private sector to the public sector in order to accomplish some of the nation's economic and social goals. A tax is a compulsory levy imposed by governments on individuals, groups of individuals, corporate residents and other legal entities (Ezirim, 2005). Specifically, taxes are normally used for the provision of public goods. Public goods include the maintenance of law and order, defence against external aggression and regulation of trade and business to ensure social and economic justice.

The need to boost revenue to meet the responsibilities of government facilitated the birth of Value Added Tax (VAT). VAT is one of the most popular taxes around the world. VAT is a tax imposed on the value which is added to goods and services as they pass through the various stages in the business chain by Registered person in the course of their taxable activities up to the final consumer. The main reason for the popularity of VAT is that it provides a buoyant revenue base that usually yields significantly more revenue than other taxes on consumption. It is relatively easy to administer and difficult to avoids. The yield from VAT is a fairly accurate measurement of the growth of an economy since purchasing power increases with economic growth (Paulo, 2002). VAT as a form of indirect tax was introduced in France in 1954. From there it spread rapidly to other developed countries except to US where it has not been adopted to date. International Monetary Fund (IMF) was at the vanguard of spreading the concept to developing and transitional economies. Since VAT worked in the form of taxation that has turned out to be goldmine, Nigeria government on August 24th 1993, promulgated the Value Added Tax Decree No. 102 part 1.

Therefore, the Value Added Tax (VAT) can be considered in its full rights as a highly productive source of raising revenue in Nigeria (Ajakaiye 2000, Adereti, Adesina and Sanni, 2011). However, VAT does not occur without the tendency to increase cost of goods and services, thereby painting the entire concept in a bad light. Naiyeju (2010) argues that the success experienced by any type of taxing system, depends on the extent of tax interpretation, implementation, and proper management. Such characteristics determine the public perception as well as how achievable the goals of the taxing system can be.Thus people avoid paying tax as a result of perceived underutilized revenue from VAT, unaccountability on the side of tax administrators, poor awareness of the issue of VAT, and ineffective administration and implementation of VAT. This revealed that there is a mixed reaction towards the impact of VAT on economic growth since prior research findings on VAT showed lack of consensus in the research findings. VAT can contribute positively or negatively on economic growth of any nation. This therefore indicates existence of knowledge gap which this study intends to investigate.

Objective of the Research

The broad objective of this study is to investigate the effect of value added tax (VAT) on the economic growth in Nigeria while specific objective is;

To determine the contributions of VAT on the Gross Domestic Product (GDP) of Nigeria.

Research Hypothesis

H_0: Value Added Tax (VAT) does not contribute significantly to Gross Domestic Product (GDP) of Nigeria.

Research Question

To what extent has VAT contributed to the Gross Domestic Product (GDP) of Nigeria?

2 . Review of Related Literature

Conceptual Review

Value Added Tax

Value Added Tax (VAT) is a consumption tax levied at each stage of the consumption chain and borne by the final consumer of the product or services. As the name implies, the VAT refers to the tax on the value added. What is the value added? The value added of a firm is the difference between a firm’s sales and its purchases of inputs from other firms. In other words, it is the amount of value a firm contributes to a good or service by applying its own factors of production. Oghuma (2017) defines VAT as consumption tax levied at each stage of the consumption chain and borne by the final consumer of the product or service. Omesi & Nzor (2015) define VAT as a consumption tax payable on the goods and services consumed by persons, business organizations and individuals. In contrast with a progressive income tax, VAT is payable by tax payers depend on their consumptions rather than their incomes. Therefore, it does not discriminate among the classes of income earners. Each person is required to charge and collect VAT at a flat rate of 5% (which has been increased to 7.5% in the new Finance act 2019 which came into effect in February 2020) on all invoiced amount on all goods and services not exempted from paying VAT, under Value Added Tax Act 1993, as amended. The yield from VAT is a fairly accurate measurement of the growth of an economy since purchasing power increases with economic growth (Paulo 2002).

