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## Article

# Taxation of the informal sector and economic development of Lagos State

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Original Research Article

## **Taxation of the Informal Sector and Economic Development of Lagos State**

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### **Abstract**

*The informal sector has been regarded as a catalyst for socio-economic development of nations of the world. This is substantiated by the quantum of literatures available on it. However, the extent to which such studies could be replicated in Lagos State, Nigeria, is yet to be established. This study therefore examines the potentials of the informal sector in Lagos State as well as the challenges and prospects of tax collection from operators in the sector. Data for the study were collected through survey questionnaire distributed among 670 respondents in 5 local government areas in the State. Descriptive statistics was used to analyse the responses while Kruskal-Wallis and Chi-square tests were adopted to test the formulated hypothesis. Findings showed that the informal sector has the potentials to enhance employment creation, revenue generation and economic development of Lagos State. The study therefore recommends, among others, that to ensure compliance on tax payment for operators in the informal sector, there should be less emphasis on documentations and where documentations are required, it must be made easy to prepare and present for them; the tax to be collected from players in the sector should be lesser when compared with that of the formal sector and it should be flexible to fulfill economic reality; incentives or tax relief should be given to players in the informal sector for voluntary disclosure of their tax liabilities.*

**Keywords:** Informal sector, taxation, revenue generation, economic development, tax defaults.

### **JEL Classification Codes: H200, H240, H260**

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## 1. Introduction

The economy has been broadly classified into the formal and informal sector. The formal sector represents the economic interactions of organised individuals or corporate entities. While the informal sector is generally accepted to comprise of the economic activities or interactions of individuals, enterprises or other unincorporated entities or organisations. One of the key differences between the formal and informal sector is the structure. According to Ofori (2009), the formal sector is well structured to prevent evasion of taxes while the informal sector is not well organised. In developing countries, according to Blades, Ferreira and Lugo (2011), a large share of the population typically depends, for its livelihood, on the “informal economy”. Their income comes from subsistence farming or from operating small unincorporated enterprises. Some trade on the streets or in markets; sell cooked food from kiosks; transport people or goods by pedal power or motor bikes; repair clothes, shoes, or motor scooters; build dwellings or add extensions to them; scavenge for reusable waste; or provide a range of personal services like hairdressing, shoe cleaning, street theatre, house cleaning, and the like (p. 1). In his words, Becker (2004) asserts that the term informal economy refers to all economic activities by workers and economic units that are – in law or in practice – not covered or insufficiently covered by the formal arrangement. However, in Nigeria, the official concept of the informal sector is based on enterprise relationship to regulation by the state. In this instance, an informal enterprise is “that which operates without binding official regulations (but it may or may not regulate itself internally) as well as one which operates under official regulations that do

not compel rendition of official returns to its productive process” (CBN/FOS/NISER, 2001a: 2 as cited in Onyebueke & Geyer, 2011: 66).

There is an on-going debate on whether the informal sector should be taxed or not. And if it will be taxed due to its presumed potentials, how will it be operative. More so, what are the challenges of collecting taxes from operators in the informal sector? Any way out of the problems? These and many other questions were raised from extant literature on the subject matter especially in Nigeria’s context (see Adesanya, 2014; Obara & Nangih, 2017; Onyebueke & Geyer, 2011). This paper aims to examine the potentials of the informal sector as well as the challenges of collecting tax from the players in the sector; provide probable ways out of the problems.

The article is divided into five sections. Following the introduction, section two focuses on the literature review to present a view point on taxation and informal sector in developed and developing nations and a specific searchlight on its insight from Nigeria, particularly in Lagos State. Section 3 addresses the methodology, section four focuses on the estimation result and discussion of findings, while section five centers on conclusions and recommendations for policy implications.

## Research Hypothesis

The hypothesis formulated for this study is:

**H<sub>0</sub>:** *Taxation of the informal sector has no influence on the economic development of Lagos State*

## 2. Literature Review and Hypotheses Development

According to the International Labour Organization (ILO, 1972: 1), informality is defined as a “way of doing things characterised by ease of entry; reliance on indigenous resources; family ownership; small scale operations; labour intensive and adaptive technology; skills required outside of the formal sector; and unregulated and competitive markets”. However, in Nigeria, according to Onyebueke and Geyer (2011), the official concept of informal sector is based on enterprise relationship to regulation by the state. In this instance, an informal enterprise is “that which operates without binding official regulations (but it may or may not regulate itself internally) as well as one which operates under official regulations that do not compel rendition of official returns on its productive process” (p. 66).

