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Value Added Tax and Economic Growth of Nigeria

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Abstract

Value Added Tax (VAT) was introduced by the Federal Government of Nigeria in 1993 to replace Sales Tax. The aim was to increase the revenue base of government and make funds available for developmental purposes that will accelerate economic growth. Time series data on the Grass Domestic Product (GDP), VAT Revenue, Total Tax Revenue and Total (Federal Government) Revenue from 1994 to 2008 sourced from Central Bank of Nigeria (CBN) were analysed, using both simple regression analysis and descriptive statistical method. Findings showed that the ratio of VAT Revenue to GDP averaged 1.3% compared to 4.3% in Indonesia, though VAT Revenue accounts for as much as 95% significant variations in GDP in Nigeria. A positive and significant correlation exists between VAT Revenue and GDP. Both economic variables fluctuated greatly over the period though VAT Revenue was more stable. No causality exists between the GDP and VAT Revenue, but a lag period of two years exists. This paper therefore recommends that all identified administrative loopholes should be plugged for VAT Revenue to continue to contribute more significantly to economic growth of the country. This should be done on the realization that any action taken on either VAT Revenue or the GDP will take two years to become effective.

Keywords: Value Added Tax, GDF, Sales Tax, Total Tax Revenue

1. INTRODUCTION

Value Added Tax (VAT) has become a major source may developing countries. In sub- Africa for example, VAT has been introduced in Benin Republic, Cote d'Ivore, Guinea, Madagascar, Mauritius, Niger Republic, Togo and Nigeria. Evidence suggests that in these countries, VAT has become an important contributor to total government tax revenues (Ajakaiye, 2000). Shalizi and Square (1988) found out that VAT accounted for about 30% of total tax revenues in Cote d'Ivoire, Kenya and Senegal in1982. The oil producing countries are not excluded from the list of countries introducing this tax hurdle. Tait (1989) showed that VAT has been in effect in Ecuador and Mexico since at least 1973 and by 1983 for accounted for 12.35% and 19.71% of total government revenues in these counties respectively. Indonesia introduced VAT in 1983 and by 1988; the ratio of VAT revenue to GDP had risen to 4.5% (Bogetic and Hassan, 1993).

The impressive performance of VAT in virtually all is where it has been introduced, according to Ajakaiye (2000), clearly influenced the decision to introduce VAT in Nigeria in January 1994. VAT is a consumption tax that is relatively easy to administer and difficult to evade and it has been embraced by many countries world-wide (Federal Inland Revenue Service 1993) Evidence

so far supports the view that VAT revenue is already a significant source f revenue in Nigeria. For example, actual VAT revenue for 1994 was N8.189 billion, which a 36.5% higher than the projected N6 billion for the year. Similarly, actual VAT revenue for 1995 was N21 billion compared with the projected N12 billion. In terms of contributions to total federally collected revenue, VAT accounted for about 4.06 % in 1994 and 5.93% in 1995. As much as N401.5 billion was collected on VAT (5.1% of total revenue) in 2008.

While the performance of VAT as a source d revenue in Nigeria is encouraging, it remains difficult to find attempts to systematically assess the impact of VAT on the economy. Recent research works on the impact of taxation on the Nigerian economy lumped up all the various taxes together without isolating VAT. How and in what direction has VAT been affecting the Nigerian economy. proxy by Gross Domestic Product (GDP)? Is there any causality between the two economic variables? Finding answers to these and other similar questions is the main trust of this paper. The rest of the paper is divided into four sections. Section two is on conceptual framework and review of related literature. Section three is on data and research methodology. Section four is on findings and discussions while Section five summarizes and concludes the paper.

