Post-pandemic Opportunities for Strengthening The Fiscal Social Contract In Nigeria

By:

Osasenaro Ese Omo-Osagie

July 29, 2020

Taxation is one of the strongest links between a State and its citizens. Government needs money to run, and citizens can provide that money, at least to an extent. Developed countries raise a significant portion of their revenue through a mix of different taxes, including personal income tax. The important status of tax in such countries has been linked to advantages beyond financing public services such as greater Government accountability, institution building and stronger democracies. In contrast, developing countries have very low capacity for revenue mobilization through taxes. In 2018, OECD data put the tax to GDP statistics for countries like Germany and Italy at 38% and 42% respectively, while developing countries such as Nigeria and Ghana were reported at 6% and 13% respectively. The poor fiscal capacity of developing countries has been attributed to non-compliance for which many causative factors have been identified.

In this article, I will attempt to demonstrate the link between the fiscal social contract and Tax non-compliance in Nigeria. I also offer my predictions on some post-pandemic societal changes and the opportunities they present for government towards strengthening the fiscal social contract.

In theory and practice, the tax system of a country is a microcosm of the social contract, the implied legal relationship between citizens and those to whom governance has been assigned. This theory, popularized by the philosophers Rousseau, Hobbes and their contemporaries, concerns the legitimacy of the authority of the State over the individual. In its extension to tax, the fiscal social contract is the implied agreement between the citizens who contribute to their collective welfare and the government, which administers that contribution.

In 2018, a total of 19 million Nigerians paid tax, according to Government data. A World Bank report in that year put the country's economically active population at 65 million, meaning that even with the rising numbers of taxpayers in recent years, the taxpaying figures are still below 30%. Estimates on payment compliance in the case of value-added tax (VAT) vary between 15 and 40 percent. Traditionally, the government's approach to increasing Tax compliance has focused on supervision, sanctions and administrative fines. Although some level of compliance can be achieved by deterrence, it is clear that none of these can solve the problem. In 2017, the Nigerian government started a voluntary assets and income declaration scheme (tax amnesty) in an attempt to raise as much as US$100 billion. According to this world bank report; however, this effort was only partly successful, with just 8% of the target achieved by the end of the amnesty period. Amid other reasons, the existence of large rents from oil has meant that governments since independence have paid relatively little attention to tax as a source of revenue. Non-oil revenue in the country is around 3-4 percent of GDP, way below that of countries such as South Africa and Brazil where non-oil revenues lie between 20 and 25 percent of their GDP.

Not only is this a money problem, but it's also a governance one. Research has shown that countries which attain large revenues from natural resources will find that the lower domestic tax effort reduces the incentive for the public scrutiny of government. In addition, exclusion from the tax system fuels

indifference to government infrastructure. There is very little care attached to the treatment of public goods, and in many cases, equipment left unsecured are either stolen or vandalized. This raises the cost of maintaining public infrastructure even higher.

The poor fiscal capacity of developing countries has been linked to non-compliance. This non-compliance is often described as a cultural phenomenon, where tax evasion is seen as the norm, rather than a crime. Researchers have even attempted to represent the concept of taxation as "a strange, unwelcome and sometimes incomprehensible concept to many people in developing countries". For African societies, however, this cannot be true. Taxation has always been an intrinsic aspect of pre-colonial African societies. Taxes in the form of goods and monetary items were collected from subjects and vassals through traditional institutions such as chiefs and market leaders and delivered onto the rulers who then used those resources to fund conquests, public projects and for the general maintenance of the society. Indeed, it was these traditional institutions that were integrated into the colonial bureaucracy for the purpose of tax collection. Tax is therefore not any more strange or alien to an African than it is to anyone else and to understand Tax evasion in Nigeria; one must look beyond the prejudicial perception of tax as a foreign concept and examine other causes that may shed light on the roots of low tax compliance.

Among the various reasons that have been linked to the difficulty of raising tax revenue in developing countries, i.e., leakages stemming from illicit financial flows, low deterrence for tax evasion and even corruption among public officials, the fiscal social contract is worthy of examination as it appears to be the common thread here. Simply put, to understand why citizens are not paying taxes, it is beneficial first to determine why they should.

The fiscal social contract places revenue mobilization and revenue utilization on both ends of fiscal legitimacy, providing insight on why an individual would voluntarily surrender their natural entitlements to obtain the benefits of governance. In its simplest form, Tax is the contribution made by members of a society towards their collective welfare. It follows, therefore, that individuals with a positive experience of public service delivery and a feeling of inclusion in governance are more likely to feel an intrinsic motivation to pay Tax. Without

this motivation or morale, as it may be termed, you would easily find that for individual citizens, there is a minimal direct benefit from paying tax. Take a street light, for example. Everyone who uses the road gets to see by its light. It doesn't matter how much tax you have paid, or whether you have even paid any tax at all, what you benefit from the street light is the same as everyone else. Public services are paid for by few and enjoyed by many. Where tax morale is weak, widespread evasion and organized popular resistance to taxation are more likely to occur.

Tax morale is also affected by the existence of substitutes. People who provide their own water, light and even security will find it difficult to understand why they should pay tax. In 2018, the Nigerian Economic Summit Group (NESG) conducted a survey to discover the factors that influence attitudes towards Tax compliance and Non-compliance. Of 16,000 individuals who participated in the survey, only 17% believed that it was 'wrong and punishable' to not pay taxes. Over 54% were of the opinion that it was wrong, but understandable. In addition, 58% agreed that 'people should refuse to pay taxes until they get better services from the government'. Added to this is the problem of unofficial taxes. More than a fifth of participants surveyed reported having to pay dues to local 'area boys' and other non-state actors such as market and motor park unions. Although these figures don't feature in our statistics, ordinary Nigerians consider these payments as Tax. Similar findings were reached in a survey conducted on self-employed taxpayers in Nigeria's capital city, Abuja. The results of the analysis revealed three key public governance issues which taxpayers cited as their dissatisfaction with the tax system viz; disengagement from governance and by extension, the tax system; poor socioeconomic conditions; and a dysfunctional audit system that breeds distrust in the government. Altogether, taxpayers expressed an absence of the expectation that tax compliance would benefit them in any way.