The definitions of VAT revealed that there are intermediaries through which every goods or services produced must pass through before getting to the financial consumer. At each stage the goods pass from one person to another, a value is added to it. It is this value that is being taxed and borne at last by the final consumer. The above mentioned, suggests that the value of the goods and services to the final consumer presents the aggregate of all the values added by successive traders or intermediaries in the chain. Since each trader pays only the VAT attributable to the value he added at his stage, the final tax for any given final value is same irrespective of the number of stages in the process or chain.

VAT was introduced in Nigeria following the recommendation of a study group set up by the federal government in 1991 to review the nation’s tax system (Olatunji, 2009). It was this group that proposed VAT and a committee was set up to conduct feasibility study on the implementation of the VAT. The Decree took effect on 1st December, 1993 and became operational in Nigeria on the 1st of January 1994. VAT is administered centrally by the federal government using the existing tax machinery of Federal Inland Revenue Services (FIRS) in partnership with the Nigeria Customs Service (NCS) and the State Internal Revenue Services (SIRS). The introduction of VAT in Nigeria through Decree 102 of 1993 marks the phasing out of the Sales Tax Decree No. 7 of 1986.

The Concept of Economic Growth

Economic development, according to Anyanwu and Oaikhenan (1995), is the increase over time of the capacity of an economy to generate the goods and services needed to improve the well-being of people in their growing number and diversity. It is often conceived over a period of time as a sustained rise in per capital income (Claus et al., 2001). Kuznets described growth (as quoted by Todaro, 1995) as a long-term increase in an economy's ability to supply its population with increasingly diverse economic goods and services.

It could be said that, with economic development, economic growth is often used interchangeably. But economic development is more holistic in that it includes growth plus improvement in well-being, eradication of poverty and illiteracy, illness and early death, changes in input and output composition. It also typically includes shifts in the underlying structures of an economy, away from agriculture or raw materials production to the manufacturing sector and institutional transformation (Kindle-Berger and Herrick 2001).

Value Added Tax and Nigeria's Economy

The object of taxation is to raise money for activities which, without government intervention, cannot be pursued. These include public commitments to economic growth, as well as helping mass public to meet their basic needs and to take advantage of broader opportunities. The government can't build a better Nigeria without taxes. VAT is a multi-level tax which is imposed on the basis of the percentage of value added to goods or services at various stages of the production-distribution cycle.

This tax is, in effect, a kind of multi-level sales tax that exempts from taxation of the indirect purchasing of goods and services. The countries with VAT have a higher level of GDP per capita and are less dependent on foreign trade (Ahmad, Mehrnoosh and Abedini 2012). The contribution of VAT to the growth of the economic state of Lagos was empirically examined by Owolabi and Okwu (2011). The aspects of development considered included infrastructural development, environmental management, development of the education sector, youth and social development, development of the agricultural sector, development of the health sector, and development of the transport sector.

The revenues from VAT have made a meaningful contribution to the growth of the respective sectors. The goal of replacing import taxes with Value Added Tax (VAT) or domestic consumption taxes was primarily to boost macroeconomic stability and offer the benefits of free trade to emerging economies. Export taxes are perceived to be ineffective since, relative to international producers, they place the local producers who export their products at a disadvantage. As it does not differentiate between domestic and imported products, VAT has been seen as more effective than import taxes. Local consumers benefit from lower prices in the rivalry produced between domestic and foreign producers by removing import taxes, and this pushes local producers to become more competitive and focus their efforts on their comparative advantage (Mohammad 2012).

Unlike oil revenues, which have little or no direct influence over the market government, VAT revenues are produced for distribution to the state and local government in Nigeria. This helps to minimize over-reliance on oil revenues, ensuring sustainable growth and development of the economy (Denis 2010). As mentioned in Sekwati and Malema (2011), Ghafoor (2005) pointed out that VAT, in addition to being a government money machine, helps companies compete internationally because it does not impact export prices and promotes savings that could lead to long-term capital development.

