THE EFFECT OF VALUE ADDED TAX (VAT) ON CONSUMPTION AND SAVING PATTERNS OF WOLAYTA SODO TOWN HOUSEHOLDS, ETHIOPIA.


&

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Abstract

This study has been conducted having the objective of on “the effect of value added tax” on consumption and saving patterns of Wolaita Sodo Town households. Descriptive research design has been implemented to undertake this study. The two most commonly used data collecting mechanisms (questionnaire and interview) have been used for this study by taking a sample size of 391, out of 18,837 households using stratified random sampling. One of the main rationales for taxing consumption rather than income is that it is believed that consumption taxes discourage consumption, encourage savings, investment and trade by modernizing the tax administration and thus generate higher economic growth. In addition to primary data’s collected so far, both theoretical and empirical evidence were reviewed whether VAT affects the consumption behaviour, thus VAT has a negative effect on consumption behaviour of Wolaita Sodo town households because of the fact that it discourage consumption and saving.

Keywords: VAT, Consumption and Saving Pattern.
INTRODUCTION

1.1. Background of the Study
As important sources of public revenue, taxes are very important part of the daily functioning of a government. The general idea behind the imposition of taxes by the government is generally to balance the economy in terms of the redistribution of funds and income from the rich to the poor (Mesfin and Sisay, 2009). Nowadays there is a global shift in paradigm, whereby the focus point is moving from a direct taxation policy towards an indirect taxation policy. This action led to the implementation of the Value-Added Tax (VAT). The VAT is undeniably the most accidental improvement of the last half-century with regard to taxation policy. Every country now makes use of the VAT and each year sees a new continent adopting it (Ebrill et al, 2001).

**Household** is composed of a group of people living in the same home/house/ who eat meals together (one income generating activity together) and acknowledge the authority of a man or woman who is the head of household and **Savings** is the portion of income not spent on current expenditures.

**Statement of the Problem**
The "value added tax" has been criticized as the burden as it falls on personal end-consumers of products. Some critics consider it to be a regressive tax, meaning that the poor pay more, as a percentage of their income, than the rich do. Defenders argue that relating taxation levels to income is an arbitrary standard, and that the value added tax is in fact a proportional tax in that people with higher income pay more on the basis of their consumption.

**Research Questions**
This study is aimed to answer the following basic questions.

- What effect does VAT had on the aggregate consumption of households in WolaitaSodo town?
- Is there any change in saving behaviour after VAT implementation among households in WolaitaSodo town?
- Is there any awareness of VAT and its rules among the households of Wolaita Sodo town?

**General objective**
The general objective of the study is to know the effect of Value Added Tax (VAT) on consumption and saving pattern of Wolaita Sodo Town households.
Specific objectives

- To assess the changes in consumption pattern of the households after implementation of VAT.
- To assess the awareness of households towards of VAT Implementation.
- To assess the influences of VAT on Households saving pattern in Wolayita Sodo Town.

Hypothesis

- H1: The implementation of Value added tax has effect on consumption pattern of households
- H2: There is relationship between the awareness of VAT rules among households and its implementation
- H3: There is influence of VAT implementation and saving pattern of households

Significance of the study

This research could be important for various concerned bodies. The study focuses on assessing the effect of value added tax on consumption and saving pattern of Wolaita Sodo town households so; the study contributes some useful insights to policy makers of Ethiopia.

Scope of the study

The study focuses on identifying the effect of VAT on consumption and saving pattern of households of the Wolaita Sodo town.

Limitations of the study

There is shortage of secondary data that can further make this paper suitable because of the non-availability of data and non-cooperation in every aspect of the town’s households. The researcher was used only primary data because of the newness of the program.

It is difficult to get significant data from concerned officials. However the researcher tried to overcome the challenges though tolerance and negotiation.

