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Effect of Indirect Taxation on Household Consumption in Nigeria

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Abstract: Establishing the relationship between indirect tax and household consumption has locales fundamental to researchers and policy makers in developing countries and Nigeria in particular. However, there has been no agreement whether indirect tax is beneficial or detrimental to household consumption. This study therefore examines the empirical relationship between indirect tax and household consumption in Nigeria using time series data covering the period of 1985 to 2020. It specifically explores the short-run and long-run relationship between indirect tax and household consumption. The study employed the ordinary least square and cointegration estimation techniques for ascertain the relationship between indirect tax and household consumption. The study reveals a positive insignificant relationship between value added tax and household consumption. The study further revealed that personal income tax impacts negatively, whereas inflation rate impacts negatively on household consumption. Value added tax was statistically insignificant. Inflation rate was statistically significant while personal income tax exhibited a statistically significant probability value. The study recommends that a more anti-inflationary policy should be formulated and regulated to check the effect of inflation on consumption. Efficient regulations policy should be formulated to check the impact of personal income tax on consumption. There should be efficient pricing of consumer good such that products and prices would not be abused.

Keywords: VAT, Personal Income Tax, Inflation Rate, Household Consumption, Regression, Cointegration analysis.

Introduction

Taxation in Nigeria started with person income tax in 1904, when lord Lugards introduced income tax in the northern part of Nigeria. Community tax become operative through the Revenue Ordinance of 1904. In 1914, after the amalgamation of the northern and southern protectorates, the. 1904 Revenue Ordinance was replaced by the native Revenue Ordinance of 1917. Furthermore, the provisions of the 1917 ordinance were amended in 1918 and extended to southern Nigeria particularly, the west and the Midwest and subsequently, to eastern Nigeria, in 1918. Taxation has been in existence in Nigeria before the advent of the British rule in 1861:

particularly in the North where there was an efficient and stable administration based on Islamic system (Ologhodo, 2007). Taxation is used as an instrument of economic regulation for the purpose of discouraging or encouraging certain forms of social behavior. Tax is use to raise money for the provision of services such as defense, health services, education etc. to re-distribute income and wealth. That is, the rich pay more tax than the poor. This is achieved by the graduation or "progressiveness" of the rates at which the taxes are levied; to discourage the consumption of harmful goods such as alcohol and cigarettes; to harmonize diverse trade or economic objectives of different countries so as to provide for the free movement of goods/services, capital and people between member states for the management of the economy (Samuel, 2010). The essence of this research is for us to analyze how the effect of indirect tax on household in Nigeria has a positive or negative effect.

All over the world, a significant attention has been drawn to Indirect tax in terms of reforms and restructuring. Perhaps, this has been owing to its sizeable contributions to government revenue, growth and development of many economies. As a veritable source of government revenue, many countries have shifted and a few others are considering a shift toward a higher indirect taxation. Since Indirect tax increases consumption expenditure, it is expected to influence the behavioural pattern of consumers.

This implies that Indirect taxation changes price and consumption behaviour of the consumer. Thus, price effects of indirect tax and the attendant consumers "consumption behaviour is an issue of relevance to countries. Especially developing countries like Nigeria. The attendant uncertainty to the economy and ripple effects are of significant study interest. Concern coder the economy-wide effect of Indirect tax is of importance because of the possibility that tax may cause consumer to cut consumption of certain commodities, hence affecting productivity. In this regard, Ajakaiye (2000) argues that value added tax has impact on consumer price, causes production cost to increase, complicates problem of unemployment, inflation and increases the growth of the informal sector. However, James and Asaama (2012) argue that one of the rationale for taxing consumption rather than income is that consumption taxes discourage consumption, encourage savings, and thus generate higher economic growth.

The need to examine the effects of Indirect tax on prices and consumption expenditure behaviour in Nigeria, especially in the face of persistent inflationary situation and paucity of empirical evidence provoked this research interest. Specifically, the study examined Indirect tax in relation to household consumption expenditure behaviour for non-durable goods and durable goods on consumers.

