

## Value Added Tax Allocation and Human Development Among States in Nigeria

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### Abstract

Based on the last human development index report released in 2019 which has a range of 0.377 to 0.954, Nigeria had a score of 0.534 which is low and below the minimum acceptable score of 0.55. This raises a concern for the standard of living level in Nigeria. In addition to this, there has been rancor over the allocation of Value Added Tax among states in Nigeria. Hence, this study is aimed at examining the current effect of Value Added Tax among states in Nigeria. This study is hinged on the endogenous growth theory. The *Ex-post facto* research design was used with secondary data collected in respect to all the 36 states in Nigeria which was gathered and used to carry out this study. The results of this study reveal that VAT allocation and internal source of finance have very low positive effect on the level of literacy of Nigerians. The result further shows that VAT allocation has a very low positive effect on the quality of life in Nigeria. The conclusion points out that VAT allocation have no significant effect on human development among states in Nigeria. Hence, it is recommended that state government focus on developing economic policies that promotes the literacy level and the quality of life of their citizens.

**Keywords:** Fiscal federalism, human development, life quality, literacy, value added tax allocation,

**JEL Classification:** H21, H8

### 1. Introduction

Allocation of revenue that seems fair and acceptable to the Federal, State and Local government seems like a mission impossible (Ojo, 2010). Adesina (1998) posits that Nigeria's allocation of roles and resource is a difficult task as it transcends through social, political and religious divide. Ekeh (1994) opines that the challenge with revenue allocation is majorly premised in between economics and politics. Irukwu (2014) traced the origin of fiscal federalism as the system of government in Nigeria from Richard's constitution which was established in 1946 and which introduced a larger legislative council at the center and three legislative assemblies for the three regions within the territory of Nigeria. Currently, Nigeria has the roles of the three levels of government stated in her (Nigeria's) 1999 constitution. The roles and resources are distributed among the Federal, State and Local government and are contained in the exclusive, concurrent and residual list respectively of the constitution. Adebayo (1990) highlighted three problems that come with federalism which are the assignment of functions reasonably between the existing tiers of government, the authorization of taxes to be collected by the various tiers of government and the revenue sharing formula among the various tiers of government. Ojo (2010) opines that there are five primary aim of revenue distribution which cuts across promoting national unity, advancing economic growth, ensuring balanced development, maintaining self-sufficiency of the federating units and lastly promoting the quality of life of her citizens.

On the other hand, the last human development index report released in 2019 had a range of 0.377 to 0.954. Nigeria had a score of 0.534 which is low and below the minimum acceptable

score of 0.55. Hence establishing a problem with the quality of life in Nigeria. Some studies have been carried out to examine the correlation between revenue allocation and economic growth in Nigeria (Ojo, 2010; Sharma, 2010; Salami, 2011) while others have examined Value Added Tax and economic growth with gross domestic product (GDP) as the proxy for economic growth (Dennis, 2010; Michael & Ben, 2007). Stanton (2007) confirms that the term economic growth can also be represented by human development index which forms part of the basis for the need of this study. In addition, studies that have examined Value Added Tax use the total Value Added Tax collected over a time-frame of years without regard for the allocation of it (Denis, 2010; Michael & Ben, 2007; Salti & Chabaan, 2011). Hence, the main purpose of this study is to evaluate the effect of value added tax allocation on the human development among states in Nigeria. Hence, in an attempt to accomplish the main objective of this study, the following specific objectives were formed which are to:

- i. evaluate the effect of value added tax allocation on the level of literacy among states in Nigeria; &
- ii. assess the effect of value added tax allocation on the quality of life among states in Nigeria.

## **2. Literature Review**

### **2.1. Value Added Tax Allocation**

Value Added Tax (VAT) can also be referred to as goods and services tax which is an indirect form of tax (Juliana & Okoye, 2016). The origin of VAT administration can be traced to France in the year 1954 by a French economist Maurice Leave by name. It was introduced in Nigeria in the year 1993 and took enforcement in the year 1994 after the set-up of a committee headed by Mr. Emmanuel Ijewere to research into its implementation (Omesì & Nzor, 2015). Sanni (2012) posits that VAT replaced sales tax which was operated and maintained by states. Omesì and Nzor (2015) posit that Value Added Tax improved on the deficiency of sales tax in Nigeria which was introduced in the year 1986. They stated that sales tax had a narrow tax base which was framed around nine specific categories of goods and services and services of hotels and motels. Ajakaiye (1999) explained that Value Added Tax is an indirect form of tax and it is a consumption tax which makes it difficult to be evaded. Value Added Tax has been shown to be an important driver of government income in many third-world countries (Ajakaiye, 1999).