They also claim that since VAT has a great potential to produce a large amount of very low-rate revenue, it may help to fix the budget deficit and the balance of payment issues. In addition, VAT can be considered as an instrument for reducing the volume of a country's unregistered economy. By taxing imports and domestic goods going into domestic use at the same pace, VAT emphasizes employment rather than use and ensures neutral treatment of imported and domestic products (Mohammad 2012)

Theoretical Framework

This study is anchored on the theory of optimal taxation by Frank P. Ramsey (1927). The theory of optimal taxation posits that a tax system should be chosen to maximize a social welfare function subject to a set of constraints. The goal of this theory is to choose the tax system that maximizes consumer’s welfare and the efficiency in tax collections to give the best productivity of taxes collected. This involves the designing and implementing of a tax structure that gives attention to individuals’ utility and minimizing the distortions caused by taxation towards optimizing the tax benefits.

Empirical Review

Ajala, Oladayo and Ayorinde (2010) examined the impact of value added tax on revenue generation in Nigeria. The Secondary Source of data was adopted and data analysis performed with the use of regression analysis. Findings showed that Value Added Tax was statistically significant on revenue generation in Nigeria. The study recommends that there should be dedication and apparent honest on the parts of all agents of VAT with respect to the collection and payment and that government should try as much as possible to improve on the way of collecting value added tax.

Onwuchekwa and Aruwa (2014) investigated the impact of value added tax on economic growth of Nigeria. The study used ordinary least square technique to test the hypothesis of the research with data spanning the period 1994-2011. The result revealed that VAT contributes significantly to the total tax revenue of government and by extension, to economic growth of Nigeria. It further showed that VAT revenue had consistently increased but it is not that explosive.

Asogwa and Nkolika (2013) examined the impact of value added tax on investment growth in Nigeria. Time series data on investment, government expenditure, real exchange rate, real interest rate and trade openness from the central bank of Nigeria statistical Bulletin (CBN) were analyzed, using multiple regression analysis. The results showed that Value Added Tax has significant effect on investment growth in Nigeria. The study recommends that there should be dedicated and honesty on the parts of all agents of VAT with respect to the collection, and government should try as much as possible to improve on the way of collecting value added tax.

Njoku (2015) examined the impact of indirect taxes on economic growth of Nigeria, utilizing time series data from 1981 to 2014. The data collected from secondary sources and analysed using the Augmented Dickey-Fuller test. The Value Added Tax (VAT), Petroleum Profit Tax (PPT), Custom and Excise Duties (CED) and Real Gross Domestic Product (RGDP) data were used for the study. Consequently, the study utilized the Error Correction Model to evaluate the impact of VAT, PPT and CED on the RGDP. The findings revealed that VAT and PPT exert a positive and significant relationship on the RGDP and VAT of two-period lags showing a negative relationship but statistical significant with RGDP.

Eyisi. Chioma and Nwaorgu (2015) examined the effects of taxation on microeconomic performance in Nigeria from 2002 to 2011. Data were collected from secondary sources.

Three hypotheses were tested using ordinary least squares regression method. The findings showed that government earnings from taxation will affect consumer spending and boost output production level. The study recommends that to ensure rapid economic growth in Nigeria, there is need for government to encourage local manufacturers of output through provisions of incentives from taxation.

Akintoye and Tashie (2013) examined the effect of Tax compliance on economic growth and development in Nigeria. Tax compliance here is proxied by willingness of the citizens to pay tax. The conclusion is that compliance through the Willingness of citizens to pay tax is very important and cannot be ignored. It is suggested that Government should pay attention to the factors that influence the willingness of citizens to pay Tax and improve on them, thereby improving peoples‟ willingness to pay tax, government Revenue and economic growth and development of the nation generally.

Adesina and Famous (2013) assesses the level of tax education, particularly the level of understanding of VAT law amongst three categories of taxpayers in Nigeria. The data for the study were collected by means of structured questionnaires administered to the respondents. The analysis of results showed that most of the respondents have poor knowledge of VAT law in Nigeria, irrespective of their level of literacy, and that there was no significant difference in the amount of knowledge of VAT law amongst the three groups of respondents used for the study.