2. Conceptual Framework

Taxation is a tool for societal development and also a means by which the rewards of development are redistributed (Oladiran, 2009). The historical backdrop of both advanced and developing nations uncovers that taxation is a critical instrument in the hands of the government, not only to generate revenue but also to achieve fiscal goals such as influencing the direction of societal development. According to New Internationalist magazine (2008), tax originated from the Latin word *'Taxare'* which means 'to assess'. While Ariwodola (2008) describes taxation as a method by which nations implements decisions to transfer resources from the private to the public sector.

Adejuwon (200) describes taxes as levies compulsorily imposed on the income, capital and consumption of the people by the government through its agencies so as to increase the resources of the government and enhance the effective provision of social amenities.

Traditionally, taxes are based on income of individuals or profits of an economic entity, (Naiyeju, 1996). Ndekwu (1991) also states that like never before, there is now an increase interest for the improvement of revenue from the different taxes in Nigeria. The call for government in the affairs of man is the basis for taxation. This follows the idea that if there is to be a government to superintend human affairs in a given territory, such a government will need resources (human and material) to achieve its objective. The most efficient way of getting such resources is for individuals in the territory concerned to contribute in an agreed manner; such contribution referred to as tax (Osetneke,2010).

In the opinion of Anyaduba (2000), tax is a levy compulsorily imposttl on the income of individual, household and corporate entity by the government or its agent for the purpose of raising revenue. While Ogbonna and Appah (2012) assert that the main aim

of taxation is to raise income to finance government expenditure and to redistribute riches and the management of the economy.

In any case, Johansson, Powerful, Arnold, Brys and Vartia (2008) portray tax system as a system that is primarily aimed at financing public expenditure. They emphases the importance of tax revenue as a tool for promoting equality and re-addressing issue of social and economic concerns.

Tax is a levy compulsorily imposed on a citizen or upon his or her properties by the state to provide security, social infrastructures and cerate the enabling environment for the economic welfare of the society (Appah, 2004, Appah and Oyandonghan, 2011). They further assert that the tax payable by an individual is not a function of the benefit derivable from the process. The fundamental reason for imposing tax has always been to finance government activities, redistribute income, stimulate economic activities, and influence the level of aggregate demand among others. From the above, tax can be seen as a necessary or an obligatory demand imposed on the income, profit and gains of individual, family unit, firms (joined and unincorporated) by the government with the end goal of raising income to meet State commitments to her nationals. In differentiating taxation from tax, the latter is a compulsory levy imposes on the profit, income and gains of individual, firm and other entity by the agencies of government or the government in other to raise revenue for the government while the former is the system or process put in place by the government or its agencies in raising the needed revenue.

2.1. Indirect Taxation

Indirect taxes are imposed on one person but paid either partly or wholly by another. The person who pays the tax in the first instance, transfers its burden to another person. In other words, the impact and incidence of indirect tax fall on different persons. Examples of indirect taxes are sales tax, excise duty, value added tax (VAT) etc. Custom duties (export duties and import duties) are imposed on imported goods. It is a very good source of income for the government. Excise duties are imposed on domestically produced goods. They are highly discriminating because it can be imposed on certain good and not on other goods. Excise duties are not important source of government revenue in developing countries because the manufacturing sectors are still minute. Another type of indirect tax is sumptuary tax. Sumptuary tax is not for raising revenue but to discourage people from consuming particular goods. Sale tax is another type of indirect tax. Two types can be identified vis: single stage-tax and multi stage-tax. Single-stage tax takes place between the producer and the consumer while multi-stage tax is imposed anytime the good changes from one individual to another. VAT is a tax imposed at every stage of production. It is usually imposed on the net-value added. To this extent, VAT can be regarded as an example of multi-stage tax.

Export duties are imposed on good exported out of the country. They serve as a substitute for personal income tax for the farmers. It is argued that this form of taxation is very easy to collect. It has also been argued that it is not equitable because it applied to those farmers who produced for export. People have also argued against export tax because it subjected the farmers to double taxation. It is a major source of revenue up to 1960's in Nigeria but it has decreased remarkably from the period of oil boom.

2.2. Effect of Indirect Tax on Household Consumption

Indirect taxation is policy which is commonly used to generate revenue from tax. It is referred to as indirect tax as it is paid indirectly by the final consumer of goods and services while paying for purchase of goods or for enjoying services. It is broadly based since it is applied to everyone in the society whether rich or poor. Since the cost of the tax does not vary according to income, indirect taxation is a proportional tax. However, indirect taxation can be viewed as having the effect of a regressive tax as it imposes a greater burden on the poor than on the rich because they all pay the same amount. The taxpayer who pays the tax does not bear the burden of tax; the burden is shifted to the ultimate consumers. Therefore, indirect tax has effect on consumption and the standard of living of the general public.

