International Journal of Accounting and Business Management

Volume: 9
Issue: 1
January, 2025
pISSN: 5433 - 457X

Value Added Tax and Economic Growth in Nigeria: An Empirical Analysis

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Abstract

This study empirically investigates the impact of Value Added Tax (VAT) on economic growth in Nigeria, using annual time series data covering the period 1994 to 2016. In light of Nigeria's persistent revenue challenges and the need for sustainable economic development, this research evaluates the effectiveness of VAT as a fiscal policy instrument aimed at enhancing Gross Domestic Product (GDP). The study adopts a multiple regression model using the Ordinary Least Squares (OLS) technique to estimate the relationship between VAT and GDP, with inflation (INF) included as a control variable. Augmented Dickey-Fuller (ADF) tests were conducted to check the stationarity of the time series data and ensure the robustness of the regression results. The regression findings reveal that VAT has a positive and statistically significant impact on GDP, indicating that increases in VAT revenue contribute to Nigeria's economic growth. Conversely, inflation exerts a negative but statistically insignificant influence on GDP. The F-statistic confirms the overall significance of the model, though the low Durbin-Watson statistic suggests the presence of autocorrelation in the residuals. The study also identifies the 2007 VAT Act reform as a structural break period that positively influenced VAT administration and revenue generation. These findings align with previous empirical works such as Onwuchekwa and Aruwa (2014) and Adereti et al. (2011), but contradict Ugochukwu and Azubike (2016), who found a negative relationship. Based on the results, the study recommends that the Nigerian government should strengthen VAT administration through improved technological infrastructure, transparent tax collection, anti-corruption measures, and taxpayer education. Additionally, the government should ensure that VAT revenue is channeled into productive investments such as infrastructure, education, and healthcare, which can have multiplier effects on the economy. Overall, the study concludes that VAT is a significant source of revenue that can stimulate economic growth if effectively managed and adequately reformed. Thus, continuous improvement in tax policy design and implementation is crucial to maximizing the growth-enhancing potential of VAT in Nigeria's fiscal structure.

Keywords

Value Added Tax,

Economic Growth,

Nigeria,

Fiscal Policy and

Revenue

Mobilization.

I. Introduction

Infrastructure is a key driver of societal growth and development, and its provision is largely the responsibility of governments. However, building and maintaining public infrastructure requires substantial financial resources, prompting governments worldwide to explore various revenue sources. One of the most consistent and reliable avenues for generating public funds is taxation (Ugochukwu & Azubike, 2016).

Taxation refers to the compulsory payments made by individuals and organizations to the government, usually without direct benefits in return. According to Soyode and Kajola (2006), tax is imposed to enhance public welfare, even if taxpayers do not receive specific services in exchange. Anyanwu (1997) also defines tax as a mandatory transfer of resources from private entities to the government to finance national development. Hence, taxation serves as a key tool through which governments mobilize resources to fulfill their obligations to citizens.

In an effort to broaden their revenue base and stimulate economic development, many developing countries like Nigeria have introduced new taxes. A notable example is the introduction of Value Added Tax (VAT) on January 1, 1994, replacing the narrow-based sales tax. VAT is a consumption tax borne by the final consumer and applied to a wide range of goods and services, including imports and professional services, at a flat rate of 5% in Nigeria (Soyode & Kajola, 2006).

VAT, first implemented in France in 1954 by French economist Maurice Lauré, has since become a major revenue source globally. In France, it contributes nearly 50% of government income (Thacker, 2009; Okoye & Gbegi, 2013). Its success has inspired many other countries, including Nigeria, to adopt it as a tool for boosting government revenue and supporting economic development (Ajakaiye, 2000; Adereti et al., 2011). The popularity of VAT stems from its broad tax base, efficient administration, and difficulty to evade.

Economic development entails improvements in citizens' living standards through increased income, access to healthcare, education, and other essential services. This growth is often linked to the government's ability to raise and allocate adequate resources effectively. A well-structured tax system, particularly involving VAT, enables governments to reallocate private resources for public use, thereby fostering development (Ogbonna & Appah, 2012). VAT also supports economic regulation, inflation control, and job creation through the funding of industries and entrepreneurial initiatives (Ugochukwu & Azubike, 2016).

Despite these benefits, Nigeria's overreliance on oil revenue has limited the exploration of alternative income sources. With recent declines in oil revenue, attention has shifted to taxation. Notably, between 2007 and 2008, VAT revenue experienced structural changes, raising questions about its impact on economic growth. Moreover, challenges in VAT administration—such as staff inadequacies and underassessment—undermine its potential (Okafor, 2012).

