Journal of Economics, Finance and Management Studies

ISSN (print): 2644-0490, ISSN (online): 2644-0504

Volume 07 Issue 04 April 2024

Article DOI: 10.47191/jefms/v7-i4-20, Impact Factor: 8.044

Page No: 1943-1957

Assessing the Impact of Value Added Tax (VAT) On Government Revenue in Zambia

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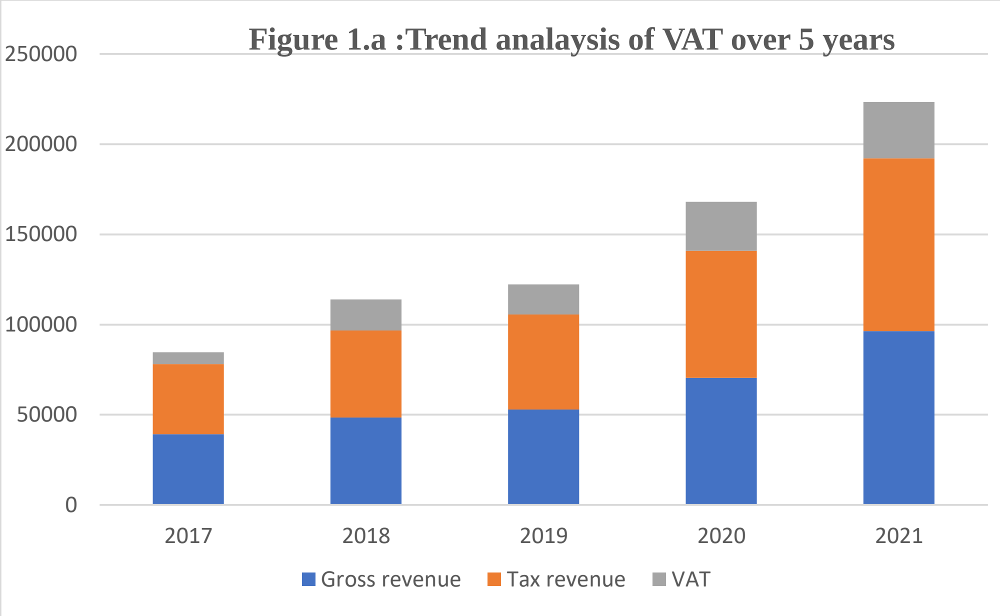
ABSTRACT: This research aimed to assess the impact of Value Added Tax (VAT) on government revenue collection. The study employed a mixed methods research design, which combines both qualitative and quantitative methodologies. The study focused on a population of 500 management-level employees at the Zambia Revenue Authority and Ministry of Finance. Seeing that the study was heavy on qualitative approach and had specific type of cadre to provide the necessary information, a sample of 30 respondents was utilized which was purposively sampled. The secondary sources on the other hand mainly involved published documentation such as reports obtained from Zambia Revenue Authority official website and journals that provided the conceptual framework and a definite meaning to the topic. Regarding the effect of VAT on Government revenue, the study revealed that an increase in VAT rate may lead to higher VAT revenue, assuming a stable level of compliance. With regard to effect of VAT on consumer behavior, it was established that when VAT rates are elevated in Zambia, the prices of a wide array of goods and services subject to VAT increase accordingly, hence consequently, higher VAT rates can drive consumers to opt for saving or investing their money rather than immediate spending. This may simultaneously lead to a reduction in consumer spending, potentially impeding economic growth. As regards to ascertaining measures to address challenges related to VAT collection, findings indicated that effectiveness of VAT is contingent upon addressing the challenges inherent in VAT collection, optimizing VAT rate policies, and adapting the system to the country's unique economic context. The study offers several recommendations, including: improving tax administration through the Zambia Revenue Authority (ZRA); combating tax fraud and evasion; simplifying VAT regulations; enhancing taxpayer education and awareness; carefully considering exemptions and thresholds; and implementing monitoring and evaluation mechanisms for VAT revenue. Further study is recommended to explore the informal economy's role in VAT collection in Zambia and its implications

KEYWORDS: Government Revenue, Value Added Tax, VAT Compliance, Net Tax Revenue, Economic Growth

1.0 INTRODUCTORY BACKGROUND

Undoubtedly, Value Added Tax (VAT) stands as a cornerstone of Zambia's tax system, playing a pivotal role in the government's revenue generation efforts. Over the years, Zambia, like many countries, has recognized the significance of VAT as a stable source of income to fund public services and infrastructure development (World Bank, 2022). The revenue generated from VAT contributes substantially to the government's budget, enabling it to fulfil its obligations to citizens, such as providing healthcare, education, and infrastructure development.

The tax system plays a pivotal role in both bolstering government revenue and shaping economic policy on the national scale. Review of Zambia Revenue Authority (ZRA) annual reports for period 2021 to 2017 revealed the following trend in VAT performance;



Source: Tax Statistics in Zambia, ZRA

As can be seen from above figure 1.a, Value Added Tax (VAT) contributes significantly to gross revenue collected, and notably to gross tax revenue collected, hence the need to address policy matters that surround its collection as it can affect general performance of government revenue if not well addressed.

Taxation policies serve diverse purposes, ranging from internalizing externalities and income redistribution to addressing market failures, incentivizing merit-worthy consumption, and discouraging the consumption of demerit goods (Chanda, 2018). On a macroeconomic level, taxes serve as a dual instrument: they can promote favorable economic outcomes like full employment, price stability, and balanced trade while also serving as a safeguard against undesirable outcomes such as inflation and unemployment.

An effective tax system exhibits intergenerational equity by ensuring that the current generation bears the cost of non-durable public goods, rather than passing it onto future generations (Gerald and Naritomi, 2018). Amid the optimism surrounding Africa's economic expansion and the anticipated rise in living standards in the twenty-first century, it's imperative to acknowledge that these advancements hinge significantly on increased public investments (Sijbren, 2015).

In the global context, nations predominantly rely on tax revenue to fund essential infrastructure, support defense and law enforcement, construct vital infrastructure like dams and roads, operate educational institutions, and provide healthcare services, among other critical functions. Taxes are generally categorized into direct and indirect taxes. Direct taxes are levied directly on taxpayers, while indirect taxes are imposed indirectly through the purchase of goods and services (Misrak, 2018).

On a national scale, the tax system reflects a country's economic priorities, political ideologies, and historical context. Zambia serves as a pertinent example. Despite its vast mineral resources, Zambia relies heavily on external funding for essential governmental functions (World Bank, 2021). The government's commitment to poverty eradication and democratic development is contingent on expanding domestic resource mobilization through tax reforms (IMF, 2020). Notably, Zambia has adopted VAT as an integral component of its tax system, mirroring a global trend in VAT adoption (ZRA, 2021).

