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***PUBLIC ADMINISTRATION***



# **INTERNET OF THINGS AND SMART CITY DEVELOPMENT: IS NIGERIA LEVERAGING ON EMERGING TECHNOLOGIES TO IMPROVE EFFICIENCY IN PUBLIC SERVICE DELIVERY?**

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**Abstract:** *Over the past four decades, technology has gradually penetrated and influenced the operation of public sector organizations by changing and increasing its roles. The world is experiencing a dramatic shift from the traditional ways of delivering service to a more information and communication technology driven approach where governments are forced to use technology to shape policies and provide services to the people. This article aims to analyze the use of internet of things in achieving smart city and to make an attempt to explain how leveraging on emerging technology can improve public service delivery. The article observes that smart cities are an endeavor to make cities more efficient, sustainable and liveable. It notes that most cities in Nigeria are deprived of vital elements like the quality of life and socioeconomic development which can be delivered by the smart cities. The article discuss how emerging technologies can improve public service delivery in Nigeria and how these factors can make the internet of things and smart city initiatives a successful project in Nigeria. The article concludes that Smart Cities through the internet of things, with a proper roadmap, will serve people at large and will surely help in reducing cost on workforce and improve public service delivery.*

**Keywords:** *Internet of Things, Smart City, Emerging Technology, Service Delivery, Public Service*

## **1. INTRODUCTION**

Today's world is advancing through accelerated transformation owing to the fast pace of advancement in technological growth and adoption. The improvement in information and communication technology is pushing governments in different countries of the world to move from manual-based to an information-based method of service delivery (Al-Khouri, 2013). The world is experiencing a dramatic shift from the traditional ways of delivering service to a more information and communication technology (ICT) driven approach where governments are forced to use technology to shape policies and provide services to the people. The existence of technological advancement as stated by Osinbajo (2017) is evident enough that the fourth industrial revolution is upon us.

There is no doubt that the 21<sup>st</sup> century is faced with fast urbanization and growing population, which presents enormous tasks and pressure in our urban areas (Abdulkadir, Adamu, & Abdul-Fatou, 2017). Globally, the challenges and opportunities of urbanization are driving the government to seek new solutions on how to manage modern cities. The problems range from how to provide an immeasurable quality of life for citizens to ensure appropriate socio-economic development. The opportunities can be

seen in public sector becoming more efficient and innovative through the use of ICT in the delivering of services to the citizen, due to the current state of migration facing most cities in the world. United Nations (2012) observes that more than half of the people of the world now live in urban areas. The global population is now predominantly city dwelling, and as a result, demand is increasing for urban infrastructure investment (Accenture, 2015). Technological advancement is seen as the critical factor that can address the challenges facing governments in managing the modern city.

The United Nations (2012) notes that the population of city dwellers of about 250 million at early 20<sup>th</sup> century has increased to 2.8 billion at the beginning of the 21<sup>st</sup> century. This is evident in 2008, for the first time in the world; the population of the urban center was equaled to that of the rural area. It is estimated that by 2050 the urban population will double to 6.4 billion (Ojo, Dzhusupova, & Curry, 2015). This poses challenges to the traditional approaches to city management and urban lifestyle (DiChristina, 2011). However, the steadily rising urban populations are placing enormous stress on the world's cities, as the available resources are required to meet the demand of more people. Ismail (2016) observes that managing the ever-increasing pressure on the available resources in the urban center is becoming increasingly difficult, and so attention has turned to developing new systems that address the challenge of megacities. Therefore, combining cities with smart technology solutions has become the expectation of today's digital age.

With an increase in the population of urban centers, governments around the world are beginning to understand the enormous potential of the emerging technologies by leveraging the Internet of Things to build a smart city that will enhance efficiency in service delivery to the people. The primary goal of the smart city is to strengthen the use of public resources, increasing the quality of services delivery and reducing operational costs. While this objective cannot be accomplished with the present mode of service delivery, leveraging the deployment of Internet of Things (IoT) within a Smart City can go a long way to reaching this goal (Meering, & Balella, 2016). This will enhance personal satisfaction by using technology to improve the effectiveness of public service delivery.

## **2. STATEMENT OF THE PROBLEM**

Our world is becoming more intelligent and interconnected due to globalization. The emerging technologies that underpin the provision of services in most countries are becoming smarter. We live in a time of modern advances in every sector of human endeavor. In the developed societies, we see the coming of age of a whole new generation of intelligent systems and technologies more powerful and accessible than ever before (Lierow, 2014; United Nations, 2015). Unfortunately, the same cannot be said of Nigeria. The country is wrestling with both an infrastructure gap, after years of underinvestment, and an innovation gap from poor innovation performance in the public sector over the years (Hajduk, 2016). This is evident in Nigeria, where the implementation of modern public project management tools, methods, and techniques is still not well established in the public sector which has resulted to failure public



infrastructures (Fatile & Adejuwon, 2014). This, as argued by Adejuwon (2012a), shows that the Nigerian public service is irrefutably beset with gross incompetence and ineffective management of public infrastructures. The state of infrastructure decay shows that the performance of the civil service in Nigeria has remained very abysmal, hence the present predicament of underdevelopment (Adejuwon, 2016). Though Nigeria has emerged as one of the world's most fast-growing economies in the world. What is surprising is that service-delivery outcomes have remained disappointing (Fatile, Olojede & Adejuwon, 2015). This shows that the public sector in Nigeria has been bedeviled with ineffectiveness (Adejuwon, 2012b).

Due to rural-urban migration, Nigeria has experienced a significant pressure on the infrastructures in the urban centers. Problems associated with health, traffic, pollution, scarcity of resources, waste management, and poor amenities arise and hence the development of city falls apart (Toppeta 2010; Washburn, Sindhu, Balaouras, Dines, Hayes, & Nelson 2010). In Nigeria, citizen's discontent with poor public services is soaring. This is because government as observes by Fatile, Williams & Adejuwon (2011) is the principal actor in service delivery. Quality education, health care, social welfare, and safety programs along with an efficient business environment that can create sustainable and competitive economies become a mirage. While traditional public management solutions have not delivered on this challenge

It is unfortunate that Nigeria with her enormous material and human resources over the years cannot boast of smart cities with modern infrastructure and public utilities. Most government services are yet to get online. Nigeria is backward in technological advancement. Though most countries are making their cities work with smart technologies that make life comfortable and secured, it is only the mobile phones that are beginning to get smarter, and that is what is we are celebrating as technology advancement in Nigeria. In Nigeria, the IoT is not widely used in the public sector.

Despite the importance of IoT as the primary driver of a smart city that will propel efficiency in public service delivery. Researchers on the Internet of Things and Smart City are mainly from developed societies. In Africa in general and Nigeria in particular, few publications have concentrated on the internet of things and smart city. These studies focus on mainly on the Internet of Things and smart City separately. This paper, however, tries to fill this gap by examining Internet of Things and Smart City, and how service delivery to the people can be improved.

This paper aims to analyze the use of internet of things in the development of a smart city and to explain how leveraging on emerging technology can improve public service delivery while addressing the opportunities and challenges faced in the process especially in developing countries like Nigeria.

### **3. CONCEPTUAL REVIEW**

This section provides the conceptual analysis and the relevant theory underpinning the study of Internet of Things and Smart City

**3.1 Internet of Things (IoT):** IoT was first used in 1999 by Kevin Ashton back in explaining how Internet-connected devices can change our lives (Wood 2015). Jin et al. (2014) observe that IoT originated as a vision to interconnect various everyday objects through the internet to achieve a common goal. The idea of IoT is the connection of internet devices through which person can interact with the physical and digital world.

IoT is the third stage in the development of the internet. It is an emerging technology that works with the integration of many other present-day technologies (Gade, Gade & Reddy, 2016). IoT makes every device internet ready and offers connectivity that enables the flow of data by creating a network of objects (Mohammed & Bagavathi, 2016). Through IoT, the future can be imagined, where the devices will be equipped with microcontrollers, sensors, trans-receivers for digital communication, suitable protocol stacks and network models will make these devices to communicate with each other, while the users become an important part of the Internet (Gade, Gade & Reddy, 2016).

**3.2 Smart city:** The smart city is an emerging concept. As a result, there is no universally accepted definition. The following are the working definitions of smart city:

Author	Year	Definition
Nam & Pardo,	2011	Smart Cities are about leveraging interoperability within and across policy domains of the city (e.g., energy, healthcare, transportation, public safety, education, healthcare, etc.). Smart City strategies require innovative ways of interacting with stakeholders, managing resources and providing services
Hall	2000	A city that controls and unites conditions of all of its critical infrastructures
Gade, Gade & Reddy	2016	Smart city is a global trend of urban policies aimed at improving the quality of inhabitants living in urban areas and at leveraging on innovation and high technologies to solve the complicated problems generated by high-population density
Bakici, Almirall, & Wareham	2013	A smart city is that city that utilizes ICTs with the purpose of increasing the quality of life of the people while providing sustainable development.