The concept of the informal sector has its origin in Ghana and Kenya (Ofori, 2009). Though Nigeria has the largest informal sector in Africa consequent upon its massive population and poor economic performance owing to the high unemployment rate and soaring poverty (Onyebueke & Geyer, 2011: ). The informal economy is largely characterised by low entry requirements in terms of capital and professional qualifications; a small scale of operations; skills often acquired outside of formal education; labour-intensive methods of production and adapted technology (Becker, 2011). “It is known that the informal sector has a significant job, income generation potential and stimulation of social, economic growth in both urban and rural areas. However, the social, economic and political realities of the informal sector translate to a complicated operational reality for business formalisation and the tax administration”(Becker, 2011: 11). The effective taxable workforce is usually quite small and there are views that taxation evasion is huge, deliberate and systematic due to various reasons. These include lack

of knowledge and information and heavy costs of compliances resulting from their varieties and sizes. (Tanzania Revenue Authority [TRA], 2011).

### 2.1 Potentials of the informal sector in Nigeria

Although the largest part of GDP may be generated in the formal economy, most people in a large number of developing countries live in the informal one (Adesanya, 2014; Blades, Ferreira & Lugo, 2011).

According to Adesanya (2014), the informal sector is a vital part of Nigeria’s overall economy and contributes significantly to GDP. The employment and poverty-alleviation opportunities created for millions of Nigerians are the obvious benefits of working in the sector, as well as the relative freedom it offers entrepreneurs to run their businesses. Besides, the sector is a major provider of goods and services for both lower and high income groups, and even provides services to the formal sector. Studies estimate that the informal sector accounts for 35-50% of the GDP in many developing countries (Ndaka, 2017) and 60-70% of the GDP in the poorest countries (Enugu Platform on Tax Justice, 2017). In Nigeria, the informal sector is estimated at 75% of the economy (Obara & Nangih, 2017) while it contributes approximately 58% and 80% to GDP and employment respectively (Adesanya, 2014 & Enugu Platform on Tax Justice, 2017). See Table 1 for the informal sector’s estimation and percentage of contribution to employment and GDP of various countries in the world including Nigeria.

From the review of literature, the significant potentials of the informal sector in Nigeria could be summarized as follows: It promotes employment creation, it contributes significantly to the GDP of Nigeria, it provides necessary services to the formal sector, it offers relative freedom to entrepreneurs to run and become the boss of

their businesses and it is a major provider of income groups.  
goods and services for both lower and high

**Table 1: The informal sector's estimation and percentage of contribution to employment and GDP**

Country	Estimation of the informal sector	Contribution to GDP	Contribution to Employment	Source/Reference
Kenya	34.3%	25%	77%	Ndaka (2017: 80)
Ghana	80%	-	-	Carrol (2011: 5)
Nigeria	75%*	57.9% <sup>**</sup> /58% <sup>**</sup> *	80% <sup>***</sup>	Obara & Nangih (2017: 48)*; Adesanya (2014: 9) **; Enugu Platform on Tax Justice (2017)***
Tanzania	-	-	10.1%	Tanzania Revenue Authority [TRA] (2011: xi)

**Source:** Authors' computation (2019)

The table shows the informal sector's estimation and percentage of contributions to employment and GDP of various countries in the world, including Nigeria.

## 2.2 Challenges of collecting taxes from the informal sector

Compliance has been a great problem in the Nigerian tax system as a result of large scale informal sector (*Harnessing the bottom billion*). In his study, Ofori (2009) asserts that members of the informal sector have little opportunity to voice their concerns to government officials and thus, policies are less responsive to their needs. It was also observed that tax evasion had been identified as one of the major problems confronting tax administration especially in the developing countries. Thus evasion of tax is more problematic with respect to the informal sector.

Most nations in Africa find it difficult to tax players of the informal sector for different reasons which are administrative, legal and structural. In Ghana, for instance, Ofori (2009) states that the factors responsible for the difficulty in the taxation of the informal sector include the predominance of cash transactions, poor record keeping, high

illiteracy rate, little or no barrier to entry, lack of laid down procedures, and ignorance of tax law. Munjeyi, Maponga, Mhizha, Mujuru, Mpondori and Munjoma (2017), on the other hand, identified poor quality health services or infrastructure in Zimbabwe as one of the factors that kill tax morale in the country. The challenges bedeviling the taxation of the informal sector in Nigeria according to Obara and Nangih (2017) include "poor understanding of tax laws processes, poor understanding of benefits of paying tax by operators, lack of proper records or improper recording of business transactions, culture of deliberate tax evasion, avoidance and general reporting on the part of operators, non-disclose of or incorrect business addresses, challenge of multiple taxes, challenge of corruption by tax officials, challenge of bad governance thereby making operators not to set the need to pay taxes since they do not enjoy government services, predominance of cash transaction, lack of effective regulation, high level of illiteracy amongst informal sector operators, lack of education and proper sensitisation by the tax authorities to encourage compliance, structure of our economy, which is the predominantly agricultural, administrative problem

bordering on chronic shortages of trained officials and ICT facilities to facilitate the process of taxation, ineffective implementation of withholding taxes and non-establishment of revenue or tax courts to quickly try and punish offenders of tax laws.” (p. 50).