In the quest for effective fiscal management and economic stability, Zambia has periodically considered changes in VAT rates (ZRA, 2021). VAT rate adjustments involve deliberations on whether to increase, decrease, or maintain existing rates. These changes are not merely administrative; they have profound implications for government revenue, economic behavior, and the welfare of the population.

VAT rate increases, for example, may lead to higher government revenue in the short term, but they can also impose a burden on consumers by raising the cost of goods and services (IMF, 2020). This, in turn, can influence consumer spending patterns, potentially impacting various sectors of the economy. On the other hand, reducing VAT rates may stimulate consumer spending and economic growth but might require careful consideration to ensure that government revenue remains stable.

The decision to alter VAT rates is complex and multifaceted (IMF, 2020). It must take into account the delicate balance between revenue generation, economic growth, and equity. Changes in VAT rates can affect businesses, consumers, and government finances, making it crucial to analyse their impact comprehensively.

In view of the above, this study endeavours to provide an in-depth examination of the effects of VAT rate changes on government revenue in Zambia. By delving into historical data, utilizing robust analytical methods, and assessing the socio-economic implications of such changes, this research aims to contribute valuable insights. Ultimately, the findings will be instrumental for policymakers, economists, and stakeholders in making informed decisions regarding VAT rate adjustments, ensuring fiscal sustainability, and promoting economic well-being in Zambia. The study acknowledges the importance of striking the right balance between revenue generation and economic development while maintaining a fair and equitable tax system for the Zambian populace.

1.1 Statement of Problem

Between the years 2017 and 2019, The Government of Zambia made policy shifts from VAT to Sales Tax, and back to VAT IN 2019. (2019,2020 budget speech). The Zambia Revenue Authority lamented struggles with VAT refunds, which they hoped Sales Tax would resolve. (F. Banda & M Kalikeka 2019). A well-structured tax system should fulfill two principles of efficiency and equity (K Shula, 2018). Incomplete reforms in VAT have done more harm than good in evolving a tax system, hence importance to assess consequences before implementation.

The global significance of tax systems for government revenue and economic policy necessitates a keen understanding of the multifaceted implications associated with Value Added Tax (VAT) rate adjustments (Chanda, 2018). This is particularly crucial in Zambia, where VAT plays a central role in the country's revenue streams. As Zambia strives for poverty eradication, democratic development, and improved governance, the effectiveness of VAT rate changes becomes paramount in achieving these overarching goals (ZRA, 2021).

While the potential short-term benefits of VAT rate increase in bolstering government revenue are acknowledged, there is a simultaneous concern about the burden placed on consumers through elevated costs of goods and services. This dynamic interplay between revenue enhancement, economic growth stimulation, and maintaining fairness in the tax system poses a challenging decision-making landscape for policymakers.

Conversely, lowering VAT rates may stimulate consumption and economic growth, but the fiscal implications demand meticulous scrutiny to ensure revenue stability. The ripple effects of these changes extend to consumer spending patterns and various sectors of the economy (IMF, 2020). In the context of Zambia, where equity and fairness in taxation are pivotal considerations, the consequences of VAT rate adjustments carry far-reaching implications for the well-being of the populace.

Despite the evident importance of comprehending the impact of VAT rate adjustments in Zambia, there exists a notable knowledge gap, hindering informed decision-making by policymakers, economists, and other stakeholders (Gerald and Naritomi, 2018). To address this critical gap, the study aimed to conduct a comprehensive and empirical analysis, shedding light on the effects of VAT rate changes on government revenue in Zambia. By delving into the intricate dynamics of fiscal management and socio-economic well-being, this research aspired to provide valuable insights for informed policy decisions, fiscal sustainability, and the advancement of economic prosperity in the Zambian context.

1.2. Study Objectives

a) Assessing the impact of Value Added Tax (VAT) on government revenue collection.
b) Assessing the impact of Value Added Tax (VAT) on consumer behaviour.
c) Ascertaining measures to address Value Added Tax (VAT) collection challenges in Zambia.

2. LITERATURE REVIEW

2.1. Introduction

Value Added Tax (VAT) is a globally recognized indirect taxation system, currently in use in more than 150 nations (Brown & Gale, 2012). Research indicates that because VAT is a successful method of raising funds and modernizing the whole tax system, it has gained tremendous recognition and popularity around the world (Ebrill et al, 2001). Though the value-added tax (VAT) is very popular among politicians and policymakers, it has a number of flaws that, like other tax types, have caused a gap between an economy's potential VAT income and its actual VAT revenue generated during a given accounting period.

According to Bhartia (2009), VAT has several benefits, including administrative ones (easier to determine tax due), tax efficiency (conduciveness), and encouraging export to gain a competitive advantage over other countries. VAT has drawbacks, including double taxation and firms abusing it to artificially raise costs for products and services, which ultimately hurts consumers financially. As the VAT rises, the government's revenue might potentially grow, but residents' purchasing habits could potentially drop. Zambia applies the Value Added Tax (VAT) at a standard rate of 16%, constituting a significant portion, approximately one-third, of the country's total tax revenue. The collection of VAT presents several challenges that governments and tax authorities need to address. Tax evasion and fraud pose significant challenges to VAT collection. Businesses may engage in various illegal practices to avoid paying VAT, such as underreporting sales, overclaiming input tax credits, or operating in the shadow economy. These activities reduce the amount of VAT collected by the tax authorities and undermine the fairness and integrity of the tax system (McLaren, 2016). The informal economy, comprising unregistered and cash-based activities, poses a significant challenge to VAT collection. Informal businesses often operate outside the tax net, resulting in lost VAT revenue for governments (Perry et al., 2018). Factors such as limited access to formal financial services, lack of awareness about VAT obligations, and weak enforcement capacity contribute to the prevalence of the informal economy. Addressing these challenges requires measures such as targeted outreach and education campaigns, simplified registration procedures, and increased use of digital payment systems (IMF, 2019). Efforts to combat tax evasion and fraud require effective enforcement measures, such as increased audits, improved data analytics, and enhanced collaboration between tax authorities and other agencies (Keen & Smith, 2018). VAT systems can be complex, with multiple rates, exemptions, and special schemes, making compliance challenging for businesses. Small and medium-sized enterprises (SMEs) often face difficulties in understanding and fulfilling their VAT obligations due to the administrative burden associated with VAT compliance (Cnossen, 2017). Complex VAT rules and regulations increase the likelihood of errors and non-compliance, leading to revenue leakage. Simplification measures, such as reducing the number of VAT rates and exemptions, can help mitigate these challenges (Bird & Zolt, 2019). The international nature of trade presents specific challenges for VAT collection. Cross-border transactions can create opportunities for VAT avoidance and evasion, particularly through invoice manipulation or the use of offshore tax havens. Divergent VAT rules across countries and difficulties in coordinating enforcement efforts pose additional challenges (Devereux & Freeman, 2017). International cooperation and harmonization of VAT rules, as well as the use of technology solutions such as electronic invoicing and real-time reporting, can enhance the collection of VAT in cross-border transactions (OECD, 2017).