Sanni (2012) states that Value Added Tax was first introduced in Nigeria in the year 1993. It is administered and collected by the agencies controlled by the Federal government which is gathered separately from other forms of revenue which are pooled in the federation account. However, Value Added Tax revenue is pooled in the Value Added Tax Pool Account before it is allocated among the Federal, State and Local tiers of Government. Prior to 2004, there were 42 sections and three schedules of VAT (Sanni, 2012). Since the oil boom of the 1970, Nigeria has been primarily dependent on revenue from the Oil sector (Juliana & Okoye, 2016). Unlike Oil revenue in which the government of Nigeria have a little impact on its generation, the government in Nigeria have more control over VAT administration in Nigeria (Juliana & Okoye, 2016). In Nigeria the implementation of Value Added Tax Act in 1994 has provided a significant amount in the revenue accrued to the government (Omesì & Nzor, 2015; Omolehinwa & Naiyeju, 2015). Somorin (2019) however pointed out that there have been agitations to raise the tax rate of Value Added Tax in Nigeria stating that Nigeria has one of the lowest VAT rate in the world as at that time which was 5%. However, in 2020, VAT tax rate was revised to 7.5% after previous unsuccessful attempts to revise it. In August, 2021 there have been agitations by various States in Nigeria to decentralize the collection of VAT in Nigeria.

#### **2.1.1. Literacy**

The United Nations Educational, Scientific and Cultural Organization (UNESCO) in 1997

described literacy rate is described as the proportion of the set population of a specific age group who can write and read. Literacy could be informal which involves the acquisition of skills and literacy can also be formal which involves going through the formal education system within Nigeria. The education system found within her boundary is 6-3-3-4 which represents the six years in primary school, 3 years in junior secondary school, 3 years in senior secondary school and four years in the tertiary institution. In this study, literacy is explained as the formal system of education. Aridegbe and Makinde (2014) show evidence that South-Western regions have a higher literacy level than the Northern region in Nigeria. They state that the 2013 Nigerian National Policy on Education makes it compulsory for every child in Nigeria to undertake the six years of primary education.

In addition, Young (2001) highlights various forms of literacy which includes digital literacy which allows users to navigate through issues with the use of data analytical skills. In addition, is computer literacy which is separated from digital literacy as computer literacy involves the peripheral aspect of digital literacy. Another form of literacy identified is computer technology literacy which is explained as the ability to handle computer hardware. Another form of literacy identified is media literacy which is posited as the interact with various media tools ranging from print to electronic. George, Donohue and Tichenor (2005) explain that literacy comes with its benefits such as ensuring accountability and transparency of leaders by the followers which drives development. In addition, literacy is linked with social benefit which adds to the well-being of the family. Furthermore, literacy improves cultural by transforming behaviors without necessarily altering them.

### **2.1.2. Quality of life**

According to the World Health Organization (2012), quality of life is described as the view of individuals in respect to their value system and culture. It refers to the healthiness of individuals to carry-out specific tasks. Quality of life can be perceived through the wealth of individuals, their ability to maintain a balance in physical and mental health. It can also be assessed through the standard of living of individuals. Quality of life as a terminology can be traced to early years in 20th century where it was used to represent wellness and a person free from sickness or health challenge (Spitzer, 1987). Brown (2015) posits that the maintenance of healthy habits has been linked to longevity of man and in essence the quality of life. Quality of life has also been used to measure the innovations and rate the health care services made available to the citizenry of a nation (Sintonen, 1994). Rodriguez-Artalejo *et al.* (2005) posits that maintaining a good quality of life level have a negative correlation with the rate of fatality and with sicknesses. Varela (2021) posits that globally, the life expectancy for male is 71 years while it is estimated at 75 years for female. In Africa, life expectancy is estimated to be 63 years for male and 65 years for female while in Nigeria, life expectancy is estimated to be 59 years for male and 63 years approximately for female.

Human development index (HDI) is explained by the World Health Organization (2021) as the aggregate measure of standard of living, health and knowledge in a country. Particular focus is set on the standard of living ranking from the human development index. This is because the standard of living seems synonymous to quality of life. Hence, the standard of living ranking is used to measure the quality of life for this study. Standard of living is also an all-encompassing term used to describe the well-being of individuals collectively in a country. A survey carried out by Numbeo in 2021 shows that out of 95 countries ranked according to the available health care service found in the various countries, Nigeria is placed as number 88 with a score of 48.52 in a score range 39.48 to 86.38. The expectancy life ratio and the ranking on health service rates Nigeria as low which is indicative of a low quality of life among her citizens.