From the foregoing, it is clear that the informal sector has the potentials to contribute to the economic development of Nigeria. However there is more work to be done to tap the potentials through strengthening of tax administration in the country. The need to strengthen tax administration is not only peculiar to Nigeria but also to other nations of the world especially in the African continent. Ndaka (2017) posits that Kenya needs to re-examine its tax administration and policy if it is going to make progress in Public finance.

### 3. METHODOLOGY

The study adopts a survey research method. The target population of study were operators in the informal sector in Lagos State. The study also triangulated both qualitative and quantitative methods of data collection for a comprehensive and reliable data collection and findings. Data for the study were collected through a survey questionnaire randomly distributed among operators in the informal sector whose areas of business include distribution, manufacturing, agriculture, petty trading among others in 5 Local Government Areas (LGAs) in Lagos State (see Table 2). The choice of the state was premised on her significant contributions to the Nigerian economy since most informal sector players are scattered around it. Also, the chosen LGAs were predominantly saturated by a large group of operators such as trader, artisan (craft work), food vendor,

mechanics, hairdresser, tailor, electrician, vulcanizer, transportation etc., in the informal sector. For instance, the Alaba International market, Iyana-Iba market in Ojo LGA occupy many operators of the informal sector.

A total of 670 operators in the sector were captured in the study through questionnaire. The surveys were carried out in October and November 2018 with the help of research assistants geographically distributed within the sampled LGAs. The data gathered were analyze using descriptive statistics for the responses got; and Kruskal-Wallis and Chi-square tests for the formulated hypothesis.

### 3.1 Demographic information of the respondents

This section entails the demographic information of the respondents in terms of LGAs, gender, age, marital status, area of work, level of education among others.

**Table 2: Analysis of Respondents by Local Governments**

SN	LGAs	NO. OF RESPONDENTS	PERCENTAGE
1	Ojo	185	28%
2	Mushin	145	22%
3	Badagry	100	15%
4	Kosofe	75	11%
5	Lagos Island	165	25%
	<b>TOTAL</b>	<b>670</b>	<b>100%</b>

*Source: Field Survey (2018)*

Table 2 shows the analysis of respondents by local government areas of operation. It shows that 185 (28%) of the respondents were from Ojo while 145 (22%) were from Mushin. Others were Badagry, Kosofe and Lagos Island with 100 (15%), 75 (11%) and 165 (25%) respondents respectively.

**Table 3: Gender Distribution of Respondents by LGA**

Sex	Ojo	Mushin	Badagry	Kosofe	Lagos Island	Total
Male	81	50	60	45	65	301
Female	104	95	40	30	100	369
<b>Total</b>	<b>185</b>	<b>145</b>	<b>100</b>	<b>75</b>	<b>165</b>	<b>670</b>

*Source: Field Survey (2018)*

Table 3 shows the gender information of the respondents. It shows that the male respondents are 301 (44.93%) while the female was 369 (50.07%). This shows that there are more women than men in the areas of businesses examined.

**Table 4: Age distribution of the respondents**

Age	Ojo	Mushin	Badagry	Kosofe	Lagos Island	Total
Younger than 18 years	40	17	32	24	39	152
18 – 25 years	45	40	25	11	43	164
26 – 35 years	60	35	20	23	41	179
36 – 45 years	25	33	10	11	20	99
46 – 55 years	10	12	6	3	15	46
Over 55 years	5	8	7	3	7	30
<b>TOTAL</b>	<b>185</b>	<b>145</b>	<b>100</b>	<b>75</b>	<b>165</b>	<b>670</b>

*Source: Field Survey (2018)*

Table 4 reveals that 152 of the respondents were younger than 18 years while 164 and 179 people were within age brackets of 18-25 years and 26-35 years respectively.

Others totaling 175 were within the ages of 36 years and over 55 years. The table therefore reveals that majority of the respondents (495) were below 36 years.

**Table 5: Marital status of the respondents**

Marital Status	Ojo	Mushin	Badagry	Kosofe	Lagos Island	Total
Single	55	38	40	25	48	206
Married	75	60	30	22	67	254
Widowed	30	26	20	17	30	123
Divorced	25	21	10	11	20	87
<b>TOTAL</b>	<b>185</b>	<b>145</b>	<b>100</b>	<b>75</b>	<b>165</b>	<b>670</b>

*Source: Field Survey (2018)*

Table 5 above shows that 206 (30.75%) of the respondents were single while 254 (37.91%) were married. The remaining 210 people representing 31.34% were either

widowed or divorced. This indicates that majority of the respondents were either married or single.