2.2 Empirical review

There are a number of studies that have been undertaken on this study. Value-added tax (VAT) is a type of consumption tax that is commonly used by many countries around the world to generate revenue for the government. For instance, Abubakar (2020) studied the impact of VAT on government revenue. Abubakar analyzed the impact of VAT on government revenue in Nigeria using econometric techniques and found that VAT revenue is positively related to government revenue. Abubakar also found that a 1% increase in VAT rate leads to a 0.08% increase in government revenue (Abubakar, 2020).

Consequently, Mukhtar & Ismail, (2020) conducted research on the impact of VAT on government revenue in Pakistan. They found that VAT has a positive impact on government revenue and contributes significantly to the country's tax revenue. They also identified some challenges associated with VAT administration, such as the complexity of the VAT system, weak enforcement, and tax evasion (Mukhtar & Ismail, 2020).

In their 2018 study, Lakuma and Sserunjogi utilized a top-down approach to analyze the Value Added Tax (VAT) gap in Uganda. The empirical findings revealed a compliance gap ranging between 39 percent and 30 percent of potential VAT revenues for the period 2009/10–2016/17, peaking in 2010/11. This estimated gap exceeded typical levels observed in Sub-Saharan countries and approached those in Latin American nations. Specifically, the compliance gap surged to 64 percent of potential VAT revenue in 2010/11. The study also identified that the VAT policy gap, including the portion explained by tax expenditures like exemptions and reduced rates, was lower than the VAT compliance gap in Uganda. Over the years, the VAT c-efficiency ratio in Uganda exhibited an increasing trend from 25.9 percent in 2009/10 to 31.9 percent in 2016/17, attributed to reductions in both the compliance and policy gaps.

In 2018, Malik, Mihm, and Timme conducted a laboratory experiment to assess the impact of Anti-Avoidance Tax Rules on overall tax compliance. Employing statistical techniques, the study found that while Anti-Avoidance Tax Rules effectively reduced tax avoidance, there was a substitution effect leading to an increase in tax evasion. The results indicated that this substitution effect diminished the effectiveness of Anti-Avoidance Tax Rules in lowering the tax gap. Despite a decrease in aggressive tax planning practices, the potential increase in tax revenues was offset by a rise in tax evasion in response to the introduction of Anti-Avoidance Tax Rules.

Houssa, Megersa, and Nikiema's 2017 study aimed to analyze the performance of Value-Added Tax (VAT) in Benin and Burkina Faso. Using data from twenty key sectors in each country over the 1999-2014 period, the study identified inefficiencies in sectors such as agriculture, sales, agro-food industries, transport, post offices, telecommunication, construction, public administration, and other service sectors as the main contributors to Benin's VAT gap. In Burkina Faso, public administration played a more dominant role in contributing to the VAT gap compared to Benin. The study observed an increasing compliance gap over time in Burkina Faso, whereas in Benin, there was a reverse trend. Despite these differences, the sectorial sources of the VAT gap were found to be similar in both countries

Al-Mutairi (2016) examined the impact of VAT on government revenue in Kuwait. The study used a time-series data analysis approach to evaluate the effects of VAT on government revenue. The findings showed that VAT had a significant positive impact on government revenue in Kuwait. The author suggested that this could be attributed to the broad-based nature of VAT, which captures a wider range of economic activities than other forms of taxes.

Another study by Al-Mulali and Sheau-Ting (2015) investigated the impact of VAT on government revenue in 128 countries from 1995 to 2012. The study used panel data analysis and found that VAT had a significant positive impact on government revenue in these countries. The authors suggested that this could be attributed to the efficiency of VAT, as it is less prone to tax evasion than other forms of taxes.

Similarly, a study by Liew and Liew (2018) examined the impact of VAT on government revenue in Malaysia. The study used a time-series data analysis approach and found that VAT had a significant positive impact on government revenue in Malaysia. The authors suggested that this could be attributed to the ability of VAT to capture a wider range of economic activities and its ability to generate revenue without significantly affecting the behavior of taxpayers.

A study by Mwega and Mutulei (2015) investigated the impact of VAT on government revenue in Kenya. The study used a time-series data analysis approach and found that VAT had a significant positive impact on government revenue in Kenya. The authors suggested that this could be attributed to the efficiency of VAT in capturing a wider range of economic activities and the ability of the government to administer VAT more effectively than other forms of taxes.

Rahman et al. (2018) conducted a study on the impact of VAT on government revenue in Bangladesh. The study found that the introduction of VAT had a positive impact on government revenue, as it increased the tax base and improved tax compliance.

Kimani and Odhiambo (2017) conducted a study on the impact of VAT on government revenue in Kenya. The study found that VAT had a positive impact on government revenue, as it generated significant amounts of income for the government and helped to reduce the budget deficit.

Nwokolo and Okafor (2018) conducted a study on the impact of VAT on government revenue in Nigeria. The study found that VAT had a positive impact on government revenue, as it generated significant amounts of income for the government and helped to reduce the budget deficit.

Azimi et al. (2018) conducted a study on the impact of VAT on government revenue in Iran. The study found that VAT had a positive impact on government revenue, as it generated significant amounts of income for the government and helped to reduce the budget deficit.

Salti and Chabaan (2010) focused on poverty and inequality in order to examine the impact of a rising VAT rate. A scientific model based on consumer theory of demand was developed to investigate the effects. According to the results of the simulation, the higher VAT rate will significantly worsen poverty. Even though the increased rate would hurt total consumption, it would have a greater impact on the poor than the affluent. By regressing tax revenue on GDP, Koester and Kormendi (2009) calculated the average and marginal income tax rates, then included the results in a growth regression. No statistically significant correlation between taxes and economic growth was found. Additionally, they discovered that tax rates appear to have a detrimental effect on the level of activity.

Michael and Ben (2007) used a panel analysis of 143 nations over 25 years to look into the reasons for and effects of the growth of value-added tax (VAT). The outcome demonstrated that VAT has a sizable but uneven influence. It means that certain nation-states would have made more money from the implementation of VAT than others. The introduction of VAT led to a cumulative long-term rise in the revenue to GDP ratio of roughly 4.5%. The benefits of acting in the other way tend to be greater in higher income and more open economies but allowing the impact of VAT to fluctuate depending on nation details will alter the effect to become negative.

