IGR expansion and public sector governance

STATES & LOCAL FINANCE

The IGR Initiative

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THE RELATIONSHIP BETWEEN improved governance and IGR expansion strategies is mutually reinforcing. Excellent public sector governance, which crystallises in the efficient provision of public goods, raises citizens' sense of shared ownership and willingness to comply with tax payment obligations. This perspective is more prevalent in literature than discussions around the role of IGR expansion efforts in fostering public sector governance. Unarguably, state and local governments' IGR expansion activities play a critical albeit indirect role in driving good governance. There are at least three ways in which this is possible. They are the tax for service or social contract channel, the spillover effect, and the responsiveness requirement. The tax-for-service or social contract notion presupposes that satisfying the citizens' economic growth and developmental yearnings increases their willingness to comply with their tax obligations. That presupposition is an incentive for subnational governments to provide good governance. In effect, therefore, the more the political and economic managers of the state serve the citizens through the provision of basic social amenities and the infrastructure for the rule of law, the more they successfully woo them to contribute to increased government revenue.

Secondly, government efforts in strengthening tax administration always have spillover effects on public administration efficiency. Consider, for instance, the capacity building of tax administrators, resulting in better revenue forecasting and public policy decision-making. Such spillover effects are also possible in taxpayer database management and intelligence that would effectively serve the government's decisions in other areas beyond the tax administration. Raising taxes effectively also requires that governments be more accountable and responsive. Accountability shows that governments are wise spenders of already collected taxes, while responsiveness ensures that those who pay taxes receive adequate government attention. These demands are evident as the government deploys them to incentivize taxpayers to show more commitment to meeting their obligations.

While the expectation is that public officeholders deploy the tools of IGR expansion to drive good governance, the reality on the ground substantially deviates from this. Most subnational governments in Nigeria are more than 80% allocation-dependent, which does not strongly support the pursuit of good governance. First, reliance on allocation significantly weakens subnational governments' IGR expansion efforts. Allocation dependency crowds out IGR expansion efforts. Increased reliance on the share of the revenue from the Federation's account substantially disincentivizes state and local governments in raising finances through tax and nontax sources. The so-called oil resource curse is consistent with this crowding-out effect. Allocations from the country's crude oil bonanza created opportunities for states and local governments to accomplish several fiscal projects and programmes beyond the level that tax receipts would have afforded. As time passed, the design of state budgets became increasingly dependent on the size of expected allocations from the FAAC, leaving out the vast internally generated revenue opportunities that tax and nontax items provide.

The second consequence of overt allocation dependence is the scrutiny avoidance effect. Those who do not comply with tax obligations may not have as much incentive to investigate the use of government funds as those who substantially comply. Higher levels of compliance induce more elevated levels of interest in the use of tax revenue and, by implication, elevated levels of government scrutiny. Therefore, subnational governments' considerable dependence on allocation from the FAAC, which degrades citizens' tax compliance levels, also minimises the expected levels of public scrutiny of their activities. Third, the scrutiny avoidance effect also results in a complementary spending effect which partially explains public sector extravagance, corruption, and inefficient fiscal programming. Increased scrutiny means that citizens ask "how?", "why?", and "in what?" questions regarding the spending of their tax payments. Such questions rarely pop up at the same frequency if their statutory oil revenue allocation shares primarily drive state and local government fiscal programming. Regardless of the budget, which most of the time is the fulfilment of a mere ritual, the actual expenditure profile of many state and local governments is shrouded in a black box whose details are known only by a few confidants of the Governor. It also encourages the compromise of the quality of fiscal programmes with little or no impact whatsoever. Consider the ugly truth that the total worth of public assets in more than 80% of Nigerian state and local government areas is not up to 15% of these governments' cumulative revenue in the past three decades. Fourth, the combination of scrutiny avoidance and the spending effects inevitably lead to the borrowing effects. Low levels of citizen participation and the scrutiny of governments' fiscal programmes and activities combined with wasteful and poor government spending lead to increased borrowing that only reinforces such wastes and poor fiscal judgments and choices. Ideally, wise decisions about using the subnational government's resources will result in the creation of projects and programmes that expand the levels of economic activity and further encourage citizens compliance in the tax obligations. Overall, such interaction minimises the need for a frivolous cycle of borrowing.

The famous "no taxation without representation" slogan with its roots in the February 1768 London magazine explains the criticality of citizens' participation in governance because of the taxes they pay. The American colonists who initially gave momentum to the slogan argued that since they had no representation in the British Parliament, the tax imposition was unconstitutional alongside denying their rights. Tax-complying citizens still hold such expectations, which appear to be satisfied through legislative representation, government openness, accountability, and civil society engagements. Unfortunately, there is a blurred line between the executive and legislative arms of government in more than 99% of subnational governments in Nigeria. Most state and local government legislatures are merely extensions of the state Governor's office who expropriate their loyalty more than the citizens. The situation is short of saying that the legislature does not sufficiently represent citizens at the state and local government levels. But again, much of this situation remains possible because of a combination of the low levels of tax compliance and weak civil society capacity to rigorously interrogate fiscal operations at subnational government levels. However, reliance on tax and nontax revenue resources requires quasi-voluntary citizen compliance, incentivising those in power to create avenues of political participation.