Source: Compiled by the Author

From the above, there are three primary attributes of the Smart City. First, Smart city is characterized by the "high intellectual or human capital" needed to sustain continuous innovation and address challenges. Second, regarding goals, smart city aims at social inclusion, significantly improved quality of life and economic development. Third, Smart city policies also target improvement of human capital through continuous learning, efficient management of resources, and sustainable urban development in general (Ojo, Dzhusupova, & Curry, 2015). While Smart city is expected to improve their citizens' quality of life dramatically, encourage investment, and create a sustainable environment. Smart city initiative is a key to building smart connections, inspire, empower people and deliver innovation in public services.

**3.3 Emerging technologies:** The term emerging technologies are science-based innovations with the potential to create a new industry or transform an existing one (Day & Schoemaker 2000). Emerging technologies can be explained as are new technologies

that are currently emerging or will be developed in the next few years, and which will largely change the social and business environment (Srinivasan, 2008). Vine (2002) defined emerging technologies as technologies that have the potential to gain social relevance within the next 10 to 15 years. Haag, Cunnings, & James (1998) identified that emerging technologies fall into two categories. These include; a technology that is so new that most businesses have not exploited it yet; or technology that is fairly well established, but business has not fully used it.

From the above definitions, it shows that emerging technologies are not necessarily new. Technology can be considered emerging when it is not widespread in a particular context.

#### **4. THEORETICAL BACKGROUND**

**Technological determinism theory:** Technological determinism (TD) is the idea that technology has important effects on our lives. This idea figures prominently in the popular imagination and political rhetoric, for example in the notion that the internet is transforming economy and society. Technological determinism has also had a long and controversial history in the social sciences in general and in organization studies in particular (Adler, 2006). Technological determinism was developed an American Economist and Sociologist, Thorstein Veblen. This theory believes that nature technology in any society defines its nature. Technological determinism viewed technology as the driving force of culture in any society, and it determines its course of history (Adler, 2006). Technological determinists interpret technology in general and communication technology as the basis of society in the past, present and even the future. Therefore smart cities regarded from a technological-deterministic view produce a lot of data and require the use of robust geographic information systems to analyze this data (Jan-Philipp, 2015).

Technological determinism has been criticised based on the fact that technology never forces itself on members of the society. Man creates technology and chooses to use them. Man invents television and wishes to view it. There is no pressure on the part of the technology to be used instead technology needs people to engage themselves at some point or another to use a microwave or a car. The decision of using technology and experiencing its effects, therefore, lies in the hand of a human being. Despite the criticisms of TD, the relevance of technological determinism, to this paper, is that technology directs the transformation of public sector organizations, which means that technology or its potential cause changes in processes, structure, people and organizational culture. In the public sector, technology is the factor that directs the transformation of organizations and their elements.

##### **4.1 THE INFLUENCE OF EMERGING TECHNOLOGY ON PUBLIC SECTOR ORGANISATIONS**

Emerging technologies today are one of the most major drivers of the performance of public sector organizations. They are transforming government agencies

and the nature of governance and pose new challenges for the civil service (Desouza, & Bhagwatwar, 2012). Over the years, the development of technology has prompted the public organization to change. One of the most significant changes in technology has been the evolution of the information systems and how their development has influenced the way the world uses technology. The combination of technology that enables the conversion of data into information has had an immense influence on the field of public administration and its theoretical foundation (Dianne, 1997). These technologies have emerged and developed after great development and progress in the area of science and technology, which in turn represented a meaningful addition to the field of public administration. These technologies mean all the innovations which help to perform the functions of all governmental activities.

In fact, emerging technologies developed as a result of rapid developments arising from the revolution in information and communications technology in particular, which in turn produced many technological distinctive innovations which are considered as an addition to the governmental process, which continuously develops and brings greater features and attributes for the field of public administration. Consequently, emerging technologies have added a lot of scientific and practical dimensions to public service delivery. The imperatives of emerging technologies to transform public service delivery provide a compelling context for the more excellent use of digital technologies and assistive technological labor-saving solutions in the public sector. Today, these new demands on governments are driving public sector modernization, which continues to require systematic and consistent efficiency and productivity, especially regarding service delivery.

## **4.2 EVOLUTION OF SMART CITY**

Today, the concept of the smart city is one of the most frequently mentioned concepts in the management of the modern city. Smart city phenomenon developed due to some significant challenges such as technological progress, innovative devices, knowledge economy, environmental pressures and the political support from various global institutions like United Nations, the OECD, the European Union, etc. (EU 2011, 2014; Thite 2011; Winters 2011; Zygiaris 2013; Cocchia 2014).

At European level, the smart cities initiative was launched in 2011 to forging partnerships between industry and cities 'to develop the future urban systems and infrastructures. Later, smart city programs have been launched by national agencies, most notably across Asia (e.g., China, India, and South Korea). Major international technology companies, including Cisco, Hitachi, and IBM, have become active both as contributors to conceptual development and partners in pilot projects (Moir, Moonen, & Clark, 2014). In the United Kingdom, the Department for Business, Innovation, and Skills in 2013 launched a smart cities initiative. This is to foster innovation as well as to enable businesses in Europe to benefit from the global market of more than £200 billion by 2030 (UK Department for Business, Innovation & Skills, 2013). The European Commission has launched a funding program to accelerate the development of system standards for smart cities and communities solutions (Caragliu et al. 2011).

In last two decades, the idea of a smart city has become more and more popular in development literature and policies. This in the opinions of Mori & Christodoulou (2012) is the prime role of cities in the social and economic aspects of people worldwide, and in the tremendous impact on environmental sustainability. In the last few years, the smart city concept has played a significant role in public sector management. In a smart city, investments in social and human capital, traditional and modern communication infrastructure always improve the economic and quality of life, with effective management of natural resources through participatory governance (Caragliu, 2011).

### **4.3. IOT AND SMART CITY: THE NEXUS**

IoT is very crucial to the development of a smart city. It has become ever more prominent in everyday life, the concept of the smart city has begun to grow. Smart cities are urban developments that combine various ICT and IoT solutions to manage public infrastructures such as transportation systems, libraries, the management of schools, water supply, waste management, hospitals, power plants, law enforcement, etc. (Advanced Maui Optical and Space Surveillance (AMOS), 2016). The most significant utilization of IoT is smart cities (Gade, Gade & Reddy, 2016). The smart city uses smart technologies such as IoT to improve the quality of life in cities and communities.

It is clear that IoT and smart city are the features of the world's major cities, which in turn means that skilled developers, operations professionals, engineers, IT security specialists, and public administrators will be in high demand. There are many growth opportunities in the immediate future and in the coming years for the government to delivery efficiency service by leveraging on emerging technologies. IoT applications that leverage ubiquitous connectivity, big data and analytics are enabling Smart City initiatives all over the world. These new applications introduce tremendous new capabilities such as the capability to remotely monitor, manage, control devices and to formulate new insights and actionable information from massive streams of real-time data (Amos, 2016). IoU shows how a city can move from being an efficient city to a brilliant city.

Though a lot of people believe that building the smart city will be exceedingly disruptive, Kolade (2016) states that governments did not have to tear down the towns of today to develop smart cities, which would enhance services and the quality of life for their inhabitants. He believes that through the use of Internet of Things technology, building a smart city with some intelligently connected services would become possible. Kolade (2016) notes further that an IoT enabled smart city can reroute traffic gridlock in real time, automatically schedule repairs for collapsed infrastructure like bridges and street light, intelligently manage energy use and pollution right across the environment. IoT can also protect citizens and businesses from crime more efficiently, and safeguard vulnerable inhabitants in their homes. The IoT is assisting the world's largest cities to do this, on a grand scale, and at a remarkable rate.

### **4.4 Relevance of IoT and smart city to efficiency in public service delivery**

Just like the Internet has helped economies to develop and flourish, the Internet of Things will do the same. It will assist governments to do their jobs in a more efficiently. The public sector needs to embrace this technological development and reap its benefits. IoT can help the government to achieve its goals, increased economic growth, improved environmental sustainability, efficient service delivery, public safety, and productivity. While many organizations in developed societies have already captured the vast potentials of IoT, most developing countries are yet to benefit from the advancement in technology through IoT.

The public sector organizations can benefit from the diversity of devices in IoT, by leveraging the power of these devices, we are entering the era of smart cities, where sensors and automation can enhance public services, and impact on daily life of citizens. The benefit of a smart city includes an efficient management of human, natural and capital resources. This revolves around improved products and services to individuals and businesses, waste management, energy renewal, high level of security and delivery of high standard education. This will inevitably reduce operational costs, increase savings and invariably improve the quality of life of citizens and inhabitants of the city.

