

# Innovations

## An Insight into the Impact of Value-added tax on Nigeria Economic Growth

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**Abstract :** *The study was carried out with the general objective of determining the extent to which value-added tax (VAT) affects the economic growth indicators in Nigeria. Ex post facto research design was adopted and the relevant historical time series data for a period of 28 years were collected and analysed. The autoregressive distributed lag (ARDL) technique was applied following the outcome of the ADF unit root test and order of integration. The findings showed that value added tax is significant and affects the gross domestic product of Nigeria in the long run but has insignificant negative effect in the short run. Value added tax also significantly affects the manufacturing sector output of Nigeria in the long run. The study recommended compliance by VAT payers and better utilization of VAT revenue by the government for public services and infrastructure because it affects economic performance which ultimately enhances the wellbeing of the people. Sustenance of current VAT policies that enhances more revenue and investments thereby stimulating productivity and overall economic development was also recommended.*

**Keywords:** *Impact, Value-added tax, economic growth, gross domestic product and manufacturing sector output.*

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### Introduction

According to Anyanwu as cited in Idoko (2018), taxation has three main objectives. These include raising revenue for the government, regulating economic activities and redistributing income. Kalaš and Milenković (2017) pointed out that “taxation is one of the major areas of public finance used to achieve economic growth and equity in income and wealth distribution”.

By definition of Netherlands Economic Institute (1998), value added represents the difference between the value of the product and the value of the input which are

used in the production process. The burden of value added tax is finally borne by the consumers.

Many studies conducted on the impact of public revenue on the economy rarely considered value added tax as a separate variable but will often lump it together with other tax revenues. Moreover, many only made use of a few micro-economic indicators and adopted short time frames in their studies. Hence, there is need to investigate the role value added tax has played using more measures taking into account the life span of value added tax so far, that is from commencement till date.

### **Statement of the Problem**

The extent to which revenue from taxes have impacted on the lives of people in Nigeria leaves much to be desired considering the enormous amount that has been generated in the country over several years. This dissatisfaction among tax payers may not be far from the fact that taxpayers' money are being mismanaged by those in public offices (Awa, 2020). The inadequate social infrastructures in Nigeria call for attention as to how tax revenue generated is to be used and accounted for. One can possibly ask if there is yet a need for an additional tax like the value-added tax (VAT) which will contribute to the burdens of the masses with arguably, little or no convincing degree of impact on the economic growth and development of Nigeria when assessed right from the time of inception to date. It will be necessary to evaluate the implications of the fiscal policies of government in Nigeria which the value added tax is an aspect of, keeping in mind its effects on the economy and whether those effects translates to real developmental indicators in the lives of the people. A tax, in as much as it is a good instrument of revenue generation ought not to be a mere burden to the people who pay it but be remarkable for improving the benefits derived by the payers.

There is a view prevalent among the representatives of non-governmental organisations and labour unions which believes that VAT has not been ascertained to serve the purpose of reducing income inequality. As a result, an attempt to increase the VAT rate to 10% has met stiff resistance from Nigerian Labour Congress (Eyisi, Eyisi&Okafor, 2017). However, this has not been the case for Nigeria according to the study by Audu and Ajibade (2021) that examined the current effect of value added tax among states in Nigeria and found that VAT allocation has a very low positive effect on the quality of life and human development in Nigeria. There is problem of inconsistencies in the findings of different researchers. This problem has led to the need to re-examine the performance of value-added tax in terms of economic growth of Nigeria using many more variables. There is need to evaluate if VAT has led to visible changes in macro-economic indicators like the gross domestic

product and manufacturing or industrial sector output. Hence, determining the effect of value added tax on the growth indicators that relates with the lives or well-being of the people matters as to whether there is reasonable considerations that will justify continuing the operation of value-added tax.

