

# Impact of Indirect Taxation on Economic Growth in Nigeria

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**Abstract**— *The mono-product nature of the Nigerian economy has hindered it from achieving its economic growth objectives. This inadequacy is further worsened by the fact that its revenue from its mono-product source is facing dwindling fortune. Over the years, it has been observed that revenue generated from indirect taxation has been substantial and constantly on the increase. This study therefore explored the impact of indirect taxation and economic growth as a possible means of diversifying the Nigerian revenue. Time series data were applied in carrying out this research work. Ordinary Least square (OLS) method of analysis was adopted after determining the stationarity of the variable using Augmented Dickey fuller technique and finding ample long run and short run relationship among variables using the Johansen cointegration and Vector Error Correction Mechanisms respectively.. The result showed that of the two indirect tax sources, Value Added Tax and Customs and excise duties, Value Added Tax that had a positive significant relationship with economic growth. Customs and excise duties on the other hand had a negative relationship but was tested and found to be insignificant. But overall the relationship between the indirect tax sources and economic growth was found to be significant. Against the above result, we recommended among others that the number of goods on the VAT list should be increased and the burden of custom duties should be lessened on infant industries, all aimed at boosting indirect tax revenue accruing to the country and ultimately stimulating economic growth.*

**Keywords**— *Value Added Tax, Custom and Excise duties, real GDP.*

## I. INTRODUCTION

The mono product nature of the Nigerian economy has received series of criticism in recent times. According to Okonjo Iweala (2012:17) ... without diversification, the Nigerian economy will soon collapse.

In order for the country to achieve the requisite level of economic growth, it needs to diversify from crude oil being the sole driver of the economy. Anyaehie and Areji (2015) in their research, found that economic diversification has

the propensity to meet the basis for development (sustained growth) like meeting the poor's basic needs which revolve around the provision of jobs, food, health, clothing and shelter by opening diverse avenues of economic activity which accommodates a broad spectrum of people.

Economic diversification is a process of broadening the range of economic activities both in the production and distribution of goods and services. It does not necessarily entail increase in output but it enhances stabilization of economies by diversifying their economic base.

The mono-product nature of the Nigerian economy is such that it depends majorly on crude oil export for its revenue. In the current year 2015, Nigeria's dependence on crude oil export for revenue based on the projected price and the assumed production is 53% of the total revenue (Okonjo Iweala; 2015 Budget Speech). During the second quarter of 2012, oil revenue accounted for over 76% of government revenue (Ebosele and Adekoya, 2012). The implication of this overly dependence on oil revenue is the boom -and -burst nature of the economy (Akpokodge; 2000). In the 2015 budget speech, the following was pointed out,

" ... The IMF in October 2014 revised downwards its projection on global growth to 3.3% and 3.8% respectively. So ladies and gentlemen, the message I want to pass across here is that the world economy is not in shape over the short to medium term. On the back of this weak global growth performance comes the recent steep drop and incredible volatility in the price of oil - a phenomena that impact us greatly. This steep price decline of about 49% so far this year, has come as result of demand from our biggest markets and a supply glut that involves the arrival of new oil producers in Africa and increased exploitation of shale oil and gas in the U.S" (Okonjo Iweala; Budget speech, 2015).

Taxation forms part of the non-oil revenue sector of the economy. In the first quarter of 2014, non-oil sector became the main driver of the Nigeria economy recording 7.89% growth in real terms in the same period (National Bureau of Statistics, 2014). Tax revenue on its part, is made up of two broad components and several sub components, the broad components being Direct and Indirect taxation. Following

Atkinson (1977), we define direct taxes as those taxes that may be adjusted to the individual characteristics of the tax payer and indirect taxes as those that are levied on transactions irrespective of the circumstance of the buyer or the seller. Due to the fact that direct taxes are dependent on the individual characteristics of the tax payer, it is at the mercy of the subjective assessment of the individual paying the tax. In such a case, some contra principles of taxation such as tax evasion (reduction of actual income value in order to earn reduced tax) and avoidance tend to abound. Indirect taxation on the other hand has limited cases of evasion and avoidance as it is not subject to the individual characteristics of the tax payer. Indirect tax sources include Value Added Tax (VAT), excise duties, customs duties and tariffs.