The benefits of smart connectivity in the public sector are tremendous. IoT lends itself seamlessly to applications in smart transportation, smart waste management, smart parking, etc. The ability to monitor tunnels, traffic, bridges, and other public facilities for problems offers both increased public safety and costs reductions. Additionally, telecommuting, or reduced travel, provides cross-agency cost savings. IoT offers exciting possibilities for effectiveness, improved public safety, and emergency response of medical officers, police, and firefighters.

In the transport sector, IoT not only makes the lives of the commuters easy but can also help the government improve their services. By analyzing all the digital information obtained from swipe cards, the frequency of public transportation can be determined at certain hours of the day. It can help you better manage traffic. Traffic police officers do not need to be physically present to help navigate traffic and avoid congestion. By utilizing GPS tracking devices, traffic can be analyzed in real-time, and the traffic lights can be managed accordingly.

IoT can make highways safer by enabling connected vehicles to interact with each other to prevent accidents. It can make quality health care more accessible through remote monitoring devices and telehealth practices to reduce delay in response and improve efficiency both in factory supply chains and in the running of cities. Smart city will not only be more useful for the citizens but will also attract more investments. For instance, Tourists can opt to get immediate notifications about what's happening in the city and which are the hottest places to hang out right now. To make city smarter, the governments need to start promoting several start-ups and other industries to operate on the IoT technologies so that they can be fulfilled in various areas of urban living.

#### **4.5 Emerging technologies and efficiency in public service delivery in Nigeria**

Emerging technologies have the potential to make major cities more functional and convenient for the people and the government. Even so, there are still challenges to

surmount. Though IoT provides immense opportunities to improve the effectiveness of governance, public safety, and support development, it also offers some challenges for the cities to overcome to build the dream smart cities. The application of information technology in improving public service delivery will transform the way government operate and deliver services. The application domains for ICTs in smart cities range from transport, tourism, health, ambient assisted living, crime prevention, governance, infrastructure, disaster management, environment management, smart homes to smart energy.

Internet of Things will play an instrumental role not just in communication networks but also in sanitation, transportation, healthcare, and energy use. It will create bits of knowledge that city specialists could use to enhance street and rail transport, lessen crime, improve social insurance, improve public service delivery, and diminish wastage of money related assets (Abdulkadir, Adamu, & Abdul-Fatou, 2017). IoT can facilitate the collection of reliable information about how efficiently public servants, policies, and programmes are addressing mission challenges and by helping the government to deliver services based on real-time and situation-specific conditions (William, 2015). By implementing the real potential of IoT, governments can improve services to its citizens, increase sustainability, and make the existing cities a better and more livable place for all its citizens. Internet of Things is the next big thing in the evolution of the information and communications technology space. IoT is a crucial aspect of smart cities that Nigeria needs to achieve.

Through the adoption of IoT, refuse collectors will make fewer journeys and use less fuel, will the operators can reduce the number of refuse trucks they use. IoT tracking devices can be installed on trains or buses to determine the location in real time. With IoT technology, cities in Nigeria can become smart cities, creating cleaner, safer and more efficient environment for the citizens.

A smart city is an idea to integrate various technologies which work together with a common aim to improve the quality of life. Smartness of a city can be shared among several sectors namely smart governance, smart building, smart environment, smart mobility and smart utilities. In this context, the IoT is growing due to the continually growing number of important devices like smartphones, laptops, tablets, and other devices such as sensors which are interconnected through the Internet (Manoj; Markus & Marija, 2016).

#### **4.6 An overview of IoT and smart city in Nigeria**

With about 48 million active internet users, Nigeria is one of Africa's' countries with an enormous market for IoT. Nigeria has been building the infrastructure slowly from the year 2010 when it formulated national information communication technology strategic plan 2010-2015. Like many countries in Africa, while Nigeria is yet to establish major IoT projects, the remarkable initiate was taken by National Agency for Food and Drugs Administration and Control (NAFDAC). Faced with perennial counterfeiting problem, NAFDAC in 2010 resorted to product verification initiative using Radio Frequency Identification (RFID). The technology carried out in collaboration with

Verification Technology Limited (VTL), use tags equipped with RFID to secure the genuineness of drugs throughout their supply chain starting from manufacturers, distributors, wholesalers, retailers and even consumers (Onyalo, Kandie & Njuki, 2015).

It is essential therefore to state that smart city initiative is the future reality in Nigeria and other developing countries which is anticipated to add more than 212 million to her urban populace between 2014 – 2050 (Abdulkadir, Adamu, & Abdul-Fatou, 2017). Many individuals are living in urban centers than in rural areas internationally, with 54% of the total populace dwelling in the urban areas. In 1950, 30% of the entire world population was urban, and by 2050, it has been estimated that 66% of the world population will be urban. While India, China, and Nigeria are required to represent 37% of the estimated population of the world, with Nigeria alone anticipated to include 212 million (United Nations, 2014; Abdulkadir, Adamu, & Abdul-Fatou, 2017).

Similarly, Kolade (2016) notes that about 48 percent of Nigerians are living in urban areas and this will continue to grow as urbanization continues. With the number of people living in cities around the world predicted to rise to 6.4 billion by 2050, cities like Lagos, Abuja and Port Harcourt need to embrace IoT technology to meet the rising expectations of a mega city.

Nigerian Smart Cities Initiative is a conscious effort by government working with the private sector and all other stakeholders to forge a public-private partnership to develop a solution that will make cities and citizens smarter through technology (International Gold Event, (IGE), 2017). Presently, Nigeria is making efforts at developing its smart cities in some states of the federation including the Federal Capital Territory, Abuja through coordinated and concerted efforts by the government through the public-private partnership. Notable amongst the cities are the Eko Atlantic City and that of Lekki which are jointly being managed by the Lagos State Government, Commercial Banks and Private Investors (The Federal Republic of Nigeria, 2016). The significant partnership between Lagos State and City of Dubai will guarantee Lagos rise as the first Smart City in Africa in an appreciated advancement (Abdulkadir, Adamu, & Abdul-Fatou, 2017). The Lagos State Attorney General and Commissioner of Justice (on behalf of Lagos state) and the CEO of Smart City Dubai have signed the Memorandum of Understanding (MOU) for the Lagos Smart City at the Emirates Towers, Dubai.

The smart city initiative in Nigeria is an idea based on the achievement of Dubai's creative information-based industry experts to engage business development for organizations and learning specialists everywhere throughout the world (Abdulkadir, Adamu & Abdul-Fatou, 2017). Through smart city project, the future has a place in Lagos state, as the smart city project would mark the major smart city in Africa when completed.

## **5. CONCLUDING REMARKS**

The above analysis of leveraging on emerging technology to improve service delivery in government has brought out important aspects of successful implementation of the internet of things and smart city in developing countries like Nigeria. The utilization of emerging technology to enhance service delivery can never be over-



estimated, while the implementation process has to be in line with what is applicable. The smart city project should be planned in such manner that the relationship between the government and people should be more understandable to the people at large. Further, the acceptability of technology interventions amongst people increases manifolds if it has a direct, immediate and visible impact on service delivery (Sharma, 2014).

With more than one-half of the world's population living in cities pioneering new IoT solutions, such as smart healthcare, smart parking, smart energy, connected waste, and traffic management, holds great promise for fighting the major challenges of high-end urbanization. We are likely to see many smart cities of the future coming to life overnight. There is no doubt that smart cities will help Nigeria move forward, pushing business and government to rethink solutions to urban problems. The public sector can leverage the emerging technologies through IoT to improve service delivery, reduce costs and engage citizens. Smart city leverages on digital technologies will boost the quality of life of its inhabitants, and also to reduce costs and resource consumption.

Internet of Things and smart city applications can generate substantial benefits for citizens and businesses in Nigeria. There is a need for policymakers to design and implement smart city projects with a long-term vision, which are defined around citizens' needs, managed through smart governance, based on open and scalable systems and promote a culture of innovation, openness and transparency.

As a result of insufficient financial resources, smart city initiative will be best executed in Nigeria by visionary leaders who manage smart city projects using public-private partnerships to invest in pilot scale projects. Government's role in providing clear policy and regulatory framework needs to be translated to concentrate actions regarding articulating a clear roadmap, implementation plan and coordination mechanism towards the attainment of relevant stakeholders' objectives. Though smart city project, no doubt are money-spinning ventures for government at all levels, the opportunity must be explored to address the problem of slums in our cities to improve the welfare of the citizenry.