CONCEPTUAL FRAME WORK AND REVIEW OF RELATED LITERATURE

Conceptual framework

VAT is a consumption tax levied at each stage of the consumption chain and borne by the final consumer of the product or service. Each person is required to charge and collect VAT at a flat rate of 5% on all invoiced amounts on all goods and services not exempted from paying VAT, under the Value Added Tax Act 1993 as amended. Where the VAT collected behalf of the government (output VAT) in a particular month is more than the VAT paid to other persons (input VAT) in the same month, the difference is required to be remitted to the government, on a monthly basis, by the taxable person (Oserogho and Associates, 2008). Where the reverse is the case, the taxpayer is entitled to a refund of the excess VAT paid or more practically, receive a tax credit of the excess VAT from the government. All exports are zero rated for VAT, i.e. no VAT is payable on exports. Also, VAT is payable in the currency of the transaction under which goods or services are exchanged.

Every person, whether resident in Nigeria or non- resident in Nigeria, who sells goods or renders vices in Nigeria under the VAT Act (as amended) is obligated to register for VAT within six months of its commencement of business in Nigeria. Registration is with the Federal Board of Inland Revenue (FBIR). The VAT Act (as amended) provides that a foreign non-resident person of company that carries on economic activities in Nigeria is also obligated to register for VAT, using the address of the person with whom it has a subsisting economic activity for purposes of correspondence with FBIR and for compliance with the VAT Law. The foreign non-resident

person or company is required upon registration for VAT to include in its invoice VAT at 5% with instructions to the receiver of the goods or services to remit the VAT in the currency of the transaction to the Nigerian government on behalf of the foreign non- resident person. A taxable person, whether Nigerian resident outside Nigeria, who fails or refuses to register for VAT administration within six months of engaging in any economic activity in the territory of Nigeria is liable to pay a penalty of $67.00 for the first month that the failure occurs and a further penalty of $34 for each subsequent month in which the failure continues. In addition to the fines for non-registration, Section 32 of the VAT Act (as amended) authorizes the FBIR to seal up the premises from where the economic activity in question is being carried on within the territory of Nigeria.

Review of Related Literature

Simply called the Goods and Services Tax (GST), it is levied on the value added that results from each exchange. It is an indirect tax collected from someone other than the person who actually bears the cost of the tax (Ochel, 2010). It was invented by a French Economist, Maurice Laure in 1954 and was first introduced in France on April 10, 1954.Feldstein and Krugman (1990) were the first set of researchers to research on the international trade effect of Value Added Taxation. Their research was based the widespread belief that VAT, because it is levied on imports and rebated on exports, acts as a combination of protection and export subsidy, giving the goods sectors of countries with VAT an advantage over the corresponding sectors of countries that rely on income taxation. The research used a simple model to show that this view is almost completely wrong. A VAT is not a protectionist measure; indeed, the allegedly pro-competitive device of export rebates is necessary if the VAT is not to act as an export tax, which in turn is actually a protectionist measure that would reduce both imports and exports. It was also established that in practice, VAT would almost surely fall more heavily on traded rather than non -traded goods, which would constitute a bias against both exports and imports.

Different scholars had used different explanatory variables to attempt some empirical measurements of tax effects in various countries. Such variables included agricultural output-GDP ratio, per capital income, mineral exports-GDP ratio, the degree of openness of the economy, money-GDP ratio, etc.. Using mining-GDP, agricultural output-GDP ratio, and export-GDP ratio as determinants of tax share in GDP to measure tax efforts, Chelliah, Bass and Kelly (1975) showed that the agriculture share is negative while the mining share is positively related to tax share, and the export ratio is not significant. Using panel data on 43 Sub-African Countries for the period 1990-1995 to measure the determinants of tax-GDP ratio to construct an index of tax effort for these countries, Stotsky and Woldemariam (1977) found that the countries with a relatively high tax- GDP ratio tended to have a relatively high index of tax effort, although the results varied across countries. Tait and Gratz (1979) later updated the work of Chellish et al (1975) using the same sample- of developing countries for the period 1972-1976. However, they

did not find the agric-GDP ratio to be significant but their measure of tax effort indices yielded similar results to the initial study.