The study is limited to Wolaita Sodo town and the households dwelling area only.
## African countries with VAT

<table>
<thead>
<tr>
<th>Country</th>
<th>Date Introduced</th>
<th>Standard Rate (%)</th>
<th>Country</th>
<th>Date Introduced</th>
<th>Standard Rate (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ethiopia</td>
<td>2003</td>
<td>15</td>
<td>Rwanda</td>
<td>2001</td>
<td>15</td>
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<tr>
<td>Egypt</td>
<td>1991</td>
<td>10</td>
<td>South Africa</td>
<td>1991</td>
<td>14</td>
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<tr>
<td>Gabon</td>
<td>1995</td>
<td>18</td>
<td>Sudan</td>
<td>2002</td>
<td>10</td>
</tr>
<tr>
<td>Ghana</td>
<td>1998</td>
<td>10</td>
<td>Tanzania</td>
<td>1998</td>
<td>20</td>
</tr>
<tr>
<td>Guinea</td>
<td>1996</td>
<td>18</td>
<td>Togo</td>
<td>1996</td>
<td>18</td>
</tr>
<tr>
<td>Kenya</td>
<td>1990</td>
<td>16</td>
<td>Tunisia</td>
<td>1998</td>
<td>18</td>
</tr>
<tr>
<td>Madagascar</td>
<td>1994</td>
<td>20</td>
<td>Uganda</td>
<td>1996</td>
<td>17</td>
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<tr>
<td>Malawi</td>
<td>1989</td>
<td>20</td>
<td>Zambia</td>
<td>1995</td>
<td>17.5</td>
</tr>
<tr>
<td>Nigeria</td>
<td>1994</td>
<td>5</td>
<td>Mali</td>
<td>1991</td>
<td>15</td>
</tr>
<tr>
<td>Senegal</td>
<td>1980</td>
<td>20</td>
<td>Niger</td>
<td>1986</td>
<td>17</td>
</tr>
<tr>
<td>Namibia</td>
<td>2000</td>
<td>15</td>
<td>Mozambique</td>
<td>1999</td>
<td>17</td>
</tr>
<tr>
<td>Morocco</td>
<td>1986</td>
<td>20</td>
<td>Algeria</td>
<td>1992</td>
<td>20</td>
</tr>
<tr>
<td>Botswana</td>
<td>2002</td>
<td>15</td>
<td>Burkina Faso</td>
<td>1963</td>
<td>18</td>
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<td>Benin</td>
<td>1991</td>
<td>18</td>
<td>Cameroon</td>
<td>1999</td>
<td>18</td>
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<td>Chad</td>
<td>2000</td>
<td>18</td>
<td>Congo republic</td>
<td>1997</td>
<td>18</td>
</tr>
<tr>
<td>Cote-Devoire</td>
<td>1960</td>
<td>20</td>
<td>Marutania</td>
<td>1995</td>
<td>14</td>
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</tbody>
</table>

*Source: Misrak Tesfaye, 2008, Ethiopian Tax Accounting Theory and Practice (pp.310-311)*
Conceptual framework

RESEARCH METHODOLOGY

Description of Study Area
The study was undertaken in Wolita Zone, Sodo town which is found in southern part of Ethiopia, at the distance of 330 Km away from Addis Ababa to the South with specific location of $6^\circ 40' - 7^\circ 10'$ North latitude and $37^\circ 40' - 38^\circ 20'$ East longitudes. Currently the town has implementing VAT collecting activities through the help of Federal Inland Revenue office Wolita Sodo branch.(Source: Wolaita zone finance and economic development statics department year 2009 E.C).