### **Objectives of the Study**

The study has a general objective of determining the extent to which value-added tax affect the economic growth of Nigeria. The specific objectives of the study are to:

- i. evaluate the effect of value added tax on the gross domestic product of Nigeria.
- ii. evaluate the effect of value added tax on manufacturing sector output.

### **Statement of Hypotheses**

The following hypotheses are stated and will be tested in this study:

- i. Value added tax has no significant effect on the gross domestic product of Nigeria.
- ii. Value added tax has no significant effect on manufacturing sector output in Nigeria.

### **Conceptual Review**

#### **Value-added Tax**

The value added tax is a peculiar kind of indirect tax in which a particular rate is charged at every stage of production and distribution of a product or service at which the product appreciates in value. Valued added tax is a tax charged on the purchase of some goods made locally or imported into the country (Tabansi, 2001). According to Anyanwu (1993) VAT is a consumption tax on economic operations including imports with the exception of those statutorily exempted. It was initially charged at a flat rate of 5%. The current rate is 7.5% covering items of goods and services(Mazars Nigeria, 2023). Evasion of value added tax is difficult and the burden ultimately rests on the consumer.

#### **Origin and Development of Value-Added Tax**

Although the concept of VAT was proposed in 1918 by a German industrialist, Wilhelm Van Siemens, Okoye and Gbegi (2013) reported that in 1954, the VAT system was initiated by Maurice Laure, the then Joint Director of the French tax authority. VAT came into operation for the first time on 10th April 1954. Thereafter, it has become a major source of revenue in many developing countries. In sub-Saharan Africa for example, VAT has been introduced in Benin Republic, Kenya, Madagascar, Guinea, Mauritius, Niger Republic, Togo etc.

VAT was introduced in Nigeria by the federal government through Decree 102 of 1993 which phased out the Sales Tax Decree No. 7 of 1986. The Decree became effective from 1st December, 1993 and was operational in Nigeria on the 1st of January 1994. VAT is under the jurisdiction of the federal government and administered by the Federal Inland Revenue Services (FIRS) with the co-operation of the Nigeria Customs Service (NCS) and state internal revenue services.

### **Concept of Economic Growth**

Economic growth can be defined as long term expansion of the production capacity of an economy over a specific period of time. The gross domestic product is a yardstick for assessing the growth of an economy through volume of output within a country's geographical boundaries. Gross domestic product (GDP) is the total monetary value of goods and services produced within the country in a particular period usually a year. It is a measure of a country's general economic activities often calculated at market prices. GDP involves all private and public consumptions, government investments and exports minus imports that occur within a defined territory. It can be measured using income approach, expenditure approach and output approach (Oxford Dictionary of Accounting, 2005). The real or inflation-corrected GDP will be used in this study. This is the GDP when the effect of inflation is factored in.

Another indicator that can measure growth is the manufacturing sector output. Manufacturing sector output may be referred to as industrial sector output. It tells the level of activity or output of all factories that make use of raw materials in the country.

### **Theoretical Framework**

The study will hinge on the Ibn Khaldun's theory of taxation (Ibn, 1958).

Propounded in 1958, this theory was described in terms of two different effects, that is, the arithmetic effect and the economic effect which the tax rate have on revenue. The two effects have opposite results on revenue in case when VAT rate is either increased or decreased. On the arithmetic effect, if VAT rates are lowered, the VAT revenue will be lowered by the amount of the decrease in the rate. The reverse is the case for an increase in VAT rates (Ishlahi, 2006). The economic effect however, recognized a positive impact that lower VAT rate can have on work, output and employment by providing incentives to increase these activities whereas raising VAT rate has the opposite economic effect by penalizing participation in the taxed activities. At a very high VAT rate, negative economic effect dominates positive arithmetic effect thereby reducing the VAT revenue (Ishlahi, 2006).

## **Empirical Review**

Gatawa, Aliero and Aishatu (2016) in their study empirically examined the impact of VAT on the level of economic activities in Nigeria. Secondary data were collected and analyzed using Johansen (1988) co-integration test. The findings show evidence of a significant positive impact of VAT on economic growth.