Toder and Rosenberg (2010) worked on the effects of imposing a value added tax to replace payroll taxes or corporate taxes (in the US). The research work was conducted against the background that the United States is the only country in the developed world that does not impose a broad-based consumption tax. The typical form of broad-based consumption tax used worldwide is a credit-invoice Value Added Tax (VAT). The credit-invoice VAT, a subtraction - method VAT or Business Transfer Tax (BTT), and a Retail Sales Tax (RST) are all intended to tax the final consumption once at the retail level, but the collection mechanisms differ among the three taxes. The researchers found out that VAT has administrative advantages over both BTT and RST. Both VAT and BTT are easier to enforce than RST because under a tax collected at different stages of production, evasion by the final seller still leaves much of the tax in place. Compared with BTT, VAT makes it easier to exempt sales of categories of consumption goods, including export sales, but more difficult to grant preferences to selected industries. The distributional burden of VAT, it was found, is rougly proportional at the bottom of income distribution but regressive at the top..

VAT was introduced by The Federal Government of Nigeria in January, 1993. It was believed by many Nigerians that the tax was introduced as a means of avoiding taking loans from international agencies (Ochei, 2010). According to analysts, the tax was intended to be a 'super tax' to eradicate completely many other taxes related on goods and services. VAT was then imposed on virtually all goods and services, whether produced or rendered in Nigeria or not. Exemptions however were granted in respect of medical and pharmaceutical products, basic food items, fertilizers, agricultural and centenary medicine, books and educational items, farming and transport equipment, etc. VAT effectively replaced the former sales tax, which, under the constitution, was supposed to be charged by states and not the Federal Government.

Although very few literature exists on the subject of VAT in less developing countries, extensive studies have nevertheless been done on the alternation prominence of Indirect Tax in developing countries in general and Nigeria in particular. The core function of taxation as a revenue generating tool in developing countries has been studied by eminent scholars. Naiyeju (1996) argued that the positive result received from any tax depends on the extent of how it is properly managed. The extent of how the tax law is interpreted and implemented as well as the publicity brought into it will determine how a particular tax is able to meet its objectives. Ariyo (1997) in his study on productivity of the Nigerian tax system reported a satisfactory level of productivity of the tax system before the oil boom. The report underscored the urgent need for the improvement of the tax information system to enhance the evaluation of the performance of the tax system and facilitate adequate macroeconomic planning and implementation. Ajakaiye (2000) worked on the impact of VAT on key sectoral and macroeconomic aggregates, using a Computable General Equilibrium (CGE) model considered suitable for Nigeria. The study

developed three scenarios. In order to approximate the presumed Nigerian situation, the study assumed that government pursued an active fiscal policy involving the re-injection of the VAT via increases in government final consumption expenditure in combination with a presumed non-cascading treatment of the VAT. Two other simulations considered an active fiscal policy combined with a cascading treatment of VAT and a passive fiscal policy combined with a non-cascading treatment. As it turned out, the scenario of a cascading treatment of VAT with an active fiscal policy not only had the most deleterious effects on the economy, it was also the one that most closely approximated the situation in Nigeria. VAT revenues under this scenario are more than 3% lower than the first scenario, the general price index increases by 12%, and wage and profit incomes fall by 8.54% and 12.27% respectively. Overall, the GDP declines by 11.34%. Such a situation, as observed by the researcher, poses a great threat to the sustainability of VAT. United Nations (2000) expert group stated that tax revenue contributes substantially to development. The stark reality in most developing countries is that while there are several budgetary pressures as a result of ever increasing demand for government expenditure, there is a limited scope for raising extra x revenues.