Taxation has been a major source of revenue to the government contributing about 25.5% of government revenue in 2002. These revenues come mostly from indirect sources of VAT, import and export duties (custom duties). Indirect taxes contribute up to 15% of the government revenue with which it carries out certain developmental expenditures; this percentage can still be increased.

Researches, carried out by Bleaney and Gemmel (1999); Bird (2003); Arisoy and Unlukaplan (2010); and Scarlet (2011) found a positive relationship between indirect tax and economic growth. This project work therefore is an attempt to provide a channel for Nigeria to diversify its economy and achieve economic growth.

## STATEMENT OF PROBLEM

The mono-product nature of the Nigerian economy has posed a lot of problem to the Nigerian economy, amongst which is the creeping growth rate of the Nigerian GDP. This has made it impossible for Nigeria to attain its vision in the areas of overall development of its economy. The current running Nigerian national development plan is vision 2020 and this plan has not materialized in terms of achieving its objective as a result of over-dependence on crude oil and its inherent price and demand instability. The vision 2020 aims at placing Nigeria among the top 20 ranking economy in the world by the year 2020, by attaining a GDP of about \$900 billion and ensuring that the GDP of Nigeria grows by at least 10% every year till the year 2020 (Adeleke; 2012). So far, this has remained utopian, as the GDP of Nigeria has not been able to attain such a growth rate nor is it close to the required GDP figure with just 2 years left in the plan. This shortcoming has exposed the need to find and develop other economic variables which has the potentials of fast tracking the growth rate of the country's national income. One of such variables is indirect taxation.

It is of no doubt that indirect taxation has had strong positive impact on the revenue of the government. In 2016, Nigeria raked in 830 billion Naira from Value Added Tax and 890 billion Naira from custom and excise duties (National Bureau of Statistics, 2014). But, there is need to if this progress recorded in the area of revenue has translated to helping the economy grow.

Stemming from the above problem stated, this research seeks to find answers to the above questions:

a) What is the impact of Value added tax (VAT) on economic growth in Nigeria?

b) What is the impact of Custom and Excise duties on economic growth in Nigeria?

## Objectives of the Study

The broad objective of this study is to assess the impact of tax revenue on economic growth in Nigeria while the specific objectives are;

(i) To determine the impact of value added tax on economic growth in Nigeria

(ii) To evaluate the impact of custom and excise duties on economic growth in Nigeria.

**Research Hypotheses** In this research work, the following hypotheses stated in the null form will be tested.

HO1: Value added tax has no significant impact on economic growth in Nigeria.

HO2: Custom and excise duties has no significant impact on economic growth in Nigeria.

## II. LITERATURE REVIEW

The Atkinson-Stiglitz theorem made a case for direct taxation as the optimal tax system to be adopted by countries all over the world. But this theorem laid down some assumptions which be met before the direct tax system can be regarded as optimal for a country, thus;

1. There are two types of households who differ only in their wage rates such that wage rate of one household is greater than the other. This difference does not exist in factor endowments.

2. There are only two goods along with labour and that households have identical weakly separable utility functions.

3. The utility function is strictly concave, and both goods as well as leisure are normal.

Atkinson-Stiglitz (1976) saw their analysis as being more useful in shaping the structure of the argument regarding the choice of optimal tax structure than in providing policy advice.

In a theoretical view, the theory agrees to the fact that taxation can indeed affect economic growth and therefore can be accepted as a policy advice to countries on the

optimal tax mix which they can employ for better working of the economy. Since the realities of the Nigerian socio-economic background are contrary to the assumptions of the theory, which is in favor of income taxes (a form of direct tax), we can infer that indirect taxation should be the optimal tax system for Nigeria.

#### **Indirect Taxation in Nigeria**

There are two main classifications of indirect taxes in Nigeria;

- Value Added Tax (VAT)
- Custom and Excise duties.

