

INFLUENCE OF GOVERNMENT EFFECTIVENESS AND REGULATORY QUALITY ON TAX COMPLIANCE IN NIGERIA

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Abstract

In emerging countries, taxes play a crucial role. The more taxes they levy, the more long-term revenue they generate. However, due to a variety of administrative issues, these countries only generate a small amount of revenue from taxes. As a result, the impact of government effectiveness and regulatory quality on tax revenue in Nigeria was investigated in this report. The study looked into the impact of government efficiency on tax revenue, as well as the relationship between regulatory quality and tax revenue in Nigeria. The study used an ex-post facto research design and ARDL technique was utilized to analyse the secondary data collected. Government effectiveness is positively significant on tax revenue in Nigeria, according to the findings, while regulatory quality is not significant. The study came to the conclusion that good governance is instrumental in understanding the level of tax revenue in Nigeria, and recommended that government should nurture a continuous desire for quality service delivery.

Key Words: Taxation, Revenue, Regulatory Quality, Government Effectiveness, Nigeria

JEL Classification: E60; E62; G18

1. Introduction

The creation of tax wealth in a nation is a form of performance initiatives that mainly rely on its administrative ability to optimize taxes and build further tax collections. Because emerging nations encounter many systemic flaws, they earn relatively low revenue through taxing. In the absence of such obstacles, such countries will be able to give their people a strong fiscal framework to accommodate their requirements for well-being.

A nation's governance is usually assumed to be a vital factor in generating tax income. For this reason, any government that wants to boost tax proceeds can start by improving its governing potentials (Hussain, Ilahi & Muqem ul Islam, 2016). In this context, the standard of governance is indeed important. The effectiveness of government and regulatory quality represent two wheels of quality governance from the viewpoint of policy making and implementation. Thus, government performance and quality of regulations is likely to herald an efficient tax structure that enhances the eagerness of taxpayers to pay their tax bills.

A prominent feature in tax study indicates that belief in leadership and tax system boosts the faith of taxpayers in government, and consequently increases tax means. Murphy and Tyler (2008) claims that taxpayers will cooperate quite well and justly while complying with the tax authorities' decisions once they are treated fairly. Therefore, the State has to be seen as playing its part via delivering its accurate best and putting in place effective policies for citizens to show support for the government.

Ocheni (2015) confirms that tax policies seem to be the fundamental part of every tax system and the strength of any tax system depends on policy initiatives. A prime objective of the tax program is to ensure that taxpayers of all categories comply with their legal responsibilities to the greatest possible extent. Regrettably, in Nigeria and several emerging nations, tax policies are usually shaky and typified by vast irregularities. Levi (1988) contended that if taxpayers deem the tax transformation rate to be small, they will feel that government has failed its obligation. Therefore, the zeal of the taxpayers will be adversely affected and the tax gap (that is, the difference between in what tax payers pay and what ought to be paid as stipulated by law) will become widened. This

trend can make it more and more complicated for successive administrations to fulfil their constitutional and campaign promises (Modugu & Anuaduba, 2014).

In Nigeria, the ambitious hopes in government have been shattered by a growing lack of effectiveness, transparency and regulatory efficiency, even in the midst of a democratic system. And as a result, tax collections have suffered largely. According to evidence derived from World Development metrics, Nigeria's tax-to-GDP level has never exceeded 7% of its GDP. This is a signal of poor tax results, which further impedes the country's growth. Albeit, in order to increase the tax-to-GDP ratio, their institutional governance could be improved upon. Based on this notion, this study investigates the impact of government effectiveness and regulatory quality on tax revenue in Nigeria.

The following hypotheses were established in order to fulfil the stated objectives:

H₀₁: In Nigeria, government effectiveness has no impact on tax revenue.

H₀₂: In Nigeria, regulatory quality has no impact on tax revenue.

