

IMPACT OF INTERNALLY GENERATED REVENUE (IGR) ON TOTAL REVENUE OF LAGOS STATE

Ahannaya, Chinedu Gandolph;¹ Daniel-Adebayo, Olugbenga;² Iwala, Andrew Taiwo,³ Sanni, Adeyemi Sheriff;⁴ & Akenronye, Christopher⁵

¹Accounting, Babcock University, Ilishan-Remo, Ogun State, Nigeria

²Accounting, Babcock University, Ilishan-Remo, Ogun State, Nigeria

³Accounting, Babcock University, Ilishan-Remo, Ogun State, Nigeria

⁴Accounting, Babcock University, Ilishan-Remo, Ogun state, Nigeria

⁵Accounting, Babcock University, Ilishan-Remo, Ogun state, Nigeria

Corresponding author: ahannayac@babcock.edu.ng 07034894419

ABSTRACT: *The State Governments in Nigeria like every other sub-national government are to raise adequate revenue to finance relevant infrastructural development needed for economic growth. However, the recent significant decline in the revenue accruable to State Governments from Federal Government, occasioned by the drastic fall in crude oil prices, has adversely affected the financial capacity of States.*

The study examined the extent of contribution of IGR and its impact on financing of infrastructural development as measured by capital expenditure on: roads infrastructures, environmental protection, health, housing and education incurred by States in Nigeria using Lagos as a case study. Data were sourced from the audited financial statements of Lagos State Government over a fifteen-year period of 2000 – 2014. Descriptive statistics and inferential statistics using linear regression method were carried out on the data.

The result of the findings showed positive relationship between internally generated revenue (IGR) and total revenue (TR) ($-0.0000 < 0,05$) and also that IGR constitutes a significant proportion of Total Revenue of Lagos state. It was also noted from the study that IGR has significant positive relationship with Capital Expenditure measured along the vectors of: roads infrastructures CERI ($-0.0000 < 0,05$); environmental protection CEEP ($-0.0000 < 0,05$), health CEHT ($-0.0000 < 0,05$), housing CEHC ($-0.0005 < 0,05$) and education CEED ($-0.0000 < 0,05$) incurred by States in Nigeria

The study concludes that IGR has significant positive impact on the infrastructural development needed to create a platform for economic growth. The study recommends that State governments should put in place policies for sustainable growth in IGR and that IGR should be invested in financing capital expenditure required for infrastructure development needed for economic growth.

Keywords: Lagos State Government, Federal Government of Nigeria, Total Revenue, Internally Generated Revenue, Infrastructural Development, Capital Expenditure and Economic Growth.

1.1 Background to the Study

The collapse of global oil price has taken its toll on the Nigerian economy. Across Nigeria, the new administration and the public have continued to deliberate on how to respond to the unrelenting dive in oil price and its impact on government revenues. Currently, many states are unable to meet their statutory obligations due to the significant decline in their share of revenue from the Federal Government and there seems to be no

light at the end of the tunnel. A few states have partially been able to offset the fall in Federal oil revenue transfers by increasing their Internally Generated Revenue (IGR). Sections 46(4) and 48(4), of the constitution of the Federal Republic of Nigeria 1999, states that the four major sources of revenue accruable to the state governments namely: share of revenue from the Federation Accounts, Internally Generated Revenue (IGR), Domestic and Foreign Debts, Grants, Donations and Subventions.

In regards to Internally Generated Revenue (IGR), the Revenue Act (1981), made it possible for state governments to partially dispense with traditional sources of revenue which are internally generated. It should be noted that between 1962 and 1983, the percentage of internal revenue generated to the total revenue was about 60% for some states. However, the reliance on statutory allocation from the federal accounts to perform basic functions by some states in Nigeria is total, as many states rely almost exclusively on the fund from the federation accounts, hence, basic operations cannot go on without the monthly allocations. In other words, internal revenue generation as a major means of financing capital expenditure was abandoned in preference to the fund received from the federal statutory allocation CBN (2012). Arising from the significant reduction from revenue from crude oil, there is a growing recognition among the state governments in Nigeria of the crucial role of "Internally Generated Revenue" (IGR) as an instrument of provision of finance for infrastructural development needed to create the platform for economic growth. IGR are increasingly accounting for significant proportion of government revenue to finance the required level of public expenditure both at federal, state and local government levels. Hence, IGR has been embraced by many state and local governments to boost total revenue nationwide (Oseni, 2013).