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# **HUMAN RESOURCES IMPACT OVER THE EFFICIENCY OF ELABORATING AND IMPLEMENTING PROCESS OF EUROPEAN FUNDED PROJECTS AT THE LEVEL OF THE PUBLIC INSTITUTIONS OF CLUJ COUNTY**

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**Abstract:** *This article is a case study regarding the existence of project management departments in Cluj county city halls. The purpose of this case study was identifying some solutions to increase the absorption rate of European funding and to increase the quality of the projects submitted and implemented in Cluj county. This study addresses subjects as the importance of a project management specialized department, the particularities of human resources in public institutions and the organizational culture at city halls levels. Also, it has attempted to identify the main problems human resources are confronting with in the public sector when elaborating and implementing projects, in order to propose as feasible and sustainable solutions. Therefore, the rate of absorption of the European funds in Cluj County was analysed for the 2013-2017 programming period as well as 2014-2020, the actual period.*

**Keywords:** *rural environment, project management, human resources, public sector, European funds.*

## **1. INTRODUCTION**

In this paper, I chose to talk about the subject of human resources management in the public sector in the context of non-reimbursable financing which Romania receives from the European Union. The objective of this paper was to identify the main shortcomings of the human resource in the public sector, mainly in within the project management departments in Cluj County. Thus, communes that have a specialized department for project management were identified along with the ones that do not to compare them and see if one represents a model of good practices for the other. At the present moment, there are a multitude of programs that offer funding for development and performance as well as for the public sector as for the private one. Even so, the data shows that the absorption of European funding is relatively low, even though, in the last years, people began to take courage and access European funding.

This theme is relevant in the context in which, public institutions, in this case municipalities, for this paper, prefer to use external collaborators, such as consulting firms to deal with the writing and implementing of the projects although they have a specialized department for project management. However, the law allows and encourages public institutions to create their own departments to not outsource so much these activities. Costs with consultancy firms are high, and due to the high level of workload, they often make mistakes that lead to non-funding of the project. Additionally,

consultancy firms fail to know the communities and their needs so well that they can get involved in the writing and justification of the necessity of the projects.

## **2. PROJECT MANAGEMENT**

In recent years, in Romania the interest for project management has increased greatly, both in the public sector level and in the private level. All the more so in the public environment given that the legislation has given the chance to set up departments at institution level to deal directly with the european funding projects through Law no.339/2007 regarding the promotion of implementing project management strategies at county and local administrative-territorial units and the subsequent amendments to it. Through this law, the stat wants to encourage access to funding through well-trained staff at the institution level. Thus, according to art.7 of Law no.339/2007 “At the level of the local and county public administration authorities, as well as at the level of public institutions and services under their authority or subordonation, for the initiation and development of international funding structures”. This encourages the institutions to find well prepared people for accessing European funding.

Management generally refers to how to organize and run an organization to make the most efficient and effective use of resources. At the same time, the project can be defined as something well organized, limited as in a time frame and resources. Each project is unique in its own way, and this brings challenges to the person writing it, respectively, implementing it. Thus, “project management represents the process of leading a project which requires implementation of planning, team building, communication, control, decision making and project completion, principles, tools and techniques” (Ilie G. 2012 apud Project Management Basics Glossary).

## **3. METHODOLOGY**

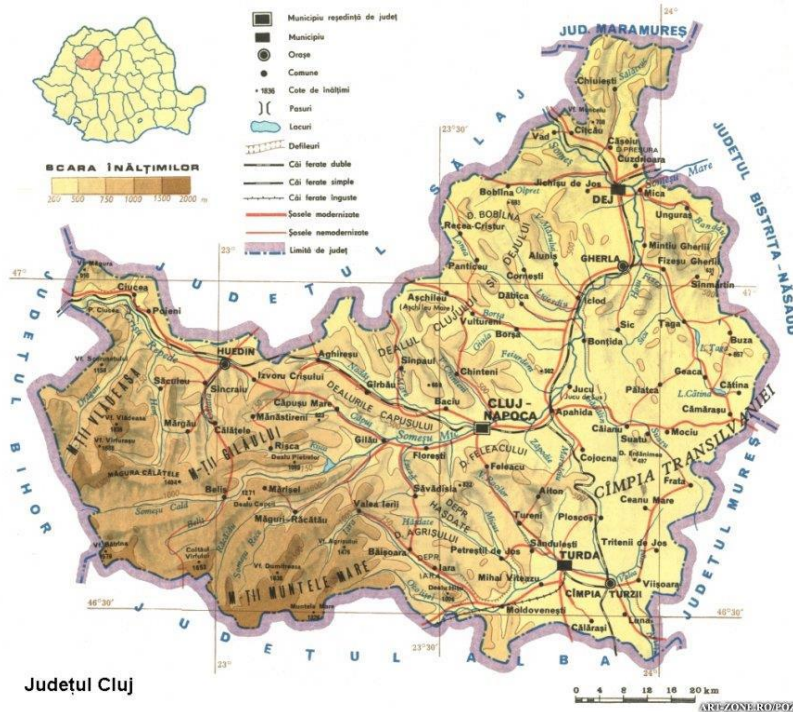
We chose this theme in the context in which although at the present moment the European Union gives a series of funding for public institutions to develop and raise the life standard of the Romanian people, few of them are accessed. Thus, the purpose of this paper is to identify the number of communes in Cluj county which have a specialized project management department, the problems they are confronting with in the elaboration and implementation of the projects and some solutions to help the employees to develop the communities in which they work. So, I made an interview guide which I applied in Cluj county city halls and through which I found more information regarding these institutions. The interview guide was sent to all the city halls in Cluj County, respectively, all 75 communes, and I got back answers from 42 communes. I chose Cluj County due to the fact that it is in continuous development in the last years and I wanted to observe if this development is justified in some measure through the running style of the public institutions at local level.

Cluj county is situated in the west-central Romania, in the center of Transilvania historic province. Its residence is the city of Cluj-Napoca and its neighbours are Sălaj, Maramureş, Bistriţa-Năsăud, Mureş, Alba şi Bihor counties. Cluj-Napoca is the fourth

city in Romania considering the size and is one of the most important academic, cultural and industrial centres in Romania. This thing implicitly leads to the development of the whole commune and the raise of the living conditions at the county level. According to the 2011 Population and Housing Census, Cluj County ranks third as the number of stable population at the country level, the first two being Iasi and Prahova. In 2017, it was ranked the 8th in the hierarchy of the national counties according to the National Institute of Statistics having a population of 725.708, the first 7 places being occupied by București, Iași, Prahova, Constanța, Suceava, Timiș și Bacău.

The administrative organization of the county of Cluj includes a network of 420 human settlements, grouped in 75 administrative-territorial units. The population of Cluj County is of approximately 700.000 inhabitants, of which 65% live in the urban area. What is characteristic for Cluj County is also the multitude of ethnicities coexisting with romanians, along with them being Hungarians, Germans, Saxons and Armenians. Regarding the majority of religions, according to the County Council of Cluj 72% of the faithful are Orthodox, 12% Reformed, 4.3% Greek-Catholic, 3.6% Roman-Catholic, 2.9% Pentecostal, 1.1% Unitarians and 1.04% Baptist.

Figure 1 Cluj County Map



Source: Cluj County Councils website

## CASE SELECTION

Considering that the interview guide will be applied to people working in the public sector, I will not be able to select the cases, but I sent the interview guide by e-mail and those able responded. The interview guides were sent to Cluj County city halls in the

19<sup>th</sup> and 20<sup>th</sup> of March 2018. Since we received very few answers on the e-mail, although the information requested was of public interest, I called the city halls, and so some of the interviews were applied on the phone, making notes as I discussed with the respondent about the main ideas he was conveying. This way, at the end of the data collection I managed to get 42 answers from the city halls, and from these ones after checking the organizational charts of the 75 communes in Cluj County, I realized that only two of them have a project management department, respectively Apahida and Floresti, communes in the metropolitan area of Cluj.

#### **4. INTERPRETATION OF DATA**

##### **4.1 Qualitative Data Analysis – Interview Analysis**

The interview guide was sent by e-mail to all the city halls in Cluj County and from the 75 existing at county level, only 42 of them responded. Even so, following the organigrams and analysing the responses received by interview from the communes, we quickly realized that only 2 communes in Cluj County have a project management department in the institution, the rest of them outsource these services.