Household consumption is the total goods and service consumed by a house hold at particular time or period, it refers to the final purchase made by the residents of a household to meet their everyday needs which include food, clothing, housing, services, transport, health, leisure etc. when referring to the household sector it does not only include the people that live in traditional homes but those also living in communal homes like prison, boarding house, retirement houses. It measured using the purchasers" price which means the price the consumer actually pays for the goods consumed.

Household final consumption expenditure (formerly private consumption) is the market value of all goods and services, including durable products (such as cars, washing machines, and home computers) purchased by households. It excludes purchases of dwellings but includes imputed rent for owner-occupied dwelling. It also includes payments and fees to government to obtain permits and licenses. Here, household consumption expenditure includes the expenditures of non - profit institutions serving households, even when reported separately by the country (World Bank national accounts data).

In that regard, indirect taxation has an impact on household consumption this is because the more the government increases tax on goods and service the higher the price becomes .and when they decrease the price of goods and services the price becomes lower. In return households are either able to buy less or more of items for consumption. A consumption tax rate increase has the potential to reduce household consumption in the long-run. If this occurs, one would expect a decline in household consumption due to decrease in disposable income.

From the evidence received so far it shows that indirect taxes have an influence on household consumption. Revenue from VAT was347, 688million as at 2012, this increased to 589,526million in 2013 (Central bank of Nigeria statistical bulletin). This increase in revenue would have also affected the prices of goods and service which in return would have affected the consumption of households. Looking at it from an economic point of view, one expects the price of goods subject to indirect tax to rise; this then determines the amount a household can consume. It can also lead to inflation in an economy. The major problem of this research therefore, is to determine the effect of tax on taxpayer in compliance with tax policies of government and its effect on household consumption.

2.3. Objectives of Taxation

The main purpose of tax is to raise revenue to meet government expenditure and to redistribute wealth and management of the economy (Ola, 2001; Jhingan, 2004; Bhartia, 2009). Anyanwu (1993) pointed out that there are three basic objectives of taxation. These are to raise revenue for the government, to regulate the economy and economic activities and to control income and employment. Also, Nzotta (2007) noted that taxes generally have allocation, distributional and stabilization functions. The allocation function of taxes entails the determination of the pattern of production, the goods that should be produced, who produces them, the relationship between the private and public sectors and the point of social balance between the two sectors. The distribution function of taxes relates to the manner in which the effective demand over economic goods is divided, among individuals in the society. According to Musgrave and Musgrave (2006), the distribution function deals with the distribution of income and wealth to ensure conformity with what society considers a fair or just state of distribution. The stabilization function of taxes seeks to attain high level of employment, a reasonable level of price stability, an appropriate rate of economic growth, with allowances for effects on trade and on the balance of payments. Nwezeaku (2005) argues that the scope of these functions depends, inter alia, on the political and economic orientation of the people, their needs and aspirations as well as their willingness to pay tax. Thus the extents to which a government can perform its functions depend largely on the ability to design tax plans and administration as well as the willingness and patriotism of the governed Tax is discriminatory in the sense that it is assessed on persons or property based on profits/incomes or gain, the benefit derived by citizens from tax payment is without reference to the contribution of individual tax payers (Nightingale, 2000).