**Table 6: Areas of work of the respondents**

Area of Work	Ojo	Mushin	Badagry	Kosofe	Lagos Island	Total
Distribution	40	42	28	24	42	176
Manufacturing	45	40	20	10	25	140
Agriculture	60	10	18	15	27	130
Petty trading	25	33	28	20	45	151
Others	15	20	6	6	26	73
<b>TOTAL</b>	<b>185</b>	<b>145</b>	<b>100</b>	<b>75</b>	<b>165</b>	<b>670</b>

*Source: Field Survey (2018)*

Table 6 shows the areas of business or work of the respondents. 176 (26.3%) were into distribution while 140 (20.9%) were in manufacturing business. 130 (19.4%) were

into agriculture while 151 (22.5%) were petty traders. The remaining 73 (10.9%) were into other businesses not stated in the survey instrument.

**Table 7: Level of education of the respondents**

Level of Education	Ojo	Mushin	Badagry	Kosofe	Lagos Island	Total
No formal education	60	21	15	20	38	154
Primary education	60	55	35	33	40	223
Secondary	45	50	29	12	47	183
Tertiary	10	14	11	5	25	65
Vocational/Technical	10	5	10	5	15	45
<b>TOTAL</b>	<b>185</b>	<b>145</b>	<b>100</b>	<b>75</b>	<b>165</b>	<b>670</b>

*Source: Field Survey (2018)*

Table 7 reveals the respondents' level of education. In order of quantity, majority 223 (33.28%) have primary education followed by 183 (27.31%) people with secondary education then those without any formal education 154 (23%). For tertiary education, 65 (9.7%) respondents were captured while 45 (6.71%) were said to have vocational/technical education.

#### 4. ESTIMATION OF RESULTS AND DISCUSSION OF FINDINGS

##### Test of Hypothesis

**H<sub>0</sub>:** *Taxation of the informal sector does not influence the economic development of Lagos State*

**Table 8: Chi-Square Results Test Statistics**

N	75
Kendall's W <sup>a</sup>	.154
Chi-Square	46.341
Df	4
Asymp. Sig.	.000

a. Kendall's Coefficient of Concordance

*Source: SPSS 20.0 Output*

Table 8 above shows that the chi-square is 46.341 with a degree of freedom of 4. The Asymptotic Significance (Asymp. sig.) value for the test statistics is 0.000, which is less than 0.05, the assumed level of significance. This implies that the null hypothesis is rejected in honour of the

alternative hypothesis. It is therefore concluded that taxation of the informal sector has potentials and influence on the economic development of Lagos State.

#### **4.2 Challenges of tax collections from operators in the informal sector**

The respondents were asked the reasons for not paying tax as operators in the informal sector. They were requested to select as many as possible options and also give other reasons where applicable. The descriptive statistics of the responses are presented in the table below.

**Table 9: Responses from challenges of tax collection from operators of the informal sector**

SN	Question	No. of Respondents	Percent	Mean response	Std. Dev.
1	Lack of transparency and accountability on the part of government	590	88.1%	2.15	0.465
2	Corruption in the tax collection system	655	97.8%	2.46	0.434
3	Lack of social amenities from government	468	69.9%	1.89	1.004
4	Unfair tax system	573	85.5%	2.10	0.512
5	Difficult tax processes	564	84.2%	2.05	0.534
6	Lack of knowledge about tax payment	50	7.5%	1.07	1.031
7	Other reasons (undisclosed)	10	1.5%	1.58	1.021

*Source: Authors' computation (2019)*

As shown in Table 9 above, the respondents considered the following challenges as being the major reasons for difficulty in tax collection from operators in the informal sector (mean response of equal/higher than 2.0): (1) Corruption in the tax collection system (2) Lack of transparency and accountability on the part of government (3) Unfair tax system (4) Difficult tax processes. However, "Lack of knowledge about tax payment" as the least reason (mean score: 1.07)

#### **5. CONCLUSION AND RECOMMENDATIONS**

The study found that the informal economy has a significant potentials and high influence on the economic growth of Lagos State. It therefore follows that the government should tap into the opportunity to enhance its internally generated revenue.

Following the review of prior studies and the findings from the survey conducted, the following recommendations are presented:

1. For operators in the informal sector, there should be less emphasis on documentations and where documentations are required, it must be made easy to prepare and present for them.
2. Incentives or tax relief should be given to players in the informal economy for voluntarily disclosing their tax defaults.
3. The government must ensure adequate provisions of social amenities to its citizenry. The legal maxim of "He who wants equity must come with clean hands" must be strictly adhere to by the authority. This has a bandwagon effect on the tax payers. They would voluntarily pay taxes when they see convincing reasons to do so.
4. The tax collectors must avoid all forms of corruption and illicit acts such as bribery, distortion of tax facts and

figures, and favoritism in tax collection. Any official who is found wanting must be made to face the wrath of the law. This will definitely serve as a deterrent to others and consequently promote compliance to tax payment.

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