Undoubtedly, some research has centred on the significance of governance in the scope of taxation (Ajaz & Ahmed, 2010; Hussain, Ilahi & Muqem, 2016; Hossain, 2014). This study makes a unique contribution because it focuses on the direct role of government effectiveness and regulatory efficiency in defining tax revenue shifts in Nigeria. Moreover, it will immensely enlighten states, policy makers and tax authorities on specific governance factors affecting tax revenue when seeking to bridge the tax-gap. It is also expected to benefit potential research students who could use the outcomes to further investigate similar subject matters, and to provide supplementary empirical evidence in their region on governance and tax revenue. This research encompasses the years 1996 to 2017.

2. Literature Review

Conceptual Framework

Tax Revenue, Government Effectiveness and Regulatory Quality

A tax is a charge, mandatorily levied by government on an individual or a corporate body, for government to attain its aim of providing basic services and establish conditions for social - economic well-being (Ocheni, 2015). The system of tax administration and assessment is known as taxation (Adeniran, Alade & Oshode, 2013). Taxation is among the feasible ways for every

government to generate income in order to meet the needs of its people. Tax revenues are nothing more than the proceeds from levying taxes. These differ province to province because revenue patterns are not consistent. In some regions, tax income shares could steadily increase, while others may record decimated total tax shares.

Governments do have unique spending goals and policies, which necessitates different tax targets. By so doing, revenue collection could be dependent on government productivity (Hossain, 2014), particularly since tax payment is seen as a behaviourally induced act depending on governments' decisions regarding basic service delivery (Akpu & Ohaka, 2017). Okello (2014) also claimed that a service-oriented approach and accountability on the part of a government and tax authorities would increase active adherence, which will trigger better tax yield.

In a nutshell, effective governance will result in a more efficient tax system that creates further revenue (Ajaz & Ahmed, 2010). Benno (2003), for example, observed that the high democracy, effective control, trust in the executive and judicial system all have a meaningful impact on tax growth. The dimensions of effective governance for the purpose of this work are government effectiveness and regulatory efficiency, which are focused on the government's capability to develop and put appropriate policies in order.

The view of the country's efforts to formulate policies and rules that allow/reinforce private sector growth is captured by Regulatory Quality (Kaufman, Kraay & Mastruzzi, 2010). It focuses more on policies, such as the prevalence of market policies and perceptions of the costs of policy irregularities (Torgler & Schneider, 2009). As a result, it emphasizes the need for authorities to continue to develop and enforce good guidelines and legislation, especially for the benefit of the private industry and its constituents.

Government effectiveness, on its own, defines peoples' expectations of the quality of service delivery, the civil service's reliability and its freedom from political constraints, the value of public policy development and execution, and the commitment of the government with regard to such policies (Kaufman, Kraay & Mastruzzi, 2010). In summary, it encapsulates public expectations of governments' willingness to formulate pragmatic strategies that will increase the standard of public services, as well as the civil service's quality (Hossain, 2014). This indicator thus emphasizes the insights which every state must have in order to develop and enforce effective public programs.

More people and corporate bodies would pay their taxes without grudges if governments are considered to be reliable. And apart from the big benefit of harnessing robust revenue, the overall tax collection expenses will be lowered. In contrast, if people do not think the authorities are trustworthy, there is indeed a greater risk that government introduces new taxes (or calls for larger rates) which would not go down well with people and might result to costly agitation, abuse or protest (Modugu, Eragbhe & Izedonmi, 2012).

Taxpayers' utmost concern is about how the state spends tax money. Thus, their morale can be viewed as a measure of the interface relationship between what they pay as taxes and what the government has given back. For example, Abati (2006) claims that the level of deterioration in Nigeria's essential services delivery and tax capacity is a manifestation of the country's weak governance structure, processes, policies and ideologies.

Theoretical Framework

Tax Benefit Received Theory

In 1896, Knut Wicksell introduced the benefit theory. This ideology has its root in public finance and the goal is to find out how much the proceeds from tax can be spent satisfactorily on social infrastructure. As per this principle, taxes are levied on citizens to majorly fund public-goods spending which will in turn be proportionately beneficial to the citizens. Tax payment will therefore be focused on the reward earned from the government who is expected to nurture a political desire to compensate tax payers for their tax burdens.