Arusha (2009), argued that increase in government expenditure on socio-economic and physical infrastructures encourage economic growth. Likewise, expenditure on infrastructure such as roads, communications, power and others, reduces production costs, increases private sector investment and organisation's profitability, thus fostering economic growth. They further concluded that expansion of government expenditure contributes positively to economic growth. However, in Nigeria rising government expenditure has not translated to meaningful economic growth and development because significant proportion of this expenditure were spent on recurrent rather than capital

expenditure. This is corroborated by the recent research on Nigeria Economic Index carried out by McKinsey & Company (2013), which showed that, Nigeria ranks among the poorest countries in the world and in addition to this, many Nigerians have continued to live in abject poverty, while more than 50 percent live on less than N500 per day. Salawu (2006), stated that the effectiveness of government at any level depends on the degree of financial independence it enjoys and this can be achieved through taxations, collection of levies, fines, charges and fees among others, all of which are components of IGR.

Oseni (2013), emphasises that irrespective of ideological background on which the economy of a nation is based, IGR in its various forms have always been the major sources of revenue to the government, and this is to enable the government to generate enough revenue needed to develop economically, socially and politically. IGR can be operated by all tiers of government, in particular, at the state level. In view of the tremendous contribution of IGR to the state government's total revenue, there is need to assess its contribution further. This study is an assessment of the impact of IGR on the economic growth of states in Nigeria for a period of fifteen (15) years from 2010 to 2014, using Lagos state as a case study.

Presently, the three tiers of government rely heavily on the allocation from the federation account to finance the personnel costs, overhead expenditures and to embark on capital projects. This monthly allocation is not enough to cater for all the above, hence state governments should focus more on generating revenue internally within the boundaries of their states with a view of using same judiciously for capital projects rather than recurrent expenditures. It is against this background that this study is focussed on finding out the impact of IGR generated on the economic growth of the states during the period under review.

2.0 Literature Review

2.1.1 Internally Generated Revenue (IGR)

The constitution of the Federal Republic of Nigeria of 1999 specifically states the types of internally generated revenue that are exclusive to the state governments. Revenue, according to Section 162 subsection 10 of the constitution of the Federal Republic of Nigeria 1999 CAP. C23 L.F.N. (2004) means that any income or returns accruing to or is derived by the State Government from any source and include any receipt, however described, arising from the operation of any law, any return, however described, arising from or in respect of any property held by the state governments, and any return by way of interest on loans and dividends in respect of shares or interest held by the state governments in any company or statutory body.

Revenue is defined as income received from all activities engaged in by the receiving entity. In governmental terms, revenue is the entire amount received by the government from sources within and outside the government entity, Omolehinwa (2001). In Nigeria, Government revenue includes proceeds from sales of crude oil, taxes (including import and excise duties), penalties, interests, fines, charges and other earnings received from government investments (bonds, dividends etc). Therefore, revenue encompasses the entire gamut of government income which is realised and available for expenditure within a particular fiscal year or period (Ekukinam, 1980). Therefore, revenue generation is viewed as the primary and most important role of taxation. However, taxation is viewed not only as a means of revenue generation to the government, but can as well be used to stimulate other sources of government revenue and develop other areas of the economy from which the government can realise further revenue (Ariwodola, 2005).

Under the 2004 Act, the relevant provision is Section 87 which provides for the establishment the State Board of Internal Revenue whose operational arm shall be known as the State Internal Revenue Service. The Board shall have the power to assess and collect the following categories of taxes and levies within the state

boundary as internally generated revenue, Federal Board of Inland Revenue (2013). The Board shall have the power to assess and collect the following categories of taxes and levies within the state boundary as internally generated revenue. Pay-As-You-Earn (PAYE), Direct taxation (Self Assessment and withholding and capital Gains taxes of individuals.

- I. Stamp duties on instruments executed by individuals
- II. Pools, betting and lotteries, gaming and casino taxes
- III. Road taxes and naming of street registration fees in the State Capital
- IV. Business premises registration fees
- V. Development levy, Right of occupancy fees and market taxes and levies.
- VI. Taxes from the informal sector.

