

Value Added Tax and Household Consumption Expenditure in Nigeria

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Abstract

This study examines the relationship between Value Added Tax (VAT) and household consumption expenditure in Nigeria by applying the Autoregressive Distributed Lag (ARDL) modeling approach. The analysis covers the period from 1994 to 2023 and incorporates key macroeconomic variables including VAT revenue, household consumption expenditure, per capita income, and the inflation rate. Annual data for the period 1994-2023 were obtained from the Central Bank of Nigeria statistical Bulletin and the World Bank Development Indicators Database. The empirical findings reveal that VAT has a negative relationship with household consumption expenditure in both the short run and the long run. However, the coefficients are statistically insignificant, implying that VAT had no measurable impact on household consumption during the study period. In contrast, per capita income emerges as the most consistent determinant of household consumption expenditure. The results indicate that increases in income levels contribute significantly to improvements in household spending. Based on the findings, the study recommends that economic policies prioritize income growth and household purchasing power. Strengthening per capita income is likely to yield more meaningful gains in consumption expenditure than adjustment to VAT policy alone.

Keywords: Household Consumption Expenditure, Inflation, Per Capita Income, Value Added Tax, Nigeria.

1. Introduction

Household consumption expenditure represents a critical component of economic activity because it reflects the level of spending by households on goods and services within an economy. In many countries, consumption expenditure constitutes the largest share of aggregate demand and therefore plays an important role in determining economic growth. In the period following the COVID-19 pandemic, however, global economic condition has been characterized by slowing household consumption growth, particularly across several developing regions. Evidence from the World Bank Development Indicators indicates that similar patterns are observable in West African economies, including Nigeria (World Bank, 2022).

In Nigeria, household consumption expenditure declined sharply over a short period between 2019 and 2021. Available data show that total household consumption expenditure was approximately US\$334.27 billion in 2019 but declined to about US\$276.22 billion in 2020 and further decreased to roughly US\$273.98 billion in 2021 (World Bank, 2022). This

downward movement suggests weakening consumer demand and reduced purchasing capacity among households. A number of macroeconomic conditions may explain this development, including fiscal policy adjustments, instability in international oil prices, rising inflation, and broader macroeconomic uncertainty.

Government policy plays a central role in addressing economic challenges in developing countries. In Nigeria, public authorities are responsible for providing essential services such as education, healthcare, electricity supply, water resources, and internal security. Fiscal policy instruments are often used to stimulate economic growth and improve living standards. Despite these efforts, debates remain concerning the effectiveness of fiscal policy in improving household welfare across Sub-Saharan Africa (Nyiputen & Abijia, 2022).

Taxation is one of the primary mechanisms through which government mobilize revenue to finance public expenditure. In Nigeria, several forms of taxation exist, including personal income tax, company income tax, customs and excise duties, and Value Added Tax. Among these instruments, Value Added Tax has become particularly important in recent decades as a reliable source of government revenue (Abiola & Asiweh, 2012). Since its introduction in 1994, VAT has contributed significantly to public finance and has attracted considerable attention within the economic literature. Value Added Tax is imposed on goods and services at various stages of production and distribution, with the final burden transferred to consumers through higher prices. Because the tax is embedded in the price of goods and services, it has the potential to influence consumption behaviour. Scholars have argued that VAT may affect household spending patterns by altering the cost of goods and services within the market (Adegbite, 2018; Kathure, 2017).

In response to economic pressures affecting household welfare, the Nigerian government has implemented several social intervention programmes designed to support vulnerable groups and improve purchasing power. Examples include the N-Power programme, Conditional Cash Transfer scheme, National School Feeding Programme, and the Government Enterprise and Empowerment Programme. These initiatives were introduced to mitigate the adverse effects of economic hardship and rising living costs. Despite these policy measures, evidence suggests that household consumption expenditure has continued to decline periodically. This raises questions regarding the effectiveness of government interventions, particularly VAT policy, and highlights the need for further empirical investigation.

Inflation is another important factor influencing household consumption behaviour. Rising prices reduce the purchasing power of income and may compel households to reduce their spending levels. Studies have shown that inflation can significantly affect consumption patterns by altering real income and increasing the cost of living (Ugwa & Embula, 2012). Consequently, increases in VAT may indirectly contribute to inflationary pressures and reduce real household income, thereby limiting consumption expenditure.

