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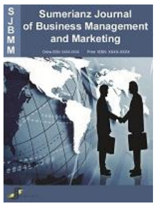

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Public Governance Quality and Tax Compliance in Nigeria (2008-2018)

Oladejo Abiodun Oyebamiji
Department of Management and Accounting Obafemi Awolowo University, Ile-Ife, Osun State, Nigeria
Email: oladejoabiodun67@yahoo.com

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Abstract

The study determined the effect of public governance quality on tax compliance in Nigeria between 2008 and 2018. The study employed secondary data. Data for governance quality indicators were sourced from World Bank Group (WBG), Worldwide Governance Indicator (WGI) while data for Gross Domestic Product (GDP) and tax revenue were obtained from Central Bank of Nigeria Statistical bulletin and Federal Inland Revenue Service Statistical report. Collected data were analyzed using unit root test and Autoregressive Distributed Lags (ARDL). The result from the study showed that in the short run, four public governance indicators had positive significant effect on tax compliance in Nigeria. This are government effectiveness ($t = 4.6983$, $p<0.05$); political stability ($t = 4.7842$, $p<0.05$); regulatory quality ($t = 4.8861$, $p<0.05$); and control of corruption ($t = 2.1792$, $p<0.05$). The result further showed that voice and accountability ($t = -3.0554$, $p<0.05$) had negative and statistically significant effect on tax compliance in Nigeria. However, government effectiveness ($t =3.4199$, $p<0.05$), rule of law ($t = .99554$, $p<0.05$), political stability ($t =10.9247$, $p<0.05$) and regulatory quality ($t = 3.0209$, $p<0.05$) had positive and significant effect on tax compliance, while voice and accountability ($t =-3.3592$, $p<0.05$) had negative and statistically significant relationship with tax compliance in the long run. The study concluded that strong government effectiveness, political stability, regulatory quality and rule of law play significant role in enhancing the level of tax compliance in Nigeria.

Keywords: Government effectiveness; Regulatory quality; Rule of law; Political stability; Tax compliance.

1. Introduction

Public governance quality is the process in which the country resources are being managed effectively for the benefit of the citizens (World Bank, 2006). The existence of public governance is to deliver political goods to the citizens. Public governance is of high quality when a state efficiently provides public goods of necessary quality to its citizens (Rotberg, 2004).

Tax compliance is the extent at which the taxpayer meets the tax obligation as set out in the appropriate legal and regulatory provisions. The willingness on the part of the individual to disclose all his income accurately and pays the tax due appropriately on the due date as prescribed in the relevant tax law is key in generating revenue from taxes. The revenue generated from taxes by the government to finance its expenditure depends on the willingness of the taxpayers to comply with existing tax laws of the country (Eshag, 1983).The inability of the taxpayers to willingly comply with the relevant tax laws has been a serious issues in some countries of the world.

What motivates people to pay taxes is an important question that has obtained increased attention in the tax compliance literature in the last few years. A low level of tax compliance is a joint effort of both supply side and demand side factors (Mohammad, 2014). According to Bird and Martinez-Vazquez (2008), supply side factors such as per capital income, composition of the economy and economic activities have capacity to increase tax effort of a developing country. Meanwhile, the quality of governance is an important demand factor for more adequate level of tax compliance in developing countries and developed countries. Developing countries are faced with low level of tax compliance that has greatly affected their revenue from taxes.

Public governance quality is an intrinsic motivation to pay tax that can help to explain the high degree of tax compliance (Alabede, 2012; Modugu *et al.*, 2012; Mohammad, 2014; Mustapha *et al.*, 2015; Torgler, 2003; Torgler and Schneider, 2009). Perception of taxpayers about the governance and institution provide an insight regarding the level of tax compliance in a country.