Dessi, Foley and Hines (2004) stated that governments have at their disposal many tax instruments that can be used singly or in concert to finance their activities. These tax alternatives include personal and corporate income taxes, sales taxes, value added taxes, capital gains taxes and numerous s. In choosing what tax instruments to use and what rates to impose, governments are typically influenced by their expectations of the effects of taxation on investment and economic activities, including Foreign Direct Investments (FDI). The researchers stated that there are extensive empirical studies that high corporate income tax rates are associated with low levels of FDI. VAT rate in Nigeria has been determined in a way that minimizes disincentive efforts on economic activities (Owolabi & Okwu, 2011). Musa (2009) opined that economic and social development laws and policies provide the basis for effective state action that lifts society from underdevelopment, improves the standard of living and facilities for the realization of the millennium development goals. Olaoye (2009) worked on the administration of VAT in Nigeria. The objective of the study was to seek ways of improving government revenue generation base in order to improve on the economy. The study among other things, recommended that more awareness was needed on VAT. Adegbie and Fakile (2011) worked on company income tax and Nigeria's economic development. They used the GDP to capture the Nigerian economy and Petroleum Profit Tax (PPT), Company Income Tax (CIT), Customs and Excise Duties and VAT to measure Company Income Tax. Findings revealed that there is a significant relationship between company income tax and Nigerian economic development and that tax evasion and avoidance are the major hindrances to revenue generation. Owolabi and Okwu (2011) empirically evaluated the contribution of VAT to the development of Lagos State economy. Development aspects considered included infrastructural development, environmental management, education tor development, youth and social development, cultural sector development, health sector development and transportation sector development. Result showed

that VAT revenue contributed positively to the development of the respective sectors. However, the positive contribution was statistically significant only in agricultural sector development.

METHODOLOGY

This research work is both inferential and descriptive in nature. It made use of secondary data sourced from Annual Reports and Accounts (various issues) of Central Bank of Nigeria (CBN). The data were on four economic variables: The GDP, VAT, Total Tax e and Total (Federal Government) 'Revenue. The period covered was from 1994 when VAT was introduced into the country to 2008. The data on VAT Revenue for 2009 and 2010 were not available the time of writing this report.

Model Specification

Guided by the perceived functional relationship between the matrix of economic growth (GDP) and VAT revenue, a link is forged between the two variables. From sub-macro and micro economic perspectives, the model for this work states that economic growth (GDP) depends on VAT revenue. The model which is in line with the work of Owolabi and Okwu (2011) is a modified form of the model specified by Golit (2008) in his study of Nigeria's tax efforts. Thus, the functional relationship and the resultant models are as specified below.

$GDP = f(VAT)$.... .....(1)

From the above functional relationship, the stochastic model is specified below:

$GDP = \alpha + \beta(VAT) + \mu$ .....(2)

This model, which will be used for this work, can be restated in its logarithm form as:

$\text{Log GDP} = \log\alpha_0. + \log \alpha_1(VAT) + \mu$…….. .....(3)

Where α_0. and α_1 are model parameters and μ is the stochastic error term. The 'priori' expectation is that the model parameter is expected to be positively signed. What this means by implication is that some economic growth is expected even when no VAT revenue is collected.

IV. FINDINGS AND DISCUSSIONS

TABLE 1: RESULTS OF REGRESSION ANALYSIS

Dependent Variable: GDP				
Method: Least Square				
Date: 08/03/Time: 04.22				
Included Observations: 15				
Variables	**Coefficient**	**Std. Error**	**t- Statistic**	**Prob**
VAT	**71.11323**	**4.484466**	**15.85768**	**0.0000**
C	**154066.1**	**734246.7**	**0.209829**	**0.8371**
R- Squared	0.950844	Mean dependent var.		8804858
Adjusted R - Squared	0.947063	S.D dependent var		8272600
S.E of regression	1903360	Akaike info criterion		31.87971
Sum squared resid	4.71E+13	Schwarz criterion		31.97411
Log likelihood	-237.0978	Hannan-Quinn criter.		31.87870
F-statistic	251.4661	Durbin – Watson stat.		1.989578
Prob (F – statistic)	0.000000			