#### **Value Added Tax in Nigeria**

Following the problem of evasion and avoidance rocking the collection of person income tax and Company profit tax and the subsequent need to boost government revenue and reducing government borrowing, the Value added tax was introduced in January 1993 by the VAT decree No. 2 of 1993 and came into force on the 1st of January 1994 to replace the pre-existing sales tax. Ochei (2010), noted that many Nigerians believed that the tax was introduced as a means of avoiding taking loans from international agencies. Ngex.com described VAT as a consumption tax levied at each stage of the consumption chain, and is borne by the final consumer. It requires a taxable person upon registering with the Federal Board of Inland Revenue to charge and collect VAT at a flat rate of 5% of all invoiced amounts of taxable goods and services. Since inception, VAT revenue has exceeded its projected amount. During 1994 the revenues earned from value added taxes in Nigeria exceeded the projections. They contributed 4% of the total revenue raised by the Federal Government in that year. In 1995 the rate of contribution was 5.39%. In 2017, VAT revenue accrued to the sum of... Value Added Tax is collected by government through an agency called FIRS (Federal Inland Revenue Services).

Emmanuel (2013) examined the effects of VAT on economic growth and total tax revenue in Nigeria using data ranging from 1994 to 2010. By formulating two hypotheses that VAT does not have significant effects on GDP and also on total tax revenue. He found out that VAT has significant effect on GDP and also on total tax revenue. This indicates that increase in value added tax would lead to an increase in tax revenue and economic growth (GDP)

#### **Custom and Excise Duty**

Custom and excise duties are classified together because they are both administered through the Nigerian Customs Services.

Custom Duties are classified into two; Import duty and export duty. Custom duty in Nigeria can be traced back to 1860 when Nigeria started engaging in foreign trade. Then, it started as just import duties. Import duties are taxes on

Nigeria's imports from other countries, charged either as a percentage of the value of the imports or as a fixed amount contingent on quantity (Akhor & Ekundayo, 2016). Akhor et al (2016) also described Export Duty is a tax on the goods exported to other countries, from Nigeria. Meanwhile, excise duties are an ad-valorem tax on the output of manufactured goods and are administered by the country's custom services (Ekeocha, Ekeocha, Malaolu & Oduh, 2012).

Scarlet, (2011) used the standard growth functions within the autoregressive distributed lag to investigate the relationship between taxation and economic growth in Jamaica. The study employed quarterly time series data from 1990 - 2010. The study found a significant and positive relationship between indirect tax and economic growth in the long run.

Aamir, Qayyum, Nasir, Hussain, Khan and Butt, (2011), using panel data of direct and indirect taxes in Pakistan and India from 2000 to 2009 discovered that in Pakistan, indirect taxes have statistically significant positive impact on total revenue and by extension economic growth. The study found that if total indirect taxes increases by Rs. 1, the increase in total tax revenue would amount to Rs. 1.495.

A similar study was carried out in Nigeria. Illaboya and Mgbame, (2012), carried out a study to investigate the indirect tax-economic growth dynamics in developing countries with Nigeria as a reference point. The study adopted a combination of co-integration and error correction mechanism after series of diagnostic tests which helped to check the adequacy of the model. The study found a negative and an insignificant relationship between indirect taxation and economic growth in Nigeria.

Onwuchekwa and Aruwa, (2014), carried out a related study. The study investigated the impact of value added tax on the economic growth of Nigeria. Ordinary Least Square technique was employed to test the hypotheses formulated. The result shows that VAT (which is a form of Indirect tax) contributes significantly to the total tax revenue of government and by extension the economic growth of Nigeria. VAT revenue growth had consistent increase, though it was not that explosive.

### **III. METHODOLOGY**

Drawing from the variables used in the work of David Umoru and M.A Anyiwe, (2013) on Tax Structures and Economic Growth in Nigeria: Disaggregated Empirical Evidence, we derive a model that establishes a relationship between the components of indirect tax (which mainly are; Value added tax, custom and Excise duties) in Nigeria and economic growth. Real GDP, used as proxy for economic

growth (the dependent variable) and value added tax, customs and excise duty, inflation (explanatory variables). Inflation is included in the model to cancel out the effect of price changes on indirect tax revenues.