However, in countries where there is institutional instability, lack of transparency and accountability and a weak rule of law, willingness to comply with tax laws will be an issue. The willingness of taxpayers to pay tax has been the major concern of the government in Nigeria and has resulted in the various tax reforms by the government. Despite the human and natural endowment as well as economic potentiality, Nigeria continues to be among the countries that has lowest rates of tax compliance in Africa (Chartered Institute of Taxation of Nigeria, 2010). However, for government to secure the willingness of taxpayer to pay their quota in the provision of public goods, certain level of confidence in public governance is necessary. According to Lassen (2003), complying with tax law provision depends on whether the political goods provided by the government are sufficient in return to taxes they are paying. Whether taxpayers get public goods in exchange for taxes paid is a major concern that determines tax compliance in Nigeria.

This study therefore is undertaken to determine effect of public governance indicators on the tax compliance in Nigeria.

2. Literature Review

2.1. Public Governance Quality and Tax Compliance

Governance is the process whereby a society makes important decisions, determines whom they involve, and how they render account. In line with Cheema (2005), Governance comprises complex mechanisms, processes, relationships, and institutions through which citizens and groups articulate their interests, exercise their rights and obligations, and mediate their differences. Governance is not just about how a government and social organizations interact, and how they relate to citizens (Graham *et al.*, 2003), but it concerns the State's ability to serve citizens and other actors, as well as the manner in which public functions are carried out, public resources are managed and public regulatory powers are exercised. In this context, governance can be viewed as the traditions and the institutions by which authority in a country is exercised for the common good.

On the other hand, public governance represents more than a means of providing common good as it can be related to the government capacity to help their citizens' ability to achieve individual satisfaction and material prosperity Rotberg (2004). Public governance is the process by which a society organizes its affairs and manages itself. It could also be defined as the activities that are undertaken with public funds, whether within or outside of core government, and whether those funds represent a direct transfer or are provided in the form of an implicit guarantee.

Public governance quality is crucial for proper planning and efficient revenue generation. It is an issue of general concern to citizens of nations as it bothers directly on benefits derivable from governance, public governance guarantees the order and the cohesion of a society. Alabede (2012). The quality of public governance is when a country efficiently provides public goods of necessary quality. Nations should be assessed on both quality and quantity of public goods provided to citizens (Rotberg, 2004).

Ordinarily, tax is collected for the provision of public goods, social security, social welfare and social amenities. The willingness of taxpayers in order to contribute their quota in the provision of such public goods must be backed by a certain level of confidence on public governance. Taxpayers are more inclined to comply to the law if the exchange between the paid tax and the performed government services are found to be equitable (Torgler, 2003).

Levi (1988), stated that the tax compliance is influenced by vertical contract. He said that the contract between taxpayers and government is vertical contract which he refers to as quid pro quo of taxation. Vertical contract focused on whether taxpayers get public goods in exchange for taxes paid or not. According to the argument of quid pro quo, complying with tax law provision depends in part on whether the political goods provided by the government are sufficient in return to the taxes they are paying (Lassen, 2003). Levi (1988), argued that if it is perceived by the taxpayers that the rate of transformation from tax to political goods is low then the taxpayers will feel that the government has not kept its obligation of the contract, as a result, voluntary tax compliance will deteriorate. Besancon (2003), also stated that there is social contract between government and taxpayers which embodied effective delivery of political goods. In addition, Lassen (2003) said that the political goods mix is also important and declared that if the political goods mix supplied by the government is very different from those the taxpayers prefer or rate of transformation is low due to corruption, taxpayers may feel the attractiveness of the quid pro quo contract diminished and that could lead to lower tax compliance. However, Torgler (2003) argued that when public governance quality is down, individuals' tax compliance may be crowded out since the government fails to honor his honesty. Examining the relationship between public governance quality and compliance further, Everest-Philip and Sandall (2009) noted that there is linkage between public governance quality and taxation and that quality governance deliver good tax system and equally better tax system make it possible to have good governance. Akpo (2009), equally stated that good governance entails the provision of quality public goods to the public and that where government fails to provide public amenities and infrastructure to the citizen in exchange for tax payment, the citizen may become reluctant to pay tax. Alm *et al.* (1992) also submitted that compliance occurs because people appreciate the political goods that their tax payments finance and that if there an increase in the amount and quality of the political goods going to them from tax payment, their compliance rates may likely increase. With good governance, the country offers the people a good tax system– better in the sense of giving the people what they want- which encourage to the people to pay taxes for better public services.