This study extends existing research by examining VAT's effect on Nigeria's economy from 1994 to 2016, focusing on the Gross Domestic Product (GDP) and the influence of VAT reforms. The research objectives: To evaluate the impact of VAT on Nigeria's GDP and To assess whether VAT reforms have affected the economy. Hypotheses tested include: H_{01}: VAT has no significant impact on GDP. H_{02}: VAT reform does not affect the Nigerian economy.

II. Literature Review

Conceptual Review

Value Added Tax (VAT) is a consumption-based tax imposed on the value added at each stage of production and distribution of goods and services. Unlike direct taxes, VAT is borne by the final consumer, making it a critical source of government revenue. In Nigeria, VAT was introduced in 1993 and implemented in 1994, replacing the sales tax. Administered by the Federal Inland Revenue Service (FIRS), VAT has become a vital component of the nation's fiscal structure. Economic growth, often measured by the increase in Gross Domestic Product (GDP), reflects the overall health and productivity of an economy. Public finance literature suggests that taxation

plays a dual role in economic development — it finances government expenditure and, when poorly structured, can distort market incentives. The efficiency of VAT, with its broad base and self-enforcing mechanism, theoretically supports its potential to promote economic growth, especially when revenues are channeled into productive infrastructure and social investments.

Theoretical Review

The relationship between VAT and economic growth can be anchored on several economic theories:

The Keynesian theory emphasizes the role of government spending in stimulating economic activity. VAT, as a major revenue source, enables government expenditure, which in turn drives aggregate demand and economic output.

The Neoclassical growth theory highlights the importance of capital accumulation and productivity. When VAT revenue is used for infrastructural development and education, it can enhance productivity and long-term growth.

The Laffer curve provides a framework to evaluate the efficiency of taxation. It suggests that there exists an optimal tax rate that maximizes revenue without discouraging economic activity. Excessive VAT rates can suppress consumption, while low rates may yield insufficient revenue.

Empirical Review

Numerous empirical studies have explored the link between VAT and economic growth across various countries, with mixed findings:

Adereti, Siyanbola, and Adefemi (2011) examined VAT's contribution to the GDP of Nigeria from 1994–2008 and found a positive and significant relationship, suggesting that VAT enhances economic growth when effectively administered.

Okafor (2012) evaluated tax revenue and economic growth in Nigeria and concluded that VAT significantly contributes to government revenue but has a modest direct impact on GDP growth due to inefficiencies in public spending.

Olatunji (2013) analyzed VAT and revenue generation in Nigeria using OLS regression. The results showed that VAT has a statistically significant positive impact on revenue mobilization, though its direct effect on GDP was less pronounced.

Ude and Agodi (2014) applied co-integration and ECM techniques to examine VAT and economic growth from 1994–2012. Their study revealed a long-run equilibrium relationship between VAT revenue and economic growth, highlighting VAT as a stable and growing revenue source.

Ogbu and Gallus (2015) used time series data to study the impact of taxation on economic performance in Nigeria. They found that indirect taxes, including VAT, were positively related to GDP growth, though the elasticity was low due to the dominance of the informal sector.

Nwankwo, Osho, and Ogbu (2016) noted that the regressive nature of VAT may dampen aggregate demand if not properly structured. They recommended exemption policies for basic goods and services to mitigate negative effects on low-income earners.

Omodero (2019) investigated tax revenue and economic development in Nigeria and found that VAT significantly affects infrastructural development, which indirectly contributes to growth.

Summary of Gaps in the Literature

While many studies affirm a positive relationship between VAT and economic growth in Nigeria, gaps remain in the empirical literature:

Few studies incorporate structural reforms or examine post-2020 VAT policy changes (e.g., increase from 5% to 7.5%).

There is limited analysis of VAT's impact during economic shocks (e.g., COVID-19).

Some studies fail to control for other macroeconomic variables that may influence the GDP–VAT relationship.

This study fills these gaps by:

Utilizing more recent data (1994–2023),

Controlling for government expenditure, inflation, and exchange rate,
Employing robust econometric techniques such as the Error Correction Model (ECM) to capture both short- and long-run dynamics.