Although several empirical studies have investigated the relationship between taxation and consumption in Nigeria, their findings remain mixed. Previous research has produced varying conclusion. For instance, Nyiputen and Abijia (2022) found out that VAT had an insignificant impact on household purchasing power, while Idris and Sebastine (2022) reported a negative and significant relationship. Gidigbi et al 2021 and Bala Sani (2020) documental mixed result depending on the time horizon, and Adegbite (2018) found out that VAT positively influence government revenue but with ambiguous effect on consumptions. Despite these mixed findings, no recent study has examined this relationship using COVID-19

data (up to 2023) while employing the ARDL methodology to distinguish short-run and long-run effect. Furthermore, existing studies have often omitted inflation and per capita income as concurrent determinants, potentially leading to omitted variable bias. This study therefore examines the effect of Value Added Tax on household consumption expenditure in Nigeria over the period 1994 to 2023.

2. Literature Review

2.1 Conceptual Review

Value Added Tax is generally recognized as a form of indirect taxation imposed on goods and services at different stage from manufacturing to final sale to the consumer. Although firms involved in the production and distribution process remit the tax to government authorities, the ultimate burden of the tax is borne by consumers through the prices they pay for goods and services (Kagan, 2019).

Unlike a traditional sales tax, which is collected only at the final stage of the transaction, VAT operates through a multi-stage collection mechanism. Each firm pays tax on the value it adds to a product while receiving credit for taxes already paid on intermediate inputs. This process prevents double taxation and ensures that the tax burden is distributed across the entire production and distribution.

Oghuma (2017) explains that the administration of VAT requires businesses to record the value added to goods and services during each stage of production. The tax payable is therefore determined by subtracting the value of previously taxed inputs from the value of outputs. Through this mechanism, suppliers remit the tax to the government while consumers ultimately finance the tax through their purchases.

Across West African countries, differences in VAT rates influence how the tax affects economic activities and consumer behavior. For instance, Nigeria currently operates a VAT rate of 7.5 percent, whereas Ghana applies approximately 15 percent and Côte d'Ivoire maintains a rate of about 18 percent (PwC, 2025). These variations imply that the magnitude of VAT's effect on household consumption expenditure may differ among countries depending on their tax structure and economic conditions. Value added tax is therefore designed primarily to generate government revenue while the final burden rests on consumers.

Household consumption expenditure refers to the total value of goods and services purchased and used by households within a given period for the purpose of satisfying their daily needs. This includes expenditure on essential items such as food, clothing, housing, transportation, health services, and education. It also includes spending on durable goods such as vehicles, electronic appliances, and household equipment that provide services over a relatively long period.

In national income accounting, household consumption expenditure includes not only direct purchases made by households but also the estimated rental value of owner-occupied housing. This is done to capture the economic value of housing services enjoyed by homeowners even when no rent is paid. However, the purchase of real estate property itself is excluded from consumption expenditure because it is treated as investment rather than consumption (World Bank, 2022). Consumption expenditure is spending by non-profit institutions that provide services directly to household. Such expenditure is included in aggregate household consumption because they directly benefit household.

Earlier contributions by Tim (1996) and Anyanwu (1995) also describe household consumption as expenditure on goods and services intended for present use. These authors

emphasize that disposable income is one of the most important factors influencing consumption behaviour. As income increases, households tend to allocate a greater portion of their resources to consumption while also increasing savings. Empirical evidence suggests that household consumption is influenced not only by income but also by broader macroeconomic conditions. Changes in taxation policies, interest rates, and inflation levels may significantly affect consumption patterns. Idris and Sebastine (2022) observe that increases in VAT may raise the prices of goods and services, thereby reducing the purchasing power of households when purchasing power declines, households may reduce their consumption expenditure.

Similarly, Ikwuagwu, Ariwa, and Onyele (2017) applied the Autoregressive Distributed Lag model to examine the determinants of aggregate consumption in Nigeria. Their findings indicate that income has a positive and statistically significant effect on consumption expenditure, while interest rates and inflation also play important roles in shaping consumption behavior. These findings justify the inclusion of income and inflation as important variables when analyzing the relationship between VAT and household consumption expenditure.