2.2. Determinants of Governance Quality and Tax Compliance

Tax compliance determinants are those factors that influence taxpayers to comply or not to comply with the Provision of tax laws. According to Palil and Mustapha (2011); Palil (2010); Kirchler (2007); Loo (2006), tax compliance determinants were analyzed and grouped into social, Economic, Individual, Behavioral, Demographical and Institutional factors.

From a social perspective, tax compliance determinant concerns with taxpayers' willingness to comply with tax law in response to other people's behavior and their social environment, that is government, friends and family members Torgler (2007). In relation to economic factors are the actions, which are associated with the cost and benefits of performing the actions Loo (2006). Such economic factors include tax rates, tax audits and perceptions of government spending. Institutional factors play an important role in taxpayers' compliance decision. The effective operation of the tax system by the tax authority influences taxpayers' compliance behavior. The study of Richardson

(2008) concluded that the role of a government has a significant positive impact on determining attitude towards tax. Personal factors like personal financial constraints and awareness of penalties and offences are likely to have a significant impact on taxpayer's compliance behavior. Actions either to evade taxes or not to evade taxes are reliant on taxpayers' personal judgment Mohani (2001). Personal financial constraints have a greater impact on tax compliance. Taxpayer that encountered personal financial constraint is likely to be prone to tax evasion unlike taxpayer in less financial distress (Mohani, 2001; Mohani and Sheehan, 2004)

Existing literature examined various governance or institutional factors that have played an important role in taxpayers' compliance decisions (Alabede, 2012; Palil, 2010).These factors are the conventional principles established by the tax authority and the government for promoting administration of tax system. The institutional factors that have been examined include: Quality of tax authority, Quality of tax service, Level of awareness among taxpayers, tax fairness and good governance.

2.3. Good Governance and Tax Compliance

Public good governance according to Alabede (2012) is concerned with authority in the public sector as well as how the society organizes its affairs and manages its resources. Similarly, World Bank (2006) viewed good governance as the capacity of the government of a country to manage its resources effectively and implement sound policies for the benefit of everyone as well as respect for the citizens and the government for the institutions that regulate economic and social interaction in the country. Expressing the relationship between good governance and tax compliance, Everest Torgler and Schneider (2009) confirmed that there is a linkage between good governance and taxation. They stressed further that the quality of governance delivers a good tax system, vis-à-vis. Thus, a better tax system with good governance enhances compliance and that failure of government to provide public amenities and infrastructure to the citizens in exchange for tax payment, may trigger the citizen not to comply with tax provisions. It is reasonable that taxpayers always develop keen interest in what government executes in term of meaningful projects Alabede (2012). They examine the activities of the government, especially those who pay high amount of tax. This encourages them not to comply with tax laws if they perceive that government spends tax money unwisely. Noncompliance behavior is however quite difficult in PAYE system than the self-employed which according to Levi (1988) have a larger opportunity to under report their income and therefore pay less tax. Kim (2008), in his study of tax noncompliance good governance in 50 selected countries, concluded that tax non-compliance is influenced positively by price control, public service, collected corporate tax, GDP per capital, tax system which are the composition of government spending on the welfare of citizens. In addition, study conducted by Richardson (2008) to examine the determinants of tax compliance across 47 countries including the USA, the UK, Argentina, Thailand, Canada, Chile and Brazil; found that the role of the government has a significant positive impact on determining attitudes toward tax compliance. Richardson also suggests that government should increase their reputation and credibility in order to obtain trust and confidence from the taxpayers. This position of Richardson could be accepted because the taxpayers always perceive the role of the government in providing social amenities before complying with legal provisions. This is also paramount in developing countries like Nigeria because the taxpayers perceived that government does not utilize the revenue collected from tax judiciously.

In addition, the study of Alm and Gomez (2008) established a significant positive relationship between the perception of the benefit to be derived from good governance and the willingness of taxpayers to comply with tax laws. In the same view, Egwaikhide (2010) noted that there is a high correlation between tax compliance and good governance. This is an indication that good governance encourages compliance. It could be argued here that provision of social amenities and other essential services by the government will motivate citizens to comply with the provisions of tax laws. Furthermore, Kasum *et al.* (2013) confirmed in their study that corruption and bad governance discourages tax compliance. It is important to note here, that the role of government in inducing tax compliance is important and relevant in self-assessment system (Richardson, 2008).