### **2.2. Theoretical Review**

This study is pitched on the endogenous growth theory which was developed by Paul Romer in

the 1980's. It states that for economic growth to take place, it is majorly determined by the internal factors such as the development of human capital, innovation amongst others. The theory holds that for economic growth to be achieved in the long-term, this is a reflection of economic policies (Lucas, 1988). In advancing the endogenous growth theory, three main models have been developed to identify the internal factors to be stirred to arrive at the desired economic growth. The first model is Romer's model which shows that economic growth is as a result of production output, externalities and increase in knowledge. The second model is Lucas model which posits that for economic growth to take place, investment in education must take place which leads to the development in human capital which transcends to higher levels of productivity and vis-à-vis economic growth. The third model developed to justify the position of endogenous theory is Romer's model of technological change. This model posits that the investment in research to spur ideas on improving ways of carrying out production functions leads to more efficient ways of achieving productivity which has an effect on the economy.

Critics of the theory states that it fails to consider the role played by exogenous factors and that it is focused on attributing economic growth on factors that cannot be measured (Ortigueira & Santos, 1997; Parente, 2001). In addition, some other critics state that the theory lays much emphasis on human capital and does not involve other factors of production (Olson, Salna & Swamy, 2000). Furthermore, the theory fails to visibly distinguish between physical capital and human capital. Fischer (1991) critiqued the theory for summarily relying mainly on stability of the state or economy and the production function

However, Howitt (2007) states that economic policies that promotes trade openness and innovation will drive growth. Hence, this theory fits into this study by explaining that Value Added Tax allocation will not promote human development but the economic policies developed and implemented by states to encourage trade openness and innovation will promote the development of the state.

### **2.3. Empirical Review**

Ajakaiye (1999) carried out a study within Nigeria to assess the effect of Value Added Tax on selected sectors in the economy. A mixed method which comprises of primary data gotten from survey and secondary data were used. It was revealed from the study that Value Added Tax is treated as part of the cost which increases the cost of items and decreases consumption of such items. Similarly, Sharma (2005) attempted to identify the issues that arise with the implementation of Value Added Tax in India. The qualitative research method was employed in carrying out the study and it was revealed that Value Added Tax can lead to loss of revenue of state government and promote centralization by enriching the Federal Government.

In Nigeria, Ojo (2010) examined the politics involved in sharing revenue between the various tiers of government. The study was also carried out using a qualitative research design. It was revealed from the study that the current system of revenue allocation can be a driver of demotivation to states ability in the generation of income. Similarly, Adeleke (2011) assessed the issues with fiscal federalism in respect of tax revenue allocation in Nigeria adopting a qualitative research design. The study pointed out that fiscal federalism is designed in Nigeria to favor the Federal government.

Sanni (2012) assessed Value Added Tax Amended Act of 2007 to identify the issues from it using a qualitative research design also. The empirical evidence from the study shows that the legal framework of VAT is simple to implement. Bird and Smart (2014) assessed how Value Added Tax can be managed in a Federal system. The research was carried out in Canada using a qualitative research design. They pointed out that a federally administered Value Added Tax is more efficient but that the Federal government can also allow a form of Value Added Tax to run smoothly at state level.

However, in Nigeria, Eneh (2015) assessed the issues presented by fiscal federalism in Nigeria by a survey research method which was implemented by the distribution of questionnaire and the conduct of interviews. The study revealed that fiscal federalism led to gemination of government functions and wastage of public funds. Juliana and Okoye (2016) also conducted research in Nigeria to measure the effect of Value Added Tax on the economic growth of Nigeria using an Ex post facto research design. It was discovered from the study that Value Added Tax has positive effect on the income generated and also the economic growth of Nigeria.

On a wider scale, Alavuotunki, Haapanen and Pirtila (2018) examined the effect of Value Added Tax on income inequality and consumption inequality among selected countries using the Ex post facto research design. The study show that Value Added Tax does not have a positive effect on income inequality while it does not have any effect on consumption inequality. Abate (2019) examined the legality of Value Added Tax administration by the Federal government in Ethiopia using a qualitative research design and revealed that Value Added Tax is within the purview of the Federal government while similar form of it is left for the State government.