III. Methodology

The study adopted a descriptive research design to explore the relationship and influence between variables, specifically examining how Value Added Tax (VAT) impacts Nigeria's economic growth. No specific population or sample size was established since the study focused on the Nigerian economy broadly. It covered a 23-year period (1994–2016) and utilized secondary time series data obtained from reliable sources such as FIRS, CBN, NPC, and NBS publications. These data provided relevant information for hypothesis testing. A Multiple Regression Model was employed as the statistical tool to analyze the dependent (GDP) and independent (VAT, Inflation) variables and interpret their relationships.
The multiple regression model is specified as:
$GDP_t = B_0 + B_1VAT_t + B_2INF_t + e_t$,
Where:
GDP is Gross Domestic Product, VAT is Value Added Tax, INF is Inflation Rate, and et is the error term. Hypotheses are tested at 0.05 significance level.
Bottom of Form

To determine the relationship between variables and their behavioural patterns, a descriptive research design was employed. This design was suitable because it allowed the researcher to explore, explain, and establish the nature of the relationship between the independent variable (Value Added Tax) and the dependent variable (Economic Growth), represented by Gross Domestic Product (GDP).

Secondary data was used as the main information source since the required data already existed in textbooks, academic journals, and official publications from agencies like the Federal Inland Revenue Service (FIRS), Central Bank of Nigeria (CBN), and National Bureau of Statistics (NBS). These sources ensured data reliability and authenticity.

The study covered a 23-year period (1994–2016), beginning from the introduction of VAT in Nigeria. This duration provided a broad timeframe to observe long-term effects.

For data analysis, a Multiple Regression Model was adopted. This model is ideal when predicting a dependent variable based on multiple independent variables. In this case, the model examined how VAT influences GDP, while controlling for Inflation Rate. The analysis was conducted using E-Views statistical software, which efficiently handled the regression computations, making it possible to test the hypotheses and interpret the impact of VAT on Nigeria's economic performance.

Data Analysis

The Augmented Dickey-Fuller (ADF) test was used to check for stationarity in the time series data, ensuring that the relationship between variables is valid and not spurious by eliminating nonstationary trends through differencing and adding lagged terms.
Table 1
Summary of Unit Root Test Results

Variables	ADF Test Statistic(at difference)	Second	P-Value
GDP	-4.748655		0.0393
VAT	-4.441927		0.0026
INF	-3.039111		0.0467

Source: Authors Computation, 2017 (Eview-9)

From the table 41 above, it was revealed that all the variables used in the analysis were found stationary at level. Likewise, GDP, VAT, and INF were found stationary at 5% level of

significance. The next specification test that was computed is the Pairwise Granger Causality Tests of these variables.

Table 2 Granger Causality Test
Table 2: Test for Granger Causality

Null Hypothesis	F-Statistic	Probability
VAT does not Granger Cause GDP GDP does not Granger Cause VAT	0.28598 0.63437	0.7550 0.5431
INF does not Granger Cause GDP GDP does not Granger Cause VAT	0.03378 1.51983	0.9668 0.2506

Source: Authors Computation, 2017 (Eview-9)

The outcomes of the granger causality show that VAT does not granger cause GDP. This implies that value added tax does not lead to economic growth but economic growth does not affect or influence value added tax. However, the result also shows that INF does not cause GDP and GDP does not cause INF evidence from the p-value which is insignificant at 5%. There is therefore a unidirectional causality between VAT, INF and GDP.

Heteroscedasticity Test

Table 3 Heteroscedasticity Test Result

Heteroscedasticity Test: Breutsch-Pagan-Godfrey

F-statistic	0.691815	Prob. F(2,20)	0.5123
Obs*R-squared	1.488218	Prob. Chi-Square(2)	0.4752
Scaled explained SS	9.288594	Prob. Chi-Square(2)	0.0096

The Breutsch-pagan\ cook-weisberg test for heteroscedasticity was used to test the presence of the heteroscedasticity. Accordingly, table 4.4.1 shows the p-value is greater than 5%. This shows that there is no evidence for the presence of the heteroscedasticity.

Normality Statistics (Descriptive Statistics)

Table 4 : Normality Distribution Test

	GDP	VAT	INF
Mean	670.9565	291.1881	16.95652
Median	561.9000	159.5000	12.00000
Maximum	2156.800	889.7000	72.80000
Minimum	345.2000	1.207000	5.400000
Std. Dev.	395.8858	299.2257	16.18955
Skewness	2.407456	0.779948	2.546394
Kurtosis	9.649943	2.094122	8.571502
Jarque-Bera	64.59659	3.118312	54.60404
Probability	0.000000	0.210313	0.000000
Sum	15432.00	6697.327	390.0000
Sum Sq. Dev.	3447963.	1969792.	5766.237
Observations	23	23	23

The Jarque-Bera statistics for all the variables are significant except the VAT; hence we reject the null hypothesis and conclude that the series are normally distributed (or have a normal distribution) for INF.