Chigbu and Ali (2014) empirically analyzed the relationship between VAT and economic growth in Nigeria. Using the Engle and Granger co-integration technique on annual data covering 1994 to 2012, the result of their findings showed that VAT has positive effect on economic growth. The results also showed absence of both long-run and short-run relationship between VAT and economic growth.

Kolahi and Noor (2016) investigated the effect of VAT on the economic growth of nineteen developing countries from 1995 to 2010. In data analysis, the GMM panel was employed because of the structure of the model. Afterwards, the effect of VAT through the channel of saving on the capital accumulation and productivity and ultimately the economic growth was examined. The results revealed that VAT has a negative effect on capital accumulation growth in the level; the positive effect of VAT on the level of economic growth seems to have been imposed through channels other than the increase of saving and its effect on capital accumulation.

Ihenyen and Mieseigha (2014) on taxation as an instrument of economic growth in Nigeria made use of annual time series data from CBN Statistical Bulletin for the period 1980 to 2013. The ordinary least square technique was adopted. The result shows that relationships exist between the various taxes and economic growth in Nigeria.

Izedonmi and Okunbor (2014) on the roles of value added tax in the economic growth of Nigeria empirically examined the contribution of VAT to the development of the Nigerian economy. Simple regression and descriptive statistical methods were used. Findings showed that VAT revenue and total revenue accounts for 92% significant variations in GDP.

The impact of company income tax and value added tax on economic growth, evidence from Nigeria by Etale and Bingilar (2016) focused on the impact of companies' income tax and VAT on the growth of Nigeria economy. Secondary time series panel data were collected for the period 2005 to 2014. The results showed that both CIT and VAT had significant positive impacts on economic growth.

Agbo and Nwadiolor (2020) carried out a study on the genesis and development of value added tax administration. The work specifically examined the origin and popularity of the VAT system globally, identified the developing issues and its related consequences, x-raying the development of VAT and its computation in

Nigeria. The study shows that VAT has gained much popularity universally in spite of its different emerging issues. It was also noted that in Nigeria, several amendments of VAT laws which include the 50% rate increase may enhance the total revenue of Nigeria but on the other hand have some negative effects on the per capita income. These possible consequences can be alleviated only if essential palliative measures are deployed at the same time.

Lalarukh and Chowdhury (2013) worked on value added tax which was introduced in the People's Republic of Bangladesh in 1991 to substitute the sales tax regime. The purpose was to improve on revenue generation for funding development projects that will bring rapid economic growth. The work analyses the relationship between VAT and GDP growth of Bangladesh and investigated how VAT contributed in the economic growth of Bangladesh based on the data for the years from 1991 to 2012. Johansen co-integration technique was adopted. The study reveals a positive impact of VAT on gross domestic product and its contributions to the economic growth of the country.

Awa (2020) in his study aimed at investigating the relevance of tax revenue in driving economic growth in emerging market economy context. Data extracted from CBN statistical bulletin for various years were used. Auto-regression estimation model was applied and the study revealed the existence of significant and positive correlation between petroleum profit taxes (PPT), company income tax (CIT) on Nigeria's economic growth. Findings further showed that value added tax (VAT) and customs-excise duty (CED) exert negative influence on economic growth. However, the study provide evidence that VAT and CED are insignificant in determining the economic growth in emerging market economy context with special interest in Nigeria. This study provide further evidence that the higher the amount of tax revenue generated, the higher the level of economic growth in the economy.

Bingilar and Preye (2020) researched on the impact of value added tax (input tax and output tax) on the economic growth in Nigeria. The results showed that both input tax and output tax have positive and significant impact on GDP and total revenue. Therefore, VAT contributes significantly to the total tax revenue of government and extension by on the economic growth.