In line with this, Ariwodola (2000) posits that it is accurate to say that thaprirnary objective and purpose of taxation in most nations of the world is essentially to generate revenue for government expenditure on social welfare such as provision of defence, law and order, health services and education. Tax revenue can also be expended on capital projects otherwise called consumer expenditure, creating social and economic infrastructure which will improve the social life of the people (Angahar& Alfred, 2012). Other than facilitating the administrative function of government, taxation as the most potential source of revenue to the government of any nation, has played very crucial roles as an instrument of government's economic, social and fiscal policy. Taxation is used for the purpose of discouraging certain forms of anti-social behavior in the society. Taxation according to Musgrave and Musgrave (1980) can be extensively used in regulating the consumption pattern resulting in economic stabilization. Anti-social behavior such as drinking of alcohol, smoking and pool betting can be controlled by imposition of higher taxes on production of such goods. There source allocation dimension of taxation policy is its role in promoting investment as a critical measure of ensuring a healthy economy through creation of new wealth. In Nigeria, government sometimes introduces tax incentives and attractive tax exemptions as an instrument to woo and induce local and foreign investors in areas such as manufacturing of goods, export processing, oil and gas and utilities, which are critical and necessary for the economic development and growth of the nation (Angahar & Alfred, 2012). The use of transfer payments and benefits to those members of the society who are less well-off according to Musgrave and Musgrave (1980) is to promote social equality. Taxation as a mechanism for income and wealth distribution holds that the burden of taxation should be heavier for the rich in the society than for the poor so that taxes collected are used to pay for social services for the less fortunate.

Harmonization according to Lekan and Sunday (2006) is said to be the modern objective k of Economic community of West African States (ECOWAS). The idea of a single market in ECOWAS member nations is to provide for the free movement of goods/services, capital and people between member states. The philosophy behind this single market therefore suggests that these tax systems of member states should be harmonized. Generally, according to Ola (2004) taxation is a powerful and potential fiscal stabilizer employed by government of nations to plan development policies. It is a device according to Nightingale (2000) to induce economic development and favourable balance of payments.

3. Empirical Review of the Literature

Taxation plays a very important role in the economic life of a developing country like Nigeria. Nigeria needs an efficient tax system to be able to function well. Taxation is seen as a burden which every citizen must bear to sustain his or her government because the government has certain functions to perform for the benefits of those it governs. Taxation is the most important source of income to the government, it accounts for ninety percent or more of their income. According to Ifurueze & Ekezie (2014), tax is "a compulsory levy imposed on a subject or upon his property by the government to generate the needed revenue for the provision of basic amenities and create enabling condition or the economic wellbeing of the society". These levies are made on personal income, such as salaries, business profits, interests, dividends, discounts and royalties. It is also levied against company's profits petroleum profits, capita] gains and capital transfer. Whereas, Ojo (2003) stresses that, taxation is a concept and the science of imposing tax on citizens. According to him, tax is itself a compulsory levy which is required to be paid by every citizen. It is generally considered as a civic duty. The imposition of taxation is expected to yield income which should be utilized in the provision of amenities, both social and security and creates conditions for the economic wellbeing of the society. According to Bariyiman and Gladson (2009), tax administration in Nigeria is carried out by the various tax authorities as established under the relevant tax laws. According to the report of the presidential committee on National Tax policy (2008), The National tax policy provides a set of rules, modus operandi and guidance to which all stakeholders in the tax system must subscribe. Tax policy formulation in Nigeria is the responsibility of the Federal Inland Revenue Services (FIRS), Customs, Nigerian National Petroleum Corporation (NNPC), National Population Commission (NPC), and other agencies but under the guidance of the National Assembly i.e. the law making body in Nigeria (Presidential committee on National tax policy, 2008). Suffice it to say that if there must be any effective implementation of the Nigerian tax system or attainment of its goal, the use of the national tax policy document remains absolutely essential. According to the Presidential Committee on tax policy (2008), "Nigeria needs a tax policy which does not only describe the set of guiding rules and principles, but also provide a stable point of reference for all the stakeholders in the country and upon which they can be held accountable.

Furthermore, James and Nobes (2008) decried the inability of tax policy to meet up with efficiency and equity criteria against which it is being judged. It was further noted that tax policy is continually subjected to pressure and changes which most time does not guarantee outcome that are in line with the overall goal (James and Nobes 2008). Unfortunately, most policy changes in Nigeria are without adequate consideration of the taxpayers, administrative arrangement and cost plus the existing taxes.

This has in no small measure hindered the effective implementation and goal congruence of the nation's tax system. James and Nobes (2008) stated as follows the best approach to reforming taxes is one that takes into account taxation theory, empirical evidence and political and administrative realities and blend them with good dose of local knowledge and a sound appraisal of the current macroeconomics and international situation to produce a feasible set of proposals sufficiently attractive to be implemented and sufficiently robust to withstand changing times, with reason and still produce beneficial results.

