

VALUE ADDED TAX ON THE NIGERIAN ECONOMIC GROWTH INDICES

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ABSTRACT

To explore the relationship between taxation policy and economic growth, this study delved into the impact of value-added tax (VAT) on Nigeria's economic growth indicators. The research adopted an ex-post facto design, utilizing data sourced from the Central Bank of Nigeria (CBN) Statistical Bulletin (2022) for 21 years spanning from 2002 to 2022. Analytical techniques employed included descriptive analysis, the Augmented Dickey-Fuller (ADF) test for unit root, and the ordinary least squares (OLS) regression model. Findings revealed that the standard VAT rate exerts a significant positive effect on Nigeria's gross domestic product (GDP), while the reduced VAT rate shows an insignificant positive effect on GDP. The study recommends that the government capitalize on the favourable impact of the standard VAT rate by carefully adjusting tax policies to promote investment in the petroleum sector while maximizing revenue generation. Additionally, it suggests that the reduced VAT rate policy be reassessed to enhance its attractiveness for businesses to invest and create jobs, thus significantly strengthening the national economy.

Keywords: Economic Indices, Gross Domestic Product, Reduced Rates, Standard Rates, Taxation, Value Added Tax.

INTRODUCTION

Taxes play a crucial role in generating government revenue and supporting public services, infrastructure, and social programs. However, the relationship between taxation and economic growth is multifaceted, and influenced by tax policies, rates, and structures (Afubero & Okoye, 2014). Economists like Adam Smith and John Stuart Mill historically discussed how taxes, such as income and consumption taxes (including VAT), can affect economic behaviour, investment, and productivity. Keynesian theory argues that higher taxes can fund public expenditures that stimulate demand and contribute to economic growth. Conversely, supply-side economists contend that elevated tax rates may hinder growth by discouraging investment, entrepreneurship, and labour participation (Ahmad & Abdul-Rahman, 2023). Corporate taxes, personal income taxes, and VATs impact economic growth differently in various contexts. The method of collecting these taxes is known as taxation.

Taxation plays a crucial role in the functioning of modern economies by providing governments with the revenue needed to finance public goods and services, such as infrastructure, healthcare, and education. The relationship between taxation and economic growth has been a subject of extensive research and debate among economists. Aghion *et al.* (2019) noted that taxes can influence economic growth through their impact on key variables such as investment, consumption, and savings. Taxes in operation in Nigeria include value-added tax (VAT), petroleum profit tax (PPT), companies Income Tax (CIT), capital gain tax (CGT) among others. This study is hinged on value -added tax.

Value Added Tax (VAT) is an indirect tax on goods and services consumption, levied at each stage of production or distribution based on the value added (Obi & Akpan, 2023). VAT has become a vital revenue source for many governments, including Nigeria. The Nigerian government introduced VAT in 1993 under Decree No. 102, replacing the less efficient sales tax system (Adewale & Ayeni, 2021). VAT is managed by the Federal Inland Revenue Service (FIRS) and has grown to be a significant revenue stream, supporting public infrastructure, social services, and economic growth in Nigeria. VAT was increased from 5% to 7.5% in 2020 (NBS, 2023).

In Nigeria, VAT applies to both goods and services and is structured to be paid by the final consumer, making it an essential component of fiscal policy (FGN, 2017). The link between VAT and economic growth has been a subject of academic debate. Theoretically, VAT can impact growth by influencing consumption, investment, and saving behaviours (Smith, 2024). Some researchers suggest that VAT can promote growth when revenues are efficiently channelled into public investments in infrastructure and human capital (Agbeyegbe *et al.*, 2006). VAT is consumption tax whose legal incidence falls on the seller, while the consumer bears the economic incidence.

The standard rate of VAT (Value-Added Tax) is the default tax rate applied to most goods and services, typically set by a country's tax authority. For instance, in Nigeria, the VAT standard rate is currently 7.5%, which applies broadly across consumer goods (Federal Inland Revenue Service, 2021). This standard rate is meant to contribute significantly to government revenue and is used to fund public services and infrastructure (Aguolu, 2017).