According to the study by Adereti, Sanni and Adesina (2011) on value added tax and economic growth of Nigeria, the researchers used time series data on GDP, VAT, total tax revenue and total federally collected revenue from 1994 to 2008. Descriptive statistics and simple regression analysis were adopted. Findings showed that the ratio of VAT revenue to GDP is 1.3%. Positive significant relationship existed between the two variables but no causality was found.

Olakunbi, Omolara and Oluwatosin (2022) studied the contributory effect of value-added tax on the level of revenue in Nigeria using time series data spanning from 2010 Q1 to 2021 Q4. The data used were from CBN statistical bulletin. The technique used for estimation was Autoregressive Distributed Lag (ARDL) model, which was employed to examine the short run and long run impact of VAT on tax revenue. The result shows that value added tax has a negative but insignificant contributory impact on revenue in both long and short runs.

**Methodology**

**Research Design**

The gross domestic product and manufacturing sector output are measured with already existing time series data. We will therefore adopt an *ex-post facto* research design in this study.

The scope of the work covers the period from the implementation of the VAT Act and collection of VAT revenue by the government of Nigeria from 1994 to the year 2021. The required data were sourced from appropriate government agencies which are Central Bank of Nigeria, FIRS, World Bank, United Nations Development Programme and National Bureau of Statistics.

**Data Analysis Technique**

The study will adopt the autoregressive distributed lag (ARDL).

**Data Analysis**

**4.1 Descriptive Statistics**

To examine the behavioral pattern of the model variables, the descriptive statistics of the variables were carried and the summary of the results is presented below.

**Table 4.1 Descriptive Statistics for the variables of study**

	LNGDP	LNMSO	LNVAT	LNGOVEXP
Mean	5.24539 6	3.06285 5	5.47543 8	7.613678
Median	5.65778 3	3.14628 9	5.85604 2	7.896835
Maximum	6.35294 3	4.16526 9	7.63668 0	9.223134
Minimum	3.52134	1.95727	1.98238	5.080721

	8	4	0	
Std. Dev.	0.93691 3	0.68777 4	1.50025 4	1.161114
Skewness	- 0.47054 8	- 0.00107 8	- 0.56185 7	-0.524797
Kurtosis	1.61679 1	1.59824 3	2.28609 1	2.282418
Jarque-Bera	3.26541 9	2.29241 4	2.06779 8	1.886002
Probability	0.19539 9	0.31784 0	0.35561 8	0.389457
Sum	146.871 1	85.7599 5	153.312 3	213.1830
Sum Sq. Dev.	23.7007 8	12.7718 9	60.7705 8	36.40104
Observations	28	28	28	28

Source: E-views computation

From the table above, there is evidence of significant variation in the trends over the period of consideration. This is shown by the large difference between the minimum and maximum values of the series. With respect to the statistical distribution of the series, LNGDP, LNVAT, LNMSO, and LNGOVTEXP are negatively skewed meaning asymmetry of the series around the mean. Kurtosis measures the peakedness or flatness of the distribution of the series. If the kurtosis is above 3, the distribution is peaked or leptokurtic relative to normal but if the kurtosis is less than 3, the distribution is flat or platykurtic relative to normal. From the table above, the values for LNGDP, LNVAT, LNMSO, and LNGOVTEXP are less than 3 which entails that the series are flat or platykurtic.

Jarque-Berra is a test statistic to test for normality in the distribution of the series. From the results, LNGDP, LNVAT, LNMSO, and LNGOVTEXP are normally distributed as their p-values are greater than 0.05.

### Unit Root Test

In this study, Augmented Dicker fuller (ADF) unit root test was employed to test for the time series properties of the model variables. This is necessary as it helps to avoid spurious regression results. They test the null hypotheses that the series has a unit root (not stationary). The choice of lag length was based on Schwartz-Bayesian

information criteria and was selected automatically by E-views. The decision rule is to reject the null hypothesis if the ADF value exceeds the critical value at a chosen level of significance (5%). The summary of the unit root results are presented in table 4.2 below.