Therefore, IGR of a state can be described as the total revenue (taxes and other sources of income) generated within the geographical/regulatory boundary of the state. It should be noted that there are distinctions between taxes and other internally generated revenue items such as charges, fines, levies and penalties.

Moreover, the Nigeria Constitution of 1999, generally allows the state governments to broad discretion in establishing fee, charges, fines, penalties levies etc. Similarly, Naiyeju (2014), highlighted that some other revenue items are not usually income or transaction based, but may be imposed for the use of utilities or infrastructure or simply imposed on certain categories of persons, persons within a particular areas or activities. In addition, (The National Tax Policy, 2012), explained working definition of other items of revenue as follows:

(i) **Charges:** this is an amount paid for the use of goods, services or infrastructure provided by the government.

(ii) **Fees:** this is a payment for the services provided by the public institutions or organisations, such as government entities or

agencies, i.e. payment for use of utilities and for obtaining government documents such as passports, certificate of occupancy (C of O), etc.

(iii) **Fines:** these are certain amount of money imposed by the government for an offence or indiscretion by a person within the jurisdiction of the government. This includes court fines, fines imposed for traffic violations by LASTMA, unauthorised usage of government properties etc.

(iv) **Penalties:** this is similar to fines, is amount paid or forfeited for not meeting a particular condition or fulfilling an undertaking. Penalties includes late filing of returns, late or inability to provide certain information to government agencies as required.

(v) **Rates:** these are usually imposed on property or assets and are usually determined with respect to the value of the property or in relation to some other factors. Rates includes tenements on shops and kiosks, development levies collected by the state governments as part of income taxes.

Although in practice, there may be little distinction between what constitutes a tax, or charge, or fine as these concept are sometimes interchangeable, however, it is important to know and understand the distinctions set above in mind Tax Foundation (2006). Furthermore, the choice of internally generated revenue collected by the state government should help matters. Egonmwan (1984), pointed that the state government have acquired the more lucrative, elastic and collectable revenue sources (e.g. water rates, motor licences fees, building plan fees). However, there are those that are administratively and politically difficult to exploit in an environment where the majority of people are poor, self employed and dispersed in some areas (i.e. the informal sector)

According to Atakpa, Ocheni, and Nwakwo (2012), other causes of poor internally generated revenue are lack of adequate resources such as vehicles, and personnel for mobilising IGR and the potential payers of taxes, rates and charges are not willing to pay due to biases and other personal

reasons. Moreover, the leakages in the system constitute a significant drain on government revenue and a challenge to efficient collections and utilisation of revenue, this occurs at the time of assessment, collection and utilisation as i.e. where disbursement is not properly accounted for, as discovered by Agu (2011). In addition, leakages in the tax systems occurs via tax evasion and tax avoidance. While tax evasion is a deliberate refusal to pay taxes or make tax returns with the intension of fraudulently retaining tax revenue. However, tax avoidance means liability is minimised or avoided by exploiting the loopholes in the law.

2.1.2 Infrastructural Development

According to Oseni (2013), economic growth is the increase in value of the goods and services produced by an economy over a period of time, It is conventionally measured as the percent rate of increase in real GDP. Growth is usually calculated in real terms (inflation-adjusted terms), In economics, "economic growth" refers to growth of potential output i.e. production at full employment, which is caused by growth in aggregate demand or observed output (GDP).

In Nigeria for instance, the broad objective of the national economic policy has been the desire to promote sustainable economic growth for the vast majority of Nigerians through the adoption of various monetary and fiscal policies. Unfortunately, the economic growth performance has been characterised by fits and starts and the prospects of rapid economic growth appear unachievable. This has reflected in inability to realise sustainable full growth potentials and to significantly reduce the rate of poverty in the economy, considering the fact that economic growth is a key policy objective of any government. In addressing the pertinent issues in economic management, experts and economic planners have had to choose between or combine some of the macroeconomic variables.