The reduced rate of VAT is a lower tax rate applied to essential goods and services to make them more affordable to the public. For example, several countries apply reduced VAT rates to basic necessities like food, healthcare, and education-related items (OECD, 2020). This reduced rate aims to lessen the economic burden on consumers, especially lower-income individuals, while still generating revenue for the government (James & Nobes, 2022).

Gross Domestic Product (GDP) measures the total market value of all goods and services produced within a country over a specific period, typically annually or quarterly (World Bank, 2021). GDP is a key indicator of economic health, and its growth rate reflects the economic performance of a nation. High GDP growth suggests economic expansion, while lower or negative growth may indicate economic issues (Mankiw, 2019).

Empirical studies in Nigeria show mixed results on VAT's effect on economic growth. For example, Iyoha and Oriakhi (2005) found a positive relationship between VAT and GDP, highlighting the importance of revenue for infrastructure development. However, Adegbe and Fakile (2011) argued that tax evasion and administrative inefficiencies undermine VAT's potential for promoting growth. Oni *et al.* (2022) also noted that VAT's contribution to growth is more effective when aligned with broader macroeconomic policies, such as inflation control and fiscal stability. Despite its importance, VAT administration in Nigeria faces challenges, such as insufficient monitoring of tax remittances and logistical shortcomings within the FIRS, leading to tax evasion and avoidance. Corruption among some tax officials further hampers effective tax collection and discourages compliant taxpayers. Additionally, many consumers are unaware of the exact VAT amount they are paying due to unclear invoicing practices. At any rate, the role of VAT in fostering economic growth remains a crucial area for research and policy evaluation in Nigeria. Understanding the dynamics of VAT's effect on economic growth will not only help improve tax policy but also provide insights into how fiscal tools can be better deployed to achieve sustainable development (Ogbonna, 2020).

This study aims to assess the impact of VAT on Nigeria's economic growth, focusing on two objectives: a) evaluating the effect of the standard VAT rate on GDP, and b) analyzing the impact of a reduced VAT rate on GDP. To achieve the above objectives, the following hypotheses formulated were formulated.

Ho₁: The standard rate of value-added tax has no significant impact on gross domestic product of Nigeria.

Ho₂: Reduced rate of value-added tax has no significant impact on gross domestic product of Nigeria.

REVIEW OF RELATED LITERATURE

Concept of Value-Added Tax

VAT is considered a regressive tax as it disproportionately impacts lower-income individuals and imposes administrative challenges for businesses. Unlike a progressive income tax, which increases with income, VAT is based on consumption rather than earnings, meaning it applies uniformly to all purchases (Oriakhi & Ahuru, 2014). VAT is a consumption tax applied at each stage of production, from raw materials to the final sale, with the ultimate cost passed on to the consumer. Buyers at earlier production stages are reimbursed for the VAT they have already paid (Oriakhi & Rolle, 2014). In Nigeria, VAT was introduced by the Value Added Tax Act of 1993 and is managed by the Federal Inland Revenue Service (FIRS). It is applied to most goods and services sold in Nigeria, as well as imported goods. Businesses are required to add VAT to the sale price of goods and services and pay VAT on goods they consume, with certain offsets allowed for VAT previously paid (Smith, 2024). VATable goods in Nigeria include items like jewellery, shoes, and electronics, while VATable services include those provided by professionals such as lawyers, engineers, and consultants.

Standard Rate of Value-Added Tax

The standard rate of VAT is the prevailing percentage applied to goods and services at every stage of production or distribution. This rate is generally consistent across a broad range of products, except for those subject to lower rates or exemptions. Besley and Persson (2014) describe it as the foundational percentage imposed uniformly on value-added processes. Amahalu (2017) highlights that the standard VAT rate is crucial for modern taxation, capturing a share of every economic transaction to fund national

revenue. Adewole and Ogunleye (2023) refer to it as the "fiscal heartbeat" of a country, influencing every transaction and contributing to sectors like public health and infrastructure. Gomez and Torres (2022) suggest that the standard rate symbolizes financial balance, taxing each stage of production uniformly. Ideh (2019) sees the standard VAT rate as a strategic tool for governments to mobilize revenue, quietly present in every transaction.