In conclusion, several authors have conducted research on the impact of VAT on government revenue in different countries. These studies have consistently found that VAT has a positive impact on government revenue and contributes significantly to the tax revenue of countries. However, there are challenges associated with VAT administration, such as non-compliance by taxpayers, weak enforcement, and tax evasion, which need to be addressed to maximize VAT's revenue generation potential.

2.3 Literature Gap

The existing literature on the impact of Value Added Tax (VAT) on government revenue has been conducted in various countries, but a notable gap exists in the context of Zambia. While studies in Kuwait, Malaysia, Kenya, Bangladesh, Nigeria, Iran, and Pakistan have generally found a positive association between VAT and government revenue, there is a lack of comprehensive research that specifically examines how VAT rate changes influence government revenue in Zambia. This gap is significant due to potential contextual differences, unique policy implications, equity considerations, administrative challenges, and macroeconomic consequences specific to Zambia. Addressing this gap through dedicated research would provide tailored insights and recommendations to inform Zambia's fiscal policies and decision-making processes.

2.3 Theoretical Framework

Three theories have been identified to guide this study.

2.3.1 Fiscal Adequacy or Productivity

The fiscal adequacy or productivity theory is a fiscal policy concept that suggests that government revenues should be sufficient to finance public expenditure needs effectively. The theory posits that tax policies must be geared towards raising sufficient revenue to finance government expenditure programs. In other words, the theory suggests that the tax system should be productive enough to generate enough revenue to meet the government's budgetary requirements.

In the case of the impact of VAT on government revenue, the fiscal adequacy theory suggests that VAT should be an effective revenue-generating instrument for the government. VAT is a consumption tax levied on the value added at each stage of production and distribution of goods and services. It is collected at every stage of the supply chain, making it a reliable source of government revenue.

According to Ngele, Edeh, and Okoro (2021), VAT has a significant impact on government revenue in Nigeria. The authors noted that VAT revenue has grown significantly over the years and has become an important source of government revenue. The authors attributed the growth in VAT revenue to the increased coverage of the tax base and the effectiveness of tax administration.

Similarly, Adesina, Adewuyi, and Adebisi (2021) noted that VAT has been an important source of revenue for the Nigerian government. The authors observed that VAT has contributed significantly to the government's revenue, and its impact has been felt in various sectors of the economy. The authors further noted that the effectiveness of the tax administration and the coverage of the tax base have been critical to the success of VAT as a revenue-generating instrument.

Overall, the fiscal adequacy or productivity theory suggests that tax policies must be geared towards raising sufficient revenue to finance government expenditure programs. VAT has been an effective revenue-generating instrument for the Nigerian government, and its impact on government revenue has been significant. The coverage of the tax base and the effectiveness of tax administration have been critical to the success of VAT as a revenue-generating instrument.

2.3.2 Rational Choice theory

The rational choice theory is a theoretical framework used to explain how individuals make decisions in their best interest. It assumes that people act rationally and are motivated by self-interest, and that they weigh the costs and benefits of their actions before making a decision. In the context of the impact of Value Added Tax (VAT) on government revenue, the rational choice theory can be used to explain how individuals and businesses react to the implementation of VAT and how it affects government revenue (Stiglitz & Rosengard, 2015).

According to the rational choice theory, individuals and businesses will respond to the implementation of VAT by making decisions that maximize their own self-interest. If the cost of VAT is passed on to consumers in the form of higher prices, individuals may choose to reduce their consumption of goods and services that are subject to VAT (Cooter & Ulen, 2019). This can lead to a decrease in sales and profits for businesses, which may lead them to reduce their workforce or cut back on investments. As a result, the government may experience a decrease in revenue from VAT as a result of reduced economic activity.

On the other hand, businesses may also respond to the implementation of VAT by seeking to minimize their tax liability. They may choose to invest in tax planning and avoidance strategies, such as shifting their operations to jurisdictions with lower tax rates or engaging in transfer pricing (Cooter & Ulen, 2019). This can result in a decrease in government revenue from VAT, as businesses seek to minimize their tax burden.

Despite these potential negative effects, the rational choice theory also suggests that the implementation of VAT can have positive effects on government revenue. For example, VAT can provide a stable source of revenue for governments, as it is collected at each stage of production and distribution (Stiglitz & Rosengard, 2015). This can provide a more predictable source of revenue for governments, which can be used to fund public services and investments (Cooter & Ulen, 2019).

Overall, the rational choice theory suggests that the implementation of VAT can have both positive and negative effects on government revenue, depending on how individuals and businesses respond to it. While it can provide a stable source of revenue for governments, it can also lead to reduced economic activity and tax avoidance strategies by businesses. Therefore, policymakers must carefully consider the potential impacts of VAT on different stakeholders before implementing it as a policy tool for generating government revenue.

2.3.3 Compliance theory

Compliance theory is a theoretical framework that explains why individuals and organizations comply with laws and regulations. In the context of taxation, compliance theory seeks to understand why taxpayers pay their taxes and how tax authorities can increase compliance. This theory has been applied to various tax regimes, including Value Added Tax (VAT).

According to the compliance theory, taxpayers comply with tax laws when they perceive the tax system to be fair and legitimate, and when the costs of non-compliance outweigh the benefits. In the case of VAT, taxpayers are more likely to comply when they believe that the tax system is transparent and easy to understand, and when they perceive that the revenue generated from VAT is being used for the public good.

Several studies have explored the impact of VAT on government revenue, using compliance theory as a theoretical framework. For example, a study by Baskaran and Feld (2013) found that higher VAT rates lead to lower compliance rates, as taxpayers are more likely to evade taxes when the costs of compliance outweigh the benefits. However, the study also found that taxpayers are more likely to comply when they perceive that the revenue generated from VAT is being used for public goods, such as infrastructure and social services.

Another study by Alm et al. (2019) found that compliance with VAT is influenced by various factors, including trust in government, the complexity of the tax system, and the perceived fairness of the tax system. The study also found that tax authorities can increase compliance by providing information and education about the VAT system, by simplifying the tax system, and by ensuring that the revenue generated from VAT is used effectively.

Overall, compliance theory provides a useful framework for understanding the impact of VAT on government revenue. Taxpayers are more likely to comply with VAT when they perceive the tax system to be fair and legitimate, and when they believe that the revenue generated from VAT is being used for public goods. Tax authorities can increase compliance by providing information and education about the VAT system, by simplifying the tax system, and by ensuring that the revenue generated from VAT is used effectively.