Banabo and Koroye (2011), were of the opinion that wealth can be created for citizens through

meaningful employment, so that citizens are able to earn income, cater for their needs and also pay income taxes to the state governments as part of their contribution to state and national development. There is also an implicit belief that the Nigerian economic environment has been unable to attract foreign investment to its fullest potentials, been characterised by unstable business environment, inefficient capital markets, high rate of inflation, unstable polity, stringent policies and fragile financial system, among others. Also, the main factor underlying these outcomes is the volatility of government expenditure arising from the boom and burst cycle of government revenue which is derived mainly from single export commodity (crude oil), whose price is also volatile. To worsen the problem, these expenditures are not channeled to productive sectors of the economy (Soyode and Kajola, 2006).

As part of the strategy to grow the economy of Lagos state, the objective of the tax strategy is to use the tax system to help grow investment, economic activities and create employment. It is expected that this will be achieved whilst maintaining stable revenue (from IGR and other sources) flow to encourage sustainable government expenditure. (Audited Financial Statement of Lagos State, 2014).

2.2 Theoretical framework

2.2.1 Theory of fiscal federalism

The basic foundations of this theory were laid by Kenneth Arrow, Richard Musgrave and Paul Sadwel Samuelson. The paper of Arrow (1970) on the roles of public and private sectors and Musgrave (1959) on public finance provided the framework. These roles as identified for the government sector were the roles of government in correcting various forms of market failure, ensuring an equitable distribution of income and seeking to maintain stability in the macro-economy at full employment and stable prices. The role of interest in this study is government's

role in correcting market failures. In this role the government is expected to step in where the market mechanism failed due to various types of public goods characteristics.

Each tier of government is then seen as seeking to maximize the social welfare of the citizens within its jurisdiction. This multi-layered quest becomes very important where public goods exist, the consumption of which is not national in character, but localised. In such circumstances, local outputs targeted at local demands by respective local jurisdictions clearly provide higher social welfare than central provision. This principle, which Oates (1972) has formalised into the "Decentralisation Theorem" constitutes the basic foundation for what may be referred to as the first generation theory of fiscal decentralisation (Oates, 1994). The theory focused on situations where different levels of government provided efficient levels of outputs of public goods "for those goods whose special patterns of benefits were encompassed by the geographical scope of their jurisdictions. Such situation came to be known as "perfect mapping" or "fiscal equivalence". Nevertheless, it was also recognised that, given the multiplicity of local public goods with varying geographical patterns of consumption, there was hardly any level of government that could produce a perfect mapping for all public goods. Thus, it was recognized that there would be local public goods with inter-jurisdictional spillovers. For example, a road may confer public goods characteristics, the benefits of which are enjoyed beyond the local jurisdiction. The local authority may then under-provide for such a good. To avoid this, the theory then resorts to traditional Pigouvian subsidies, requiring the central government to provide matching grants to the lower level government so that it can internalize the full benefits.

But in the face of unstable matching grant from the central government and the assignment of social welfare maximisation through public goods to the lower subnational government, same government must have to raise fund internally to

complement such grant in order to carry out its functions effectively.

2.2.2 The Linear-Stage-of-Growth Theory

The linear-stages-of-growth model was first formulated in the 1950s by W. W. Rostow in *The Stages of Growth: A Non-Communist Manifesto*. The linear-stage-of-growth model was primarily an economic theory of development in which the right quantity and mixture of saving, investment, and foreign aid were all that was necessary to enable developing nations to proceed along an economic growth path that historically had been followed by the more developed countries.

This school of thought focused on the lack of domestic savings and investment. In order to promote growth, policymakers had to induce higher savings and investment rates in developing countries, a proposition that was easier said than done. This economic model was postulated by Rostow's Stages of Growth and Harrod Domar Growth Model. The former model postulates that economic modernisation occurs in five basic stages of varying length, i.e. traditional society (when the society is preoccupied with understanding and use of technology), preconditions for take-off (education, capital mobilization, establishment of banks and currency, entrepreneurial and manufacturing develops), take-off (which occurs when sector led growth becomes common and society is driven more by economic processes than traditions society), drive to maturity (this refers to the need for the economy itself to diversify, i.e. from oil and gas to non oil sector) and age of high mass consumption (refers to the period of contemporary comfort afforded by many western nations, wherein consumers concentrate on durable goods wherein consumers concentrate on durable goods, and hardly, and hardly remember the subsistence concerns of previous stages, however, the developing nations are still flooded with inferior goods and materials). And the later model postulates that GDP growth is proportional to the share of investment spending in GDP which means that, the growth rate of GDP

depends on the level of savings and the capital output ratio.