Igweonyia and Obiageli (2011) investigated the impact of VAT on the Nigeria economy as it relates to how it can improve government revenue and throws more light in its contribution to the economic growth and development of Nigeria. In addition to the oral interview and questionnaires distributed, was a review of study of literature relating to the impact, administration and collection of VAT in Nigeria. Simple percentages, bar chart, pie chart, and chi-square were used for data analysis on which purposive sampling technique was adopted. The findings showed that VAT has economic impact in consumption pattern in Nigeria, VAT has positive impact on the economy of Nigeria and that payment of VAT has improved the prospects of businesses, organizations and industries in Nigeria.

Alireza, Fariba and Akbarian (2012) examined the effect of value added taxes on GDP as economic growth for Iran economy. In this regard we use annually data for 1979-2009 using auto regressive distributed lags (ARDL). Results showed that value added taxes have significant effect on real output for Iran and it means value added taxes as a fiscal policy tool have useful performance in this country. Also, government expenditure, consumption, investment and net exports have significant effects on GDP.

Ebeke (2010) investigated whether the presence of value added tax (VAT) system increase the benefit of the inflows of remittances in terms of high and less volatile tax revenue ratio. This is supported by the fact that remittances are largely used for consumption. Purposes and contribute to smoothing private consumption. Using a large sample of developing countries observed over the period 1980-2006, and even after factoring in the endogeneity of remittances and VAT adoption, the results highlight that remittance Significantly increase both the level and the stability of government tax revenue ratio in receiving countries that have adopted the VAT.

Omolapo, Aworemi and Ajala (2013) performed a data analysis with the use of regression analysis. Findings show that Value Added Tax has a significant effect on revenue generation in Nigeria. The results from their analysis revealed that Value Added Tax (VAT) is beneficial to Nigeria economy. From the findings it also shows that for Nigeria to attain its economy growth and development, Nigeria should be able to generate enough revenue in other to meet up her challenges in provision of social amenities and cost of government administration. The result from the analysis indicates that if more goods and services are taxed more revenue will be accrued to the government.

Afolayan and Okoli (2015) made a study set to ascertained how VAT has impacted on Nigeria economic growth. The causal relationship is tested using Granger Causality. Findings show a positive and significant correlation exists between VAT revenue and reveal GDP. This study recommended that all identified problems and administrative loopholes should be plugged for VAT revenue to contribute significantly to economic growth of the country.

Izedonmi and Okunbor (2014) empirically investigated the contribution of VAT to the development of the Nigerian economy. Time series data were used on the Gross Domestic Product (GDP), VAT Revenue, Total Tax Revenue and Total (Federal Government) Revenue from 1994 to 2010. The data were analyzed using the econometric methodology of multiple regression technique. Their findings showed that VAT Revenue accounted for 92% significant variations in Nigeria's GDP. It revealed a positive relationship between VAT Revenue and GDP but not statistically significant.

Some empirical studies dealing with VAT and Economic growth were reviewed which provided a lot of information to the present study. However, none of these studies was specifically carried out recently to reflect the current changes in Value Added Tax (VAT) policy in Nigeria. Consequently, this study was designed to cover these areas which seemed to have been neglected by previous research studies.

3. Methodology

The research employed descriptive research design to study existing phenomenon. Therefore, the data cannot be controlled or manipulated. This study employs annual data on the rate of Value Added Tax (VAT), and Economic Growth (proxied by Gross Domestic Product) for Nigeria. The data covering the period 2000-2020 were collected on the study variables using secondary sources from the statistical Bulletin of CBN, the publication of Federal Inland Revenue Services, Federal ministry of Finance and National Bureau of Statistics. This time period was considered long enough to establish a causality influence between the study variables. This study adopted simple linear regression analysis with ordinary Least Square (OLS) econometric techniques for data analysis. The variables were tested and analysed using coefficient of determination (R^2), t-test, f-statistics and Durbin Watson (DW) statistics. The statistical package for social sciences (SPSS) windows 20 software was used to run the analysis.

Model Specification

To achieve the objectives of the study and test the hypothesis, the following regression model was developed to capture the relationship between VAT and GDP. The functional model for estimation is stated thus:

$$GDP = \beta 0 + \beta 1 VAT + U$$

Where:

GDP = Real Gross Domestic Product (proxy for Economic Growth of Nigeria)

VAT = Value Added Tax

$\beta 0$ = constant term or intercept

$\beta 1$ = coefficient of the independent variable

U = error term.