From the review of existing literature, a methodological gap can be pointed out as some of the studies adopted a qualitative research approach while others adopted a quantitative approach. However, in the area of quantitative research design, those that addressed Value Added Tax examined it from the perspective of an aggregate amount and measured economic growth based on the gross domestic product. However, this study attempts to measure Value Added Tax based on the allocation to states to and economic welfare based on the literacy level and the standard of living of individuals within the country. To this end, the following hypotheses will be posed in a bid to achieve the specific objectives of this study. The null hypotheses in their null form are as stated below:

H<sub>01</sub>: Value added tax allocation does not have a significant effect on literacy level in Nigeria.

H<sub>02</sub>: Value added tax allocation does not have a significant effect the quality of life in Nigeria in Nigeria.

### 3. Methodology

The quantitative research method and *Ex-post facto* research design is adopted in this study. Secondary data were collected on the variables (VAT allocation, internal source of finance, literacy level and quality of life) for the year 2017 based on states basis in Nigeria which sums up to 36 observation period. The multiple linear regression was used in analyzing the data in order to examine the effect of the explanatory variable on the dependent variables. The multiple linear regression model is as shown below:

$$Y=f(X)$$

$$\text{Human development} = f(\text{VAT Allocation}).$$

Mathematically, this can be written as shown below:

$$LL = \beta_0 + \beta_1 VATa + \beta_2 ISOF + e \quad (1)$$

$$QL = \beta_0 + \beta_1 VATa + \beta_2 ISOF + e \quad (2)$$

Where:

LL =Literacy Level (Dependent Variable)

QL =Quality of Life (Dependent Variable)

$\beta_0$  = Intercept where independent variables are zero

$\beta_1$  VATa = Value added tax allocation (Independent Variable)

$\beta_2$  ISOF = Internal source of finance (Independent Variable)

e = error term

**Table 1. Measurement of Variables**

S/N	Variable	Type	Measurement	Source
1	VAT allocation ( $\beta_1$ VATa)	Independent Variable	Measured by the proportion of VAT of each state to the total VAT revenue generated	National Bureau of Statistics Bulletin, 2017
2	Internal source of finance ( $\beta_2$ ISOF)	Independent Variable	Measured as internally generated revenue divided by internal debt	National Bureau of Statistics Bulletin, 2017
3.	Literacy level (LL)	Dependent Variable	Measured by aggregating the primary, secondary and tertiary education enrollment rate	United Nations Development Programme report, 2017
4.	Quality of Life (QL)	Dependent Variable	Measured as the standard of living	United Nations Development Programme report, 2017

Source: Authors' computation, 2021.

#### 4. Data Analysis and Discussion of Findings

##### 4.1 Descriptive Statistics

Table 2 reveals that the average literacy level is 71% approximately with the lowest literacy level among the states in Nigeria shown as 33% which is below average. The result further shows that the average level of human development among states in Nigeria is at 55% approximately which is slightly above average. The result also shows that on the average each state gets a Value Added Tax allocation of 0.9% approximately which seems to be very low.

**Table 2. Descriptive Statistics**

	N	Minimum	Maximum	Mean	Std. Deviation
VAT Allocation	36	.00	.05	.0089	.00760
Human development index	36	.34	.67	.5470	.09928
Literacy level	36	.33	1.01	.7140	.20140
Valid N (listwise)	36				

Source: Authors' Computation (2021)

##### 4.2 Value Added Tax allocation and literacy level in Nigeria

Table 3 shows that there is a combined low positive effect of Value Added Tax allocation and internal source of finance on the level of literacy in Nigeria. This is captured by the R square of 0.065. This explains that Value Added Tax allocation and source of finance jointly explain very little about the literacy level among states in Nigeria.

Table 4 reveals the computed p-value as 0.330 which is higher than the set p-value of 0.05. Hence, the alternate hypothesis is rejected and the null hypothesis which states that 'Value Added Tax allocation does not have a significant effect on the literacy level among states in Nigeria' is retained. This is further confirmed by the low F-statistics result of 1.147 which shows that the independent variables (VAT allocation and internal source of finance) do not have a significant effect on the dependent variable (Literacy level) in respect of objective one.