2.4. Methodology

The data for this study was obtained from secondary source. This study used time series data from 2008 to 2018 to determine the effect of public governance indicators and tax compliance in Nigeria. This effect was determined in two stages. First, a unit root test was undertaken and the correlation between public governance indicators and tax compliance were estimated. Second, some statistical test were carried out and autoregressive distributed lag (ARDL) was performed where public governance indicators are regressed on tax compliance.

Public governance indicators are measured based on Kaufmann *et al.* (2010) as follows:

2.4.1. Voice and Accountability

This measured the extent to which a country's citizens are able to participate in selecting their government.

2.4.2. Political Stability and Absence of Violence

This captured the perceptions of the likelihood that the government destabilized or overthrown by unconstitutional or violent means, including political violence or terrorism.

2.4.3. Government Effectiveness

This measured the quality of public services, the quality of the civil service and the degree of its independence from political pressures, the quality of policy formulation and implementation, and the credibility of the government's commitment to such policies.

2.4.4. Regulatory Quality

This is measured by the ability of the government to formulate and implement sound policies and regulations that permit and promote private sector development.

2.4.5. Rule of Law

This measured the extent to which agents have confidence in and abide by the rules of society, and in particular the quality of contract enforcement, the police, and the courts, as well as the likelihood of crime and violence.

2.4.6. Control of Corruption

This measured the extent to which elites and private interests exercise public power for private gain, including both petty and grand forms of corruption, as well as "capture" of the state.

2.4.7. Tax Compliance

This is dependent variable, which measured tax revenue (TRV) as a percentage of Gross Domestic Product (GDP).

These variables are therefore included in the multiple regression specification as follows:

$$TXC = \beta_1 + \beta_2 GOV + \beta_3 CORR + \beta_4 LAW + \beta_5 PST + \beta_6 REG + \beta_7 VAC + e_t$$

3. Results and Discussion

3.1. Unit Root Test

The unit root test on all the variables were carried out using the Augmented Dickey Fuller (ADF) test and Phillips-Perron (PP) test with constant and the result is presented in Table 1. The result from both ADF and PP show that all the variables are stationary at first difference except Government effectiveness and voice and accountability that are stationary at level in both ADF and PP. hence, the mixture of I(0) and I(1) allows the use of ARDL.

Table-1. Result of Unit Root Test

	UNIT ROOT TEST TABLE (ADF)					Unit Root Test (PP)				
	At Level		At First Difference			At Level		First Diffrence		
Variable	t-Statistic	Prob.	t-Statistic	Prob.	Remarks	t-Statistic	Prob.	t-Statistic	Prob.	Remarks
TXC	-2.2528	0.1955	-5.2559	0.0005	I(1)	-2.5062	0.1288	-5.0706	0.0009	I(1)
REG	-2.0148	0.2777	-4.9018	0.0024	I(0)	-2.0734	0.2564	-4.839	0.0027	I(0)
PST	-2.1954	0.2158	-4.8481	0.0027	I(1)	-2.2299	0.2052	-3.6024	0.0236	I(1)
LAW	-1.5792	0.4663	-3.0333	0.0578	I(1)	-2.9722	0.0662	-3.0333	0.0578	I(1)
GOV	-2.692	0.0997	-6.4534	0.0002	I(1)	-2.7083	0.0971	-5.4237	0.001	I(1)
CORR	-2.0522	0.264	-3.3142	0.036	I(1)	-2.0522	0.264	-3.3141	0.036	I(1)
VAC	-0.3495	0.8935	-3.5903	0.0224	I(0)	-0.3495	0.8935	-3.5889	0.0225	I(0)

Source: Author's Compilation 2020

3.2. Correlation Analysis of the Data

Testing the correlation among variables helped researcher to detect whether the variables have high multi-collinearity among themselves. The rule of thumb is that if the pair-wise or zero-order correlation coefficient between two regressors is high, say, in excess of 0.8, then multi-collinearity is a serious problem. From Table 2, the result showed that the correlation among the variables were low, while both positive and negative correlation were witnessed among the variables. Specifically, government effectiveness, political stability and regulatory quality have a positive relationship with tax compliance while control of corruption, rule of law and voice and accountability has a negative relationship with tax compliance.