###### a) Data reduction by encoding

<i>Category</i>	<i>Codes</i>
Position held in the institution	Counciler Mayor Specialty Inspector Public Administrator Commune Secretary
Existence/inexistence of a project management department	Generally there is no such department at the level of the communes in Cluj County Only two communes have such department: Apahida Commune and Floresti Commune
Perception of the usefulness of the existence of such department	It would help a lot in tracking the financing lines suitable for the commune It would reduce the costs the city hall has: outsourcing services, travel, failure to meet deadlines It would not be justified considering the size of the commune
Main projects submitted	Building sport grounds and playgrounds for children Modernization of the commune roads Modernization of the agricultural roads Extend sewage and water supply
The main problems encountered in the writing and/or implementing the projects and the main actors involved	Excessive bureaucracy Unprepared consultants Large outsourcing costs for the project management activities Failure to meet deadlines
Outsourcing the activities regarding project management and justifying the costs of these	Most of these activities were outsourced There were no projects submitted in the previous programmed period



consultants	The outsourcing costs of these activities are too high The cost of outsourcing these activities are relatively justified
The importance of the existence of an organizational culture and specialists within the public institution	The existence of a department within the city hall would be more useful The organizational culture is extremely important and leads to greater work efficiency Faster development of the community by tracking territorial needs
The main reasons for not creating such a department	The creation of such department is not justified considering the size of the commune There is no specialized work force in the commune Recruitment and selection would be difficult due to the lack of interest of the young people for the public institutions There would be specialized work force in the commune

**b) Data presentation**

During the interview, there were a series of questions aimed to identify the existence/inexistence of a specialized project management department as well as the way writing and implementing projects takes place in the absence of such department. From the interviews conducted, I found that although Cluj-Napoca is in full development and expansion phase, the rural environment in Cluj County is declining. Only 2 of its 75 communes have a project management department, these two being located in the metropolitan area of Cluj.

Although there is no such department, Cluj County city halls submit projects for European or governmental funding through the consultancy firms existing at the county level. So, these activities are outsourced and projects are being submitted under different measures. The secretary of Căianu commune told me that even though they have no project management department in the commune "we submitted four projects, three of them are approved, and the approved projects are for asphaltting the communes roads, the purchase of a backhoe loader and the equipment of the dental cabinet, and the fourth of which we do not know yet if it will be approved is for the renovation and modernization of the gymnasium school". On the other hand, following the responses obtained from the respondents, I found that almost all city halls obtained funding for the same type of expenses. I also discussed with the accountant of Aiton commune, who told me that "there were submitted, won and implemented three projects in the present programming period for the rehabilitation of the communes roads and a project for endowing with specific furniture and equipment of the human dispensary".

Also, most respondents consider that the establishment of a specialized project management department would lead to an increase in the number of projects submitted at the commune level. The public administrator of Panticeu commune told me that "if a project management department was set up at the commune level, the number of projects submitted for the development of the commune would certainly increase because in this way there would always be a person to follow the funding possibilities and fold them to meet

the commune needs. Considering the current state, we only access funds when consultancy firms contact us and let us know what is being funded or when there is a great need that cannot be postponed.”

Instead, I noticed that the public institutions that have project management departments inside them submit projects with higher financial value and also community impact. It is obvious that, in the case of different project types, there are certain eligible application categories, but due to the poor training and lack of knowledge of the field, small dimensions communes will never have the courage to try and absorb higher funds due to the fact that they will not have the capacity to manage them. For example, Floresti commune submitted and won a project which is now in the implementation phase ” Project financed by the Human Capital Operational Program – afferent to the project call POCU/82/3/7 ”Increasing employment through supporting non-agricultural firms in the urban area – Romania Start Up Plus with the title ”Entrepreneurship – your chance!”, project code 105931”, project which could reach up to 4.999.999 euros, depending on the business plans financed.

Following the situation and the status of the two communes that have a specialized project management department, I noticed that at the moment, Apahida city hall has five projects in progress, as follows: (1) execution work at the cultural center in Sănnicoară, (2) establishment of the sewage network in Dezmir village and partially in the villages Sănnicoară și Apahida, (3) expansion of the sewage treatment plant in the commune, (4) modernizing and rehabilitation of the commune streets and (5) building infrastructure for protection and prevention against commune flooding.

So, the activities and description of these projects can be found in more detail in the table below:

**Table 1 Ongoing projects at the level of Apahida commune**

Project title	Description
Construction work at the cultural centre Sănnicoară, from Apahida commune, Cluj county	The existing building will be demolished and a new building will be built, with a high regimen ground floor + mansard on a land with a surface of 527 sq m, with a street front of 18.90 m and depth of 19.45 m.
Establishment of sewerage network in the village Dezmir and partially in the villages Sănnicoară and Apahida, Cluj county	Establishment of the sewerage network with approximate parameters of 38.712 m sewerage network of gravity and pressure type and 14 pieces of new sewage pumping stations for extracting used water.
Expanding the sewage treatment plant in Apahida commune	The wastewater treatment plant will involve the expansion of the current station and the takeover of the current debit surplus of 1.58 l/s, respectively, 4.75 l/s debit collected from Dezmir village and a part of Sănnicoară village.
Modernization and rehabilitation of the streets of Apahida	Asphalting streets in Apahida commune, Corpadea and Apahida villages, of which total roads 1,946.81 ml, total altitudes 2,290 sqm, ditches 235 ml.
Construction of flood prevention and protection infrastructure in Apahida commune, Cluj county	Construction of flood prevention and protection infrastructure in Apahida village, declogging,

	indigestion, consolidation.
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Source: own processing based on the data obtained from the website of Apahida commune

At the moment, Florești commune has only the above-mentioned project under the Human Capital Operational Program within the project call POCU / 82/3/7 "Increasing employment by supporting non-agricultural enterprises in the urban area - Romania Start Up Plus with the title "Entrepreneurship - Your Chance!", which will have to fund about 40 young entrepreneurs to set up a business. This is a big project and the implementation will be carried out entirely by the city hall in Florești, without resorting to other external aids, represented by the consultancy.

#### 4.1 Qualitative data analysis – document analysis

We conducted an analysis of the attracted funds in the programming period between 2007 and 2013 to see to what extent the administrative-territorial units from the rural environment managed to attract funding for development. So, at the end of 2013, respectively, in December, the absorption rate in Romania was extremely low. This absorption rate is also explained by the fact that an important part of the funded projects were not settled for payment, the implementation being made, and most likely they did not ask for advance or reimbursement. In this way, the absorption rate for the programming period can be seen only in 2015, when it is n+2, also being implemented the projects that entered in the funding period only at its end.

Therefore, initially, I decided to follow the absorption rate of European funds at national level, regardless of the type of eligible beneficiary to see the increase in interest in accessing European funding from one programming period to another. According to the data published by the Ministry of European Funds, only 26.48% from the total allocations from the European Union were absorbed, and most of the projects were submitted under the Regional Operation Program. Under this Operational Program, most of the eligible beneficiaries were and are also public beneficiaries in this programming period. However, most funding lines are addressed to towns or municipalities where the residence municipality of the county is located, as few measures are available for larger communities. The values allocated under this Operational Program for a project are large and require good project management so that they can be successfully completed.

Also, although the present exercise is still in developing. I chose to follow the way the submission and contracting the projects evolved the present programming period 2014-2020. Therefore I chose to give an overall image on national level, but I also centralized the project situation for the ones submitted in Cluj county under the National Program for Rural Development, where the beneficiaries were the communes.

According to the project situation submitted until the 7<sup>th</sup> of June 2018, in the programming period 2014-2020, there were 226 projects submitted under the submeasure 4.3 "Investments for the development, modernization and adaptation of the agriculture and forestry infrastructure - irrigations", from which 192 projects of a total value of 189.050.230 euros were selected. Also, under the same submeasure, but for the

component of agricultural access,, were submitted 441 projects, from which only 78 were selected of a total value of 76.014.119 euros. On the other hand, for the component of forestry access, there were 104 projects submitted, from which 65 of them were selected of a total value of 91.277.869 euros.

**Table 2 Submitted project status until the present in the programming period 2014-2020 under the submeasure 4.3**

Submeasure	Projects submitted		Projects selected		Projects contracted	
	Number	Value-euros	Number	Value - euros	Number	Value - euros
4.3 Investments for the development, modernization and adaptation of the agriculture and forestry infrastructure - irrigations	226	226.680.858	192	189.050.730	141	139.926.881
4.3 Investments for the development, modernization and adaptation of the agriculture and forestry infrastructure - agricultural access infrastructure	441	418.451.214	78	76.014.119	69	65.571.212
4.3 Investments for the development, modernization and adaptation of the agriculture and forestry infrastructure - forestry acces infrastructure	104	146.772.415	65	91.277.869	62	86.881.827

*Source: own processing based on the data published on the Agricultural Ministry website*

I processed the selection reports afferent to the submeasures of the present programming period 2014-2020 to identify the communes in Cluj county that submitted projects for funding, but also obtained funding through the National Rural Development Program. This aspect is relevant, as obtaining large funding, as the ones obtained through NRDP can bring higher impact into the community in comparison with the smaller projects. Within the 4.3 "Agricultural and forestry infrastructure" submeasure, 17 projects were submitted in Cluj county in the programming period 2014-2020, from which only two were ineligible, and 10 did not receive funding because of the score they had.