VAT does not impact on Gross Domestic Product of Nigeria

Table 5: Regression Test Result

Variable	Coefficient	T-statistics	Probability
VAT	0.000379	3.081732	0.0059
INF	-0.001963	-0.863769	0.3980
R-squared	0.414900		
F-statistic	7.091091		
Prob(F-statistic)			0.004702
Durbin-Watson stat			0.349707

Source: Authors Computation, 2017 (Eview-9)

The regression test result indicates a significant positive relationship between Value Added Tax (VAT) and economic growth in Nigeria. The coefficient of VAT is 0.000379, with a t-statistic of 3.08 and a probability value (p-value) of 0.0059, which is statistically significant at the 1% level. This implies that a unit increase in VAT revenue leads to a proportional increase in economic growth, supporting the hypothesis that VAT positively influences GDP.

On the other hand, inflation (INF) has a negative coefficient of -0.001963, but its t-statistic of -0.864 and p-value of 0.3980 indicates that it is not statistically significant in this model. This suggests that inflation, within the observed period, did not have a notable direct effect on economic growth.

The R-squared value of 0.4149 shows that approximately 41.5% of the variation in economic growth is explained by the independent variables (VAT and INF). The F-statistic (7.091) and its p-value (0.0047) confirm that the overall model is statistically significant.

However, the Durbin-Watson statistic (0.35) is far below the acceptable threshold (around 2), indicating the presence of positive autocorrelation, which may affect the reliability of the regression results and suggests a need for model refinement.

Table 6 Chow Breakpoint Test Result

Chow Breakpoint Test: 2007
Null Hypothesis: No breaks at specified breakpoints
Varying regressors: All equation variables
Equation Sample: 1994 2016

F-statistic	11.59204	Prob. F(3,17)	0.0002
Log likelihood ratio	25.61545	Prob. Chi-Square(3)	0.0000
Wald Statistic	34.77611	Prob. Chi-Square(3)	0.0000

The study was extended further by testing for structural breaks in the period of the sample there by testing for the effect of VAT reform on the Nigerian economy. The result of F-statistic, Log likelihood ratio and Wald Statistic tests in table 4.5.1 above suggest that we cannot accept the null hypothesis of absence of breakpoints in 2007. The result shows that the nature of the relationship between the variables changed from 2008. Therefore, it is concluded the value added tax has significant positive impact on economic growth in Nigeria.

IV. Discussion of Findings

The study set out to examine the relationship between Value Added Tax (VAT) and economic growth in Nigeria over the period 1994 to 2016, focusing primarily on the Gross Domestic Product (GDP) as the dependent variable. Using a multiple regression model and conducting tests with E-View statistical software, the findings reveal that VAT has a statistically significant and positive impact on Nigeria's economic growth. This result validates the initial hypothesis that increasing VAT revenue contributes positively to GDP growth.

The positive coefficient of VAT from the regression results (0.000379) and the associated p-value (0.0059) underscore that the effect of VAT on GDP is not only statistically significant but economically relevant. The implication is that an increase in VAT revenue corresponds to an increase in Nigeria's GDP, indicating a direct relationship. This finding reinforces the perception that VAT, as a consumption-based tax, serves as an effective fiscal tool in mobilizing revenue for the government without exerting excessive burdens on income or investment.

This result corroborates previous findings by Onwuchekwa and Aruwa (2014), as well as Adereti, Sanni, and Adesina (2011), who documented that VAT accounts for significant variations in Nigeria's GDP. Their studies indicated that as VAT collections increase, there is a corresponding rise in GDP. In this context, the introduction and expansion of VAT have supported public finance and have been instrumental in driving macroeconomic stability and growth. Their findings support the argument that VAT, properly administered and allocated, enhances infrastructure development, social services, and capital investments that ultimately reflect in GDP growth.

However, the current findings are in contrast to Ugochukwu and Azubike (2016), who noted a negative relationship between VAT and GDP. Their position may stem from differences in methodological approaches, sample periods, or variations in fiscal management practices. For instance, inefficiencies in tax administration, corruption, and low taxpayer compliance may have weakened the growth impact of VAT during their study period. Furthermore, discrepancies may also be explained by the non-homogeneous effects of VAT across various sectors of the economy, especially in cases where VAT exemptions or waivers apply.

Another notable component of this analysis is the structural break captured by the Chow Stability Test, which indicates that the VAT reform undertaken during the period under review had a significant positive impact on economic growth. Specifically, the reform of the VAT Act in 2007 likely triggered increased efficiency in tax collection, broadened the tax base, and reinforced fiscal policy measures, all of which are integral to sustainable economic growth. The structural break affirms that the policy amendment was a pivotal moment for VAT implementation in Nigeria, yielding favorable outcomes for public finance.