Reduced Rate of Value-Added Tax

The reduced rate of VAT is a lower percentage applied to certain essential goods and services, designed to reduce the financial burden on consumers. Obi and Akpan (2023) explain that it serves as a government strategy to ease costs for essential items. Adesanya *et al.* (2024) view it as a policy tool aimed at influencing consumer choices and encouraging behaviours that align with societal goals. The European Union, for example, applies reduced rates on essentials like food, books, and medicines to enhance access and promote social welfare. Ebieri and Ebimobowei (2016) opine that the reduced VAT rate is a distracting tool shaping both economic and social landscapes.

Gross Domestic Product (GDP)

GDP measures the total value of all goods and services produced within a country over a specified period, typically a year (NBS, 2023). It is a key indicator of economic performance and allows comparisons between nations. Nigeria's GDP history reflects its economic evolution. Following independence in 1960, agriculture was the primary contributor to GDP, with commodities like cocoa and palm oil playing major roles (National Bureau of Statistics, 2022). The discovery of oil in the late 1950s drastically shifted the economy, making oil production the dominant sector driving GDP growth (Central Bank of Nigeria, 2022). While oil booms significantly boosted GDP, declines in oil prices, mismanagement, and political instability led to economic downturns and recessions (World Bank, 2020).

Theoretical Framework

Theory of Anchorage: Benefit Received Theory

This study is grounded in the Benefits Received Theory (BRT), which asserts that individuals should be taxed based on the benefits they receive from government-provided public goods and services (Musgrave, 1959). The theory argues for a direct link between taxes paid and the advantages gained from public infrastructure, education, healthcare, and security (Musgrave, 1959; O'Brien, 2008). It assumes that those who benefit more from these services should bear a larger share of the tax burden and that tax amounts should reflect the monetary value of benefits received, ensuring a fair system of tax liability.

Empirical Review

Akpan and Nwogugu (2024) investigated the effects of VAT policies (standard, reduced, zero) on Nigeria's economic growth. The specific objectives were to analyze the contribution of VAT to Nigeria's GDP and explore the impact of VAT on inflation and consumer spending. The research design was Mixed-methods approach combining quantitative and qualitative data. 20 years of data (2003-2023) from various

economic reports were used for analysis. The study employed a Vector Autoregression (VAR) model for the quantitative analysis. Qualitative data were collected through interviews with tax authorities and business owners. The results showed that the standard VAT rate significantly contributed to revenue generation and positively influenced GDP growth, reduced rates increased spending in specific sectors, while zero-rated VAT had an insignificant effects on overall economic performance. Recommendations made were for a review of VAT rate structures to optimize economic impact and enhancing taxpayer education and compliance can improve VAT revenue and bolster economic growth. The qualitative component provided valuable insights, but the small sample size of the interviewee's limited generalizability.

Johnson and Smith (2024) analyzed the effect of varying VAT rates on small and medium-sized enterprises (SMEs) and economic growth within the European Union. The study aimed to assess how standard, reduced, and zero VAT rates influence SME growth. A comparative case study design was used, examining 20 SMEs across four EU countries. The research relied on econometric modelling of VAT rate changes from 2010 to 2023, combined with interviews and financial data. Results showed that reduced VAT rates benefited SMEs, particularly in hospitality and food service, boosting revenue and employment. Zero-rated VAT on essential goods enhanced SME sustainability, especially in agriculture. Standard VAT caused slight reductions in profit margins but did not significantly affect growth. The study recommended lower VAT rates for SME-relevant sectors to drive employment and economic activity, as well as simplification of tax administration for SMEs. However, the focus on SMEs and EU countries limits the generalization of findings to other regions and larger economies.

Ahmad and Abdul-Rahman (2023) examined the influence of VAT rates on economic growth in Southeast Asian developing countries. The study aimed to evaluate the effects of standard, reduced, and zero VAT rates on essential goods, inflation, and economic development. Using a cross-sectional quantitative approach, 100 countries were analyzed through panel data regression, covering the period from 2010 to 2022. Findings indicated a positive relationship between standard VAT rates and GDP growth in countries with efficient tax systems, while reduced VAT rates had a minor positive impact on consumer spending. Zero-rated VAT on essential goods helped curb inflation without hindering GDP growth. The study advised implementing a mix of standard and reduced VAT rates for optimal economic growth, with essential goods kept at zero rates to protect low-income groups. The exclusive focus on developing countries limits applicability to developed economies, and the omission of other tax policies like corporate income tax is a noted limitation.

Adewale and Ogunleye (2023) explored the effect of VAT on Nigeria's economic growth from 2015 to 2023. The study aimed to analyze the relationship between VAT revenue, GDP growth, employment, and inflation. Using an ex-post facto design, national economic data over nine years were examined through multiple regression analysis, with GDP growth as the dependent variable. The results showed that VAT had a positive, significant impact on economic growth in Nigeria, and increasing VAT revenue was associated with higher GDP growth. The study recommended expanding the VAT base rather than increasing the rate. However, the findings are specific to Nigeria, limiting their broader applicability.

Obi and Akpan (2023) investigated the link between VAT and economic growth in Nigeria, focusing on the effect of VAT revenue on GDP and private sector investment. Using a longitudinal design and data from 2010 to 2023, econometric models such as vector autoregression (VAR) were applied. Results showed VAT significantly influenced economic growth, but its impact on private-sector investment was minimal. The study advised reducing VAT administrative burdens for SMEs but lacked a sensitivity analysis for robustness across periods.

Amadu and Osei (2023) assessed VAT's contribution to economic growth in Ghana, focusing on government revenue and industrial output. A descriptive design was employed, using data from 2010 to 2023, with OLS regression analysis revealing a positive correlation between VAT revenue, government revenue, and industrial output. However, administrative inefficiencies weakened the benefits of VAT. The study recommended enhancing VAT collection mechanisms but was criticized for its reliance on OLS without addressing potential endogeneity.

Osei and Osei-Tutu (2023) analyzed the impact of different VAT rates (standard, reduced, and zero) on economic growth in Ghana. Specifically, the study assessed the relationship between VAT rates and GDP growth and evaluate the effects of VAT compliance on economic development. Quantitative analysis using time-series data was utilized and data from 2000 to 2022 were used. Regression analysis was conducted using the Ordinary Least Squares (OLS) method and data were sourced from the Ghana Revenue Authority and the World Bank. The study found a positive relationship between standard VAT rates and GDP growth, Reduced VAT rates were linked to higher consumption in specific sectors, contributing to economic activity, while Zero-rated VAT on essential goods had an insignificant impact on overall GDP but improved access to goods for lower-income households. The study recommended that policymakers should consider the trade-offs between VAT rates to balance revenue generation and economic growth. The study could have included qualitative insights from stakeholders to enrich findings.

Gómez and Torres (2022) studied the effects of VAT rates on economic growth and income inequality in Latin America. The study analyzed the impact of VAT on income distribution, economic growth, and exemptions using a longitudinal mixed-methods design across 12 Latin American countries from 2005 to 2020. Findings showed that standard VAT rates increased revenue but worsened income inequality, while reduced VAT on basic goods mitigated VAT's regressive nature. Zero-rated VAT had minimal long-term economic growth effects but protected low-income households. The study recommended more progressive VAT systems, though it lacked a thorough examination of the complexities of VAT administration.

Mohammed and Yeboah (2022) explored VAT rate structures and economic growth in Sub-Saharan Africa, focusing on standard, reduced, and zero VAT rates' effects on government revenue and economic growth. A descriptive design using time series data from 15 Sub-Saharan African countries (2008–2021) applied an ARDL model. Findings showed standard VAT significantly boosted government revenue, with mixed growth effects based on tax collection efficiency. Reduced VAT rates spurred consumer spending, especially in retail and food, while zero-rated VAT helped reduce poverty without affecting growth. The

study recommended improving VAT administration but did not explore potential VAT reforms beyond reduced and zero rates. Enhanced currency with 2021 data inclusion.

Udezo and Ven (2021) examined VAT reforms and their impact on Nigeria's economic growth using time series data from 1991 to 2018. The study utilized an ex-post facto design, employing multiple regression and co-integration tests. The results indicated that VAT reforms, including standard and reduced VAT rates, had a significant positive effect on Nigeria's economic growth. Recommendations included improving tax administration to boost revenue collection. However, the study's reliance on secondary data limits insights into country-specific VAT challenges.

Peter and Obi (2016) analyzed the relationship between VAT and revenue trends in Nigeria from 1981 to 2014. They used secondary data sourced from the Central Bank of Nigeria and the Federal Inland Revenue Service. The analysis employed descriptive statistics and econometric models, including the Augmented Dickey-Fuller and Phillips-Perron unit root tests. Results showed that income taxes were statistically significant and positively related to total federally collected revenue. The ECM coefficient was negative and significant, indicating a long-run dynamic relationship with 76.61% of deviations in total federally collected revenue corrected annually. The Durbin-Watson statistic of 1.677 indicated no autocorrelation. The study recommended that the government address corruption, which undermines revenue administration, and implement monitoring mechanisms to track progress on the Federal Inland Revenue Service's strategic pillars.

Gap in Literature

Several studies have explored the impact of value-added tax (VAT) on Nigeria's economic growth, focusing on aspects such as revenue generation, economic stability, and development. For instance, Ogbodo and Mehara (2021) examined the effect of VAT on internally generated revenue between 2004 and 2019, while Udezo and Ven (2021) evaluated its influence on Nigeria's economic growth from 1991 to 2018. These studies utilized various methodologies and statistical tools to offer insights into the effects of VAT. However, the latest research only covers data up to 2019, which may not fully represent the current dynamics of Nigeria's capital market. Therefore, this study seeks to address this gap by investigating the impact of VAT on Nigeria's economic growth from 2002 to 2022, employing the ordinary least squares (OLS) regression technique for data analysis.

METHODOLOGY

This study employed an ex-post facto research design since it aims to analyze the effects of past events. The data for the research were sourced from secondary materials, specifically covering 21 years from 2002 to 2022, obtained from the CBN Statistical Bulletin (2022). The collected data were analyzed using descriptive statistics, the Augmented Dickey-Fuller test for unit root analysis, and ordinary least squares (OLS) regression techniques.

Model Specification

The linear functional relationship of the specified model is presented as follows:

$$\text{GDP} = f(\text{SRVAT} + \text{RRVAT}).$$

Econometrically, the above equation can be rewritten as:

$$GDP_t = \beta_1 SRVAT_t + \beta_2 RRVAT_t + e_t \dots\dots\dots \text{Model}$$

Where:

- GDP = represents Gross Domestic Product;
- SRVAT = represents Standard rate of value-added tax;
- RRVAT = represents Reduced rate of value-added tax;
- β_1 - β_2 = Coefficient of independent variables;
- t = Period (Time);
- e = Error time; and
- f = Functional relationship.

Table 1: Variable Measurement and Justification

Variable	Measurement	Justification
Gross Domestic Product (GDP)	Value of goods and services produced in an accounting year.	Adewale and Ogunleye (2023) and Obi and Akpan (2023).
Standard VAT Rates (SRVAT)	The legislated rate of value-added tax.	Johnson and Smith (2024) and Ahmad and Abdul-Rahman (2023).
Reduced VAT Rates (RRVAT)	The rates allowed on some special goods and services to encourage consumption.	Mohammed and Yeboah (2022) and Gómez and Torres (2022).

Source: Researcher’s Compilation, 2024.

DATA ANALYSIS AND DISCUSSION OF FINDINGS

Descriptive Statistics

Table 2 below is the result of the descriptive summary of the variables.

Table 2: Descriptive statistics of the entire data set.

	GDP	SRVAT	RRVAT
Mean	56565526	277.5879	188.0560
Maximum	2.15E+08	699.3703	479.9616
Minimum	1731838	30.64380	13.90870
Std. Dev.	74518949	194.2506	137.3253
Observations	21	21	21

Source: E’view 10 software.

Table 2 shows that GDP has a standard deviation of 74,518,949, which exceeds its mean of 56,565,526, indicating a wide dispersion and higher growth. In contrast, SRVAT and RRVAT have lower standard deviations (194.2506 and 137.3253) compared to their means (277.5879 and 188.0560, respectively), suggesting that these independent variables were less dispersed and exhibited lower growth rates. The

means of all three variables fall within their respective minimum and maximum values, signifying that the data was evenly distributed as expected.

Unit Root Test

Table 3: ADF Test for Unit Root

Variables	ADF test Stat	5% Critical Level	Prob.	Order of Integration
RRVAT	-3.382325	-3.020686	0.0243	1(0) - Stationary
GDP	2.121075	-3.081002	0.0096	1(1) - Stationary
SRVAT	-4.146739	-3.029970	0.0052	1(1) - Stationary

Source: E'view 10 software

The ADF stationary test results shown in Table 3 indicated fractional integration. Specifically, the Reduced Rate of Value Added Tax (RRVAT) is stationary at level 1(0), whereas both Gross Domestic Product (GDP) and the Standard Rate of Value Added Tax (SRVAT) are stationary at first difference 1(1). These findings suggest that the Ordinary Least Squares (OLS) methodology is appropriate, as it accommodates co-integration among variables with varying orders of integration. Consequently, employing the OLS method for data analysis in this study is warranted.

Regression Analysis

Table 4 below presents the results of the regression analysis conducted with the aid of the ordinary least square (OLS) method for analysis.

Variable	Coefficient	Std. Dev.	T-statistic	Prob.
SRVAT	51.9804	24.1337	2.1539	0.045**
RRVAT	13.5597	11.2589	1.2044	0.245
C	-317186	338757	0.9363	0.715
R-sqd				0.3480
Adj. R-sqd				0.2730
F-statistic				3.0251
Prob(F-statistic)				0.051

Source: Researcher's Computation using E'view 10 software

Based on the OLS results presented in Table 4, the adjusted coefficient of determination (Adjusted R²) for the model is 0.2730. This indicates that the explanatory variables, specifically the Standard Rate of Value Added Tax (SRVAT) and the Reduced Rate of Value Added Tax (RRVAT), explain roughly 27% of the variations observed in Gross Domestic Product (GDP). The validity of this outcome is supported by an F-statistic of 3.0251 and a p-value of 0.051

Hypothesis Testing

To evaluate the effect of value-added tax on Nigeria's economic growth, the hypotheses were tested using Ordinary Least Squares (OLS) results.

Ho₁: The standard rate of value-added tax does not significantly affect gross domestic product (GDP) in Nigeria. The results in Table 3 indicate a t-value of 2.1539 and a corresponding p-value of 0.0459, demonstrating that the standard rate of value-added tax positively and significantly influences GDP in Nigeria during the review period. Consequently, we reject the null hypothesis, which posits that the standard rate of value-added tax has no significant effect on GDP in Nigeria.

Ho₂: The reduced rate of value-added tax does not significantly affect GDP in Nigeria. Table 3 also shows a t-value of 1.204353 and a p-value of 1.2044, suggesting that the reduced rate of value-added tax has an insignificant positive impact on GDP in Nigeria for the period analyzed. Therefore, we accept the null hypothesis stating that the reduced rate of value-added tax does not significantly affect GDP in Nigeria.

Discussion of Findings

The study indicates that the standard rate of value-added tax (SRVAT) has a significant positive effect on Nigeria's GDP. Specifically, an increase of 1 naira in SRVAT correlates with an increase of 51.98043 in GDP. This finding aligns with research by Adubi (2017), Confidence and Tovie (2022), Cornelius *et al.* (2016), and Udezo and Ven (2021), but contrasts with the findings of Ogbodo and Mehara (2021).

Furthermore, the study shows that the reduced rate of value-added tax (RRVAT) has an insignificant positive effect on nominal GDP in Nigeria, suggesting that an increase in RRVAT would raise GDP by 13.55970. This result aligns with the studies by Cornelius *et al.* (2016) and Udezo and Ven (2021) but differs from the findings of Adubi (2017) and Confidence and Tovie (2022).

CONCLUSION AND RECOMMENDATIONS

Given the significant positive relationship between the standard rate of value-added tax and GDP, it is clear that SRVAT contributes to economic growth in Nigeria. However, a heavy reliance on SRVAT and other taxes could make the economy vulnerable due to their limited overall impact. Based on these findings, the study recommends:

- i) The government should harness the positive impact of the standard rate of value-added tax on GDP by strategically adjusting tax rates to promote investment in the petroleum sector while maximizing revenue.
- ii) A reevaluation of the reduced rate of value-added tax policy is necessary to enhance its attractiveness for businesses, potentially through tax reductions for specific industries or incentives for research and development initiatives.

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