4. Data Source and Technique of Analysis

The data used for this study are essentially secondary data. They were sourced from the publications of the central bank of Nigeria and world bank development indicators (2018). The variables for which data was sought include: indirect tax using two major components of tax: personal income tax and value added tax, inflation and household consumption for the period of 1985 to 2020.

The method of data analysis used in this study is analytical. The analytical tool used is the Ordinary Least Square (OLS) method and cointegration analysis. This approach, which is quantitative technique, includes table and test for the hypothesis formulated by using regression analysis at 5% level of significance. In demonstrating the application of the ordinary least squares method, the multiple linear regression analysis was used with the household consumption expenditure as the dependent variable in the model while the explanatory variables are value added tax, personal income tax and inflation. In this study, a model was formulated for the purpose of this analysis. The model will help to verify the impact of indirect tax on house hold consumption in Nigeria. Taking inference from the empirical finding and theories, a model which examines the impact of indirect tax on household consumption was specified. The functional form of the model is:

$$HCON = F(INTAX, PIT, INF) \tag{1}$$

Where:

$HCON$ = household consumption

$INTAX$ = indirect tax

PIT = personal income tax

INF = inflation

The indirect tax is proxied by the value added tax, thus equation **1** is restated as:

$$HCON = F(VAT, NT, INF) \tag{2}$$

Where:

HCON = household consumption

INTAX = indirect tax

PIT = personal income tax

INF = inflation

VAT = value added tax

The model in equation 2 can be stated in a linear form as

$$HCON, = \alpha o + filVATI + fi2PITt + fi3INFt + ut \tag{3}$$

Results and Discussion

In time series analysis, it is imperative to determine the nature of the data to be examined. This is because a prior determination of the stationarity of economic time series is crucial for empirical inferences. Since standard econometric methodologies are based on the premise of stationarity in the time series, while they are in the real sense non-stationary. As a consequence, the usual statistical tests are likely to be inefficient and the conclusions drawn are likely to be misleading and incorrect. For example, the ordinary least squares (OLS) estimation of regressions in the presence of non-stationary variables gives rise to spurious regressions if the variables are not cointegrated (Gujarati, 1995).

The results of the unit root tests are given in table 4.1. The ADF result in table 4.1 shows some variables to be stationary at the level form. Further test at the first difference level shows all variables to be stationary. The variables were being integrated order 1. That is there attained stationarity after first differencing. Therefore, we conclude that the variables included in the model are stationary at their 1 ʻ difference; since this study uses the rejection of the null hypothesis of unit root at least by one test to arrive at a verdict of stationarity.

Table 4.1: Unit Root Tests

	ADF T-Statistic @ Difference	*Critical Value @ 5% level of sig.*	*Order of Integration*
HCOND(HCON)	0.368-8.472	-2.948-2.948	I (0)(1)
LOG (VAT)D(LOG(VAT)	0.297-6.629	-2.943-2.946	I(0)I(1)
LOG(PIT)D(LOG(PIT)	0.723-3.393	-2.943-2.946	1(0)I(1)
LOG(INF)D(LOG(INF)	-3.401-6.157	-2.943-2.946	1(1)I(1)

Source: Author's Estimated Output

4.2. Cointegration Analysis

Since the variables are stationary, the next step is to use Johansen (1988) full information maximum likelihood to test for cointegration. The cointegration result are presented in table 4.2 and 4.3 below.

Table 4.2: Unrestricted Cointegration Rank Test (Trace)

Hypothesized No. of CE(s)	*Trace 0.05 Eigenvalue*	*Statistic*	*Critical Value*	*Prob.***
None *	0.999994	453.5893	47.85613	0.0001
At most 1 *	0.358565	33.28280	29.79707	0.0191
At most 2 *	0.270744	17.74113	15.49471	0.0226
At most 3 *	0.173998	6.690547	3.841466	0.0097

Trace test indicates 4 cointegratingeqn(s) at the 0.05 level
* denotes rejection of the hypothesis at the 0.05 level
**MacKinnon-Haug-Michel is (1999) p-values
Source: Author's estimated result

Table 4.3: Unrestricted Cointegration Rank Test (Maximum Eigenvalue)