2.2 Theoretical Framework

This study is anchored on the Absolute Income Hypothesis and the Sacrifice Theory of Taxation. These frameworks provide the conceptual basis for examining the relationship between Value Added Tax and household consumption expenditure in Nigeria. The Absolute Income Hypothesis, originally proposed by John Maynard Keynes and later refined by scholars such as James Tobin, emphasizes the central role of income in determining consumption behavior. According to this theory, the level of consumption expenditure depends largely on current income. Keynes argued that as income increases, consumption also rises, although the increase in consumption is typically smaller than the increase in income. This behavioral pattern is captured in the psychological law of consumption, which states that individuals tend to spend a portion of any increase in income while saving the remainder.

In his seminal work *The General Theory of Employment, Interest and Money* published in 1936, Keynes identified several factors that influence consumption behavior. These factors can be broadly classified into subjective and objective elements. Subjective factors include psychological motives such as precaution, foresight, and the desire to improve living standards. Objective factors involve broader economic conditions such as income changes, interest rates, and fiscal policies. Within this framework, taxation policies such as Value Added Tax may influence consumption behaviour indirectly by affecting the disposable income available to households. Although the Absolute Income Hypothesis offers a useful explanation of short-run consumption patterns, its applicability in the long run has been subject to debate. Empirical observations by Kuznets (1946) suggested that the average propensity to consume remains relatively stable over extended periods, even though short-run evidence supports Keynes' proposition that consumption grows less proportionately than income. Despite these limitations, the theory remains relevant to this study because it highlights the importance of income as a determinant of household consumption expenditure. The Sacrifice Theory of Taxation complements this perspective by focusing on fairness and equity in tax systems. According to this theory, taxation should be designed in a way that distributes the burden of tax payments according to the level of sacrifice imposed on taxpayers. The concept of sacrifice refers to the reduction in welfare or utility that individuals experience when they pay taxes.

John Stuart Mill argued that individuals with greater income or wealth can bear higher tax burdens with relatively less sacrifice compared with individuals with lower income levels. Consequently, taxation policies should be structured in a manner that avoids placing disproportionate pressure on low-income households (Mill, 1848; Musgrave & Musgrave, 1989). When applied to the context of this study, the Sacrifice Theory suggests that consumption taxes such as VAT should be carefully designed so that they do not impose excessive burdens on households with limited financial resources. Since VAT is embedded in the prices of goods and services, it may affect the purchasing power of households, particularly those whose consumption is concentrated on essential goods. Examining the impact of VAT on household consumption expenditure therefore provides an important basis for assessing whether the tax structure aligns with principles of fairness and social welfare.

2.3 Empirical Review

Several empirical studies have examined the relationship between taxation and household consumption expenditure across different countries and time periods. These studies provide valuable insights into how fiscal policy instruments, particularly Value Added Tax, may influence consumption behavior.

Tabulo, Aye Agele, and Adewale (2025) investigated the effect of Value Added Tax on household consumption expenditure in selected ECOWAS countries including Nigeria, Ghana, and Côte d'Ivoire. The study covered the period from 1994 to 2023 and employed panel estimation techniques such as the Pooled Mean Group, Mean Group, and Dynamic Fixed Effects models. The analysis included VAT, household consumption expenditure, per capita income, and inflation rate as key variables. The results indicated that VAT had a negative but statistically insignificant effect on household consumption expenditure in the long run. The study also identified a bidirectional causal relationship between VAT and household consumption, suggesting that consumption patterns influence VAT revenue while VAT policies may also affect consumption behavior. Based on these findings, the authors recommended policies aimed at improving per capita income in order to strengthen household consumption levels.

Omodero, Ebieri, and Ekundayo (2023) examined the relationship between VAT and household consumption in Sub-Saharan Africa using panel time series data covering the period from 1994 to 2021. The researchers employed the Panel Autoregressive Distributed Lag model using the pooled mean group estimation technique to analyze both short-run and long-run dynamics. Their findings revealed that VAT had a positive and statistically significant effect on household consumption in the long run. However, the exchange rate exhibited a negative influence on consumption expenditure. In the short run, VAT also demonstrated a statistically significant relationship with household spending. The study recommended that governments should increase public awareness regarding VAT policies and consider zero-rating essential goods in order to protect vulnerable households.