4. Data Presentation and Discussion of Findings

Table 4.1: Regression Result for Variable Value Added Tax (VAT) (Independent Variable) and Real Gross Domestic Product (GDP) (Dependent Variable).

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	27308.790	1707.797		15.991	.000
	VAT	43.866	2.685	.968	16.340	.000

a. Dependent Variable: GDP

Source: SPSS Version 20.0

Table 4.2: Model Test

Diagnostic Test	
R-squared	0.937

Adjusted R-squared	0.933
F-statistic	266.989
Prob(F-statistic)	0.000

Source: SPSS Version 20.0

Interpretation of Result

GDP = 27308.79+ 43.87*VAT

$ß_0$ = 27308.79. The constant term of the model shows that Real Gross Domestic Product (RGDP) stands at 27308.79 units when other VAT is held constant.

$ß_1$ = 43.87. The intercept of the model shows that a positive relationship exists between Value Added Tax (VAT) and Real Gross Domestic Product (RGDP). A unit increase in VAT increases the RGDP by 43.87units.

The adjusted R^2 = 0.933. Adjusted R^2 value in the model indicates that the power of the independent variable in explaining the variations in the dependent variable is very strong. It implies that 93 per cent of variation in dependent variable (RGDP) is explained by independent variable (VAT).

F-statistics = 266.989; p-value = 0.000. This signifies that the dependent variable has a significant relationship with the explanatory variables.

Hypothesis Testing

The hypothesis is stated thus;

HO_1: Value Added Tax (VAT) does not contribute significantly to Economic Growth of Nigeria.

Decision Rule

From the result of the regression analysis, the t-statistic = 16.340; p-value = 0.000 and F-Statistic = 266.989; p-value = 0.000values revealed that the model is statistically significant because the ρ-values are less than 5% level of significance. H_0 is not accepted and therefore, the study concluded that Value Added Tax (VAT) contributed significantly to Economic Growth of Nigeria within the period of study.

Discussion of Findings

Table 4.2 shows the regression result on the contributions of Value Added Tax (VAT) on the Real Gross Domestic Product (RGDP) of Nigeria. The coefficient of the constant term is positive and statistically significant. Value Added Tax (VAT) had significant influence on Economic Growth of Nigeria at 5% level of significance. In addition, the coefficient of VAT possesses positive sign in support of the a priori expectation. This is in line with Izedonmi and Okunbor (2014) whose result showed that VAT had significant impact in Economic Growth in Nigeria. Also, the result of Umeorah, (2013) testified that VAT has significant effect and contributed positively to GDP.

Conclusion and Recommendations

The study was able to shed some light on the current state of Value Added Tax (VAT) in Nigeria. It empirically investigated the contribution of Value Added Tax (VAT) on Economic Growth of Nigeria covering the period 2000 to 2020. This was done against the background that VAT was introduced by the Federal Government of Nigeria in 1993 to replace Sales Tax which was targeted at increasing the revenue base of government in other make funds available for developmental purposes that will foster Economic Growth of Nigeria. Time series data on Real Gross Domestic Product (GDP) as dependent variable and Value Added Tax (VAT) as independent variable were generated from the CBN Statistical Bulletin and Federal Inland Revenue Service (FIRS) Publications for the period. The data were analyzed, using simple Regression Analysis. The findings revealed that Value Added Tax accounted for 93.3 percent of variations in Economic Growth of Nigeria. This high explanatory power shows that the model is a good fit, and that VAT revenue made a significant contribution to the Economic Growth of Nigeria with the period under review.

Based on the findings, the following recommendations were made, government should use VAT proceeds to improve on the standard of living of the populace and render their traditional functions such as provision of public goods, maintenance of law, order and defense, and improve on infrastructures so as to strengthen the productive capacity and motivate taxpayers in paying their taxes. Government should adopt fiscal policies that will enhance investment in small and medium scale industry, agriculture and technology thereby stimulating overall productivity growth. Federal government should disallow the introduction of other consumption taxes by other tiers of government in Nigeria to avoid multiple taxation.

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