Table 5 shows the value of the explanatory variables' coefficient derived in the regression model that was used in analyzing hypothesis one. It shows that the value of all the explanatory variables are positive which suggests that VAT allocation and internal source of finance both have positive effect on the level of literacy among states in Nigeria

**Table 3. Model Summary**

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.255 <sup>a</sup>	.065	.008	.20056

a. Predictors: Internal Source of Finance, VAT Allocation

Source: Authors' Computation (2021)

**Table 4: ANOVA<sup>a</sup>**

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	.092	2	.046	1.147	.330 <sup>b</sup>
	Residual	1.327	33	.040		
	Total	1.420	35			

a. Dependent Variable: Literacy level

b. Predictors: Internal Source of Finance, VAT Allocation

Source: Authors' Computation (2021)

**Table 5: Coefficients<sup>a</sup>**

Model		Unstandardized Coefficients		Standardized Coefficients Beta	t	Sig.
		B	Std. Error			
1	VAT Allocation	3.932	4.482	.148	.877	.387
	Internal Source of Finance	.036	.031	.194	1.147	.259

a. Dependent Variable: Literacy level

Source: Authors' Computation (2021)

#### 4.3 Value Added Tax allocation and quality of life in Nigeria.

Table 6 reveals that Value Added Tax allocation and internal source of finance both have a combined low positive effect on the level of the quality of life in Nigeria. This is presented by the R square of 0.087. This means that VAT allocation and internal source of finance explains very little about the quality of life among states in Nigeria.

Table 7 shows the F-statistics result as 1.566 which is low and indicates that the independent variables (VAT allocation and internal source of finance) both have no significant effect on the dependent variable (quality of life). Furthermore, the computed p-value as 0.224 which is higher than the set p-value of 0.05. Therefore, the alternate hypothesis is rejected and the null hypothesis which states that value added tax allocation does not have a significant effect on the quality of life among states in Nigeria' is retained.

Table 8 reveals the value of the integers contained in the regression model that was developed in analyzing hypothesis two. It shows that the value of the explanatory variables is all positive which indicates that there is a positive effect of VAT allocation and internal source of finance on the quality of life among states in Nigeria.

**Table 6: Model Summary**

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.294 <sup>a</sup>	.087	.031	.09772

a. Predictors: Internal Source of Finance, VAT Allocation

**Source: Authors' Computation (2021)**

**Table7: ANOVA<sup>a</sup>**

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	.030	2	.015	1.566	.224 <sup>b</sup>
	Residual	.315	33	.010		
	Total	.345	35			

a. Dependent Variable: Quality of Life

b. Predictors: Internal Source of Finance, VAT Allocation

**Source: Authors' Computation (2021)**

**Table 8: Coefficients<sup>a</sup>**

Model		Unstandardized Coefficients		Standardized Coefficients Beta	t	Sig.
		B	Std. Error			
1	VAT Allocation	2.263	2.184	.173	1.036	.308
	Internal Source of Finance	.020	.015	.223	1.332	.192

a. Dependent Variable: Quality of Life

**Source: Authors' Computation (2021)**

#### 4.4 Discussion and Policy Implication of Findings

The results reveal that VAT allocation and internal source of finance generated by states in Nigeria does not have a significant effect on the level of literacy and quality of life of citizens found among the states. This is contrary to the findings of Juliana and Okoye (2016) who posits that VAT has a significant positive effect on the level of economic growth in Nigeria. The reason for the variation in result can be attributed to the difference in methodology used. While they used VAT in aggregate sums over a time frame and gross domestic product to measure economic growth, VAT was measured based on proportions allocated to each state and various metrics that makes up the human development which is considered as a modern form of measuring economic growth was used hence giving a different result however which seems to be in tandem with the position of Adeleke (2011) who pointed out that VAT is structured to favor the Federal government. However, the results are in tandem with endogenous growth theory which posits that economic policies drive economic growth. Therefore, it means that judicious utilization of the funds generated will promote human development and not just the ability to raise funds within the states in Nigeria.

#### 5. Conclusion and Recommendations

This study was designed to examine the effect of a Value Added Tax on human development among states in Nigeria. It is shown from the study that there is a very low positive effect of

Value Added Tax on the level of literacy in Nigeria. It further shows that Value Added Tax has a very low positive effect on the quality of life in Nigeria. Hence, it is concluded from this study that Value Added Tax allocation does not have a significant effect on human development in Nigeria. Based on the findings, the study therefore recommended that:

- i. state governments should identify economic policies to be implemented in order to promote the level of literacy in their states.
- ii. In addition, State governments in Nigeria should set an undivided attention on the welfare of their citizens by identifying ways to promote it rather than engaging in agitations on the allocation of VAT which may heat up the polity of Nigeria.

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