Azer and Tengiz (2022) investigated the determinants of household consumption expenditure in Georgia using annual data covering the period from 1983 to 2018. The study employed the ARDL estimation method to analyze both long-run and short-run relationships among the variables. The results indicated that gross domestic savings had a negative long-run relationship with household consumption expenditure, whereas GDP per capita exhibited a positive and statistically significant effect. Savings were also found to negatively influence

consumption in both the short and long run. Although the study provides useful insights into consumption behavior, its findings are limited to the economic context of Georgia.

Idris and Sebastine (2022) examined the relationship between indirect taxation and household consumption expenditure in Nigeria using time series data spanning the period from 1985 to 2020. The study utilized cointegration analysis and ordinary least squares estimation techniques to examine both long-run and short-run relationships among the variables. The findings indicated that VAT had a positive but statistically insignificant effect on household consumption expenditure. Inflation and personal income tax, however, were found to exert negative effects on consumption, with inflation showing statistical significance. Based on these findings, the study recommended the implementation of stronger policies aimed at controlling inflation in order to protect household purchasing power.

Nyiputen and Abijia (2022) analysed the impact of Value Added Tax on private consumption expenditure relating to manufactured goods in Nigeria using annual data from 1990 to 2021. The study applied the ARDL modelling technique and incorporated several explanatory variables including VAT, per capita income, real GDP, consumer price index, infrastructure, and private domestic credit. The results revealed that VAT, consumer price index, per capita income, and infrastructure had positive and statistically significant effects on private consumption expenditure on manufactured goods in both the short run and the long run. However, private domestic credit emerged as the variable with the most consistent statistical significance.

Gidigbi et al. (2021) explored the influence of indirect taxation on household consumption in Nigeria using secondary data covering the period from 1981 to 2017. The variables included in the study were VAT, exchange rate, per capita income, interest rate, inflation rate, and customs and excise duties. The analysis employed the ARDL modelling framework to examine long-run relationships and short-run adjustments among the variables. The results indicated that VAT and interest rates had positive and statistically significant effects on household consumption expenditure. The error correction mechanism also showed that deviations from equilibrium were corrected within approximately eleven months.

Otemu (2020) examined the relationship between Value Added Tax, government revenue, and household consumption patterns in Nigeria using quarterly data from 2000 to 2018. The study utilized the Ordinary Least Squares estimation technique. The findings indicated that VAT made a significant contribution to government revenue and also influenced consumption behavior by moderating household spending patterns. The study recommended improved tax administration and stronger institutional capacity for VAT collection agencies.

Omodero (2020) investigated the impact of indirect taxation on consumption behaviour in Nigeria using data from 2005 to 2019. The analysis included Value Added Tax and Customs and Excise Duties as explanatory variables. The results showed that VAT had a positive but statistically insignificant relationship with consumption expenditure, while Customs and Excise Duties had a positive and statistically significant impact.

Bala and Sani (2020) examined the impact of VAT on consumption expenditure in Nigeria using annual data covering the period from 1994 to 2018. The ARDL model was employed to estimate the relationships among consumption, VAT, interest rate, and inflation rate. The findings indicated that VAT had a positive and statistically significant effect on consumption expenditure. The authors suggested that periodic adjustments in VAT rates could serve as a policy instrument for regulating consumption levels.

Adegbite (2018) investigated the effect of Value Added Tax on household consumption expenditure in Nigeria between 1994 and 2016. The study used multiple regression analysis and incorporated econometric techniques such as unit root tests, Johansen cointegration, Vector Error Correction Model, and Granger causality tests. The findings indicated that disposable income had a positive and statistically significant relationship with household consumption expenditure. VAT, however, had a negative and statistically significant impact on consumption in both the short run and long run.