These theories have been criticised for not recognising that, capital accumulation is not a sufficient condition for development. The theory failed to account for political, social and institutional obstacles to development, particularly, in the developing countries, such as Nigeria.

2.3 Empirical review

A number of studies have been conducted on Nigeria's fiscal federalism. These range from analysis of revenue and expenditure decentralisation and financial autonomy of the different tiers of government, (Jimoh, 2003; Ekpo, 2004; Adesopo & Asaju, 2004, Obi, 2006 and European Journal of Management, 2013) to local government financing. In Nigeria, the term 'resource control' has almost come to assume a life of its own, defining the contention between proponents of increased revenue devolution and federalists who fear that accountability is still too weak at the sub national level to allow for such high devolution.

Moreover, Agba and Obi (2006), analysed data on the federation account in relation to the unending contention about allocations to the different tiers of government. They calculated indices of revenue and expenditure decentralisation and financial autonomy of the three tiers of government and concluded that expenditure power is concentrated at the federal government. They identified the usual non-correspondence between revenue and expenditure assignment especially to other tiers apart from the federal government and recommended conscious effort to allocate more revenues to the sub-national governments.

However, studies on assessment of the impact of taxes and other IGR on the economy of Bangladesh by Mohammad Nayeem (2012), concluded that direct and indirect taxes contributes only a small portion of the total revenue, i.e. the tax system is complex, difficult to

administer and enforce. His findings showed that revenue collection and administration has been a perennial challenge for Bangladesh and there has been a persistent pressure to address the challenge. He stressed that revenue budgeted by the government cannot be met and this caused a great increase in budget deficit during the fiscal year, hence taxes (direct & indirect) does not contribute significantly to government total revenue. He further concluded that the implementation of an effective revenue system will involve setting up of new organisational structure, designing of new policies and procedures, writing of new instructions, provisions of better management of information and statistics to give the revenue administration the opportunity to develop new skills and abilities that can subsequently be deployed.

Also, recent studies carried out by Taiwo, Samson and James (2015), on Impact of Tax Reforms on Revenue Generation in Lagos State between 2006 and 2012, using Time Series Analysis and Ordinary least square regression techniques (OLS) concluded that there was a continuous increase in taxpayers growth and steady increase in internally generated revenue during that period. The result further showed a long run relationship between IGR and total revenue and this has enabled the state to carry out its budgetary responsibilities, hence IGR has a positive relationship to the total revenue generated in Lagos State during this period.

3.0 METHODOLOGY

The research design provided a rigorous research process for achieving the objectives of this study. It also suggests a 'road map' that clarifies the action plan for attaining the research objectives described above and a logical consequence that connects the empirical data (materials and data collected) to initial research questions in pursuit of the conclusion (Yin, 2009).

The study employed ex-post facto research design, carried out critical analysis of data extracted from financial statements of Lagos state,

IGR summary of state boards of internal revenue service, FAAC records and national GDP figures for a period between 2000 to 2014. Other relevant data were extracted from the websites of Central Bank of Nigeria (CBN), Nigeria Bureau of Statistic (NBS), Ministry of Finance, Lagos State Debt Management Office, Joint Tax Board (JTB), journals and textbooks.

This period was selected to permit the use of the study's findings for long term prediction of the explanatory variables (IGR) on the explained variable (infrastructural development). The data collected through secondary sources were analysed to generate information required to achieve the objectives of this study. The results and findings from data analysis were presented using descriptive answers and this helped the researcher to explain the physical attributes of data collected.