Source: Computation using E-Views Statistical Package, Version 7.0

As can be seen in Table 1, the positive coefficient of VAT Revenue confirms priori expectation of a positive relationship between VAT Revenue and the GDP. In evaluating the model, the R. Squared (which is the coefficient of determination) of 0,95 means that 95 percent of variations in the GDP explained by VAT Revenue which is highly is impressive. With the probability (F-statistic) development of Nigeria and composition of the value of 0.00, VAT Revenue is making a unique significant contribution to the economic development of Nigeria and the composition of the GDP.

TABLE 2: RESULT OF GRANGER CAUSALITY TESTS

Pairwise Granger Causality Tests			
Date: 08/03/11 Tine: 05:07			
Sample: 1994 – 2008			
Lag: 2			
Null Hypothesis	Obs	F- Statistics	Prob
VAT does not Granger Cause GDP	13	2.13902	0.1802
GDP does not Grange Cause VAT		3.41879	0.0845

Source: Computation using E-Views Statistical Package, Version 7.0

There is no causality between GDP and VAT Revenue (Table 2). There is a lag period of two years. Many factors are responsible for it. Firstly, the ratio of VAT Revenue to Total Revenue was never stable. It was 4.1% in 1994, fluctuated to its peak (7.8%) in 1998 and crashed down to 3.1% two years later (2000). It rose marginally to 63% in 2002, me down to 3.2% in 2005 before finally sealing down to 5.1% in 2008 (Figure 1) (not shown)

Secondly, the ratio of VAT Revenue/Total Tax Revenue, which was 9.9% in 1994, got to its peak of 13.5% in 1998 and reduced drastically to 7.9% in 2000. The sharp rise to 14.1% in the following year weld not be sustained as it fell to 7.3% in 2005 before finally settling down to 11.3% in 2008 (Figure 2).(not shown).

Abo, the VAT Revenue/ GDP, which was only 1.8% at the inception of VAT in 1994, rose marginally on yearly basis to 1.4% in 1999, reduced slightly to 1.2% the following year before rising to its peak of 2.3% in 2003. Ever since, it has been fluctuating between 1.1% and 14% (Figure 3). The lag period of two years (Table 2) means that any action taken on any of the variables (VAT Revenue or the GDP) will take two years to become effective.

The reason for the fluctuation in VAT Revenue! GDP is that the growth rate of GDP itself was never stable over the period under review (Figure 4). It grew from 2.2 percent in 1994, increased to 3.8% in 1996 and nose- dived to 2.7% two years later. It reached its peak of 9.6% in 2003 and crashed to 4.8% in 2008.

When absolute figures are used however, VAT Revenue is more stable than the GDP (Figure 5). The Total Tax Revenue, it must be pointed out, has been taken to mean total revenue from Petroleum Profit Tax (PPT), Company Income Tax (CIT). Customs and Excise Duties (C&S), and Value Added Tax (CIT) in line with the work of Adegbie and Fakile (2011).

Table 3: Comparative contributions of VAT to the economy

	Nigeria	**Indonesia**	**Kenya, Senegal, Cote d'Ivoire**	**Mexico**
VAT/GDP	2.3%	4.5%	Not Available (NA)	NA
VAT/Total Tax Revenue	12.4%	NA	30%	NA
VAT/Total Government Revenue	4.9%	NA	NA	19.71%

Sources: Ajakaiye, D.0 (2000): Macroeconomic Effects of VAT in Nigeria assessed: A Computable General Equilibrium Analysis, assessed from www.citescerxist.psu.edu/viewdoc/downlead on 4th July, 2011. Computations by the Authors.