Idoko (2018) analysed the impact of consumption taxes on household standard of living in Nigeria. The study used household consumption expenditure as a proxy for standard of living and included VAT, excise tax, and personal income tax as explanatory variables. Using the Error Correction Mechanism approach, the study found that these taxes had negative effects on household welfare.

Onyinyechi et al. (2016) examined the role of fiscal policy in Nigeria's economic performance between 1994 and 2014 using multiple regression analysis. The results showed that capital expenditure, recurrent expenditure, and tax revenue did not have significant effects on real GDP, whereas external debt had a significant negative relationship with economic growth.

3. Methodology

3.1 Data and Sources

The analysis relies on secondary data obtained from two major sources. Statistical information was collected from the Central Bank of Nigeria Statistical Bulletin and the World Bank Development Indicators (2023) database. The data span the period from 1994 to 2023 and provide annual observations on household consumption expenditure (HCE) - The dependent variable - and value added Tax (VAT), per capita income (PCI) and the inflation rate (INF) - the independent variable used in the empirical analysis.

3.2 Model Specification

The specification of the empirical model is guided by the Keynesian consumption theory and the Sacrifice theory of taxation. These theoretical perspectives explain how income and tax policies may influence household spending behavior. In developing the model, the study modifies the framework previously applied by Bala and Sani (2020) while introducing additional variables suggested in related empirical studies. The basic model adopted by Bala and Sani (2020) can be represented as follows:

$$CONS = f(VAT, INT, INF) \dots\dots\dots (1)$$

Where,

CONS = Consumption

VAT = Value added tax

INT = Interest rate

INF = Inflation rate

For the present analysis, the original model is modified to focus more clearly on the relationship between value added tax and household consumption expenditure. The reformulated model therefore provides a framework for evaluating how variations in VAT influence household spending behavior within the period under study.

$$HCE = (VAT, PCI, INF) \dots\dots\dots (2)$$

Where:

HCE= Household consumption expenditure

VAT= Value Added Tax

PCI= Per Capita Income

INF= Inflation Rate

Assuming linearity among the variables, the model is further specified in linear form:

$$HCE_t = \beta_0 + \beta_1 VAT_t + \beta_2 PCI_t + \beta_3 INF_t + \dots\dots\dots (3)$$

Where:

U is the composite error term capturing unobserved factors.

3.3 Estimation Technique

To examine the short-run and long-run impact of value added tax on household consumption expenditure, this study adopts the Autoregressive Distributed Lag (ARDL) modelling technique. The ARDL method is appropriate because it permits the estimation of both short-term adjustments and long-term relationships within a single framework. Another advantage of this approach is its suitability for analyses involving relatively small sample sizes, as noted by Narayan (2004).

Based on this approach, the ARDL model used in the study is specified as follows:

$$\Delta \ln LHCE = \beta + \beta \Delta \ln HCE + \beta \Delta \ln VAT + \beta \Delta \ln PCI + \beta \Delta \ln INF + \lambda ECM + \mu \dots\dots\dots (4)$$

Where:

L denotes natural logarithmic transformation to reduce heteroscedasticity and compress variable scales (Gujarati & Porter, 2009)

β is the intercept

β, β represent long-run coefficients of the explanatory variables

ECM is the error correction term capturing adjustment to long-run equilibrium

μ is the stochastic disturbance term

The model provides a structured basis for examining how changes in value added tax, per capita income, and inflation affect household consumption expenditure in both the short run and the long run. It also allows the analysis to reflect economic conditions that are specific to the country under study.

4. Results and Discussion

To avoid misleading statistical relationships, the analysis began with an examination of the stationarity properties of the variables. This was carried out using the Augmented Dickey-Fuller (ADF) unit root test. Time series variables often display trends over time, and regression analysis conducted on non-stationary data may produce unreliable results. Therefore, it was necessary to determine the order of integration of each variable before estimating the Autoregressive Distributed Lag (ARDL) model, which allows both long-run and short-run relationships to be investigated.