Table-2. Correlation Matrix

	TXC	CORR	GOV	LAW	PST	REG	VAC
TXC	1						
CORR	-0.13	1					
GOV	0.28	-0.06	1				
LAW	-0.22	0.71	-0.20	1			
PST	0.22	-0.3291	0.09	-0.41	1		
REG	0.04	0.74	-0.13	0.71	-0.37	1	
VAC	-0.14	-0.17	-0.14	0.29	-0.38	-0.10	1

Source: Author's Compilation 2020

Table 3 reports the result of bound test for the model estimate and critical values provided by Pesaran *et al.* (2001). The F-statistic is compared with the critical bounds at 5% level of significance with unrestricted intercept and no trend (Upper bound is 3.28 and Lower bound is 2.27). Specifically, the F-statistics of the model 5.7027, which is greater than the upper bound critical value (3.28), and we therefore concluded that there is evidence to reject the null hypothesis of no long run relationship among the variables. Hence, the alternate hypothesis accepted that there is long run equilibrium relationship among the variables.

Table-3. ARDL Bounds Test

Null Hypothesis: No long-run relationships exist		
F-statistic	**K**	
5.702738	6	
Significance level	I0 Bound	I1 Bound
10%	1.99	2.94
5%	2.27	3.28
2.5%	2.55	3.61
1%	2.88	3.99

Source: Author's Compilation 2020

3.3. Effect of Public Governance Quality on Tax Compliance in Nigeria

The effect of public governance quality on tax compliance is achieved using Autoregressive Distributed Lag Model. Table 4 report the short run model of the relationship between tax compliance and public governance. The joint significance of the coefficients indicate that the variables are jointly different from zero ($f = 26.2739$, $p < 0.05$). The r-square and its adjusted counterpart report that the variables jointly account for high proportional variation of the change in the dependent variable. The short run coefficient of government effectiveness (GOV) is positive and statistically significant at 5% level of significance ($t=4.6983$, $p<0.05$). It implies that an effective government induces tax compliance positively. The effectiveness of government will lead to strong tax compliance behavior among the corporate and individuals. This finding is similar to the submission of Richardson (2008) and Akpo (2009). On the other hand, control of corruption has positive and significant effect on tax compliance in the short run ($t = 2.1792$, $p < 0.05$). This indicates that strong institution with less corrupt practices will bring about enhanced tax compliance among the populace. This finding is consistent with the findings of Kasum *et al.* (2013) who confirmed in their study that corruption and bad governance discourage tax compliance. It is expected that compliance level will increase whenever government takes a serious measure to control corruption. However, we may assume that since tax is a compulsory levy for all taxpayer; the control of corruption affects their decision to pay. Also, taxpayers will be more willing to pay in an environment that is free from corruption.

Similarly, short run coefficient of political stability (PST) has a positive effect and significant effect on tax compliance ($t=4.7842$, $p<0.05$). This indicates that as a country continues to witness political stability, the populace complies with tax law. Specifically, an increase in political stability leads to 3.70 change in tax compliance in Nigeria. The above findings supported by the work of Masud and Dandago (2014). In addition, from Table 4, regulatory quality (REG) has a positive effect on tax compliance in the short run and this relationship is statistically significant ($t = 4.8861$, $p < 0.05$). However, the empirical interpretation of this result is that the degree of responsiveness of regulatory quality to a unit change in tax compliance is 3.69%. On the other hand, voice and accountability (VAC) has a negative significant effect on tax compliance in Nigeria ($t=-3.0554$, $p<0.05$). Specifically, as voice and accountability increase, tax compliance decreases by 3.48. This is contrary to the work of Torgler, Schaffener and Macintyre (2008) who found that public accountability is positively related with tax morale. The coefficient of the error correction term (ECT) -0.166 implied that 16.6% of long run disequilibrium is to be corrected periodically by the model. It indicates that the model will converge to its long run equilibrium path.