**Table 4.2: Summary of ADF and PP tests results at 1% and 5% critical value**

Variable	ADF Test Statistics	ADF Critical Value		Order of Integration
		1%	5%	
<b>LnGDP</b>	-3.4813	-3.7114	-2.9810	I ~ (1)
<b>LnVAT</b>	-3.5709	-3.6998	-2.9762	I ~ (0)
<b>LnGOVTEXP</b>	-7.5380	-3.7114	-2.9810	I ~ (1)
<b>LnMSO</b>	-3.9218	-3.7114	-2.9810	I ~ (1)

Source: E-views computation

From table 4.2, it is observed that the variables LnGDP, LnMSO and LnGOVTEXP were not stationary at level form test but became stationary after first difference, which implies that the variables are integrated of order one (I ~ (1)). The variable LNVAT is integrated of order zero (I ~ (0)), as it is stationary at level form. The decision is based on the fact the ADF statistic was greater than the critical values at 5% level of significance; thus, the autoregressive distributed lag (ARDL) bound cointegration test is applied. To apply the ARDL bound cointegration test, optimum lag length is determined using Akaike information criteria.

**Model One**

**ARDL Optimum Lag Length Selection.**

After twenty (20) models automatically generated, ARDL (1,4,1) model was chosen based on Akaike information criteria for the first model.

**ARDL Bound Cointegration Test**

A necessary condition for testing for ARDL bound co-integrating test is that each of the variables be integrated of either of order one or zero or both (Pesaran, Shin & Smith, 2001). Since all the variables were integrated of order one and zero, we proceeded to estimate the ARDL bound test. The null hypothesis of ARDL bound cointegration is that the variables are not cointegrated as against the alternative that they are cointegrated. The decision rule is to reject the null hypothesis if the F-statistics is greater than the upper bound critical values at a chosen level of significance. The result of the ARDL bound cointegration test is shown in table 4.3 below.

**Table 4.3: ARDL Bound Cointegration Test Result for model one (VAT-GDP nexus)**

Model	F-Statistics	K	Significance level	Critical Bound Value	
				I(0) (Lower Bound)	I(1) (Upper Bound)
1	4.8249	2	5%	3.1	3.87
			1%	4.13	5

**Source: Author's computation using Eviews10 (2024)**

From table 4.3, the F-statistic is greater than the upper bound at 5% level of significance. Thus, the null hypothesis is rejected and we accept the alternative hypothesis which implies that there is a long run significant effect of value added tax (VAT) on the GDP of Nigeria. This is in line with the a priori expectation. Following therefore, short run tests were estimated.

**Short Run Parsimonious ARDL Result (VAT-GDP nexus)**

The summary of Short Run Parsimonious ARDL result of the effects of international remittances on financial sector development in Nigeria is presented in table 4.4 below.

**Table 4.4 ARDL Model (1,4,1)**

Variable	Coefficient	Std. Error	t-Statistic	Prob.
D(VAT)	-0.073217	0.186082	-0.393464	0.6995
CointEq(-1)*	-0.380335	0.079031	-4.812457	0.0002
R-squared = 0.606; Adj R-Squared = 0.497				

**Source: Author's computation using Eviews10 (2024)**

From table 4.4 above, the coefficient of VAT is negative and statistically insignificant implying that VAT does not drive economic growth in Nigeria in the short run. This further suggests specifically that a 1 Naira increase in VAT will decrease the rate of GDP by N0.07. This result is not consistent with economic 'a priori' expectation.

The coefficient of error correction model (ECM (-1)) is (-0.3803) and is appropriately signed and significant. This speed of adjustment suggests that about 38.3% of the previous period's disequilibrium in VAT is corrected every quarter by GDP.

The coefficients of multiple determinations and its adjusted are 0.606 and 0.497 respectively, suggesting that about 60.6% of the variation in LNVAT is explained by the variables included in the model and that variations in VAT accounted for 60.6% of the variations in economic growth in Nigeria. This further shows a good explanatory power of the model.