Research Design
The study was applied a descriptive research design that involves gathering much or more numbers, often via (through) surveys, to describe or measure a phenomenon so as to answer the questions of who, what, where, when, and how (Tanner and Raymond, 2010). For this study, a survey was conducted in the scope to, describe, Interpret and analyze the effect of VAT on saving and consumptions pattern of Wolaita town households. Moreover the study used both quantitative and qualitative data’s.
Source of Data

For this study, both primary and secondary data can be used. Data can be gathered mainly from primary sources using questionnaires from the town’s household of different sub cities and interview for officials and management team of IRA Wolaita Sodo branch office. Some data were collected from secondary sources including books, scholarly articles, government agencies (Ministry of Finance, MRA, CSO) online databases (World Bank, IMF), research reports, theses etc.

Total population of the households in the town

<table>
<thead>
<tr>
<th>S. No</th>
<th>Name of sub city</th>
<th>Number of households</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Arada</td>
<td>5,943</td>
</tr>
<tr>
<td>2</td>
<td>Mehal</td>
<td>5,094</td>
</tr>
<tr>
<td>3</td>
<td>Merkato</td>
<td>7,800</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td><strong>18,837</strong></td>
</tr>
</tbody>
</table>


Sample size

Thus According to Yemane (1967-886) to determine the desired sampling size, standard statistical approach equation will be used. Sample Size for ±5% Precision level where confidence level is 95% and e=0.05

Sampling procedure

The sampling method used in this study was Stratified Random Sampling – where the population is divided into three strata’s/ sub cities. The sample size is going to be taken from each sub cities;
in proportion to the number of household they hold, using simple random sampling. To share the total sample size among the strata’s/sub cities the following formula is applicable.

\[ i.e. n_i = \frac{p_i n}{N} \]

Where \( n_i \) = sample size of the sub cities

\( P_i \) = Population of each strata’s/sub cities

\( n \) = Sample size of total household population. i.e. 391

\( N \) = Total population

Table 3.2 Sample of the households from total population for the study

<table>
<thead>
<tr>
<th>S.No</th>
<th>Name of sub city</th>
<th>Number of households</th>
<th>Sample ((n_i = \frac{p_i n}{N}))</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Arada</td>
<td>5,943</td>
<td>123</td>
</tr>
<tr>
<td>2</td>
<td>Mehal</td>
<td>5,094</td>
<td>106</td>
</tr>
<tr>
<td>3</td>
<td>Merkato</td>
<td>7,800</td>
<td>162</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>18,837</td>
<td>391</td>
</tr>
</tbody>
</table>

. Recommendations

- By Judging from the results of this study it seems that respondents received less information and promotions from the relevant authorities. Many people still unsure on how the VAT will be implemented. The government should promote VAT more through media so that people are ready for the effects.
- Secondly, due to less information, in current people’s mindset, Value added will increase goods prices. Therefore, the government should convince that VAT will not increase goods prices significantly and if VAT increases the prices, the government should have alternatives planning to reduce the burden of lower and middle income earners such as lowering the income tax rates or increasing exemptions for individuals.
- Thirdly, as this study suggested that people’s consumptions and saving behaviour would change significantly due to the implementation of VAT, it is believed that respondents would be more prudence and selective in their purchasing behaviour. This would potentially distort the economic growth particularly on aggregate demand.
The country ERCA authority should implement the VAT in near future as an alternative approach to increase the government revenues although at the early stage of implementation there would be many operational problems and acceptance issues from various parties such as traders and consumers.

Conclusions.
Generally speaking, it is widely believed that for the implementation of VAT to go down well with Consumers, the scheme has to come with some compensatory measures such as the reduction of income taxes to put more money in the pockets of households and to boost their purchasing power. And to ensure that the low-income and poor consumers – who may not enjoy the benefits of lower income taxes as most likely they are already exempted from such payment in the first place - are not worse off with VAT, zero-rating some basic essential products and providing other targeted assistance programmes are necessary measures to help them.

References
5. Baunsgaard, T. & Keen M 2005, "Tax Revenue and (or?) Trade Liberalization", IMF Working Paper No. 05/112
19. MisrakTesfaye, 2008, Ethiopian Tax Accounting Theory and Practice (pp.310-311)