3.3 Theoretical Implication

This study adopted all the three theories on the basis that the fiscal adequacy or productivity theory emphasizes the need for government revenues to effectively cover public expenditure requirements. In the context of Value Added Tax (VAT) and its impact on government revenue, this theory suggests that VAT should serve as a reliable revenue source for the government due to its efficiency and broad coverage. Studies in Nigeria by Ngele, Edeh, and Okoro (2021) and Adesina, Adewuyi, and Adebisi (2021) affirm VAT's substantial contribution to government revenue, attributing this success to an expanding tax base and efficient tax administration. Overall, the fiscal adequacy theory underscores the importance of tax policies that generate sufficient revenue to meet government budgetary needs, with VAT proving effective in this regard.

Consequently, the rational choice theory, applied to the context of VAT, explores how individuals and businesses make decisions based on self-interest when confronted with the implementation of VAT and how it subsequently affects government revenue. Individuals may respond to VAT by reducing consumption of taxed goods due to price increases, potentially leading to decreased sales and profits for businesses. On the other hand, businesses may employ tax planning and avoidance strategies to minimize their tax liability, further affecting government revenue. Nevertheless, rational choice theory also acknowledges VAT's positive attributes, such as providing a stable revenue source through its collection at multiple production stages. Policymakers must carefully consider these potential positive and negative impacts on government revenue when implementing VAT.

The compliance theory delves into the reasons behind individuals and organizations adhering to tax laws and regulations. In the context of VAT, taxpayers are more likely to comply when they perceive the tax system as fair, transparent, and beneficial. Studies, like one by Baskaran and Feld (2013), have indicated that higher VAT rates may lead to lower compliance due to the perceived imbalance between compliance costs and benefits. However, trust in government, the complexity of the tax system, and the perceived fairness of the system also influence compliance. Tax authorities can enhance compliance by providing information, simplifying the tax system, and ensuring that VAT revenue is effectively utilized for public goods. In summary, compliance theory offers insights into how VAT can impact government revenue through taxpayer behavior and the role of fairness and transparency in fostering compliance.

2.4. Conceptual Framework

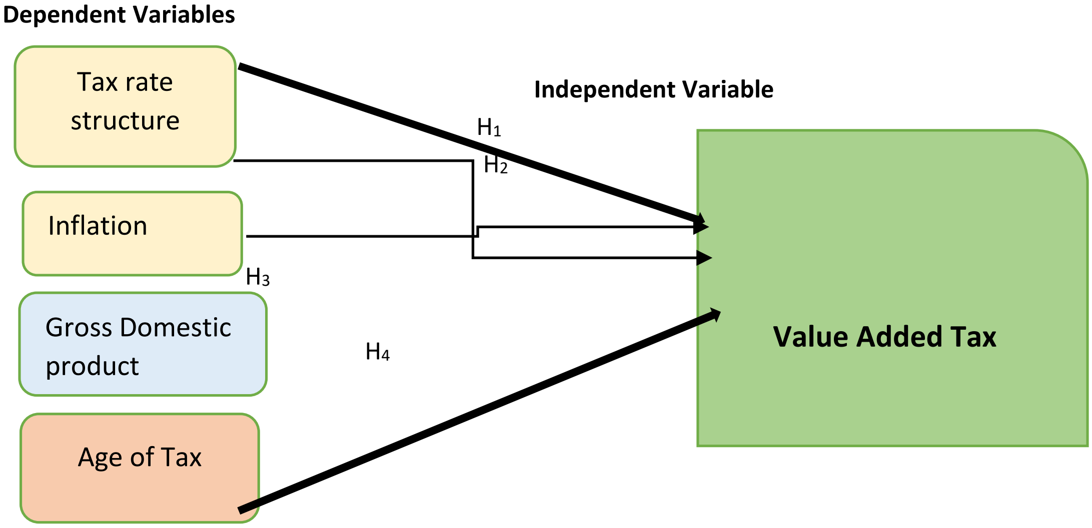


Figure 3.4: Conceptual Framework

As shown in ***Figure 3.4*** above, three variables also referred to as determinants aligned to the research objectives guide this study. Determinants of revenue collections refer to the factors or variables that influence the amount of revenue a government or organization collects over a specific period. These determinants can vary depending on the context, but they typically include economic, demographic, institutional, and policy-related factors (Chanda & Kasanda, 2018). Understanding these determinants is crucial for policymakers, tax authorities, and organizations as it helps them make informed decisions and formulate effective revenue generation strategies. The impact of the tax rate structure on revenue collections is influenced by several factors, such as the elasticity of taxable income, compliance behavior of taxpayers, and the overall economic conditions. Taxpayers' responses to tax rate changes can affect revenue collections. For example, high marginal tax rates can create disincentives for individuals to work or invest, potentially reducing taxable income and overall revenue collections. Research by Feldstein (1995) suggests that changes in tax rates can have significant effects on taxpayer behavior and consequently influence revenue outcomes. Although the VAT is either non-inflationary or deflationary, time is crucial when applying the tax. Practical knowledge suggests that the VAT should not be implemented while inflation is on the rise; otherwise, the VAT would be mistakenly viewed as inflationary and become difficult to sell to the general people (Le, 2003). The "European model," which has a consumption base, tax credits based on invoices, a single rate rather than multiple rates, a single, relatively high turnover threshold, a broad base with few exemptions to prevent distorting purchase (input) decisions and to provide transparency, use of the destination principle (Devereux, 1996) whereby exports are zero rated and imports are taxed, and the "single, relatively high threshold" regarding turnover are the main characteristics followed by the majority of (Jones & Johnson, 2019). A VAT with a single rate and no exemptions is likewise preferred by the majority of tax professionals, partly because it decreases evasion and makes administration and compliance more affordable and simpler (Jones & Johnson, 2019).

It is important to note that while GDP growth generally leads to higher revenue collections, the relationship is not entirely linear. Other factors such as tax policies, tax rates, economic structure, and the efficiency of revenue administration systems can also influence revenue collections. Additionally, economic downturns or recessions can temporarily decrease revenue collections despite a high GDP, as unemployment and reduced economic activity impact tax revenues negatively

However, the relationship between GDP and revenue collection is not always straightforward. Other factors such as tax policy, tax administration efficiency, and tax compliance rates can also influence revenue collections (Alemayehu & Hailemariam, 2019). For instance, even in high GDP countries, if the tax policies are not effective, the government may not be able to collect sufficient revenue. Similarly, if the tax administration is inefficient, revenue collection may not match the potential even in high GDP countries.