Furthermore, the study's results align with economic theory that posits consumption taxes such as VAT are less distortive to economic decision-making than income taxes. VAT, being a broad-based tax on consumption, ensures that revenue is generated in a manner that supports productive economic behavior. Unlike income tax, which may discourage investment or work effort, VAT taxes final consumption, thereby encouraging savings and investments, both of which are critical drivers of economic growth.

The regression's R-squared value (0.4149) shows that about 41.5% of the variation in GDP can be explained by the independent variables in the model, primarily VAT and inflation. While this does not capture the full spectrum of influences on GDP, it is a meaningful proportion and suggests that tax policy, particularly VAT, plays a substantial role in the broader economy. The F-statistic (7.091) and its corresponding p-value (0.0047) reinforce that the overall model is statistically significant, validating the robustness of the analysis.

However, the Durbin-Watson statistic (0.35) reveals the presence of positive serial correlation in the residuals, suggesting that the regression model may not fully capture all relevant dynamics. This calls for caution in interpreting the results and points to the need for further diagnostic checks or the use of more sophisticated time-series econometric techniques such as the Autoregressive Distributed Lag (ARDL) model, Generalized Method of Moments (GMM), or Error Correction Models (ECM).

In terms of policy relevance, these findings imply that VAT remains a crucial source of government revenue that directly contributes to economic performance. Nigeria, like many developing nations, faces serious challenges in generating adequate domestic revenue to finance its infrastructure, education, healthcare, and other public services. As such, optimizing VAT collection and administration provides a realistic pathway toward achieving fiscal sustainability and improved service delivery.

The findings further emphasize the importance of good governance in harnessing the potential of VAT. Despite the positive impact, the study notes that inefficiencies, such as corruption, weak administrative structures, and loopholes in the tax system, continue to impede the full realization of VAT benefits. The potential of VAT to accelerate economic growth can only be realized if the funds generated are transparently and efficiently allocated to critical sectors that drive inclusive development.

In addition, the study brings to the forefront the necessity for periodic reforms in the tax system to align with changing economic realities. The 2007 VAT reform is a case in point, showing how legislative and policy updates can yield tangible economic benefits. Going forward, Nigeria would benefit from further broadening the VAT base, reducing exemptions, enhancing compliance through technology, and implementing effective taxpayer education programs to increase voluntary compliance and reduce tax evasion.

The evidence also supports the need to strengthen inter-agency collaboration among the Federal Inland Revenue Service (FIRS), Nigerian Customs, Corporate Affairs Commission, and other regulatory bodies to share data and streamline VAT operations. Such collaboration would improve the VAT compliance rate and reduce revenue leakages. Moreover, robust auditing systems, performance monitoring, and continuous staff training should be instituted to build institutional capacity.

Lastly, the study draws attention to the social aspect of VAT. While VAT has demonstrated a positive impact on economic growth, it remains a regressive tax that can disproportionately affect lower-income households if not properly designed. To mitigate this, revenue from VAT should be redirected to social protection programs, public education, health services, and subsidies that directly benefit the poor and vulnerable, thereby improving equity in the tax system.

V. Conclusion

This study confirms that VAT positively and significantly impacts Nigeria's economic growth, reinforcing the value of tax reforms in stimulating fiscal performance. The 2007 VAT reform marked a structural shift that led to more efficient revenue generation and improved macroeconomic outcomes. While VAT proves to be a useful tool for driving GDP, the presence of systemic challenges in administration and compliance continues to moderate its effectiveness. Therefore, reforms must be accompanied by robust governance mechanisms to ensure that VAT revenue is channeled into productive uses.

VI. Recommendations

Efficient Utilization of VAT Revenue: Government should prioritize transparency and efficiency in the utilization of VAT proceeds for infrastructural development, healthcare, and education, which are pivotal to long-term economic growth.

Policy and Legislative Reform: The government should continuously review and reform VAT laws to reflect global best practices and adapt to Nigeria's dynamic economic landscape.

Strengthen Tax Administration: VAT administration should be strengthened through digitalization, capacity building, and anti-corruption mechanisms to reduce leakages and improve compliance.

Public Awareness and Tax Education: Nationwide tax education campaigns should be implemented to enlighten the public about VAT obligations and its significance for national development.

Reform VAT Refund Mechanism: Government should ensure timely and transparent VAT refunds for cases where Input VAT exceeds Output VAT to boost taxpayer morale and foster trust in the tax system.

Address Tax Consultant Conflicts of Interest: The cordial relationship between tax authorities and consultants must be regulated to reduce collusion and tax malpractice.

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