Consequently, as the state offers tax products to community, residents and recipients are also required to pay for the basic infrastructures they use. The benefit standards of taxing, according to Musgrave (1959), serve a double purpose: on the first hand, they serve as mutual justice principle premised on a bond of partnership between the government and citizens, while on the other side, they introduce the right to equality in taxation, which requires taxpayers to remit taxes equal to the total of benefits earned by the government.

People are only able to pay when they are given commensurate value of public goods in comparison to the taxes levied on them. However, citizens can only think of having a commensurate value of public goods if they feel the democratic and ruling process is equitable, and considered government to be efficient in practices and regulations (Feld & Frey, 2007). Hence, if the state makes the tax exchange approach that it assured its people, proceeds from taxation could improve.

Empirical Evidence

Gurdal, Aydin, and Inal (2020) looked at the connection among taxes collected, state spending, and economic development in the G7 economies. The findings of panel causality test revealed a direction relationship between tax revenue and government spending. The significant point was that well-implemented tax policies would serve as the framework for achieving fiscal and overall economic goals. Also, Salam (2019) used facts from the Nigerian metropolis of Ilorin to examine the level of public governance and tax enforcement. The research was reinforced with Ordered Logistic Regression to evaluate the hypotheses. According to the findings, the quality of regulations has no impact on income tax enforcement. However, there is a correlation between government effectiveness and tax collection.

Epaphra and Massawe (2017) looked at Africa's corruption, governance, and tax revenues. The estimates were based on random-effect model having been proven more appropriate. Regression outcome revealed that in Africa, corruption and governance are two of the most significant predictors of tax payment. Corruption showed a negative impact, while good governance (when measured in terms of government effectiveness, regulatory quality, the rule of law, and voice and transparency) boost tax income generation. In another cross-country study, Hussain, Ilahi, and Muqem ul Islam (2016) investigated the effect of institutions and governance on the tax-to-GDP ratio. World governance metrics (including corruption, political stability, due process, government effectiveness, regulatory efficiency, and voice and transparency) were regressed with tax to GDP ratio in order to identify the impact of governance and institutional efficiency. A positive association was reported between tax-to-GDP ratio and the governance metrics using panel data regression analysis. The researchers reported that improving governance (in areas such as transparency, effectiveness, regulatory balance and accountability) is more sufficient to result towards more comprehensive policy measures for growing revenue generation than raising tax rates and tax bases.

In Tajikistan, Khujamkulov (2017) researched to examine the effect of institutions on tax revenue. The low quality of government agencies and the increased share of the informal sector, which provides an option to manipulating the agencies and implementation of established fiscal policy, were discovered as being the most possible reasons of inadequate tax income. Faizal, Palil, Maelah, and Ramli (2017) also investigated how Malaysians perceive fairness, confidence, and tax enforcement. The details on respondents' perceptions of fairness in the Malaysian tax regime was analyzed using a quantitative method. After all, the analysis results

indicated that expectations of procedural justice in the tax structure, as well as confidence in the tax agency, may increase tax enforcement.

In addition, Ali, Fjeldstad, and Sjørusen (2015) looked at the factors that influence tax enforcement in Africa, using data from Kenya, Tanzania, Uganda, and South Africa. Based on a binary logit analysis, it was reported that members of society who may be more comfortable with state policies and public service delivery seem to be more inclined to be tax compliant across the four nations. In a related report, Kiabel and Oyadonghan (2014) supported that tax payment is influenced by goal-oriented fiscal policies, as well as the governments' efficiency, and regulatory/acceptable use of taxes collected.

Furthermore, Modugu, Eragbhe, and Izedonmi (2012) investigated the correlation between government transparency and voluntary tax enforcement using the theoretical framework that the state and citizens have a mutual fiscal/social agreement. The results were positive, suggesting that citizens' perceptions of transparency in government play a major role in the formation and preservation of tax morale, which leads to individual taxpayer's enforcement. This is backed up by the findings of Alabede, Ariffin, and Idris (2011), having looked into the standard of public governance and tax enforcement in Nigeria.

