

Effect of gst on inflation rates



A causality analysis of the effect of implementation of GST in the financial development and inflation rate of a country

Introduction

1. 1 Overview

Goods and Service Tax (GST) or also known as Value-Added Tax (VAT) is a tax on goods and services. It applies to most products consumers buy. Malaysia will be implementing GST in 2015. Implementation of GST has still an unknown result to the economy in Malaysia. In this introduction chapter, the overview of GST and the background of economic development in South Africa are introduced. Secondly the problem statement then followed by the significance of study will be discussed. Furthermore, the objectives used in this study is introduced. Lastly, the scope of study and organization of this study will also be included.

1. 2 Overview of GST

GST or Goods and Services Tax, which is also known as VAT or the Value Added Tax in many countries is a multi-stage consumption tax on goods and services whereby each point of supply in a production chain is potentially taxable up to the retail stage of distribution. At the same time suppliers are entitled to refunds of GST incurred on business inputs. A French tax Official in the 1950s had invented the concept behind GST. Today more than 160 nations are practicing this form of taxation, including the European Union and Asian countries such as Sri Lanka, Indonesia and China.

GST is a broad based consumption tax covering all sectors of the economy. If their yearly sales income has topped the prescribed limit, business making <https://assignbuster.com/effect-of-gst-on-inflation-rates/>

chargeable supplies have to be listed under GST. GST only can be charged and collected by person who registers under GST on the taxable supplies of goods and services supplied by that person. GST is charged in the value or selling price of products. The amount of GST earned on input can be deducted from the amount of GST charged by the registered person. There are penalties charged if offences regarding GST are made. Penalties may be imposed if there is incorrect return, evasion of tax, improperly obtaining refund, offences in relation to goods, invoices and receipts, general offences and late payment of GST.

1. 3 Background of economy development in South Africa

South Africa is Sub-Saharan Africa's largest economy and one of the world's largest producers and exporters of gold and platinum. The economy of South Africa is the second largest in Africa, it reports for 24% of its gross domestic product in terms of purchasing power parity, and the World Bank has ranked it as an upper-middle income economy. At the end of over twelve years of international sanctions since 1996, South Africa's Gross Domestic Product has almost tripled to \$400 billion, foreign exchange assets have increased from \$3 billion to nearly \$50 billion, generating a flourishing and substantial African middle class, within two eras of instituting democracy and ending apartheid. In May 2009, National Assembly has elected Jacob Zuma as President of the African National Congress. Since the end of apartheid in 1994, the ANC has dominated politics.

Manufacturing, mining, services, and agriculture equal similar sectors in the developed world. However, poverty is extensive, public education is poor,

formal-sector unemployment and crime are high and much of the population absence of access to infrastructure and basic services. Controlling inflation and the budget deficit are the economic policies focus. Services contribute the most GDP and employment. The government aims to increase black South African farmland ownership to 30% by 2014, but its affirmative-action mandates threaten private property rights.

A quarter of the population is unemployed according to official estimates. That number had increased to 35% when including people who have given up looking for job according to a 2013 Goldman Sachs report. A quarter of South Africans survive on below US \$1. 25 a day. South Africa has a relative benefit in the production of agriculture, manufacturing and mining goods relating to these sectors. South Africa has shifted from a primary and secondary economy in the mid-twentieth era to an economy driven primarily by the tertiary sector in the current day which accounts for an estimated 65% of GDP or \$230 billion in nominal GDP terms. The country's is reasonably diversified with key economic sectors including agriculture and fisheries, mining, vehicle manufacturing and assembly, clothing and textiles, telecommunication food processing, energy, real estate, financial and business services, tourism, transportation, wholesale and retail trade.

The unemployment rate which is more than 25%, very high statistic and the poor have limited access to money making chances and basic services. Poverty also remains a major problem. The high levels of inequality and unemployment are measured by the government and most South Africans to be the most noticeable economic problems facing the country. These issues

linked to them such as crime, have in turn gratified investment and growth, consequently having an undesirable reaction consequences on employment. In South Africa, Crime is considered a foremost constraint on investment by 30% of enterprises.

Unlike other emerging markets, South Africa has struggled through the late 2000s stagnation, and the repossession has been essentially controlled by private and public consumption growth, while export bulks and private investment have yet to completely improve. The long term potential growth rate of South Africa has been estimated 3.5% under the current policy environment. Per capita GDP growth has proved average, though improving, developing by 1.6% a year from 1994 to 2009, and by 2.2% over the 2000 to 2009, compared to world growth of 3.1% over the same period.

VAT was introduced in South Africa in 1991 to replace their general sales tax. VAT is an indirect tax and is levied on the value added in production during the different stages of production. In South Africa VAT is levied on the supply of goods and services as well as the importation of any goods or services, while exported goods and services are exempted. However, VAT is generally seen as consumption tax as the consumer pays it at the final stage of production. VAT was imposed in 1992 at a statutory rate of 10%, the rate was increased to 14% in 1993. The newest changes in VAT aims at improving the administration of VAT with the objective to reduce the administrative burden especially.