For the 4.3 "Investments for development, modernization or adaptation of the agricultural and forestry infrastructure – the agricultural component", no less than 135.585.187 euros were allocated for the programming period 2014-2020, for the 2015 session 25.000.000 euros were allocated, while for the one in 2016 20.690.109 euros were allocated. So, I realised a situation, that can be traced in the table below:

**Table 3 Submitted project situation in the programming period 2014-2020 until present afferent to the 7.2 and 7.6 submeasure**

Submeasure	Projects submitted		Projects selected		Projects contracted	
	Number	Value-euros	Number	Value - euros	Number	Value - euros
7.2 Investments in the creation and modernization of the small scale base infrastructure - water and used water infrastructure	501	726.335.354	335	476.597.571	298	416.545.347
7.2 Investments in the creation and modernization of the small scale base infrastructure - local interest roads infrastructure	976	1.007.959.285	489	510.942.432	471	486.220.447
7.2 Investments in the creation and modernization of the small scale base infrastructure - educational and social infrastructure	444	168.742.693	325	121.037.443	304	113.178.046
associated with the protection of the cultural heritage	913	304.492.065	584	189.004.141	514	165.289.772

Source: own processing based on the data published on the Agricultural Ministry website

At the level of Cluj county, in 2015, 26 projects were submitted under the submeasure mentioned above, out of which 11 within the 7.2 "Investments in the creation and modernization of the small scale base infrastructure", and 15 were submitted within the submeasure 7.6 "Investments associated with protecting the cultural heritage". Such projects submitted under the 7.2 "Investments in the creation and modernization of the small scale base infrastructure" submeasure at the level of Cluj county have a total value of 9.717.002 euros in 2015.

Within the same submeasure, in 2016, the number of projects submitted and approved for funding was much higher, with projects worth a total 28.159.975 euros, representing a total of 30 projects funded at the level of Cluj county. Also, there were 4 projects submitted by the communes Cătina, Călățele, Căpușu Mare și Sînpaul, but those did not get into funding because two of them, namely Călățele și Cătina did not have a good score, and the other two were declared ineligible. In 2017, the number of projects that have been won in Cluj County by the communes under this submeasure has decrease, only three communes obtaining funding under this submeasure. So, in the 3 years approximately 50 projects were submitted by the 75 communes, because some of them submitted projects under different components, such as Apahida or Gilău or projects have been submitted, but were not funded.

In 2016, only 2 projects were submitted, both of them being funded through the 7.6 submeasure, projects involving the modernization and endowment of cultural centers from communes Iara and Cornești having a total value of 815.973 euros. The funding applications submitted by the communes from Cluj county that have received a total value of the funding over 30.000.000 euros show as the fact that the local public administration is interested in the life of the rural environment population and wishes to improve it as much as possible. He

Generally, as it can be seen in the above analysis, the projects with a higher value are the ones within the 7.2 submeasure, where the majority of the projects come close to 1.000.000 euros which are intended for road, education, water or waste water. The rural population must have better and better living conditions and access to services of public interest, otherwise there is the risk that the Romanian villages will remain without work force and with an aging population, which will lead to the loss of the of the rural environment and its authenticity.

Following this research, I came to the conclusion that only two of the 74 communes in Cluj county have a specialized project management department, and the main problems faced by the local authorities are mainl bureaucracy and lack of competent staff in the field of European funding. Most of the communes consider that the creation of a department is not justified due to the dimensions of the commune, but the existence of one would be essential for the harmonious development of the rural environment. On the other hand, the representatives of pulic institutions think that the establishment of such a department, would lead to a better coverage of the needs of the community, given that it will be a territorial vision over the necessities and problems.

## **CONCLUSIONS AND RECOMMENDATIONS**

The aim of this paper was the research of the researching of the situation of the human resources in the project management field and the impact its impact over the European or governmental funding projects. After aplying the interviews, I found that at the level of Cluj county there are no project management departments, except for two communes in the metropolitan area of Cluj. Thus, there are many communes that lose important funding because of the fact that they do not have specialized staff to constantly follow funding lines which they can apply for. Considering the fact that each consultancy firm is specialized on certain tpes of investments, there is the probability that when there is a funding opportunity under a programm that they have not worked on before, they could hide this thing, and the community may not continue de development because of this. Increasing the quality of the written and implemented projects can be realised only with specialized staff in the field of European funding, because the procedures are cumbersome and do not encourage other people who do not know the field.

Part of the communes at the county level of Cluj choose to submit projects only for certain types of activities, because they have not identified a firm to trust and with whom to try the territorial development. From the talks I had with the city halls, these have spent significant amounts of money with different consultancy firms, which havenot

brought any benefit to the communities because these were star-up firms and lacked expertise in non-reimbursable funding. Mayors and leading staff in Cluj county city halls are aware that they do not have specialized persons and recruiting young graduates into the county's communes would be very difficult, because they choose to move to the urban area, where they have many opportunities.

However, Romania could try to offer specialized courses for these funds that come from the European Union, and the courses should be seriously organized, not only on paper, to give the local public administration the opportunity to develop and know better what writing and implementation of a European funded project means. Thus, I consider that the establishment of a project management department would be useful for 3-4 smaller communes, and the persons in it should deal only with identifying funding sources, writing projects and implementing them for their communes. This way, the costs would be much lower, the mayors would know exactly who works for the communes projects, and the project team would have easier access to information, documents, location and all they need to carry out a quick and efficient project.

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# ***FINANCE***



## **THE RELATIONSHIP BETWEEN FINANCE AND ECONOMIC GROWTH**

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**Abstract:** *The relationship between economic growth and the development of financial systems indicates a causal relationship, which facilitates the accumulation of resources and the development of a country. The beneficial influence of the development of the financial system, on the growth of the economy is confirmed by a whole series of studies, but the methodological issues and the tendency to report only the relevant results are some of the criticisms brought about empirical evidence. Finally, some recent theoretical developments tend to highlight that the relations between the financial system and economic growth is not precisely linear but rather it can become a limiting factor if we consider population credit. Thus, new theoretical approaches put into doubt the direct relationship between financial system development and economic growth. However, the predominant view in the economic literature points to rather beneficial relationship between financial system development and economic growth.*

**Keywords:** *finance, economic growth, methodology issues*

### **1. INTRODUCTION**

The relationship between economic growth and the development of the financial system is one type of causality. The literature indicates that an increase of the financial system is beneficial in the long-term economic development of a country. Thus, the development of the national capital market can influence the development of economic growth though channeling long term financing sources in modern economies.

In the new economic environment outlined in the wake of the financial crisis of the 2007-2009, there is a considerable emphasis on the ability of the financial system to ensure the required resources for financing medium and long-term economic development. Therefore, the development of capital markets is a concern of policy makers in terms of supervision and regulation of national and international financial systems (IMF, 2015, pp.75-77). Access to resources long-term financing allows companies and governments to undertake new investments and to reduce the risk of refinancing in the short term.

Neoclassical theoretical approaches concerning economic growth often leaves the stability of the financial system, its capacity to allocate resources effectively, which allows achieving a long-term macroeconomic equilibrium. However, this traditional approach often ignores the mutations that occur within the financial systems transformation occurring in parallel with the development of the banking system and the financial markets. Therefore, "ignoring the role mutations within the financial system can

have systemic consequences" (Ang, 2008, p.563), looks all the more evident in the context of the recent financial crisis (de Haan, Vlahu, 2015).

In this context, we consider it appropriate to highlight the role that you play in developing capital markets and economic growth right next to the following key issues: (1) what factors impose the emergence of capital markets (financial) financial intermediaries; (2) channels of influence to the development of capital markets in economic growth; (3) theoretical approaches concerning the mechanisms of implementation of financial intermediation.

The emergence of capital markets and financial intermediaries is linked to ensure an efficient allocation of resources within an economy. Through capital market development and efficient financial intermediaries the inconveniences associated with the direct transfer of resources between the participants is reduced, because the market provides information relevant for assessment and monitoring by the investors. In this context, investors know that their resources are managed effectively by the recipients, which reduce the information asymmetry between the two participants (Williamson, 1986). Thus, capital markets can facilitate meeting the demand with the supply of resources in the context of a formal institutional mechanism, offering safety and confidence of investors. Finally, easing investor's demands with recipients of resources through capital markets reduce the cost of agency (Williamson, 1986) and increase the efficiency of resource allocation in an economy (Nurunnabi, 2012). Thus, the purpose of this paper is to review the implications of the adoption of the development of financial system on economic growth.

The rest of this paper is organized as follows: Section 2 provides a brief introduction behind the theoretical views behind financial system development, Section 3 characterizes the relationship between finance and growth, and Section 4 concludes.

## **2. THEORETICAL CONSIDERATIONS**

Capital markets can ensure an efficient allocation of resources and facilitate economic growth. Through the reduction of information asymmetry, the costs of trading and tensions between investors and beneficiaries are lowered. The increase the efficiency of resource allocation is a key factor in economic development in the long term (Williamson, 1986; King, Levine, 1993).