The model is specified as follows:

$$GDPR = f(VAT, CED, INF)$$

This function may be further represented in a linear econometric format thus:

$$\ln GDPR = B_0 + B_1 \ln VAT + B_2 \ln CED + B_3 \ln INF + U_i$$

Where:

GDPR = Real Gross Domestic Product

VAT= Value added Tax

CED = Customs and Excise Duty

INF = Inflation

B's = Slopes or the parameters of the coefficient of the regression model

$U_i$  = Stochastic disturbance or error term.

The above model is stated in the natural logarithmic form, to standardize the variables and aid interpretation.

This research made use of data on Real GDP, VAT revenue, Custom and Excise Duties Revenue and inflation from 1981 – 2018 (37 years). This data was sourced from the 2017 CBN statistical Bulletin, World Bank development indicators and various credible journal articles.

#### IV. DATA PRESENTATION AND INTERPRETATION

The use of OLS method of regression analysis is based on the assumption that the values of the variables have no unit root and hence are stationary.

Table.1.1 Summary of the Augmented Dickey Fuller Unit Root Test

1 <sup>st</sup> Difference	Variables	ADF Test Statistics	5% Significance level	Lag length	Remark
	LNGDPG	-4.410302	-2.948404	1	Stationary
	LNVAT	-6.879544	-3.004861	1	Stationary
	LNCED	-6.202937	-2.948404	1	Stationary
	INF	-5.522626	-2.948404	1	Stationary

Source: Aurthor's Computation

From the result above, it is clear that all the variables are stationary after the first difference. Using the AIC (Akaike Information Criterion), the appropriate lag length was determined as 1.

Therefore, we proceed to carry out the Johansen co-integration test to find out if there exists any relationship among the variables.

Table.2: Summary of Johansen Co-integration test

Hypothesized No. of CE(s)	Eigenvalue	Trace Statistic	0.05 Critical Value	Prob.**
None *	0.746929	54.26869	47.85613	0.0111
At most 1	0.454772	24.03883	29.79707	0.1988
At most 2	0.297259	10.69470	15.49471	0.2310
At most 3	0.124846	2.933826	3.841466	0.0867

Trace test indicates 1 co integrating eqn(s) at the 0.05 level

\* denotes rejection of the hypothesis at the 0.05 level

Source: Aurthor's Computation

The table above shows the existence of at least one (1) cointegrating equation between the variables as we reject the hypothesis of none as denoted by the asterisks sign. It is therefore necessary to test the existence of short run adjustments between the variables, using the error correction model.

Table.3: Summary of VECM

Error Correction:	D(LOG(GDPR))	D(LOG(VAT))	D(LOG(CED))	D(INF)
CointEq1	-0.065369	-0.071621	0.035011	-17.34673
	(0.04429)	(0.08019)	(0.24689)	(2.84866)
	[-1.47586]	[-0.89310]	[ 0.14181]	[-6.08943]

D(LOG(GDPR(-1)))	0.152916	-0.269039	0.070651	19.86363
	(0.22940)	(0.41534)	(1.27872)	(14.7540)
	[ 0.66659]	[-0.64775]	[ 0.05525]	[ 1.34632]
D(LOG(VAT(-1)))	0.185234	0.452654	0.267423	-4.990453
	(0.11562)	(0.20933)	(0.64447)	(7.43591)
	[ 1.60214]	[ 2.16239]	[ 0.41495]	[-0.67113]
D(LOG(CED(-1)))	-0.026818	-0.095861	-0.181987	0.514946
	(0.04558)	(0.08253)	(0.25407)	(2.93152)
	[-0.58837]	[-1.16158]	[-0.71628]	[ 0.17566]
D(INF(-1))	0.000165	0.001921	0.002016	0.111365
	(0.00115)	(0.00208)	(0.00642)	(0.07403)
	[ 0.14357]	[ 0.92183]	[ 0.31418]	[ 1.50439]
C	0.012732	0.112950	0.125346	-2.552928
	(0.03009)	(0.05447)	(0.16771)	(1.93505)
	[ 0.42318]	[ 2.07346]	[ 0.74740]	[-1.31931]

Source: Aurthor's Computation

The result of the cointegration equation shows that the short run adjustments exist among the variables. The adjustment in real GDP, Value Added Tax, Custom and Excise duties complete in less than one year shown by their coefficients which is less than one, while inflation completes it

adjustment in more than one year shown by its large coefficient.