None of this would come as a surprise to the average Nigerian. Government expenditure for the past few years has essentially revolved around debt financing and recurrent expenditure, including salaries. At 1.7 percent and 0.6 percent of GDP, levels of spending on education and health in Nigeria are among the lowest in the world. Staff strikes over non-payment of salaries and benefits are common in hospitals and universities. If one considers this against

the backdrop of rising insecurity, poor power supply, and a mix of social issues ranging from multidimensional poverty to police brutality, it is quite easy to draw a straight line from the government's actions under the fiscal social contract to non-compliance among taxpayers in Nigeria.

On February 26 2020, Nigeria recorded its first case of the novel Coronavirus. By the time the virus was declared a global pandemic, it had infected 118,000 people in 114 countries. As at the close of the Second Quarter, global figures were reaching 10,000,000 with almost 500,000 deaths, and Nigeria had recorded north of 22,000 infected cases. The rapid nature of the outbreak has created an alarming health crisis which over 200 countries in the world are dealing with. Besides the devastating human impact, there is also significant economic and commercial impact being felt across the world. The outlook of the impact of the pandemic and the long-term damage it has dealt to prospects for growth is the subject of the World Bank's June 2020 Global Economic Prospects. The baseline forecast predicts a 5.2 percent contraction in global GDP in 2020, the deepest global recession in decades. Furthermore, the pandemic is expected to trigger deep recessions which will have long term effects on investment, schooling and global trade.

Experts are already predicting that the post-pandemic world could become less global and more humane. The way we interact and do business has already changed and will likely continue to evolve along this path. Social distancing has centralized the role of technology in human communication much quicker than any expert could have predicted before the pandemic. The import of this is that despite the gloomy economic outlook, improved digital connectivity has the potential to provide a cushion to the impact of the pandemic. Currently, Nigeria's internet penetration rate is expected to grow to 84.5 percent of the population by 2023, and with the pandemic increasing our reliance on digital technologies for communication and business, the digital space can be expected to expand tremendously. Without overselling the potential of improved digital connectivity on economic development and inclusive growth, the broader post-pandemic digital space provides an opportunity for the government to engage more wholesomely with citizens on the tax system and other aspects of government communication that will serve to strengthen the fiscal social contract. In addition, as the Nigerian digital economy grows, so

does the economic strength of the youth who have in the past decade, impressively harnessed the power of the internet to build profitable businesses across industries and high-income careers around technology products, digital content and freelance work. This sector, highly populated by 'millennials' and 'zoomers' is set for a leading position in the Continental and even Global economy. Half of the country's 200 million people are under the age of 30. As most of them are just entering the Tax bracket, Nigeria has to tackle the issues that affect the economic power of its newest taxpaying demographic. These issues range from improved broadband access, improvements in digital skills and literacy, access to digital payments and other financial services, as well as digital support to start-ups and existing businesses.

It is undeniable that the link between taxation and service delivery has been broken for so long in Nigeria. Still, with the directions being forged by the pandemic, the government has the opportunity to bargain new terms in its fiscal social contract and also deliver on old ones. The data from the NESG survey grouped tax non-compliance in Nigeria under four main reasons-- having relatively little information about tax (only 12 percent of participants had received any kind of communication from the government on taxation in the previous year); a negative experience of interactions with tax authorities; the feeling of not getting anything back in return and; lack of transparency and trust in the Tax system. In the coming years, there will be more people connected to the internet, and the conversation on social issues like these will expand online. The role the government plays in enabling that conversation will have a huge impact on how these issues progress. Although Tax authorities (and many other public services) in Nigeria have maintained a fairly good social presence since the early to mid-2010s, that presence is yet to translate to citizens engagement in the way that it should. Conversations around governance remain in an 'us' vs 'them' dichotomy. While it is indeed true that there are many areas of public service delivery which the government needs to improve on, it is also true that it can do a better job of engaging citizens in the areas where it is recording progress. As a member of the OGP, the Nigerian government ensures that a fair amount of public information is available online -but it is one thing to provide access to data, and quite another thing for that data to translate into real change in the eyes of citizens. With more Nigerians online, things like virtual town hall meetings can become a staple in the

discourse. Many people who would ordinarily not have attended due to busy schedules -including Nigerians in the diaspora- will be encouraged to engage with public service conversations at the touch of a button. By improving communication, governments can boost the feeling of inclusion its citizens have when they think about governance.

The quality of public service delivery has been shown to affect tax non-compliance in an important way. Among other issues that have been attributed to low tax revenues in Nigeria, the State of the fiscal social contract can be said to be the single most important underlying cause. While there remains a depth of systemic issues to be resolved in order to rebuild the broken links in the fiscal social contract properly, the predicted post-pandemic impact on digital communication and business provides Nigeria with the opportunity to leverage on digital growth and engagement to bargain a stronger social contract, particularly with its largest demographic. Indeed, it will be interesting to see as things unfold, what opportunities for growth Nigeria can tap into in the post-pandemic world.

View online: Post-pandemic Opportunities for Strengthening The Fiscal Social Contract In Nigeria

Provided by Afronomicslaw