Capital markets development can influence economic growth through mechanisms, which aim the development of the entire financial system. Therefore, capital market development can be a prerequisite for economic growth. The theoretical economic literature recognizes **two channels of influence of the development of capital markets on economic growth** (Ang, 2008, pp.538-539): accumulation channel and the total productivity channels.

*The accumulation of capital* often called the quantity channel, works on the principle of "accumulation of debt" proposed by (Gurley, Shaw, 1955). Through this channel, capital markets and financial system allow accumulating of long-term resources by mobilizing resources from a dormant economy and then redistributing them into the economy to finance investment projects that determines economic growth. Thus, capital

market facilitates economic growth through accumulated resources, which channel into new investments, which determines economic growth.

*The total productivity of capital channel*, often called the quality channel, highlights the role of the financial markets in reducing the asymmetry of information between participants, which restricts the efficient allocation of resources and increase the monitoring costs and financing (Townsend, 1979; King, Levine 1993). Therefore, a developed capital market can reduce the costs of trading of investors by facilitating financial intermediation.

Through two channels, the development of the financial system is a factor that can influence economic growth, and the analysis of the efficiency of financial intermediation can be observed through four distinct perspectives (Levine, 1997; Levine, 2005):

a) *intermediaries based approach*: what is the role of the financial intermediaries in selecting the best funding opportunities, attracting passive resources from an economy and direct monitoring of investments with risk management. The main advantage of financial intermediaries is their ability to reduce information asymmetry and effectively managing investment risks (Allen, Santemero, 1998). As a rule, the approach based on the financial intermediation is more effective in the case of poorly developed economic states (Levine, 2002).

b) *market-based approach*: highlights the ability of financial markets to manage the risk of investors through analysis of assets (Levine, Zervos, 1998). Funding through capital markets provides competitive advantages for companies acting in innovative industries, where risks are higher, and investors carefully consider any investment opportunity (Rajan, Zingales, 1998);

c) *financial services approach*: offered suggest that financial intermediaries can offer advantages over financial markets. Under this point of view, it matters the high degree of diversity and complexity of a financial products and service, which offers to financial intermediaries and does not concern their quality. It does really matter what is the best financial channel either market based economy or a financial intermediaries economy but rather the balancing of financial intermediaries and the financial market (Levine, 1997);

d) *the regulation and institutions approach*: which argues the role of the institutions and the legislative framework in determining the nature of the link between the financial system and economic growth. A determinant factor for the development of the financial sector that encourages economic growth is represented by the origin of the legal system in a state (La Porta et al., 1998).

The idea that an efficient financial system is capable of facilitating and determining economic growth has the origins from neoclassics such as Bagehot and Schumpeter, but the first empirical tests capable of highlighting the causal link have been carried out by (Goldsmith, 1969) which highlighted the existence of a correlation between economic growth and the development of the financial system. In Goldsmith's (1969) vision the main vector, which contributes to economic growth, is the capacity of financial intermediaries to increase the efficiency of capital allocation by reducing the information asymmetry in the market. While Goldsmith's work highlighted only a

correlation between the degree of development of the financial sector and economic growth, it does not establish that there is a causal relationship between the two macroeconomic variables, but only a simple link to correlation.

### **3. ECONOMIC GROWTH AND FINANCE**

While Goldsmith's (1969) study laid the foundations, in this area, the theoretical developments of King and Levine (1993a) provided an overview of the causal links between the development of the financial sector and capital markets as a growth vector. Today, following countless studies in the field, the relationship between the development of capital markets and economic growth reveal a series of elements relating to the causal link between the two variables. In this respect, we consider it appropriate to present the following key issues: (1) implications for the development of financial systems and economic growth; (2) Criticism of the methodologies used in the studies on economic growth; (3) New approaches in the field-too much financial system?.

#### **3.1 Implications of the development of financial systems on economic growth**

In regards to the role of the financial sector in promoting economic growth, the analysis of literature highlights that there is a causal link between the two systems. The main points of interest in this direction are as follows:

##### *A. The development of the banking sector and economic growth.*

King and Levine's Study (1993) emphasizes that for 77 states between the years 1960-1989 the development of the banking sector and the development of private credit determines economic growth. The two authors use two methods of assessing the development degree of the financial sector: a bank depth index that measures the degree of development of the banking system as a ratio between the volume of bank credit divided by the amount of bank credit and total Assets of the central bank, and a second index of the ratio between private lending volume and GDP. Their results indicate that the size of the financial sector in the year 1960 allowed forecasting, growth, investment and productivity over the next 30 years.

Even though the study of King and Levine (1993) used two methods of estimating the financial sector, there is now a consensus in the economic literature that the main way of assessing the degree of development of the banking sector is the ratio between private credit and total GDP loans (Panizza, 2013). This finding leaves the premise that if banking systems mobilize resources from the population, which then redistribute in the form of loans to governments and state companies is lost from the functionality of the financial system. Thus, credit allocation, risk management and corporate control functions lose their efficiency.

Another criticism of the study of King and Levine (1993) is aimed on the methodology used to predict economic growth as it is incapable of demonstrating a causal link between economic growth and the development of the financial system. Therefore, subsequent studies such as Levine et al., (2000) and Beck et al. (2000)

highlight the causality between the development of the banking sector and economic growth. Thus, Levine et al. (2000) based on an instrumental variable model highlights the role of the legal origin of the legal system (La Porta et al., 1998) in the origin of economic growth for 71 states between The years 1961-1995.

Similarly Beck et al. (2000) uses a GMM type model with specific estimators (Arellano, Bond, 1991; Arellano, Bov, 1995; Blundell, Bond, 1998) and demonstrates that there is a causal link between economic growth and the development of the banking sector, but reveals that the main channel of growth influence is the productivity channel and does not concern the accumulation of capital within the banking system. Thus, the main vector of economic development is the efficiency of financial intermediation and not capital accumulation.

#### *B. Development of capital markets and economic growth*

Empirical approaches in this direction have highlighted since the first study that there is a link between economic growth and the development of capital markets. Thus Atje and Jovanovic (1994) based on a sample of 94 states between the years 1960-1985 concluded that there is a beneficial effect between the development of capital markets and economic growth.

Later Levine and Zervos (1998) based on a sample of 47 states between 1976-1993 points out that the development of capital markets determines economic growth. Their results indicate that the liquidity of the capital market is the main vector of influence of capital markets on economic growth, while the stock capitalization, the volatility of the integration degree are neutral. The lack of a direct link between economic growth and stock capitalization is normal because the mere listing of a company does not involve the transfer of further resources, but only the current trading of a financial title facilitates the exchange of resources. However, a number of theoretical developments have at the same stage discussed the results of the study being brought to the table six critics of this Levine study (2005): the use of OLS models (estimation models based on the smallest squares method or ordinary least square), weights to estimate liquidity regardless of geographical range or period of time, the location of capital markets is not exactly relevant being possible to trade financial instruments at a distance, excluding from analysis the bonds market representing almost half of the stock capitalization in some states (Beck et al., 2001) and capital markets is not limited to stock capitalization and liquidity, but also provides other risk protection mechanisms via hedging.

In this context, further studies have highlighted that: the bond market determines economic growth (Guiso et al., 2002) and the development of the financial system through the banking system and capital markets provides additional resources for companies (Demirgüç-Knut, Levine, 2001a).

#### *C. The dilemma between the system financed by banks and the system financed by the capital market*

The influence of the financial system on economic growth, empirical studies reveal in reality there is no significant difference between the two financial systems, based on the comparison between the evolution of the UK and the US as superscripts of

the market based markets and Germany and Japan respectively as superscripts of the bank financing system (indebtedness, financial intermediation). The studies of Demirgüç-Knut and Levine, (2001) and Stulz (2001) reach the same conclusions. However, studies in this direction reveal the following **minor differences** between the two systems:

- the developed capital markets are usually found in more developed countries, and as the states develop, we are seeing an increase in the development of capital markets and a migration of resources from financial intermediaries to the capital market (Demirgüç-Knut, Levine, 2001b);
- the financial system is more developed in the market-based system that tends to be more efficient for developed economies while for poorly developed economies a banks-based system tends to be more efficient (Tadesse, 2002).

#### *D. Influence of regulations on the development of capital markets and economic growth*

The approach from the perspective of regulations and institutions highlights the role played by the legal framework on the development of capital markets and economic growth. Based on the study La Porta et al. (1998) and subsequent developments (at Porta et al., 2000; La Porta et al., 2002; Djankov et al., 2008), indicate the superiority of the British legal system based on common law against of the legal system based on civil codes. Common law-based states usually record higher rhythms of economic development than those based on the French civil codes.