Having established ample long run and short run relationships among the variables, we can proceed to the OLS estimates and assess fully the impact of indirect taxation on economic growth.

Table.4: OLS Regression Estimates

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	22.08539	0.735402	30.03174	0.0000
LOG(VAT)	0.355007	0.059373	5.979244	0.0000
LOG(CED)	-0.003554	0.072382	-0.049105	0.9613
INF	0.004937	0.001915	2.577748	0.0180
R-squared	0.944140	Mean dependent var		31.26735
Adjusted R-squared	0.935761	S.D. dependent var		0.469910
S.E. of regression	0.119101	Akaike info criterion		-1.266682
Sum squared resid	0.283700	Schwarz criterion		-1.070339
Log likelihood	19.20018	Hannan-Quinn criter.		-1.214592
F-statistic	112.6790	Durbin-Watson stat		1.214627
Prob(F-statistic)	0.000000			

Source: Aurthor's Computation

From the estimates shown above, VAT revenue and Inflation have significant positive relationships with economic growth proxied by real GDP. While a percentage

in VAT on average will cause a 35% percent increase in the real GDP, holding all other variable constant, increasing inflation as well will lead to 0.4% increase in the real GDP

on average, holding other variables constant. The fact that the probability figures of both VAT and Inflation are less than 0.05 depicts that both variables are significant in the model.

On the other hand, Customs and Excise duties (CED) showed an insignificant negative relationship with economic growth. Such that a percentage increase in Custom and Excise duties on average, will reduce real GDP by 0.3%

Overall the model has been shown to be significant:

Considering the high F value and the very low probability figure of the F value (0.000), we can conclude that the model is significant. Also the coefficient of determination ( $R^2$ ) has a value of 0.944140 and the Adjusted  $R^2$  value of 0.935761 which still gives give credence to the validity of the model. It follows that at least, 93% of changes in the dependent variable are explained by the regressors.

#### Summary of Findings

The findings of this research, suggests the existence of ample long run and short run relationships between the various components of indirect taxation and economic growth proxied by Real GDP.

Based on the hypothesis formulated earlier, the following has been discovered from the research;

a) Value Added Tax (VAT) has a positive significant relationship with economic growth, such that increase in VAT revenue will in effect boost economic growth in Nigeria. This can be explained that increase in VAT revenue will translate to increased government expenditure in direct consumption or investment activities which will spur economic activities in the country.

b) Custom and Excise Duties (CED) on the other hand had an insignificant negative relationship with economic growth. Such that an increase in custom duties will stunt economic growth. This can be explained in the context that Nigeria is a consuming nation and that most of the goods consumed, traded and sold in the country come from external sources. Imposition of customs and excise duties will make such good expensive and discourage demand. It may even get to the stage where companies that source for raw materials abroad will have to close shop or move to countries with fairer custom and excise duties.

c) Inflation on the other hand showed a positive relationship with economic growth, but the small coefficient of 0.4% shows how infinitesimal this positive effect is. This can be as a result of the fact the inflation requires people to spend just a little bit more to obtain basic good and service and thence, this extra expense and such extra expenses will translate into a positive effect on economic growth.

#### V. CONCLUSION AND RECOMMENDATIONS

In executing this study, the Ordinary Least Squares (OLS) was applied after determining the co-integration of variables using the Johansen technique.

From the results obtained from the OLS, it was observed that all independent variables, Value Added Tax (VAT) and Inflation (INF), had a positive relationship with economic growth in Nigeria, while Customs and Excise duties (CED) had a negative impact, of which VAT and INF that had a significant impact on economic growth in Nigeria. The effect of CED was found to be insignificant. Based on this, the following are recommended.

1. Government should Increase in the Number of goods and services on the VAT list from 31 to account for more sectors that have become more productive since 1994. For instance pharmaceutical products.
2. Companies remittance of VAT revenue should be addressed by the government to ensure full compliance.
3. Government should ensure that manufacturing industries sourcing for raw materials abroad should not be charged excessive custom duties, to enable them thrive most especially the infant industries.
4. Government should ensure that VAT revenue is properly utilized in the provision of autonomous capital investment as against paying salaries.

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