3. Methodology

$$TR = f(GOE, RQT) \dots\dots\dots (i)$$

$$TR = TGDP \dots\dots\dots (ii)$$

$$TGDP = f(GOE, RQT) \dots\dots\dots (iii)$$

$$TGDP_t = \beta_0 + \beta_1 GOE_t + \beta_2 RQT_t + \beta_3 ECD_t + \mu_t \dots\dots\dots (iv)$$

Where:

TGDP= tax as a % of gross domestic product; GOE = government effectiveness; RQT = regulatory quality; ECD = economic development (control variable); μ = Error term

Based on the theoretical background, *A-priori* expectations from the relationship between dependent and independent variables are: β_1 and $\beta_2 \geq 0$.

4. Data Presentation, Analyses and Interpretation of Results

The study examined the impact of government effectiveness and regulatory quality on tax revenue in Nigeria from the period 1996 to 2017 and adopted ex-post facto research design. Tax revenue was represented by annual tax revenue as a ratio of GDP (TGDP) while regulatory quality and government effectiveness (independent variable) were measured via World Governance Indicators (WGI) which is a depiction of the quality of governance in a country. The study used annual (time series) secondary data obtained from World Development Indicators and World Governance Indicators for the relevant years. This research also adopted Auto Regressive Distributed Lag (ARDL) technique to test the study's hypotheses and variable impacts. ARDL technique was utilized after subjecting the series in the model to unit root test and co-integration test.

Model Specification

A model hinged on Wicksell's theory of benefit received was constructed in this study. Economic development was used to increase the explanatory power of the model and to control for the economic effect on tax revenue. The variable was identified from past studies (Haldenwang & Ivanyina, 2015; Tsakumis, Curatola & Porcano, 2007) and GDP per capita is its traditional indicator (Kodila-Tedika & Mutascu, 2015). The relationship among the variables of this study is presented as follow:

Descriptive Statistics

The results in Table 4.1 shows that regulatory quality-RQT, government effectiveness-GOE, economic development-ECD, and tax compliance-TCP have a mean value of 19.9642, 14.6363, 1769.92, and 2.2844 respectively for the period 1996-2017. Based on the skewness statistic all the variables except for tax revenue are positively skewed, while Kurtosis statistic indicates that both the dependent and explained variables have a thin-tailed distribution.

Table 4.1: Descriptive Statistics

	RQT	GOE	ECD	TR
Mean	19.9642	14.6363	1769.92	2.2844
Skewness	-0.6164	-0.1515	-0.1029	1.0695
Kurtosis	2.5213	2.5629	1.7438	3.1535

Source: Author's Analysis

Unit Root Test

The study utilized the Augmented Dickey-Fuller (ADF) unit root test to determine the stationarity of the variables in order to avoid spurious regression result. The test hypothesis is that the variable contains unit root. The result in Table 4.2 reveals that regulatory quality-RQT,

government effectiveness-GOE, and economic development-ECD are stationary at level while tax revenue-TR becomes stationary after first differencing. This implies that there is a mix of I(0) and I(1) series in the variables, as a result of this, ARDL bounds test would be used to test for cointegration of the variables.

Table 4.2: ADF Unit Root Test Results

Variable	Level		First difference		Order of Integration
	Test statistic	p-value	Test statistic	p-value	
RQT	-2.001	0.0353	————	————	I(0)
GOE	-2.057	0.0321	————	————	I(0)
ECD	-2.030	0.0336	————	————	I(0)
TR	-0.775	0.2274	-1.852	0.0455	I(1)