Overall, Gross Domestic Product is a key determinant of revenue collections for governments. As GDP grows, the potential for revenue collection also grows, as there are more goods and services to tax, and more people earning taxable income. However, other factors such as tax policy, tax administration efficiency, and tax compliance rates can also play a significant role in revenue collection. One determinant affected by the age of tax is taxpayer compliance. Over time, taxpayers become more familiar with the tax laws and regulations, leading to increased compliance. As the age of tax increases, taxpayers have a better understanding of their tax obligations, including reporting requirements, deductions, and exemptions (Jones & Johnson, 2019)

3. METHODOLOGY

The study employed a mixed methods research design, which combines both qualitative and quantitative methodologies. The study focused on a population of 500 management-level employees at the Zambia Revenue Authority and Ministry of Finance. Seeing that the study was heavy on qualitative approach and had specific type of cadre to provide the necessary information, a sample of 30 respondents was utilized which was purposively sampled. As regards to how a researcher determines a sample size in qualitative research, Creswell (2012) gives salient insights. He states: "It is typical in qualitative research to study a few individuals or a few cases. This is because the overall ability of a researcher to provide an in-depth picture diminishes with the addition of each new individual or site. In some cases, you might study a single individual or a single site. In other cases, the number may be several, ranging from 1 or 2 to 30 or 40." Previously, it has been recommended that qualitative studies require a minimum sample size of at least twelve (12) participants to reach data saturation (Clarke & Braun, 2013; Fugard & Potts, 2014; Guest, Bunce, & Johnson, 2006). In view of the above, the sample size for this study was 30 participants (fifteen from ZRA and 15 from MoF). It is believed that this sample will be adequate for this type of study and will achieve data saturation. The study used a structured interview guide to collect both quantitative and qualitative data in order for the study to yield in-depth results on the topic under investigation. However, the study adopted both primary and secondary sources of data in order to accomplish the study objectives. The secondary sources on the other hand involved published and unpublished documentations such as reports from Zambia Revenue Authority official website and journals that provided the conceptual framework and a definite meaning to the topic. Qualitative data was analysed using content analysis whereas quantitative data was analysed using Microsoft Excel and SPSS version 21.

4. FINDINGS

4.1 Effect of Zambia's current VAT Collection on Government revenue

A meticulous analysis by UNICEF on Zambia's Budget brief for the year 2023 unveiled interesting findings as far as VAT contribution to the country's revenue collection. Specifically, VAT collections have experienced a substantial increase of 27.5 percent, amounting to ZMW 29.2 billion in the fiscal year 2023. This represents a significant upswing from the K22.9 billion figure outlined in the 2022 Budget.

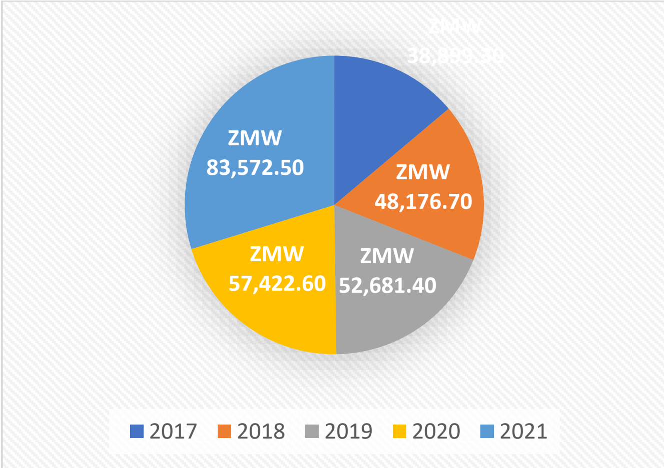
This notable increase in revenue can be primarily attributed to the decision to apply the standard VAT rate to the supply of petrol and diesel. The expansion of VAT coverage to these essential energy sources has significantly bolstered the government's revenue inflow.

Furthermore, as part of efforts to enhance VAT compliance and streamline tax administration, there is a proposed rollout of Electronic Fiscal Devices (EFDs). These devices are expected to revolutionize the tracking and reporting of VAT transactions, minimizing tax evasion and improving overall compliance.

In essence, this surge in VAT collections, driven by the broadening of the tax base and the introduction of EFDs, represents a pivotal development in Zambia's fiscal landscape. It underscores the government's commitment to strengthening revenue generation while ensuring a more transparent and efficient tax system.

Furthermore, the budget for the year 2023 outlines several tax adjustments with the specific objective of fostering growth within the agricultural sector. In alignment with the government's overarching commitment to value addition, as articulated in the 8th National Development Plan (8NDP), the budget introduces a proposal to extend the two percent local content allowance to income derived from value addition to fruits. Additionally, the budget encompasses a harmonization of VAT exemptions, incorporating feed for quails and guinea fowls. This strategic move is expected to reduce expenses related to the rearing of these birds, thereby facilitating diversification within the poultry sub-sector.

Nonetheless, according to the ZRA statistics in terms of net tax revenue, there has been a noticeable increase in the last five years as indicated by figure 4.1a below.



Source: Tax Statistics in Zambia, ZRA

Figure 4.1a: Net Tax Revenue (Nominal, K'Million)

Figure 4.1a presents the net tax revenue as per tax statistics in Zambia provided by ZRA. According to the figure, there is a noticeable increase in net tax revenue over the period of reference, which simply depicts the significant role of tax collection in government revenue.

4.2 Effect of VAT Rate Increases on Consumer Behavior

In order to assess the effect of VAT rates on consumer behavior, the study utilized a number of avenues to make conclusive statement on this investigation. One of the avenues was to perform a t-test which was doing the test the hypothesized statements that VAT rates influence consumer behavior and that VAT rates has an effect on the purchasing power of the consumer. Findings of this inquiry are presented in table 4.2a below.

Table 4.2a: T-Test

Statement	Mean	SD	T	Sign.	Result
H1. VAT rates influence consumer behavior	4.38	1.22	1.41	0	Accepted
H2. VAT rates has an effect on the purchasing power of the consumer	3.77	1.25	1.74	0	Accepted

Source: *Field Data, 2023*

According to table 4.2a, it was established that the t-test value was < 1.41 ($p = 0.5$), it indicates that consumer behaviour which reflects that consumer behaviour is indeed affected by changes in VAT rates. With regards to the second statement that VAT rates influence consumer behavior and that VAT rates has an effect on the purchasing power of the consumer. Regards this statement, $t > 1.74$ ($p < 0.5$), signify that VAT significantly affects consumer purchasing power. This suggests that consumers with higher salaries tend to purchase more products with less consideration for prices. Conversely, individuals with lower incomes are inclined to buy fewer and cheaper products, showing greater price sensitivity.

