

EGAP STORIES OF CHANGE

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# FORMALIZATION, TAX APPEALS, AND VOLUNTARY COMPLIANCE

## LESSONS FROM NIGERIA

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The Metaketa Initiative is a **collaborative research model** with a mission to improve knowledge about critical governance issues through **rigorous field experiments**. In each Metaketa "round," the initiative coordinates multiple studies on a specific topic or intervention in a variety of countries and contexts.

The second Metaketa round focused on **formalization, taxation, and public services**, with studies in six countries exploring if demand-side behavioral interventions, which reduced upfront transaction costs that prevent people interested in entering into a fiscal contract with their government from doing so, increase formalization, access to public goods, and tax payments. Here we share the story of an experiment in **Nigeria** aimed at increasing formalization and tax payment by informal sector vendors located in Lagos marketplaces.

The Metaketa Initiative is led by Evidence in Governance and Politics (EGAP) at the University of California, Berkeley. It is partially funded by the UK's Department for International Development and involves a global network of researchers conducting studies in countries around the world.

## PROJECT COUNTRY: NIGERIA



## PROJECT TIMELINE



BASELINE: MARCH 2018  
INTERVENTION: JUNE 2018  
ENDLINE: DECEMBER 2018

Wax vendors sell traditional cloth in the shadow of a church and mosque on multicultural Lagos Island.



# THE CHALLENGE

Across much of Africa, the informal sector accounts for up to 80 percent of the labor force and a similar share of overall economic activity, but this sector remains largely outside the regulatory and tax reach of states. State appeals can shift formalization and tax compliance, especially if appeals shift the perceived costs and benefits of formalization and compliance. The understanding of the conditions under which these appeals are effective, however, remains incomplete.

Since 2006, Lagos State Government in Nigeria has launched a number of initiatives to increase the registration of taxpayers and the payment of income tax. These initiatives have been successful, generating a more than 400 percent increase in tax revenue over this period, and they have been accompanied by a significant expansion of state services delivery, even in the poorest areas of Lagos.

The majority of the informal sector, however, remains outside the state tax net. To this point, tax enforcement efforts in the informal sector have been minimal. Furthermore, most current income tax contributions by small businesses and vendors has occurred through indirect payment to the trade and marketplace associations to which many members of the informal sector belong. The aim of this study is to assess how the framing and delivery of formalization and tax appeals shape behavioral and attitudinal response.

“CAN INFORMATION ABOUT THE BENEFITS OF TAX PAYMENTS PERSUADE MARKET VENDORS TO PAY TAXES?”

Informal vendors work in more than 600 marketplaces across Lagos, and they compose one of the most important segments of the informal economy.





# RESEARCH DESIGN



Vendors' knowledge of the tax registration process, benefits attached to registration, and their own potential income tax liability was low. Thus, Adrienne LeBas at American University and Jessica Gottlieb at Texas A&M teamed up with the Lagos Internal Revenue Service (LIRS) to implement a study with two interventions aimed at increasing formalization and tax payment by informal sector vendors located in Lagos marketplaces, the bulk of whom are operating small businesses with fewer than five employees.

The two interventions included:

1.) Tax formalization visit in the form of provision of information and registration assistance by a local NGO

2.) Tax payment appeals that varied the framing of the appeals (stressing the potential costs of non-compliance or benefits of payment) and the identity of the agent delivering the appeal.

One of the significant features of this research site was the importance of pre-existing institutions that already play a role in mediating the relationship between informal sector workers and the state. Thus, in the second intervention, an individual vendor received a visit from an agent representing that important local institution -- the marketplace association -- or from a LIRS agent representing the state government.



# RESULTS

This project found that a low-cost informational intervention, designed to reduce the direct costs of formalization, was insufficient to increase vendors' willingness to register with the state tax authority. Additional interventions, which were designed to change the expected costs of tax evasion or the expected benefits of tax compliance, were differentially effective. We found that the effectiveness of these appeals was mediated both by vendors' past experiences of public goods delivery and by the relative trust they placed in state institutions versus an important social institution, the marketplace association. Identity also mattered: members of minority ethnic groups were more likely to register in response to state appeals. These findings suggest that state tax campaigns must take into account differences in social context as well as improving citizens' perceptions of state performance.

This study's results are most similar to the Malawi study that formed part of this Metaketa round. The Malawi project focused on an information campaign about the linkages between tax compliance and city service delivery in the city of Zomba, Malawi. The information campaign included in-person visits with citizens in which details about owed taxes, barriers to paying taxes, overdue payments, and benefits of formalizing were shared.

While these two studies look at different programs, their results are similar. In both contexts, there was a weak latent demand and too many barriers to entry for formalization. In Nigeria, people who paid for their registration cards did not always go to pick them up from the IRS office. In Malawi, while people prefer formal trash collection in the abstract, they are not willing to pay for it.

Additionally, in both studies, some citizens believe that there are better alternatives to the state. In the case of Nigeria, some market associations and other social networks have a better record of getting things done for vendors. In Malawi, the simple act of dumping trash in pit latrines is free, and thus preferred.

# 7%

Percentage of minority-group respondents that registered for e-TCC in the control and MPA appeal groups

# 14%

14% of minority-group respondents that registered for e-TCC in the LIRS appeal group

# LESSONS + IMPACT

One of the most important lessons learned from this project is that alternatives to state formalization procedures matter. That is, for interventions to work, the choice to formalize with state institutions has to be preferable to the status quo. In the case of Nigeria, the state has been relatively absent in markets historically. Some market associations, especially those representing ethnic minorities, have been good at avoiding the state and protecting their members from taxation. Others have gotten things done for vendors by being part of clientelistic networks.

Despite mixed results, this study was shared with LIRS senior officials who were interested in the policy implications, the feasibility (both political and logistical) of particular strategies, and the fit within existing LIRS plans for increasing compliance in the informal sector. In fact, the LIRS Director of Human Resources indicated that she would be pursuing diversification of the staff hired for the informal sector team. This was based on the findings about the ethnic

diversity of the informal sector vendor population (which is roughly half non-Yoruba) and ethnic groups' differential responses to tax appeals.

Key takeaways from this project and the other studies that form this Metaketa round suggest that formalization is attractive to individuals when governments offer valuable personal benefits, such as access to retirement income in exchange for formalizing. Furthermore, easy processes—for example, a one-time online sign-up that can be done with relatively little assistance—are crucial for formalization to occur. Finally, and perhaps most importantly in the case of Nigeria, it is important to understand the pre-existing norms, beliefs, and politics that may pose challenges to formalization. In the Nigerian context, when state agents instead of NGOs delivered the information, the intervention was more successful among those who had accessed state services in the past and those for whom the status quo was relatively more costly.



The research has been quite rewarding to the agency as it covers an area of our operations that requires changes predicated on detailed analysis.

- Ayo Subair, Executive Chairman of LIRS

I wish to expand the project to other areas and transfer research capacity within the agency itself, because this experience has been so informative and beneficial. The relationship with [Research Adrienne] LeBas and the research team transcends the project, and I hope to continue working with them.

- Abideen Akande, Special Adviser to the Executive Chairman of LIRS





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## LEARN MORE

For additional information about this study, visit the [project webpage](#).

For more on the researcher / implementing partner relationship, read [Partnership Lessons 16: Nigeria Marketplace Taxes with Lagos Internal Revenue Service](#)

Explore other projects in the [Metaketa II round](#).

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