Though the ratio of VAT revenue to GDP in Indonesia, a developing country like Nigeria was 4.5 percent as far back as 1988 (just five years after is being introduced) the highest for Nigeria was 2.3% in 2003 (ten years after its being introduced) (Table 3), VAT Revenue to Total Tax Revenue, which averaged 12.4%, is rather low compared to Cote d'Ivoire, Kenya and Senegal in 1982. VAT Revenue accounted for 19.71% of Total government revenue in Mexico as far back 1983 as against the average of 4.9% for Nigeria- during the period under review. Agreed that the economy had not been stable as had already been. pointed out, poor VAT administration had

been identified by Olaoye (2009) as one of the problems about 30% in confronting VAT in Nigeria. In his own words:

> *Although it is agreeable that there is the need for VAT to replace the former Sales Tax because of the progressive nature, government's ability to adequately and effectively retrieve the proceeds from companies and other agents of collection remains a problem. It does not appear as if there is adequate machinery for effectively monitoring the remittance of tax withheld to the relevant tax authority. The Federal Inland Revenue Service (FIRS) lacks logistics support for effective administration of VAT.(pg 4).*

The further problem of VAT administration is the present composition and functions of the tax authorities which weaken the effective tax administration in the country. Tax authorities perform only the technical functions and not the needed management functions. The non- performance of management functions, given the increasing complexity of tax administration largely explains the ineffectiveness of tax administration in Nigeria. Basically, the performance of only technical functions leads to false declaration, refusal to complete tax return forms, fraud, inflation of deductible expenses, smuggling, default, illegal bunkering, etc. The dishonest practices by some tax officials also pose a serious rest to the effective tax administration in Nigeria especially when such practices are capable of having demoralizing effects on honest tax payers. It has to be acknowledged however that the FIRS is currently being reorganized and it is hoped that the reorganization would take care of this administrative short-coming.

Again, Nigerian companies treat their VAT expenses as input costs and pass these on to the consumer. On its part, the government injects VAT revenue back into the system as consumption expenditures. Because this combination results in a serious negative impact on the economy, it is necessary to consider strategies for ensuring that companies treat VAT properly and that government directs its expenditure towards sectors that are most likely to lessen the adverse effects of VAT consumer welfare, production, employment and income.

Not to be forgotten is the fact that there is currently a legal struggle between the federal and state governments over who has the competence to impose VAT. As a matter of fact, there is currently a case in the Supreme Court filed by Lagos State challenging the constitutionality of VAT. Until this case is finally settled, the amount accruing from VAT may not be too much as VATable bodies may not know who to remit VAT proceeds to.

V. SUMMARY AND CONCLUSIONS

This paper empirically investigated the contribution of Value Added Tax (VAT) to the GDP from the time of its inception to 2008. This was done against the background that it was introduced by the Federal Government of Nigeria in 1993 to replace Sales Tax. The aim was to

increase the revenue base of government and make funds available for developmental purposes that will accelerate economic growth. Time series data both the GDP and VAT Revenue from 1994 to 08, sourced from Annual Reports and Accounts of the Central Bank of Nigeria (CBN) were analyzed, using both simple regression analysis and descriptive statistical method.

Findings showed that VAT Revenue to Total Tax Revenue, which averaged 12.4%, is rather low compared to about 30% in Cote d'Ivoire, Kenya and Senegal in 1982. VAT Revenue accounted for 19.71% of Total government revenue in Mexico as far back as 1983 as against the average of 4.9% for Nigeria during the period under review. The ratio of VAT Revenue to GDP averaged 1.3% though VAT Revenue accounts for as much as 95% significant variations in the GDP. A positive and significant correlation exists between VAT Revenue and GDP. Both economic variables fluctuated greatly over the period though VAT Revenue was more stable. Though no causality exists between the GDP and VAT Revenue, a lag period of two years exists. This paper therefore recommends that all identified administrative loopholes should be plugged for VAT Revenue to contribute more significantly to economic growth of the country. This should be done on the realization that any action taken on either VAT Revenue or the GDP will take two years to become effective

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