4.1 Unit Root Test

The unit root test was carried out using Augmented Dickey Fuller (ADF) as presented in table 1

Table 1: Unit Root Test Results (ADF)

Variables	ADF Statistic	Critical value (5%)	Order of Integration
HCE	-5.0556	-2.998064	I(0)
VAT	-0.2762	-2.998064	I(1)
PCI	-2.9688	-2.998064	I(1)
INF	-4.1775	-2.998064	I(0)

Source: Researchers' computation using E-Views 10

The results of the ADF test indicate that the variables exhibit mixed orders of integration. Household consumption expenditure (HCE) and inflation (INF) are stationary at their level values, which means they are integrated of order zero. In contrast, value added tax (VAT) and per capita income (PCI) become stationary only after first differencing, indicating integration of order one. The presence of both I (0) and I (1) variables satisfies the basic requirement for the application of the ARDL approach. This technique is particularly suitable when variables are integrated at different orders, provided that no variable is integrated of order two I (2) or higher.

4.2 ARDL Bounds Test for Cointegration

The existence of a long-run relationship among the variables was examined using the Autoregressive Distributed Lag (ARDL) bounds testing approach. The results of the bounds test are presented in Table 2.

Table 2: ARDL Bounds Cointegration Test Results

Test Statistic	Value	K
F-statistic	5.27	3
	Critical Value Bounds	
Significance Level	I (0) Lower Bound	I(1) Upper Bound
10%	2.37	3.20
5%	2.79	3.67
2.5%	3.15	4.08
1%	3.65	4.66

Source: Researchers' computation using E-Views 10

The ARDL bounds test was conducted to determine whether a long-run equilibrium relationship exists among the variables included in the model. The computed F-statistic of 5.27 exceeds the upper bound critical values at all conventional significance levels. This result leads to the rejection of the null hypothesis that no long-run relationship exists among the variables.

The implication is that household consumption expenditure, value added tax, per capita income, and inflation move together in the long run. The presence of cointegration confirms that meaningful long-run estimates can be obtained within the ARDL frame

4.3 VAR Lag Order Selection

The results of the VAR lag order selection criteria are presented in Table 3.

Table 3: Lag Length Selection Criteria

Lag	LogL	LR	FPE	AIC	SC	HQ
0	-127.4186	NA	812.5473	9.531240	9.816712	9.618512
1	-114.6924	19.10284*	361.2841	8.698957	9.032008	8.800774
2	-113.1849	2.098431	349.9176	8.661244	9.041874	8.777607
3	-110.5263	3.577812	309.4468*	8.543521*	8.971729*	8.674428*

Note: * indicates optimal lag according to the minimum information criterion

Source: Researchers' computation using E-Views 10

The selection of an appropriate lag length is entrant step in ARDL estimation because it helps capture the dynamic behavior of the variables. Using this lag specification, the estimated long-run relationship reveals that per capita income has a positive and statistically significant influence on household consumption expenditure. The coefficient of 0.637 suggests that a one percent increase in per capita income leads to a 0.637 percent increase in consumption in the long run. On the other hand, value added tax and inflation both display negative and significant coefficients. An increase of one percent in VAT reduces household consumption by about 0.284 percent, while a similar increase in inflation lowers consumption by approximately 0.021 percent. These results indicate that income growth stimulates consumption, whereas taxation and rising prices tend to restrain household spending over time.

4.4 Long-Run ARDL Estimates

Given long-run relationship among the variables, the long-run dynamics were estimated using ARDL model and the result is presented in table 4.

Table 4: ARDL Long-Run Estimated Results

Variable	Coefficient	Std. Error	t-Statistic	Prob.
VAT	-0.284	0.112	-2.54	0.018
PCI	0.637	0.148	4.30	0.000
INF	-0.021	0.009	-2.33	0.026
Constant	4.912	1.284	3.83	0.001

Source: Researchers' computation using E-Views 10

The long-run estimation results highlight the individual effects of the explanatory variables on household consumption expenditure. Per capita income shows a positive and statistically significant coefficient. This implies that increases in income lead to higher levels of household spending over time. In numerical terms, a one percent rise in per capita income increases consumption expenditure by about 0.637 percent. This finding is consistent with the Keynesian theory of consumption, which states that consumption grows as income rises.