#### *E. Relationship between industry type, company characteristics and financial system development*

Rajan and Zingales (1998) consider that a developed financial system, based on financial intermediaries and developed capital markets, may exceed the limits of the information asymmetry, reduce the cost of capital and facilitate the development of companies and growth. Therefore, industries that are constantly dependent on external funding resources benefit from the development of the financial system towards non-dependent industries. In this context, with the development of the financial system the main beneficiaries would be companies dependent on external financing resources.

Similarly, subsequent studies have revealed that following the increase in the concentration of the banking sector the main beneficiaries are the companies dependent on external resources (Claessens, Laeven 2005) and the low level of protection offered to investors It determines an inefficient allocation of resources in emerging countries (Claessens, Laeven 2003).

### **3.2 Skepticism and methodological criticism**

A first category of studies, which analyzed the relationship between the development of the financial system and economic growth, highlighted the existence of a causal relationship between these two phenomena, but many of them were criticized either from skepticism or from a methodological aspect.



As the emergences of many studies on the implications of the development of the financial sector highlighted the link between economic growth and the development of the banking sector and capital markets, so did appear many skeptics who emphasis on the negative influence on economic growth that imperfections can have in the lending mechanism that can lead to an increase or perpetuation of social inequality. Therefore, *critics* like (Lucas, 1988; Galor, Ziera, 1993; Galor, MOAV, 2004) believes that in reality, with the development of lending, in an imperfect market is limited by the development of human capital, which, unlike physical capital, must circulate evenly throughout the population.

Apart from skepticism, the main criticisms of the first estimates of the link between economic growth and the development of the capital market have targeted methodological aspects. Some of the most relevant criticisms of the methodology used in this direction are:

- ✓ *the use of a simple linear regression* that is prone to endogeneity when using time series (Ang, 2008);

- ✓ *use of small samples of countries*: such as studies on the influence of banks-based and market-based economies;

- ✓ *arbitrarily dividing countries* into economies based on intermediation and savings based on capital markets. In principle, the economies of the States were divided into countries with developed and poorly developed financial systems, but they had banking systems developed beyond the world average (Ang, 2008);

- ✓ *use of a small series of data*: usually refers to the results of tests carried out on the basis of time series, requiring large samples not available for macroeconomic variables;

- ✓ *reporting of preferential results*: the publication of the results only when they were of interest to the publisher or author. Recent tests reveal that the first estimates of the relationship between the development of the financial sector and economic growth are subject to preferential environmental reporting, with significant differences being recorded between the results presented and their average evolution (Valickova et al., 2015).

- ✓ *the low degree of comparability*, being used several variables to quantify financial development and measure its propagating vectors (Valickova et al., 2015).

### **3.3 New approaches in the field and the two much finance dilemma**

Based on the first estimates of the relationship between the development of the financial system and economic growth, the subsequent studies mainly aimed at two important directions. A first direction aims at the theoretical developments in the first models, while a second approach requires a radical approach to the causal relationship between economic growth and the development of the financial system. With regard to recent theoretical developments on the relationship between economic growth and the evolution of the financial system, the following key issues are:

- a) *capital markets can finance long-term projects more efficiently than banks*: because they can offer, financial products specially designed to finance long-term projects with a high risk requiring a volume of low guarantees. By financing long-term

projects, capital markets can encourage a more accelerated economic growth rate. Instead, banks are more effective when offering short-term financial products (Demirgüç-Knut et al., 2013);

b) *the development of the financial system "steals" skilled people from the labor market reducing the pace of growth.* Some studies such as Philippon and Reshed (2013) or Jocelyn and Kharroubi (2015) indicate that with the development of the financial sector, highly qualified persons with intellectual abilities above average prefer to activate in the financial sector because they are very well paid, rather than using their skills in innovative industries that are dependent on the quality of human capital. With the development of the financial system, innovative companies are deprived of the human capital needed for innovation, limiting the pace of economic growth in a country.

c) *the development of the financial sector has a selective impact on countries:* Valickova et al. (2015) based on a meta analysis of 67 studies in the field reveals that the development of the financial sector has had a strong impact on economic growth in Europe and America Latin while the influence of the financial sector on the countries of North Africa was a small one;

d) *the impact of the development of capital markets on economic growth is higher than that of the development of the banking system,* therefore achieving an optimum in terms of financial structure must bet on the development of capital markets instead of the financial intermediaries (Valickova et al., 2015);

e) *the main vector of economic growth is the increase in the amount of credit given to companies while increasing the financial system by increasing the amount of credit of the population does not influence economic growth.* Some studies such as Beck et al. (2012) or Beck et al. (2014) show only the increase in the volume of credits that companies determines economic growth while the development of the financial system by increasing the amount of credit taken by the population does not determine economic growth.

Alongside new theoretical developments on the link between economic growth and the development of the financial system and the capital market in recent years, the direct causal relationship between economic growth and the development of the financial sector has brought discussion a new dilemma of "*extinction effect*" (Rousseau, Wachtel, 2011) and the "*too much financial system*" dilemma (Arca et al., 2012; Arcaing et al., 2015).

*The effect of the disappearance* proposed by Rousseau and Wachtel (2011) implies that the link between economic growth and the development of the financial system is not linear but exceeding the degree of development over a certain level may result in a contrary effect, turning into a limiting factor for economic growth. As a rule, studies, which analyze the link between economic growth and the development of the financial system, see less extensive effects of the implications of the development of the financial sector on economic growth, especially in the background of development financial system in the last 20 years. In this context, Arcand et al. (2012) provides the first indications that the development of the financial system by means of crediting the population has a negative effect on economic growth.

Arcand et al. (2012) and Arcand et al. (2015) stresses that after the volume of the population's lending exceeds 100% of GDP further development has negative effects on economic growth. The authors believe that in the case of developed countries the degree of development of the financial system is so high that any additional growth above a certain threshold has a negative effect due to the effect of extinction. Based on estimates, Arcand et al. (2015) considers that exceeding more than 100% of GDP in the amount of credit granted to the population has negative effects on economic growth. The authors, test in analysis the implications of the legal and institutional framework, macroeconomic volatility and financial instability, and emphasize that the effect is evident only to states that have developed their financial sector in recent years. Their results indicate a potential "*too much finance*" for the private lending sector of the population. Similar studies such as Jocelyn and Kharroubi (2012), Pagano (2012), Law Singh (2014) or Aizenman et al. (2015) bear the same viewpoint, whereby overcoming the lending to the population over a certain threshold it has rather negative effects on growth.

Supporters of the term "too much financial system" believe that there are three factors that can explain the results achieved: reducing the role of bank credit (provided by financial intermediaries) with the development of capital markets (Demirgüç-Knut et al., 2013), assumptions that claim that the financial system evolves from balance to economic imbalance (Minsky, 1974) and the transfer of key persons to the financial sector (Tobin, 1984).

#### 4. CONCLUSIONS

The aim of this paper was to establish some insights into the relationship between financial market development and economic growth.

The relationship between economic growth and the development of financial systems and capital markets respectively indicates a causal relationship, facilitating the accumulation and management of resources in the economy for the growth of national economy. The beneficial influence of the development of the financial system, on the growth of the economy is confirmed by a whole series of studies, but the methodological issues and the tendency to report only the relevant results are some of the criticisms brought about empirical evidence. Finally, some recent theoretical developments tend to highlight that the relations between the financial system and economic growth is not precisely linear but rather it can become a limiting factor if we consider population credit. However, the relationship is still a rather beneficial rather than a limiting factor.

From the perspective of capital markets, economic theory highlights that direct reporting between an economy based on capital markets and one based on indebtedness is not one intended to outline a winner. It matters rather the development of capital markets or banking system than the dilemma between who is effective or not. Therefore, the policy makers must take into account mechanisms to encourage and direct the development of capital markets as an instrument, which can constitute a genuine source of economic growth and accumulation of national wealth.

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## **RE-ASSESSING EFFECTS OF POLITICAL INSTABILITY ON FOREIGN INVESTMENT IN NIGERIA: AN EMPIRICAL SURVEY**

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**Abstract:** *The study examined the effect of hostage taking on Foreign Direct Investment (FDI) in Nigeria to have a reliable and constant growing economy with assured security for foreigners. It is the duty of the government to provide the citizenry and foreigners with secured environment that allows equal participation in activities that engender economic development. It empirically examined professional ideas as well as explores documentary evidences about hostage taking and foreign investment, the political situation, security situation, socio-development and psychological imponderances of the leaders in the unfolding scenarios of Nigeria. The use of the internet, journal, thesis and archival material assisted in the source of information. The paper found evidence of pervasive tendencies for declining Foreign Direct Investment (FDI) due to unyielding effort of government to have a secured environment, especially for foreign investors. The paper concluded, among others, that there are devastating effects such as unemployment, declining standard of living, winding up of foreign established organisation, etc as a result of hostage taking that reduce Foreign Direct Investment.*

**Keywords:** *Hostage Taking; Foreign; Direct Investment; