

**VALUE ADDED TAX (VAT) AND PRICE STABILITY  
IN NIGERIA**

**BY**

**JIDEOFOR .O. IBE**

**EC/2007/604**

**DEPARTMENT OF ECONOMICS**

**FACULTY OF MANAGEMENT AND SOCIAL SCIENCES**

**CARITAS UNIVERSITY AMORJI-NIKE**

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Title Page

# **VALUE ADDED TAX (VAT) AND PRICE STABILITY IN NIGERIA**

**A Project Submitted to the Department of Economics,  
Caritas University, Amorji-Nike, Enugu.**

**BY**

**JIDEOFOR .O. IBE**

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Caritas University, Amorji-Nike, Enugu.**

**Project Supervisor:**

**Mr Ikpe M.**

**AUGUST, 2012.**

# APPROVAL PAGE

This is to certify that this project was undertaken by Jideofor .O. Ibe and duly supervised and approved as having met the requirement for the award of Bachelor of Science (BSc) degree in the Department of Economics, Caritas University, Amorji-Nike, Enugu.

\_\_\_\_\_

Date: \_\_\_\_\_

Mr. Ikpe M.N.

Supervisor

\_\_\_\_\_

Date: \_\_\_\_\_

Barr. Onwudinjo P. C.

Head of Department

\_\_\_\_\_

Date: \_\_\_\_\_

Prof. Umeh C. C.

Dean of Faculty

Management and Social Sciences

\_\_\_\_\_

Date: \_\_\_\_\_

External Examiner

## **DEDICATION**

This work is dedicated to Almighty God, my father, Mr Mark Ibe, my brothers and sisters and all the students of economics department.

## **ACKNOWLEDGEMENT**

My profound gratitude goes to God Almighty by whose grace alone I have become a graduate of Caritas University. My special thanks goes to my parents Mr. Mark U Ibe and my inlaw Mr Samuel Eze for all their efforts and support to me, financially, morally, spiritually and otherwise throughout my stay in school.

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## ABSTRACT

*Value Added Tax (VAT) is a consumption tax on the value added to a product in the process of production. Like all other indirect taxes, it is a tax that targets the final consumer of goods and services. The main purpose of VAT in Nigeria is to increase government (state and Local) revenue from the non-oil sector thereby reducing the government's dependence on oil sales and the budget deficits. In this research work my aim is to determine the stabilizing roles of VAT in the Nigerian economy. The study employed multiple regression analysis as a method of study using the ordinary least square (OLS) regression technique in estimation. Result of the analysis revealed that price level is not stimulated by VAT in Nigeria.*

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## **CHAPTER ONE**

### **1.1 BACKGROUND OF THE STUDY**

The introduction of value added tax(VAT) in Nigeria came from the report of the study group set up by the federal government in 1991 to review the entire tax system in the set up to carry out feasibility studies on its possible implementation.

In January 1993, the federal government agreed to introduce VAT by the middle of the year. But due to some logistic reasons for the relevant legislation to be made and proper ground work done. It was shifted to January 1<sup>st</sup> 1994.

VAT replaced the former existing sales tax carried out by the different state<sup>3</sup> governments, the wages first implemented in 1986 and operated under the federal government legislated degree no.7, of 1986. VAT replaced the sales tax because of the following reasons.

VAT is neutral in that a considerable part of the new tax is to be realized from imported goods unlike the sales tax that targets only locally produced goods based on the general consumption behavior.

VAT is a consumption tax on all economic operation in the country including imports and has a zero rate for export. The federal Inland Revenue service (FIRS) is the main body charge with the administration of VAT in Nigeria custom service (NCS) for the collection of VAT on imports and the help of VAT on the locally produced goods and services.

VAT has a single low rate of 5% with a zero rate for exports and is borne sole by the final consumers of VAT able goods and services like any other indirect tax, some essential goods and services are exempted from VAT that is they are not VAT able

The main reasons that led the introduction of VAT are to be referred to as the main gains of VAT and they included.

- I. Need for increased government revenue due to increased public expenditure.
- II. Reduction in the over dependence on sales of crude oil with its attendant uncertainties in the international market.
- III. Making the tax equitable for all the masses by curbing the rice, thereby reducing the gap between the very rich and the very poor.

IV. Reducing the rich's materialistic tendencies for unnecessary luxury goods.

## **1.2 STATEMENT OF THE PROBLEM**

In terms of contributions the total federal collection revenue, VAT revenue at the time of inception in 1994 was anticipated to be much larger, indicating that Nigeria then may soon join the growing list of developing countries here VAT contributes at least 20% of total government revenue . While the performance of VAT as a source of revenue in sub-Sahara Africa and Nigeria in particular is clearly encouraging, it remains difficult to find attempts to systematically asses the impact of VAT on these economies (Ajakaiye, 1999). Nevertheless, include (1989) opines policy makers considering the adoption of VAT should be interested in the macroeconomic impact, especially on price, output, income and consumption.

Economically, one expect the price of VAT able goods to rise, however beyond this expected rise, business are taking advantage of the existence of VAT the increas4e price of goods and services arbitrarily.

The excessive price increase according to Aruwa (2008) has further led to higher inflation in Nigeria. Given the foregoing seeks to assess the macroeconomic impact of VAT on price level in Nigeria.

### **1.3 OBJECTIVE OF THE STUDY**

The study seeks to examine the following specific objectives.

- I. To ascertain if any significant relationship exists between VAT and price stability in Nigeria.
- II. To determine the impact of VAT on price level in Nigeria.

### **1.4 HYPOTHESIS**

Ho<sub>1</sub>: There is no significant relationship between VAT and price level in Nigeria.

Ho<sub>2</sub>: The impact of VAT on price level in Nigeria cannot be determined.

### **1.5 SCOPE OF THE STUDY**

The study intends to focus on the Nigeria economy with the period 1994 to 2010. The choice of range of period is informed by the fact that VAT policy implementation in Nigeria began by 1994. Quarterly data will be employed to

extend the sample size, but where this is not available; we will have no choice than to use annual data for the study.

## **1.6 SIGNIFICANCE OF THE STUDY**

Finding from the study will be of immense benefit to policy makers in assessing the performance of VAT on the stability of price level in Nigeria.

Secondly, it will serves as a reservoir of knowledge for further studies.

## **CHAPTER TWO**

### **2.0 LITERATURE REVIEW**

#### **2.1 CONCEPTUAL FRAMEWORK**

VALUE- ADDED TAX (VAT). This is an indirect tax levied on goods or services as a percentage of their value added. The customer pays price the seller then pays the VAT they have paid on purchased inputs. VAT is levied in the UK in 1973. Goods may bear VAT at different rates. Some goods, for example food in the UK are exempt, and VAT is not payable by business with turnover below some minimum level.

#### **2.1 INFLATION RATE**

This is a measure of inflation, or the rate of increase of a price index such as the consumer price index. It is the percentage rate of change in price level over time, usually one year. The rate of decrease in the purchasing power of money is approximately equal.

The inflation is used to calculate the real interest rate, as well real increase in wages. Official measurements of this rate are input variables to a adjustment and inflation derivatives price.

### **(GDP)**

Gross Domestic Product is the market value of all product and services produced in one year by labour and property supplied by the residents of a country? Unlike across domestic product (GDP), which defines production based on the geographical location of production, GDP allocated production based on ownership GDP does not distinguish between qualitative improvements in the state of the technical arts (e.g., increasing computer processing speeds), and qualitative increases in goods (e.g., number of computers produced), and considers both to be forms of “economic growth”.

### **(Import)**

Is derived from the conceptual rearing as to bring in the goods and services into the part of a county. The buyer of such goods and services is referred to an “importer” who is based in the country of import whereas the overseas based



seller is referred to as an “exporter” 1. Thus an import is any good (e.g. a commodity) or services brought in from one country to another country for sale 2. Import goods or services are provided to domestic consumers by foreign producers. An impact in the receiving country is export in the sending country.

## **DEGREE OF OPENNESS**

Degree of openness is import plus exports, divided by GDP? it represents the idea of openness in trade.

## **2.2 A REVIEW OF THE TAXATION SYSTEM IN NIGERIA HISTORICAL REVIEW**

For a long time, government imposed taxes to raise revenue to cover its expenditures like the cost of administration and defence and taxation has the most important source of the Nigeria government revenue.

In drawing out a development plan or the yearly budget government always seeks out ways of raising its revenue that is finding ways of raising revenue from tax at the lowest possible cost.

Government expenditure has been growing over time due to increased demand of the people and this is caused by the increase in population. Government now has to provide more economic and social amenities for its growing population. As Okigbo puts it “government now fulfills a multiple act of roles traditional, religion, developmental and directly productive”.

And be able to play out these roles, government needs funds to finance these activities and taxation is the main sources of revenue for the funding of government activities. Tax is a compulsory levy imposed by the government on individuals and business firms and paid by them to the government. There are two base elements in a tax, the base and the rate. The tax base is the object which is taxed for example income, profits properly, etc. while the tax rate is the percentage of the base that will be paid as tax and rate is usually in form of flat rate. Taxes are not the imposed solely for generating revenue but also for the purpose of furthering social and economic policy. Some of the main purposes of taxation are as follows.

- I. To generate revenue for the financing of government activities
- II. To control the economy e.g. if a country is experiencing inflation, by increasing taxes, income at the disposal of the people i.e. disposable income will be reduced and hence aggregate demand.
- III. To redistribute income under a progressive tax system, more money is taken from the rich to finance projects beneficial to the poor and rich equally.
- IV. To discourage consumption of certain goods. In Nigeria, there are three tiers of government the federal the state and the local government has its own function in terms of assessing, collecting and sharing the accrued revenue.
- V. There are some taxes that are exclusively collected by the federal government and some of them are the company income tax, personal income tax of certain individual's petroleum profit tax, capital gains tax, custom and excise duties etc.

And the state collects the personal income tax of individuals resident in the state, capital transfer tax and capital gains tax of individuals also resident in the state. All these taxes are paid into the federal account and shared out to the federal state and local government.

## **TYPES OF TAXES IN NIGERIA**

Taxes can be categorized on the basis of border or incidence, but generally. They are categorized into two groups depending on whether persons or things are taxed. The two broad groups are direct and indirect taxes. And this is the classification used in Nigeria till now.

### **DIRECT TAXES**

Here taxes are levied directly on the income and property of individuals and companies. The burden of tax is borne directly by the person paying the tax and it varies with the status of the taxpayer. Examples of direct taxes are taxes on income (personal income tax and company tax). Profits from petroleum (petroleum profit tax) capital gains (capital gain tax) and capital transfer tax.

### **INDIRECT TAXES**

Here, taxes are levied on the goods and services and are paid as people consume such goods or services. It is paid indirectly since it is included in the price of the commodity or services being consumed, the taxpayer is not often aware of

how much tax he pays. They are levied on persons or groups whom they are not intended should bear the burden or incidence and they will shift them to other people. The ability to pay under indirect taxes is assessed indirectly some examples of indirect taxes are custom duties (import and export duties). Excise duties, sales tax, stamp duties, value added tax, turnover tax etc.

## **EXAMPLES OF DIRECT TAXES**

### **PERSONAL INCOME TAX (PIT)**

This is levied on an individual's income earned during a certain period of time, usually a year. It varies with the size and sources of the tax payers' income and various other characteristics laid down by law e.g. marital, status and number of dependents. In Nigeria; the personal exemptions before the tax are personal allowance e.g wife allowance, children allowance, dependent relative allowance, life insurance premiums and contribution to pension funds.

The incomes to be taxed consist of net income minus personal exemptions while the net income is getting when losses and expenses are deducted from the gross income.

The relevant legal basis is the income tax management act of 1961 (as amended). The administration is undertaken at the state level.

According to the existing tax laws, the deductible allowances are pension fund contribution, personal allowances (on earned income) children allowance of N1,000 per child subject to the maximum of four children, dependent relative allowance of N100 for one person, life insurance contribution and subscriptions to professional societies. The PIT rates range from 10% to 55% up until the end of December 1991 and was reduced to 10% to 45% in 1992 and was reduced to 5% to 30% with six slabs of incomes.

The progression scale of the PIT in Nigeria as from January 1995-1995 is

First N10,000 at 5%

Next N10,000 at 10%

Next N10,000 at 15%

Next N10,000 at 20%

Next N20,000 at 25%

Next N60,000 at 30%

Earned income of up N7, 500 is only subjected to the minimum tax rate of 0.5%.

Sources; the daily times of the 1995 budget breakdown. In Nigeria, the personal income tax (PIT) form a small proportion of government revenue due to many people making incorrect income declaration with widespread tax evasion and avoidance.

### **COMPANY INCOME TAX (CIT)**

This is levied on not profits of companies. The gross profit of companies include any or all of the followings, profit from sales, interest and divide is received, rents and royalties, receipts room services and capital gains and losses. To get the net income some of the following are deducted from the gross income, wages, salaries, rent, interest, taxes, casually losses, repairs bad debt, depreciation and depleting, amortization or emergency facilities advertising. Pension and profit sharing plans, contribution to charities etc.

The legal basis of the company income tax (CIT) is the company income tax act (CITA) in 1976 (as amended) the tax rate of 45% before 1992.

### **C PETROLEUM PROFIT TAX (PPT)**

This is levied on the profits of each accounting period of any company engaged in petroleum operations during such accounting period, usually one year. The profit of such companies include, the proceeds of sales of all changeable oil during the period the value of all chargeable oil during the period, the value of chargeable natural gas in that period and all income of the company of that period incidental to and arising from any one or more of its petroleum operation. Before taxing some necessary deductions are made and they include rents, all royalties (liabilities incurred in respect of crude oil exported from Nigeria and liabilities incurred in respect of national gas sold and actually delivered to NNPC). Interest on borrowed funds, repair cost, exploration and drilling etc the legal act is the petroleum profit tax of 1959 (as amended). The PPT has remained the single largest source of government revenue in Nigeria.



## **D CAPITAL GAINS TAXES (CGT)**

A capital gains accrue when the value of capital asset goes up and it is realized when the asset is sold. They are unearned increments brought about by market and development forces the capital gains tax is levied with reference to its realization and its rates are progressive. The legal basis in Nigeria is the capital gains tax act of April, 1, 1967 as amended in 1972 and 1976. It is levied at the state level and does not generate much revenue.

## **E CAPITAL TRANSFER TAX (CTT)**

It is levied on all gratuitous transfers of capital whether they occur during a person's life or at death. It is levied not yet on the estate of a deceased person but also on gifts made during a person's lifetime, (with minor exception). But transfers between husband and wife are free of tax. The tax is progressive in nature since each successive slice of the taxable amount is taxed at a higher rate. The legal basis of the CTT is the capital transfer tax act of 1994 it exhibits three textures. It is a property tax, a wealth tax and in aspect of a death duty.

## **EXAMPLES OF INDIRECT TAXES**

### **a) IMPORT DUTIES**

These are levied on goods coming into the country from abroad. The duty is collected from the importer at the time the goods enter the country and become an element of costs of the goods to him. The main reason for levying import duties is to discourage importation of a goods by an artificial tax addition on its price. In Nigeria, they are levied on equipment raw materials, spare parts, manufactured goods etc. it also forms a substantial portion of government revenue, for example, revenues from import duty form a greater percentage of national income.

### **b) EXPORT DUTIES**

These are taxes levied on goods, which are exported or sold to other countries by the home country in Nigeria, they used to be levied on groundnuts cocoa, palm kernel, crude oil etc. revenue accruing to the government from the source has been insignificant due to the declining volume and value of exports, particularly the agricultural form.

### **c) EXERCISE DUTIES**

These are levied on certain goods produced or manufactured locally. Such goods include beer, cigarettes, sugar etc. revenue from this source have been substantial in Nigeria over the years.

### **d) SALES TAXES**

These are taxes on selected sales transactions but applied at only one stage of business activity. Production has many stages being from the manufacturer to the retailer before the goods finally reach the consumer.

A general sales tax can be applied at any of these stages. It is usually collected either at the wholesale level or at the retail level. The sellers charge the sales tax on their sales and deposit the proceeds with the authorities. The idea of the seller tax was mainly to apply a general retail on consumption with heavier taxation on luxuries. The legal basis of the sales tax in Nigeria was decree number 7 of June 1986 (as amended by decree number 55 of January 1989). It was levied at 5% of turnover of all taxable goods and services except for wine liquor and spirits that attract 10% of turnover as tax devices affected are sales and services in registered

hotels, motels, catering establishment's restaurants and other personal service establishments (excluding drink). The cigarettes and tobacco. Jewels and jewelries, perfumes and cosmetics, electrical and electronics equipments, (steers sets, radio and television sets, video cassettes cameras, air conditioners, fans, deep freezers). Carpets and rugs and bottled natural water.

The sales tax was administered by the internal revenue department each state. The revenue from the sales tax was very substantial. For example, in Lagos the sales tax revenue rose from 1.63% of the state revenue in 1935 to 13-23% in 1989, and Anambra, the sales tax portion of the states revenue rose from 10% in 1985 to 21% in 1990.

The sales tax was abolished and replaced by value added tax in January 1, 1994 because it is narrow in base and does not cut through most commodities and services.

### **2.3 ECONOMIC STABILITY IN NIGERIA**

The major roles of any government in an economy are that of efficiency in resource allocation, equity inn income distribution and stabilized economic

activities. The first two roles come under micro economic problems that involved individual market and person. Efficient allocation of scarce resources to the sectors that need them most and that will efficiently and productively make use of such resources and also will help in the development of other sectors i.e., the scarce resources of the country should be efficiently allocated to sectors in need of these resources to increase economic activity and national income of the country. Under equity in distribution, the government is charged with the responsibility of maintaining an even distribution of goods, services and income to the individual sectors in the economy i.e. equity in distribution involves ensuring that all the goods and services are well distributed and the distribution of income in the country is such that the gap between the very rich and the poor is not too wide. This does not mean equality in income distributed but rather, the difference in income should relate to the differences in effort or contribution to total output. Therefore government ensures that all are paid according to their contributions to the economy.

The role of government in stabilization will be our major focus since it is the topic in question; government uses taxation to achieve this role but our main concern is how government will use VAT.

In stabilizing the economy, Government role in economic stability is a macro economic problem because it involves the aggregates in an economy, i.e. national, unemployment rate, balance of payment, position, balanced budget, exchange rate and interest rate. When we talk about stabilization, we refer to stability in this economic variable.

In reference to our topic of discussion, we will restrict our discussion to those variables that will be influenced by VAT like the ADP, balanced budget, national income and inflation rate. Since the main objective of VAT is to increase GDP. And national income, reduce the produce the problem of budget deficits and curb inflation. Since we know that the greatest problem that brings about economic stability in deficits through borrowing from the banking sector which leads to increased money supply without an increase in the national output.

## **2.4 THEORICAL LITERATURE**

Over the centuries, writers of public finance have developed two important approaches to taxation these are the benefit theory and the ability theory.

## **THE BENEFIT APPROACH**

This has two merits, first it is considered fair being that the beneficiaries of government expenditure pay proportionately for these benefit approach determines simultaneously the tax level and public services of different government in other words, how extensive the individual benefits from the government should determine along with taxation, who should pay for these services.(wikipedeia,2011)

This is the most important principle of taxation being that it treats revenue and expenditure is imposed on the basis of tax payer's ability to pay. Here there is no quip-pro-quo arrangement. The ability to pay principle is conceived in terms of sacrifice on the part of thee tax payers. It is the most progressive tax system leading to complete egalitarian distribution of offer tax income. It is also the least aggregate sacrifice or minimum principle since the total sacrifice will be the least (wikipwdia, 2011).

## **2.5 EMPERICAL LITERATURE**

1. Professor Sam Aluko (1913) in discussing the arguments for and against VAT states that VAT, like sale tax, is an indirect, consumption tax which has the administration than sale tax, for instance in the manufacturing of taxable's, instead of collecting 5% sales tax at the point of sale of the cloth, VAT is collected at the burden of record keep and processing of VAT information by the various production levels and the kind of record keeping needed may be very expensive for an illiterate society and may also give rise to fraud on the side of the producer and or tax collectors or evasion from the side of the4 producer or seller also since credits are given for VAT paid at earlier production stages, it give4s rise to complications, repayment claims and counter claims if the records are not adequately helped. On the other hand, VAT discriminates less between different types of goods and services because tax is levied as long as there is evidence that value is added. VAT reduces distortion in consumer's choice and so reduced the mis-allocation of resources that arises under sales tax. Therefore VAT can be described as neutral between all goods and services if it is levied at single rate and is also neutral between vertically integrated companies like the one producing



only cloth or thread or cotton alone because it is claimable on payment made at lower production stage.

VAT does not penalize efficiency, since the same rate of VAT is payable<sup>4</sup> at lower as well as higher value added. It also easier for example capital formation under VAT than sale tax.

VAT is very difficult to evade if the collectors are honest and competent, In order to reduce the cost of collection of VAT in some countries, self assessment by companies and sellers in being introduced, which enables them to pay their every month or every quarter, using their sales and purchase figures. Using their sales and purchases figures finally VAT can harmonize consumer taxes in a customs union of many countries like the Ecowas or EEC.

2. Ad man and woods (1983) while writing on VAT and sales tax claim that VAT avoids the<sup>3</sup> double tax element that could occur under other forms of sales tax. They are both destination based taxes that take domestic expenditures not produced goods as their base sale tax applies to the consumer price of taxable

commodities while VAT applies to the value added at each stage of the production distribution sequence.

VAT has many administrative advantages over sales tax. Under sale tax, the seller must determine whether or not the buyer is entitled to an exemption while under VAT the seller simply collect tax on every transaction. The VAT mechanism also provides buyers and sellers with an investment to comply with the tax that is under absent sales tax. The compulsory issue of invoices under VAT enables the tax authorities to perform gross checks more easily than it can perform under sales tax. The countries administering VAT gave some reasons for their choice which is that.

VAT is more comprehensive in its coverage than sales tax. It is better equipped to include services in the tax base and also to correctly adjust the tax on exports and import and also its potential for raising revenue is greater than that sale tax.

On the administrative and compliance cost of the two taxes, sales tax would appear to be simpler to administer and comply with than VAT. But Adedeji (1969)

observed that VAT had numerous advantages that out-weigh the cost associated with its administration. VAT has a greater potential for raising revenue which facilitate greater dependence on internally generated revenue or more stable sources of revenue as against to inflationary finance or revenues from primary commodities and crude oil whose price changes continues to be violated in the world market.

VAT is often seen as the best way to promote neutrality and uniformity of the tax burden and to provide for increased productivity and industrialization.

VAT is a buoyant revenue source closely linked to increase in consumption and has become a crucial part of over all revenue for most countries using it. But there are still controversial points about it for instance, it is expensive to administer. It is regressive.

On the expensiveness of VAT, it would require the expansion of internal revenue services but the high revenue yields from it would cause administration cost to be measured as a percentage of revenue yield. According to Chosen (1992) the degree of regressively can be reduced by the following government policies;

- a. Income tax credits should be given either a flat credit or one that diminishes as income rises.
- b. Exemption and multiple rate
- c. Ear marking of some revenue for increased social spending beneficial to the poor.
- d. Operating VAT in conjunction with a highly progressive income tax.
- e. Lower bracket taxpayers to be taken off the income tax rolls by means of higher income tax exemptions.

However, experiences has shown that to reduce regressively by ridding VAT with exemptions complicates administration considerably and erodes VATs enforcement mechanism.

Okafor 1993 also maintain that since rates payable for both luxuries and essentials are basically similar, the brunt of VAT could fail heavily on the poor.

This disadvantage to him could be dangerous if not eliminated by the process of exemptions and zero rating Aliko however stated that it is advantagerious to kee4p the application of VAT as uniform as possible and to help-0 the poor by means of

adjusting elsewhere in the fiscal system. This shows that although VAT is regressive, it regressively can be caused and although it is expensive, its expensiveness can be reduced. And although it contains a self-checking mechanism. It can still be evaded which can account for 2-4% of revenue forgone.

On broadening the tax base and lowering tax rate of VAT shall and Shivazi 1991 maintained that it should be the foremost goal of any reform initiative in developing countries. For them, developing countries typically levy high tax rate on narrow base, encouraging tax evasion and compromising the fairness of the tax system. Broadening the tax base can generate higher revenue while also providing similar tax treatment to various activities and individuals in similar circumstances.

A broad-based VAT would have limited exclusion while a narrow based VAT would have numerous exclusion.

The broader the tax base, the lower the tax rate necessary to raise a given amount of revenue, also the broader the VAT base, the more efficient the tax system. The two primary justifications for excluding specific items from taxations are.

1. VAT difficult to collect on some goods and services because sellers could easily avoid reporting their sales
2. Some goods are excluded on equity grounds since these goods claims is proportionately large percentage of the in come of lower income families.

They also claim that VAT can further assist in improving collection of other taxes by creating verifiable records of transactions through production and channels. They maintained that VAT adoption has been successful in raising additional revenue and reducing the efficiency costs of taxation in countries like Indonesia, turkey, Korea, Columbia etc. but has the disadvantage of the inability to encompass a large number of economic activities that are carried out in the informal sector in a typical developing like Nigeria.

According to bickleg (1990) any tax that reduces the budget deficit saving would be expected to raise the rate of national saving. VAT only taxes saving once they are spent on consumption. Hence choosing VAT to raise revenue will increase the return

## **2.6 SUMMARY OF LITERATURE AND JUSTIFICATION OF THE STUDY**

A review of past studies revealed that investigation into the macroeconomic effect of VAT was carried out by Ajarkaiye (1999) using a computable general equilibrium model. As much as the study is aware of no other detailed study has so far been carried out on this particular investigation since then. This study intends to carry out reinvestigation of the macroeconomic effect of VAT in Nigeria with specific focus on the price stability, using a different econometric model. This reinvestigation is necessary given the fact that the economic environment in Nigeria has since changed from what it was in 1994 to 1999. This forms the existing gap in literature which this study intends to bridge.

## CHAPTER THREE

### 3.0 METHODOLOGY AND DATA

#### 3.1 METHODOLOGY

The study intends to employ multiple regression analysis in analysis in herein, using the ordinary least square (OLS) regression technologies. This is chosen based on its BLUE property the analysis will be based on the simple linear relationship between price stability to be proxed by inflation rate, and VAT alongside other chosen variables that also affect stability.

#### MODEL SPECIFICATION

The model for the analysis will be specified as:

$$\text{INF} = f(\text{GDP}, \text{M}, \text{VAT}, \text{and IOP}) \dots$$

**EQUATION** (7.1) is the mathematical form of the model. The inclusion of an error term “U” to take care of other variables that are not included but affect inflation, transforms equation (3.1) to

$$\text{INF} = B_0 + B_1 \text{GDP} + B_2 \text{M} + B_3 \text{VAT} + B_4 \text{IOP} + U \dots \dots \dots (3.2)$$



Where INF= inflation rate GDP = gross domestic product as a proxy for goods manufactured in Nigeria M= import which is proxy for imported manufacture IOP=degree of openness, the flow of imported manufacture depends on how open the economy is VAT=Value added Tax.

## **MODE OF EVALUATION**

Evaluation herein shall be based on the following criteria:

- 1. Economic criterion**
- 2. Statistical criterion**
- 3. Econometric criterion**

Economic criterion assesses to what extent the coefficient of the independent variable conform to the prior expectations with respect to their signs. Statistical criterion shall be used to assess the significance of the variables (independent variables) in explaining changes in the level of price stability.

Economic criterion shall be useful in assessing the extent to which the model conforms to the assumption of classical normal linear regression model (CNLRM).

$B_1$  is expected to be less than zero,  $B_3 > 0$ , while  $B_2$  and  $B_4$  can be greater or less than zero, this is so because an increase in import is expected to supplement domestic supplies which through competition drives down price. But if the goods imported have inflation content, it transfers that to the domestic economy. Similarly increase in the degree of openness will facilitate the inflow of goods and services which will help to reduce level of prices, but this same policy will increase the level of inflation if the imported goods and services have inflation content in them.

## **ESTIMATION PROCEDURES**

The data will be subjected to multiple regression analysis using OLS regression technique. Effort will further be made to subject the model to various econometric tests to determine the extent to which it conforms to the assumptions of CNLRM.

## **DATA AND ECONOMETRIC SOFTWARE**

The time series data will be sourced from the 2009 and 2010 edition of the CBN statistical bulletin.

Eview econometric software will be used for the analysis while MS 2003 computer software will be used for data entry.

## CHAPTER FOUR

### 4.0 PRESENTATION AND DISCUSSION OF RESULTS

This is the presentation of the result of the multiple regression models and the test which has been carried out in the table below.

#### RESULT OF THE MULTIPLE REGRESSION MODEL

	Coefficient	t-statistics	Other statistics
C	430.1112	3.878787	$R^2=0.60$
Log GDP	-14.75461	-0.945044	Adj $R^2=0.47$
Log IMP	-12.54127	-0.724402	F-stat=4.52
LogIOP	33.12375	1.897967	D.W 1-21
VAT	0.000205	2.259233	

Source authors computation from regression result.

The results presented in table 1 above, shows that the model is well behaved on the average. Judging by the  $R^2$  of 0.60 and adjusted  $R^2$  of 0.47. This indicates that the level of explanation of variation in the rate of inflation within the period under study, by the independent variable is averagely satisfactory. F-statistics is significant statistically. Durbin Watson value of 1.21 indicates the presence of positive autocorrelation in the quality of data we had unconnected with the quality of data we had our disposal.

On prior ground the sign of VAT failed to conform to a prior expectation, but other variable in the model did. It is of note that VAT and the degree of openness statistically account for variation in the rate of inflation.

The implication of the result above is that increasing the degree of openness by one unit will increase price level by 3312%. On the other hand, increasing VAT revenue by one unit will lead to an increase in price level by 0.000205. What this means is the fact that VAT revenue does no harm to the stability of price in Nigeria.

## **RESULT OF THE ECONOMETRIC TEST**

The result of white hetroskedasticity test indicates the presence out hetroskedasticity in the model. This is however attributable to the quality of data used. Multicollinearity test result showed in the model. However, multicollinearity problem is not enough reason to throw away a good regression result outcome, especially if the purpose is for prediction (Gujarati, 2003). The normality test conducted produced a Jarque-Bera value of 5.14, with a probability value of 7%. The model is not normally distributed. This however does not call for any alarm that this form for any is specifically an asymptotic test, an assumption our model parts to satisfy.

## **CHAPTER FIVE**

### **5.0 CONCLUSION AND RECOMMENDATION**

#### **5.1 CONCLUSION**

The result of extensive investigation carried out under the study revealed that contrary to the view by private firm owners that VAT raised the prices of their products, which genders inflationary outcome, Value Added Tax (VAT) actually has no inflationary consequence in Nigeria as speculated.

Specifically:

- ❖ Inflation in Nigeria is stimulated to a very high extent by openness
- ❖ Increased tax revenue from VAT does not give rise to inflation in Nigeria.

#### **5.2 RECOMMENDATION**

Based on the above stated findings from the investigation carried out, the study makes the following recommendations.

- ❖ Although openness is inevitable in today's global economy, sequencing of faces of liberalization is necessary to check possible inflationary consequences in Nigeria
- ❖ The study advocate for relative increase in the overall share of VAT within the framework of fiscal policy whenever expansionary fiscal measures is adopted for achieving the goal of economic growth.



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Dependent Variable: INF  
 Method: Least Squares  
 Date: 08/06/12 Time: 15:07  
 Sample: 1994 2010  
 Included observations: 17

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-0.283090	23.85225	-0.011868	0.9907
GDP	-2.37E-06	2.29E-06	-1.032828	0.3221
IMP	-1.09E-06	1.24E-05	-0.088015	0.9313
VAT	0.000205	0.000376	0.545705	0.5953
IOP	49.11631	39.50782	1.243205	0.2375
R-squared	0.284270	Mean dependent var		18.31176
Adjusted R-squared	0.045693	S.D. dependent var		18.63769
S.E. of regression	18.20690	Akaike info criterion		8.881407
Sum squared resid	3977.896	Schwarz criterion		9.126470
Log likelihood	-70.49196	F-statistic		1.191525
Durbin-Watson stat	0.438882	Prob(F-statistic)		0.363716

Dependent Variable: INF  
 Method: Least Squares  
 Date: 08/06/12 Time: 15:16  
 Sample: 1994 2010  
 Included observations: 17