**Model Two**

**ARDL Optimum Lag Length Selection.**

After twenty (20) models automatically generated, ARDL (2,0,0) model was chosen based on Akaike information criteria for the first model.

**ARDL Bound Cointegration Test**

The result of the ARDL bound cointegration test is shown in table 4.5 below.

**Table 4.5: ARDL Bound Cointegration Test Result for model two (VAT-MSO nexus)**

Model	F-Statistics	K	Significance level	Critical Bound Value	
				I(0) (Lower Bound)	I(1) (Upper Bound)
1	5.763600	2	5%	3.1	3.87
			1%	4.13	5

**Source: Author’s computation using Eviews10 (2024)**

From table 4.5, the F-statistic is greater than the upper bound at 5% level of significance. Thus, the null hypothesis is rejected and we accept the alternative hypothesis, implying that there exists a long run significant effect of value added tax (VAT) on manufacturing sector output (MSO) of Nigeria which is in line with the a priori expectation. Following therefore, short run tests were estimated.

*Short Run Parsimonious ARDL Result (VAT-MSO nexus)*

The summary of Short Run Parsimonious ARDL result of the effects of VAT on manufacturing sector output in Nigeria is presented in table 4.6 below.

**Table 4.6 ARDL Model (2,0,0)**

Variable	Coefficient	Std. Error	t-Statistic	Prob.
CointEq(-1)*	-0.420786	0.081976	-5.133019	0.0000
R-squared = 0.560; Adj R-Squared = 0.542				

**Source: Author’s computation using Eviews10 (2024)**

From table 4.6 above, VAT has no effect on the manufacturing sector output in the short run. The coefficient of error correction model (ECM (-1)) is (-0.4207) and is appropriately signed and significant. This speed of adjustment suggests that about 42.7% of the previous period’s disequilibrium in VAT is corrected every quarter by manufacturing sector output (MSO).

The coefficients of multiple determination and its adjusted value are 0.560 and 0.542 respectively, suggesting that about 56% of the variation in LNVAT is explained by the variables included in the model which suggests that variations in VAT accounted

for 56% of the variations in manufacturing sector output (MSO) in Nigeria. This further shows a good explanatory power of the model.

### Summary of Findings

The general objective of the study is to ascertain the effect of value added tax on economic growth and development of Nigeria. From the results of the data analysis, it can be observed that:

- i. Value added tax is significant and affects the gross domestic product of Nigeria in the long run but has insignificant effect in the short run period.
- ii. Value added tax in line with a priori expectation significantly affects the manufacturing sector output of Nigeria only in the long run.

### Conclusion

In Nigeria currently, VAT has gained popularity despite the issues bordering on its efficient administration. VAT laws have passed through series of amendments, the latest which led to increasing the rate from 5% to 7.5% has generated debates and criticisms among diverse interest groups. The argument in some quarters is that, even if VAT increment ends up increasing the total revenue generation, it will likely affect the standard of living of Nigerians adversely, worsen the already existing income inequality in Nigerian and drive inflation.

From the findings of this study after analyzing the relationships existing among the variables, it can be concluded that economic growth and development of Nigeria are influenced or driven by value added tax in the long run period. Changes in value added tax which is the explanatory variable accounts for significant variations in the macro-economic indicators of growth in the country. These changes are mostly visible or manifest observable impact of value added tax in the long run. In as much as VAT has both favourable and unfavourable implications, it can be regarded a good policy instrument in the hand of the government.

### Recommendations

Based on the observations, the following recommendations are made.

- (i) Government should ensure that all organisations in the manufacturing sector fully comply with the VAT Act by remitting the VAT they collect from their operations accordingly.
- (ii) Sustenance of current fiscal policies that enhances investment in agriculture, industries and technology, thereby stimulating productivity and overall economic growth.

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