Source: Author's Analysis

Cointegration Test

ARDL bounds test is performed to test for the presence of cointegration due to the combination of I(0) and I(1) series in the model. The bounds test involves two asymptotic critical value bounds depending on whether the variables are I(0) or I(1) or a mix of I(0) and I(1). The two asymptotic critical value bounds are lower bound values and upper bound values. According to Pesaran, Shin and Smith (2001), the lower bound values assume that the forcing variables $\{X_t\}$ are I(0) only, and the upper bound values assume that $\{X_t\}$ are purely I(1). The null hypothesis for the bounds test is stated as:

$$H_0: \beta_1 = \beta_2 = \beta_3 = \beta_4 = 0 \text{ (No co-integration)}$$

To reject the null hypothesis, the F-statistic must exceed the upper bound critical value. On the other hand, null hypothesis is accepted if F-statistic falls below the lower bound critical value. If the F-statistic falls between the lower and upper bounds critical values, the evidence of co-integration is inconclusive. The Schwarz information criterion is used to determine the optimal lag length for each variable in the ARDL model. Table 4.3 presents the result of the bounds test obtained from an ARDL (1, 2, 1, 1) model.

Table 4.3 shows that the F-statistic is lesser than both the lower bound and upper bound critical values at 10%, 5%, 2.5% and 1% significance levels, thus indicating that the null hypothesis cannot be rejected. This indicates that there is no cointegration (nolong-run relationship) among the variables in the model.

Table 4.3: Bounds Test Result

F-statistic	Significance level	Critical value bounds	
		Lower bound	Upper bound
2.394	10%	2.72	3.77
	5%	3.23	4.35
	2.5%	3.69	4.89
	1%	4.29	5.61

Source: Author's Analysis

Model Estimation Result

Table 4.4 presents the short-run coefficients obtained from the ARDL model selected based on the Schwarz information criterion. As shown in Table 4.4, in the short run, government effectiveness has a significant and positive effect on tax revenue. This implies that a unit change in government effectiveness increases tax

revenue by 0.143, *ceteris paribus*, government ineffectiveness declines tax revenue. In the same vein, economic development showed a significant positive effect of 0.011 (*p*-value < 5% level of significance) on tax revenue in Nigeria. Contrarily, regulatory quality reveals a negative and insignificant effect (*p*-value > 5% level of significance) on tax revenue in Nigeria for the period under study.

Table 4.4: Short-run Results

Variable	Coefficient	Standard Error	p-value
GOE	0.1431	.09182	0.018
RQT	-0.1290	.09489	0.232
ECD	0.011	.001	0.037
constant	2.1799	2.5108	0.425

Source: Author's Analysis

Discussion of Findings

From 1996 to 2017, this study examined the impact of government effectiveness and regulatory efficiency on tax revenue in Nigeria. The discussion of results is focused on the short-run outcome and findings indicated that government effectiveness positively and substantially impacts Nigeria's tax revenue. This means that tax revenue in Nigeria is influenced by government effectiveness, which includes the quality of service delivery, the civil service's reliability and its freedom from political constraints, the strength of public policy development and execution, and the commitment of the government with regard to such policies. The result is consistent with the findings of Khujamkulov (2017), Epaphra and Massawe (2017), and Hussain, Ilahi, and Muqem ul Islam (2016), who all found that government effectiveness is likely to provide more substantive policy options towards increasing tax collection.

Furthermore, regulatory quality, which measures a state's ability to consider and enforce effective laws and regulations that foster private sector growth, has no discernible impact on tax revenue in the country. The result contradicts the findings of Modugu, Eragbhe, and Izedonmi (2012) and Alabede, Ariffin, and Idris (2011), who say that perceptions of government transparency and public governance efficiency, which are clarified by regulatory quality, have a significant positive relationship with tax enforcement conduct. The result, however, supports a claim that regulatory quality has no bearing on tax inflow, according to Salam (2019).

5. Conclusion and Recommendations

Overall, this research backs up the notion that good governance is essential in justifying tax revenue levels or actualising tax revenue projections. Therefore, the study concludes that government effectiveness has an impact on tax revenue in Nigeria, while regulatory quality has no bearing on tax revenue generation in the country. The

recommendations on this study based on the conclusions reached include:

- i. Good governance should be a priority for tax policymakers, particularly when drafting tax legislation.
- ii. Government should nurture a continuous desire for quality service delivery

- iii. When addressing tax issues, tax authorities should come up with policies and regulations that foster the growth of all sectors.

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