The social contract notion presupposes that political leaders must deliver good governance to deserve tax compliance from the people and vice versa. While this is not the only foundation upon which compliance resides, it is significant. Citizens benefiting more from and satisfied with the quality of public goods are likely to be more tax compliant. On the other hand, the income sacrifices of taxpayers should yield socio-economic benefits in return. This expectation stands on public trust that those who manage the statecraft understand this implicit two-way relationship and abide by it. The three principles the contract stands on are freedom, shared interests, and reciprocity. Taxpayers surrender their liberty to surrender their resources to the government through their tax payments.

Consequently, governments' violation of this freedom surrender principle prompts the citizens' resistance via tax evasion. Tax evasion is a window for reinstating abused citizens' freedom when the government fails to respect their right to surrender their resources through tax compliance freely. The common interest principle stands on the pedestal of patriotism and the norms of morality. But again, when political leaders do not show significant commitment to mutual concerns between the governed and the government, the former expresses a withdrawal from the joint interest contract through the tax evasion window. The reciprocity principle is mainly associated with the social contract notion of taxation. Citizens naturally expect that the government reciprocates their taxpaying gestures with the good governance they provide.

As already mentioned, efforts to improve tax administration can result in significant information sharing outcomes. Of course, tax data is critical to governments' economic and overall policy decisions. But an essential foundation for increased internally generated revenue is the development of robust taxpayer databases integrated with the databases of other ministries, departments, and agencies for optimal data intelligence. These efforts to strengthen tax collection through database development significantly enhance the quality of information available to decision-makers in other public policy formulation and implementation areas beyond IGR expansion. Therefore, efforts to improve the IGR of subnational governments indirectly through the possible deployment of taxpayer data intelligence further equips the governments with the capacity to make more informed decisions and provide a better quality of governance. Such spillover effects can go beyond database improvements. Consider, for instance, that enforcing taxpayer compliance requires further improvements in other areas such as streamlining payment processes, improving the professionalism of tax administration, land and general property registration, improvements in the related justice system such as tax courts and so on. In general, the underlying reason for pursuing these improvements [good governance] is to achieve significant progress in achieving IGR growth.

Underscored by the social contract thinking, the leaders of subnational governments are desirous of raising independent revenue through taxation to provide the citizens with commensurate value for tax paid. Citizens willing to comply, but would also like to receive the benefits of their tax payments, would receive more incentives with loads of evidence of high-quality public service performance. For instance, it is a growing tradition among state governors and local government chairpersons to recount their achievements within the first one hundred days and perhaps at the end of the first year to send a signal of rendering befitting service to the people. Critical civil society organisations have likewise acted on behalf of the masses to scrutinise and gauge some subnational governments' performance to pressure political leaders to do better. In effect, therefore, the desire to grow internally generated revenue always comes with measuring public service performance. No good leader wants to have a poor assessment, and thus, their performance measurement by the taxpaying citizens often drives them to improved governance.

Citizens' tax compliance also further strengthens civil society activism to push for improved governance. The underlying argument is that citizens have paid for well-deserved governance through tax compliance. Accordingly, civil society organisations demand openness, transparency in tax revenue and accountability as justified responsiveness from the government that collects these revenues. In general, civil society organisations and the citizens demonstrate how effectively an internally generated revenue push leads to improved governance by the demand for asset declarations and the public declaration of tax returns by political leaders. The thinking is that political leaders who have been paying their taxes may not fritter away other people's contributions to the treasury. The public would not like to surrender their collective resources in the hands of someone who does not have a culture of doing the same. Another angle is the consistency of tax returns with the value of declared assets by political leaders. This consistency or otherwise is a veritable barometer for gauging whether a political leader has demonstrated whether sufficient faith and trust in the government would be more likely disposed to the prudent deployment of people's tax payments.

Finally, subnational governments that frontally embark on internally generated revenue expansion are more likely to have a better governance environment than state and local governments that depend more on statutory allocations from the Federation Account. Theoretically speaking, such allocation-dependency disposition facilitates the crowding out of the subnational governments' willingness and capacity for vigorous internally generated revenue expansion. It also creates incentives to evade public scrutiny, lower fiscal programming quality, and unproductive debt expansion. The reverse is the case where the focus is more on the growth of internally generated revenue, which provides the stimulus for political leadership to put in place structures and processes to make the citizens who pay taxes continue to comply and encourage those who do not join the bandwagon. There are also spillover effects as efforts to enhance the tax administration may improve overall decision-making by the government.

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