1.4 Problem statement

The problem of this study is that there is no proper agreement on how GST/VAT is going to affect the economy. There are many perception of how good is GST to the country's economy and vice versa. There are many article regarding implementation of GST in Malaysia. (Ghani, 2013) Deputy Head of Cluster Economy and National Convention of Financial Professors, Professor Dr Nor Ghani Md Nor, said implementation of GST needs a very good mechanism so that the average earning citizen and the poor would not be affected. He added on if the government would like to increase the economy of the country, the leakage has to be controlled, and believed that the economy will be stronger than now. (Bernama, 2014) The Prime Minister said GST will be able to secure the country's future with most robust yields. (Bernama, 2014) According to the Asian Pacific Regional Head of China KPMG, Lachlan Wolfers, The Goods and Service Tax (GST) in Malaysia is one of the best in the world. Wolfers added that had experience in implementation of GST in Australia, he can say that the Customs Department had been well prepared for this GST implementation unlike what he have seen in Australia. In addition, challenges in Australia is the same and it's not only a changes in tax but a change that affects the daily business, and not only the tax expertise have to understand this system. This issues shows that there are many different ideas of effect of GST. Since GST haven been implemented yet in Malaysia, thus two countries of the same economy system with Malaysia has been chosen to run this study which is South Africa. Malaysia and South Africa have mixed economy system. South Africa have implemented GST or either known as VAT way before Malaysia have planned to implement it which is in year 1991 and 1992. Thus, in this case of study the economic relationship between the GST implementation with the <https://assignbuster.com/effect-of-gst-on-inflation-rates/>

inflation rate and financial development in these countries is studied and can be related to how will the result be in Malaysia.

1. 5 Significance of study

The purpose of this paper is to identify the casual relationship among GST/VAT, financial development and inflation rate by using an econometric methodology to determine the direction of causality between these three variables in South Africa. The result of this study can help to provide information to draw a new conclusion on how Malaysia financial development and inflation rate is going to get affected by GST. This study can roughly show the future situation of Malaysian financial development and inflation rate, since South Africa has implemented GST/VAT in year 1991.

1. 6 Objectives of study

The main objective of this paper is to examine the effect of GST/VAT on the financial development and inflation rate of South Africa. Then the result will be then used to relate to Malaysia's financial development and inflation rate. In order to achieve the main purpose these objectives should be achieved. Specifically, the objectives of this project are as follow:

1. First of all, in order to determine empirically the tri-variate casual relationship of VAT/GST tax, financial development and inflation rate, the study tests the stationary of the variables, as well as the order of the integration of time series model. The stationary of the variables is vital because non-stationary of the variables will cause spurious regression.

2. Thirdly, this paper examines the presence of short run and long run relationship among the GST/VAT, financial development and inflation rate. This is important for the policy purpose.
3. Lastly, this paper examines the causality relationship among GST/VAT, financial development and inflation rate. This is important to determine the direction of the causality.

1.7 Scope of study

This study examines the casual relationship between the VAT/GST, inflation and financial development in South Africa that includes both theoretical study and empirical study. This study also determines the short run and long run relationship among VAT/GST, financial development and inflation.

The field of economy in this study is focused more on applied econometrics. Applied econometrics consist of unit root tests, which are the Augmented Dickey-Fuller (ADF) test and Phillip-Perron (PP) test to test the stationary of the variables which are time series model. Unit root test also determine the order of the integration of the timer series model before proceeding to the next test. Johansen co-integration test is included to determine the short run and the long run relationship amongs the three variables. Modified Framework Granger causality test via Toda-Yamamoto is also included to examine the casual relationship among GST/VAT, financial development and inflation.

This study focuses on the case in South Africa as they have the same type of economy system with Malaysia. The variables for financial development are liquid liabilities (M3), total domestic credit provided by banking sector and

domestic credit to private sector. Liquid liabilities are used to measure the ability of banks to launch funds or the size of the banking system that are relative to the economy. While domestic credit to private sector is the most corresponding for measuring the opportunities for a few firm, or in other words, financial development. The total domestic credit provided by banking sector is the total domestic credit to the economy, which is the least suited to measure financial development. On the other hand, annual inflation rates were computed in most cases from consumer price indexes. All the data are collected from World Data Bank.

1. 8 Organization of study

The structure of this paper includes abstract, introduction, literature review, methodology, result, discussion, conclusion, reference and appendix. These study is organized in five chapters as the Introduction is chapter 1, Literature Review is chapter 2, Methodology is chapter 3, Result is chapter 4 and Discussion & Conclusion is chapter 5.

The introduction introduces the problem statement, background study of the economy of South Africa, significance of study, a brief idea on the model and methods, the objectives, explanation on the methodology and the scope of the study. The literature review provides a theoretical background of some empirical research done previously. It also reviews the problem faced by the other researchers and methodology of the empirical research. Methodology explains the research design, model specification and data description. The proposal of the methods used to achieve the objective are also stated in the methodology. The results provides overview of the data and discussed the

empirical results of the study. Lastly, the Conclusion and Discussion of this study will be provided. Appendices and References will be attached at the end of the project paper.