Table-4. Short Run Effect of Public Governance Quality on Tax Compliance in Nigeri Dependent variable: TXC

Variable	Coefficient	t-Statistic	Prob.
D(TXC(-1))	0.6601	6.607218	0.0071
D(GOV)	5.9028	4.698304	0.0182
D(CORR)	4.5292	2.179236	0.0534
D(LAW)	3.2581	1.678344	0.1919
D(PST)	3.7006	4.784292	0.0174
D(REG)	3.6938	4.886142	0.0164
D(VAC)	-3.4877	-3.055499	0.0522
ECT	-0.1668	-11.62767	0.0014
R-squared	0.9545	F-statistic	26.2739
Adjusted R-squared	0.9182	Prob(F-statistic)	0.000010
Durbin-Waston Stat	2.0993		
Joint significance	309.7337(p<0.05)		

Source: Author's Compilation 2020

The Lagrange Multiplier (LM) tests for the presence of ARCH disturbances in the models were presented in Table 5. The LM test showed that the null hypothesis for no ARCH errors is accepted ($p > 0.05$), indicating there should be no ARCH left in the standardized residuals of the model. Furthermore, the ARCH test used to test for the presence of heteroskedastic in the residual accepts the null hypothesis of no heteroscedasticity in the model since the probabilities values are greater than 0.05. The Ramsey Regression Specification Error Test (RESET) for the sectors also presented in Table 5. Under RESET, the null hypothesis that the model is correct specification of the model is linear tested against the alternative hypothesis that the correct specification of the model is non-linear. From Table 5, the null hypothesis is accepted ($p > 0.05$) which means that we do not reject the null hypothesis that the original estimated linear form is the correct specification of the model. Similarly, the Jaque Berra test for normality among the residuals also revealed that the residuals are normally distributed ($p > 0.05$).

Table-5. Diagnostic Tests

LM	**ARCH**	**RESET**	**Normality Test**
4.432 (0.056)	1.004 (0.325)	1.784 (0.214)	0.031 (0.984)

Source: Author's Compilation 2020

The long run estimates in Table 6. revealed that government effectiveness will enhance the tax compliance in Nigeria in the long run (t=3.4199, p<0.05). This shows that both short and long run relationship between tax compliances and government effectiveness follow the same path. Similarly, REG exhibits positive relationship with tax compliances in the long run (t=3.0209,p<0.05), while VAC report negative long run relationship with tax compliances.

Table-6. Long Run Effect of Public Governance Quality on Tax Compliance in Nigeria Dependent variable: TXC

Long Run Relationship			
Variable	Coefficient	t-Statistic	Prob.
GOV	6.642249	3.419934	0.0188
CORR	-0.804935	-0.454548	0.6685
LAW	2.208415	0.995596	0.3252
PST	3.817445	10.92475	0.0001
REG	3.708458	3.020978	0.0294
VAC	-1.531652	-3.359294	0.0201

Source: Author's Computation 2019

4. Summary and Conclusion

The study found that in the short run; political stability, government effectiveness, regulatory quality and rule of law, control of corruption have positive and significant effect on tax compliance while voice and accountability have negative and significant effect on tax compliance. However, in the long run, the result showed that control of corruption has a negative but insignificant effect on tax compliance. Government effectiveness, rule of law, political stability and regulatory quality have positive and significant effect while voice and accountability have negative and significant effect on the level of tax compliance in Nigeria.

The conclusion of this study is that a very strong governance quality indicator is an important precondition for more adequate level of tax compliance. It also revealed that the quality of governance through its indicators matter for improved tax revenue. There is positive relationship between four indicators or proxies of public governance quality and tax compliance in Nigeria. These indicators include political stability, government effectiveness, rule of law and regulatory quality. However, result did not indicate positive effect between tax compliance and two other indicators (voice and accountability and control of corruption). It concluded that willingness to pay taxes depends on the better quality of governance indicators.

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