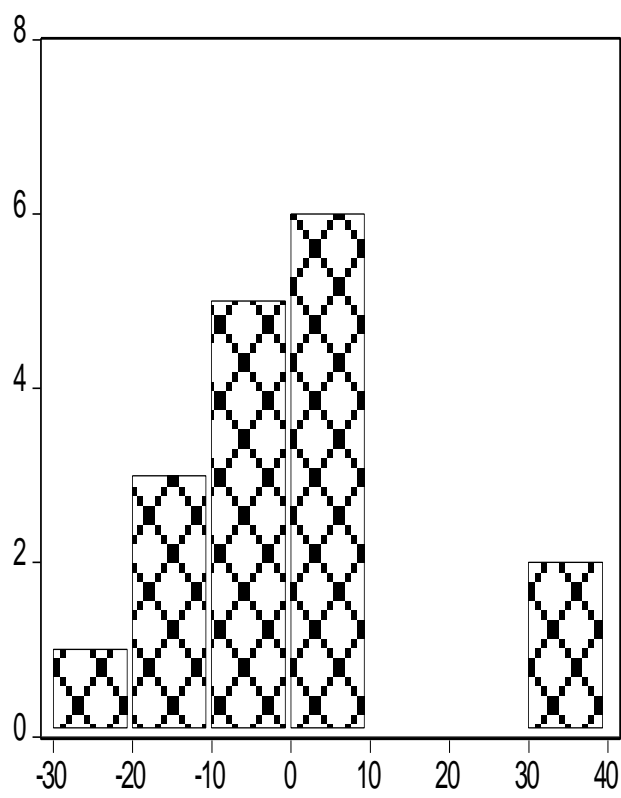
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	430.1112	110.8881	3.878787	0.0022
LOG(GDP)	-14.75461	15.61262	-0.945044	0.3633
LOG(IMP)	-12.54127	17.31257	-0.724402	0.4827
LOG(IOP)	33.12375	17.45223	1.897967	0.0820
VAT	0.000205	9.09E-05	2.259233	0.0433
R-squared	0.601136	Mean dependent var		18.31176
Adjusted R-squared	0.468181	S.D. dependent var		18.63769
S.E. of regression	13.59170	Akaike info criterion		8.296725
Sum squared resid	2216.813	Schwarz criterion		8.541788
Log likelihood	-65.52216	F-statistic		4.521361
Durbin-Watson stat	1.214382	Prob(F-statistic)		0.018550

White Heteroskedasticity Test:

F-statistic	2.001581	Probability	0.173027
Obs*R-squared	11.33632	Probability	0.183361

Test Equation:  
 Dependent Variable: RESID^2  
 Method: Least Squares  
 Date: 08/06/12 Time: 15:08  
 Sample: 1994 2010  
 Included observations: 17

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	3190.862	1706.259	1.870092	0.0984
GDP	-0.000147	0.000189	-0.779237	0.4583
GDP^2	7.45E-12	5.54E-12	1.345620	0.2153
IMP	-0.001111	0.000715	-1.552396	0.1592
IMP^2	7.48E-11	6.09E-11	1.229109	0.2540
VAT	0.026878	0.022355	1.202322	0.2636
VAT^2	-8.48E-08	7.31E-08	-1.160744	0.2792
IOP	-8157.036	5997.495	-1.360074	0.2109
IOP^2	7592.996	5041.121	1.506212	0.1704
R-squared	0.666842	Mean dependent var	233.9939	
Adjusted R-squared	0.333685	S.D. dependent var	431.1310	
S.E. of regression	351.9243	Akaike info criterion	14.86976	
Sum squared resid	990805.4	Schwarz criterion	15.31087	
Log likelihood	-117.3930	F-statistic	2.001581	
Durbin-Watson stat	1.579893	Prob(F-statistic)	0.173027	



Series: Residuals	
Sample 1994 2010	
Observations 17	
Mean	-6.17E-15
Median	-1.329114
Maximum	38.42967
Minimum	-21.04393
Std. Dev.	15.76764
Skewness	1.207575
Kurtosis	4.195071
Jarque-Bera	5.143310
Probability	0.076409

	INF	GDP	IMP	VAT	IOP
INF	1.000000	-0.401409	-0.345051	-0.357794	0.288718
GDP	-0.401409	1.000000	0.965870	0.976971	0.038736
IMP	-0.345051	0.965870	1.000000	0.983161	0.083264
VAT	-0.357794	0.976971	0.983161	1.000000	0.029527
IOP	0.288718	0.038736	0.083264	0.029527	1.000000

YEAR	VAT	INF	GDP	IMP	IOP
1994	5026	57	899863.79	162788.8	0.4098
1995	6256.9	72.8	1933211.55	755127.7	0.8827
1996	11286	29.3	2702719.13	562626.6	0.6927
1997	13905.3	10.7	2801972.58	845716.6	0.3463
1998	16206.8	7.9	2708430.86	837418.7	0.5868
1999	23750.5	6.6	3194014.97	862515.7	0.6423
2000	30643.8	6.9	4582127.29	985022.4	0.6396
2001	44912.9	18.9	4725086	1358180.3	0.6828
2002	52632	12.9	6912381.25	1512695.3	0.4712
2003	65887.6	14	8487031.57	2080235.3	0.6089
2004	96195.6	15	11411066.91	1987045.3	0.5775
2005	87449.8	7.8	14572239.12	2800856.3	0.6895
2006	110566.8	8.2	18564594.73	3108519.3	0.562
2007	144372.8	5.4	20657317.67	3911952.2	0.5916
2008	198056.8	11.6	24296329.29	5189802.6	0.6318
2009	229323.2	12.6	24794238.66	5102534.4	0.5428
2010	275574.63	13.7	29205782.96	8005374.2	0.652