3.1 Findings and Discussions

Test of Hypothesis

Regression Estimate

Variable	model 1			
	Coefficient	Std Error	t-Stat.	Prob.
C	4.443697	0.831366	5.345052	0.0005
LOG(TAX)	0.834558	0.037307	22.37028	0.0000
LOG(FINES)	0.063232	0.028034	2.255524	0.0505
LOG(LICENSES)	0.051522	0.041373	1.245321	0.2445
LOG(EARNINGS)	0.027484	0.036842	0.746010	0.4747
LOG(CHARGES)	0.004517	0.015823	0.285444	0.7818
R²	0.997328			
Adj. R²	0.995844			
S.E of Reg	0.065536			
F-Statistic	671.9552			
Prob.(F-Stat)	0.000000			
Obs	15			
Durbin-Watson	1.815629			

Ramsey's Reset test	1.891441 (0.2063)
Jarque-Bera	0.85 (0.65)

Dependent Variable: Log(TR)

*significance at 5%

Model 1 & A- prior expectation

$$TR = \beta_0 + \beta_1X_1 + \beta_2X_2 + \beta_3X_3 + \beta_4X_4 + \beta_5X_5 + \mu$$

$$\begin{aligned} \text{Log(TR)} = & 4.443697 + 0.834558\text{Log(tax)} \\ & 0.063232\text{Log(fines)} + \\ & 0.051522\text{Log(licenses)} \\ & + 0.027484\text{Log(Earnings)} + \\ & 0.004517\text{Log(Charges)} \end{aligned}$$

The Multiple regression estimate of the above showed that there exists a negative relationship between Log(fines) and Log(Total Revenue); while positive relationship exist between Log(TR) and each of the remaining indicators of IGR of Log(Tax), Log(Licenses), Log(Earnings), and Log(Charges). This is indicated by the sign of the coefficients, that is $\beta_{1-5} = 0.8346 > 0$; $-0.0632 < 0$; $0.0515 > 0$; $0.0275 > 0$; $0.0045 > 0$. This result is inconsistent with aprior expectations.

Interpretation of Result

Furthermore, the size of coefficients of the independent variables explained that a 1% increase in Tax, Fines, License, Earnings and Charges will cause a 0.83% increase, 0.06% decrease, 0.0515% increase, 0.027% increase, and 0.0045% increase respectively in Total Revenue (TR).

Also, the adjusted R-squared showed that about 99% variations in Total revenue (TR) can be attributed to the indicators of IGR of Tax, Fines, Licenses, Earnings and Charges, while the remaining 1% variations in TR are caused by other factors not included in this model. This shows a strong explanatory power of the model. This is further emphasized by the F-statistic p-value 0.00

which shows that the regression result is statistically significant because this is less than 5%, the level of significance adopted for this study.

Several diagnostic tests were also performed on this model, the result of the durbin Watson statistics of 1.82 is within the acceptable range of 1.5 to 2.4 showing an acceptable level of auto correlation. Furthermore, the Ramsey reset test result indicates that the series is linear, thus, satisfying another assumption of OLS regression estimate. Also, the P-Value of Jarque Berra statistics of 0.65 shows that the residuals are normally distributed.

Decision rule

From the above analysis, with level of significance 0.05, the F- statistic is 671.9552 while the P- value of the F- statistic is 0.0000 which is less than 0.05, we therefore reject the null hypothesis and accept the alternate which means that IGR contribute significantly to the proportion of total revenue in Lagos state. The objective one is achieved and question one answered.

Therefore, the model is adequate and the null hypothesis 1 of this research may not be accepted. Hence, contribution of IGR is statistically significant to the total revenue of Lagos State for the period of 2000 to 2014.

Conclusion and Recommendation

The study examined the extent of contribution of IGR to internal generated revenue and also the impact of IGR on the infrastructural development of states in Nigeria as measured by capital expenditure on road, environmental protection, health, housing and education, using Lagos as a case study.

Findings of this study therefore provide insight into the effect of Internally Generated Revenue (IGR) and infrastructural development measured by capital expenditure on: road infrastructure, environmental protection, health, housing and education. The study concludes that overall, IGR

has significant positive impact on the infrastructural development of states in Nigeria due to the fact that the IGR enhances the capacity of state governments to finance relevant capital expenditure on infrastructural development necessary for economic growth.

Based on the findings and conclusion of this study, the following recommendations are made: Policies should be put in place by the government for effective and efficient administration of IGR in order to create a sustainable growth in the IGR of the States of Nigeria. Also, government should monitor and enforce tax laws to reduce leakages in IGR to the barest minimum

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