Hypothesized No. of CE(s)	*Max-Eigen Eigenvalue*	*0.05 Statistic*	*Critical Value*	*Prob.***
None *	0.999994	420.3065	27.58434	0.0001
At most 1	0.358565	15.54168	21.13162	0.2528
At most 2	0.270744	11.05058	14.26460	0.1517
At most 3 *	0.173998	6.690547	3.841466	0.0097

Max-eigenvalue test indicates 1 cointegratingeqn(s) at the 0.05 level
* denotes rejection of the hypothesis at the 0.05 level
**MacKinnon-Haug-Michelis (1999) p-values
Source: Author's estimated result

The above cointegration test indicates that the trace test as well as the maximum eigenvalue suggest the presence of a long run relationship between the variables in the model at a 0.05 significance level. Thus, the maximum eigenvalue statistics and the trace test rejects the null hypothesis at 0.05 level of no cointegration; stating otherwise, there exists one cointegrating vector, suggesting a linear model with intercept but no trend.

4.3. Estimated Ols Ouput

Table 4.4: The result of the estimated model is presented below

Variable	*Coefficient*
C	28.68696
LOG(VAT)	0.036293
LOG(PIT)	-0.130294

LOG(INF)	-0.116148
R-squared	0.825933
Adjusted R-squared	0.810109
S.E. of regression	0.248437
Sum squared resid	2.036792
Log likelihood	1.140802
F-statistic	52.19402
Prob(F-statistic)	0.000000

Source: Author's estimated result.

Std. Error	*t-Statistic*	*Prob.*
0.290182	98.85850	0.0000
0.022063	1.644992	0.1095
0.030030	4.338758	0.0001
0.059638	-1.947543	0.0600
Mean dependent var	30.55670	
S.D. dependent var	0.570117	
Akaike info criterion	0.154551	
Schwarz criterion	0.328705	
Hannan-Quinn triter.	0.215948	
Durbin-Watson stat	0.776193	

The estimated OLS intercept result above shows that at zero levels of VAT, PIT, and INF, EICON will rise significantly by 28 units. The result further reveals that the value added tax has a positively insignificant relationship with house hold consumption. The result show that a unit increase in value added tax would cause a 0.032 unit increase in house hold consumption.

However, Personal income tax which is another variable used in the study, shows a significantly negative relationship with household consumption. The result reveals that a one unit increase in Personal income tax would lead to a 0.13 unit decrease in the level of household consumption. Similarly, inflation is revealed to have a negative effect on household consumption. The negative effect is no the contrary, shown to be significant. Form the output in table 4.4, a unit rise in inflation will result in the decline of the household consumption by 0.11 units.

Interpreting the coefficient of determination (R2) value of 0.82; show the model to be linear by approximately 82%. Adjusted coefficient of determination (Adjusted **R2)** value reveals that 81% variations in the level of household consumption can be accounted for by variations in value added tax, personal income tax and inflation.

The f=statistics significant value shows that all the repressors are jointly significant in explaining variations in the dependent variable.

Conclusion and Recommendations

This study was conducted to affirm the existence of a relationship between indirect tax and household consumption between the period of 1985 to 2020. During the review of the relevant literature on the impact of indirect tax on household consumption, the modern consumption theory and fiscal federation theory was adopted as theoretical models. A model formulated for the study with household consumption as he dependent variable and value added tax, personal income tax and inflation were used as independent variables. The study started by testing for unit roots where all variables were found to be stationary at first difference, the cointegration technique was adopted to test for the relationship between variables in the model and some findings were revealed. Key findings to the study revealed that the existence of an insignificantly positive effect between value added tax and the level of household consumption. In addition, there exists a significantly negative relationship between personal income tax and the level of household consumption and a significantly negative relationship between inflation rate and the level of household consumption. Based on the aforementioned findings, it would not be erroneous to ascertain that indirect tax has no impact on the level of household consumption. Even though it was statistically insignificant. Personal income tax and inflation were shown to be negatively related to house hold consumption and there are statistically significant, thus there is the propelling force behind the determination of household consumption. Owning to this, the level of indirect tax would rather not affect the level of consumption but personal income tax and inflation goes a long way to affect consumption patterns of households.

The study therefore recommends that a more anti-inflationary policy should be formulated and regulated to check the effect of inflation on consumption. Also, efficient regulations policy should be formulated to check the impact of personal income tax on consumption. Furthermore, there should be efficient pricing of consumer good such that products and prices would not be abused.

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