Value added tax displays a negative and significant relationship with household consumption expenditure. The estimated coefficient of -0.284 suggests that increases in VAT tend to reduce household spending. This outcome indicates that higher tax burdens may reduce disposable income and consequently lower consumption levels. Inflation also shows a negative and statistically significant effect on consumption expenditure. Rising price levels reduce the purchasing power of households and limit their ability to spend. The estimated coefficient indicates that a one percent increase in inflation decreases consumption by approximately 0.021 percent in the long run.

4.5 Short-Run Error Correction Model (ECM)

The short error correction model was estimated and the result is presented in table 5.

Table 5: ARDL Short-Run Error Correction Model Results

Variable	Coefficient	Std. Error	t-Statistic	Prob.
D(VAT)	-0.142	0.061	-2.33	0.028
D(PCI)	0.314	0.097	3.24	0.004
D(INF)	-0.273	0.006	-2.17	0.039
ECM(-1)	-0.619	0.124	-4.99	0.000

F-Statistic = 12.154, R-Squared = 0.701, Durbin Watson = 2.656

Source: Researchers' computation using E-Views 10

The short-run estimates reveal that changes in VAT and inflation have negative and statistically significant effects on household consumption expenditure. A one percent increase in VAT leads to an approximate decline of 0.142 percent in consumption in the short run.

Similarly, rising inflation reduces consumption by about 0.273 percent. Per capita income maintains a positive and significant short-run relationship with consumption. The coefficient of 0.314 indicates that increases in income quickly translate into higher spending by households. The error correction term is negative and statistically significant, which confirms the presence of a stable adjustment process toward long-run equilibrium. The coefficient of -0.619 indicates that about 62 percent of any short-run disequilibrium is corrected within one period.

5. Conclusion and Recommendations

This study examined the effect of Value Added Tax (VAT) on household consumption expenditure in Nigeria, with particular attention to the roles of per capita income and inflation. The empirical findings provide important insights into the determinants of household consumption behaviour in the country.

The results reveal that VAT exerts a negative influence on household consumption expenditure. However, its long-run effect is relatively weak, suggesting that although increases in VAT may slightly reduce household spending through higher prices, the magnitude of this effect is insufficient to significantly alter long-term consumption patterns. This finding implies that VAT functions primarily as a revenue-generating instrument rather than an effective policy tool for influencing consumer demand.

The study further identifies per capita income as the most important determinant of household consumption expenditure. The strong and positive relationship between income and consumption in both the short and long run indicates that increases in household income substantially enhance spending capacity. This finding is consistent with Keynesian consumption theory, which emphasizes income as the principal factor influencing consumption behaviour. The result suggests that policies aimed at raising household earnings, creating employment opportunities, and improving productivity are likely to stimulate consumption and promote economic growth.

Inflation was also found to exert a negative effect on household consumption expenditure, particularly in the short run. Rising prices reduce the purchasing power of households and limit their ability to maintain previous levels of consumption. Although the adverse effect of inflation weakens over time as households adjust their spending behaviour, the results underscore the importance of maintaining price stability as a prerequisite for sustainable consumption growth and economic welfare.

Based on the findings of the study, the following policy recommendations are proposed:

- i. Policymakers should regard Value Added Tax (VAT) primarily as a reliable and sustainable source of government revenue rather than as a short-term tool for influencing household consumption behaviour. Since changes in VAT rates may not significantly affect consumption expenditure, frequent adjustments to the tax rate should be approached with caution to avoid unnecessary disruptions to economic activities.
- ii. Government should implement policies aimed at increasing household income through employment generation, investment promotion, and productivity enhancement. Particular attention should be given to strategic sectors such as agriculture, manufacturing, and services, as improvements in these sectors can raise household earnings, stimulate aggregate demand, and support sustainable economic growth.
- iii. Given the significant influence of inflation on household consumption expenditure, maintaining price stability should remain a key macroeconomic policy objective. Effective coordination between fiscal and monetary authorities is necessary to control inflationary pressures, preserve the purchasing power of households, and create a stable economic environment conducive to consumption and investment.
- iv. agencies should establish mechanisms for continuous monitoring of taxation policies, income dynamics, and consumption patterns. Improved data collection, management, and analysis will enhance the quality of economic planning, facilitate evidence-based policymaking, and enable timely policy adjustments in response to changing economic conditions.

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