Table 4.2b: Impact of VAT on consumption and purchasing power

Effectiveness of VAT system	Frequency (n)	Percent (%)
Effective	22	74
Ineffective	5	16
Indifferent	3	10
VAT Reduces Consumption		
Yes	21	70
No	9	30
Buying less due to VAT		
Yes	14	47
No	16	53
TOTAL	**30**	**100**

Source: *Field Data, 2023*

Assessing the Impact of Value Added Tax (VAT) On Government Revenue in Zambia

Table 4.2b above reveals that the majority of the participants (70%, n=21) felt that VAT reduces their consumption, while 30% (n=9) of the participants felt that VAT had no effect on their consumption. Nevertheless, 53% (n=16) of the participants felt that VAT had no effect on their purchasing power.

In some extreme but very rare cases, some consumers may seek ways to avoid paying the higher VAT rates by turning to the informal economy or purchasing goods through unofficial channels where VAT is not collected. This behavior can result in reduced tax collection for the government and hinder efforts to formalize the economy.

4.3 Challenges related to VAT collection

Undoubtedly, VAT collection in Zambia, like in many countries, faces several challenges. These challenges have adverse effects on the revenue collection of the country as well as the overall effectiveness of the tax system. The study participants were asked of their perceptions on some challenges associated to VAT collection using a Likert Scale. A 5-point Likert scale, which ranges from "Strongly Disagree" to "Strongly Agree" and "Not sure" in the middle. The scale was applied in order to capture the opinions, attitudes and feelings of study participants for easy analysis and reporting of data

Table 4.3a: Challenges Related to VAT Collection in Zambia

Challenges	SD	D	InDiff	A	SA	Mean
Compliance Issues	0 (0.0%)	0 (0.0%)	0 (0.0%)	16 (53.3%)	14 (46.7%)	**4.67**
Poor Law enforcement	10 (33.3%)	12 (40.0%)	5 (16.7%)	3 (10.0%)	0 (0.0%)	**2.36**
VAT implementation is complex	13 (43.3%)	10 (33.3%)	0 (0.0%)	7 (23.3%)	0 (0.0%)	**2.15**
VAT nature is regressive	1 (0.3%)	1 (0.3%)	6 (20.0%)	16 (53.3%)	6 (20.0%)	**4.25**
Low Awareness on VAT	0 (0.0%)	9 (30.0%)	0 (0.0%)	15 (50.0%)	6 (20.0%)	**4.25**

Source: *Field Data*

Table 4.3a above revealed that 53.3% (n=16) of the study participants agreed that the major challenge faced in VAT collection by government authorities was due to lack of compliance by taxpayers. 46.7% (n=14) of the study participants strongly agreed that lack of compliance by taxpayers influenced VAT collection by government authorities. None of the participants disagreed or were indifferent on whether or not lack of compliance by taxpayers influenced VAT collection by government authorities. The table further shows that the mean score to this enquiry was 4.67 (the average ranking score given by study participants), which shows that on average, majority of the responses were either agreeing to a great extent (based on the 5-point Likert scale ranking) to the assertion that lack of compliance by taxpayers influenced VAT collection by government authorities.

Conversely 40% (n=12) of the study participants disagreed that poor law enforcement by government was a factor influencing VAT collection. Further, 33.3% (n=10) of the participants strongly disagreed to the assertion that poor law enforcement by government was a factor that influenced VAT collection in Zambia. 16.7% (n=5) of the participants were indifferent on whether or not poor law enforcement by government was a factor that influenced VAT collection in Zambia. However, 10% (n=3) of the participants agreed that poor law enforcement by government influenced VAT collection in Zambia. The mean score to this enquiry was 2.36, which shows that on average, majority of the responses were disagreeing to the assertion that poor law enforcement by government was a factor that influenced VAT collection in Zambia.

The table further shows that 43.3% (n=13) and 33.3% (n=10) of the study participants strongly disagreed and disagreed, respectively, that the complexity of VAT implementation was a challenge that influenced collection of VAT in Zambia. None of the participants were indifferent over this assertion. However, a small proportion of study participants (23.3%, n=7) agreed to the assertion that the complexity of VAT implementation was a challenge that influenced collection of VAT in Zambia. The mean score to this enquiry was 2.15, which shows that on average, majority of the responses were strongly disagreeing to the assertion that that the complexity of VAT implementation was a challenge that influenced collection of VAT in Zambia.

Lastly, it can be seen from the table that 50% (n=15) of the study participants agreed that lack of proper awareness on VAT by taxpayers may have had an influence VAT collection in Zambia. Consequently, 20% (n=6) of the participants strongly agreed to this assertion that lack of proper awareness on VAT by taxpayers may have had an influence VAT collection in Zambia. None of the participants were indifferent over this assertion. However, 30% (n=9) of the study participants disagreed to the assertion that lack of proper awareness on VAT by taxpayers may have had an influence VAT collection in Zambia. The table shows that the mean score to this enquiry was 4.25, which shows that on average, majority of the responses were strongly agreeing to the assertion (based on the 5-point Likert scale ranking) that lack of proper awareness on VAT by taxpayers may have had an influence VAT collection in Zambia

5. DISCUSSION OF FINDINGS

5.1 Effect of VAT Changes on Government revenue

Changes in VAT rates can influence compliance levels. For example, an increase in VAT rates might lead to higher compliance as businesses and individuals are incentivized to adhere to tax regulations to avoid penalties. Therefore, it was established that an increase in VAT rates may lead to higher VAT revenue, assuming a stable level of compliance. Consequently, it has been highlighted by the study that Changes in VAT exemptions can have a direct impact on tax revenues. Introducing or expanding exemptions may result in a reduction of tax revenues, while narrowing exemptions may increase revenue collection. These results are consistent with those of Schoeman et al., (2021) who established that increasing the rate of value-added tax (VAT) has been identified as one option to increase tax revenue, although the likely effect of VAT rate changes on tax compliance behavior is undetermined.

5.2 Effect of VAT Changes on Consumer behavior

The study further reports that increase in VAT rates might contribute to higher consumer prices, potentially leading to inflationary pressures. This association as evidently depicted in the result section is not a direct one as there could be other factors that could influence this association. A similar relationship was depicted between VAT changes and economic growth. This simply suggest that macro-economy variables such as inflation and economic growth can be influence by a number of variables and this makes it very complex to measure them

When VAT rates are elevated in Zambia, the prices of a wide array of goods and services subject to VAT increase accordingly. This translates to consumers having to allocate a larger portion of their income to cover the higher VAT costs. Consequently, consumers are left with less disposable income for other expenditures, particularly those related to non-essential or luxury items.

This phenomenon is exemplified by the statement of one study participant, who noted that higher VAT rates prompt consumers to reassess their spending priorities. Consumers are more inclined to reduce their expenditure on non-essential or luxury items and focus on essential goods and services they cannot easily do without. For instance, an increase in the VAT rate on luxury items such as cars, jewelry, or high-end electronics may lead consumers to delay or reconsider these purchases, potentially resulting in reduced sales within these sectors.

Consequently, higher VAT rates can drive consumers to opt for saving or investing their money rather than immediate spending. They may explore financial instruments or savings accounts offering better returns. This shift toward saving and investment can have varied economic consequences. While it promotes financial security for individuals, it may simultaneously lead to a reduction in consumer spending, potentially impeding economic growth. A study by Keen and Smith (2006) suggests that consumers may shift their spending towards products or services with lower or no VAT rates. For instance, they might increase purchases of essential goods or opt for public transportation over private vehicles if VAT rates on these items are lower.

In some rare instances, consumers may seek alternatives to paying the higher VAT rates by resorting to the informal economy or purchasing goods through unofficial channels where VAT is not collected. Such behavior can result in decreased tax collection for the government and hinder efforts to formalize the economy. Research by Fuest and Peichl (2019) highlights that significant VAT rate increases can incentivize consumers and businesses to participate in the informal or underground economy to avoid paying higher taxes. Smuggling and tax evasion may become more prevalent.

5.3 Ascertaining measures to address challenges related to VAT collection

VAT collection in Zambia faces several challenges, which not only impact revenue collection but also the overall effectiveness of the tax system. A survey of study participants assessed their perceptions of challenges associated with VAT collection. The following were the results:

- **Compliance Issues:** A significant majority (74%) of study participants felt that a major challenge in VAT collection was the lack of compliance by taxpayers. This suggests that ensuring taxpayer compliance remains a substantial hurdle.
- **Poor Law Enforcement:** Surprisingly, 40% of participants disagreed that poor law enforcement by the government was a factor influencing VAT collection. This indicates a mixed perception regarding the role of enforcement.
- **Complex VAT Implementation:** Most participants (76.6%) disagreed that the complexity of VAT implementation was a significant challenge affecting VAT collection.
- **VAT Nature Being Regressive:** A substantial majority (73.3%) agreed that the regressive nature of VAT was a challenge influencing VAT collection. This suggests concerns about the tax's impact on lower-income households.
- **Low Awareness on VAT:** A majority (70%) agreed that a lack of proper awareness among taxpayers may have influenced VAT collection in Zambia.

These findings align with existing literature, which highlights various challenges in VAT collection in Zambia. The significant presence of the informal economy poses compliance issues, while complexities in VAT laws and regulations, as well as frequent changes, can hinder businesses' ability to comply. Additionally, the lack of taxpayer education and awareness, particularly in remote areas, contributes to non-compliance. Delays in processing VAT refunds and challenges in cross-border trade further compound these issues.

Zambia's VAT system is fundamentally a consumption-based tax, levied on the value added to goods and services at each stage of the supply chain. It applies to all businesses across the production chain, including imports. This system allows for VAT to be collected at each stage of the supply chain, reflecting the incremental value added to goods or services. While this approach generates substantial revenue, it's vital to assess its suitability for Zambia's unique economic, social, and administrative context.

The effectiveness of the VAT system hinges on factors such as compliance, enforcement, and balancing revenue needs with impacts on businesses and consumers. Zambia's significant informal sector presents a challenge as informal businesses may not be registered for VAT, leading to potential revenue leakage. The choice of which goods and services to exempt or zero-rate can also affect the VAT system's equity and efficiency.

To ensure the suitability of the VAT system, Zambia should consider aligning it with international best practices and standards. This alignment can enhance the country's reputation among investors and trading partners. Additionally, efforts to formalize the informal sector and improve taxpayer education are essential to address compliance challenges and ensure effective VAT collection

6. CONCLUSION AND RECOMMENDATIONS

6.1. Conclusion

This study has examined various facets of Value Added Tax (VAT) in the context of Zambia, offering insights into its economic consequences, challenges in collection, and the measures to enhance VAT collection in this developing nation.

6.2 Effect of Value Added Tax (VAT) Changes on Government revenue

Changes in VAT rates can influence compliance levels. For example, an increase in VAT rates might lead to higher compliance as businesses and individuals are incentivized to adhere to tax regulations to avoid penalties. Therefore, it was established that an increase in VAT rates may lead to higher VAT revenue, assuming a stable level of compliance. Consequently, it has been highlighted by the study that Changes in VAT exemptions can have a direct impact on tax revenues. Introducing or expanding exemptions may result in a reduction of tax revenues, while narrowing exemptions may increase revenue collection.

6.3 Effect of Value Added Tax (VAT) Changes on Consumer behaviour

When VAT rates are elevated in Zambia, the prices of a wide array of goods and services subject to VAT increase accordingly. This translates to consumers having to allocate a larger portion of their income to cover the higher VAT costs. Consequently, consumers are left with less disposable income for other expenditures, particularly those related to non-essential or luxury items.

Consequently, higher VAT rates can drive consumers to opt for saving or investing their money rather than immediate spending. They may explore financial instruments or savings accounts offering better returns. This shift toward saving and investment can have varied economic consequences. While it promotes financial security for individuals, it may simultaneously lead to a reduction in consumer spending, potentially impeding economic growth.

In some rare instances, consumers may seek alternatives to paying the higher VAT rates by resorting to the informal economy or purchasing goods through unofficial channels where VAT is not collected. Such behavior can result in decreased tax collection for the government and hinder efforts to formalize the economy.

6.4 Ascertaining measures to address challenges related to VAT collection

VAT collection in Zambia faces several challenges, which not only impact revenue collection but also the overall effectiveness of the tax system.

Zambia's VAT system plays a crucial role in generating government revenue and supporting economic development. However, its effectiveness is contingent upon addressing the challenges inherent in VAT collection, optimizing VAT rate policies, and adapting the system to the country's unique economic context. By doing so, Zambia can harness the full potential of VAT as a tool for revenue generation while fostering sustainable economic growth and equitable taxation.

7.0 Recommendations

Addressing these challenges requires a multifaceted approach:

- There is need to invest in comprehensive taxpayer education and awareness programs, particularly targeting smaller businesses and remote areas.

- There is need to strengthen enforcement mechanisms to combat tax evasion and fraud, including better monitoring of high-risk sectors.
- Similarly, there will be need to evaluate the possibility of simplifying tax laws and reducing frequent changes to enhance compliance.
- Improve access to technology and infrastructure for businesses across the country to facilitate electronic filing and reporting.
- There is also need to collaborate with neighboring countries to enhance cross-border trade controls and reduce VAT leakage.
- Explore ways to reduce the compliance costs for businesses, especially smaller ones, through streamlined procedures and support mechanisms.
- Responsible authorities need to address delays in VAT refund processing to ensure businesses receive timely reimbursements and also consider implementing alternative dispute resolution mechanisms to expedite the resolution of VAT-related disputes.

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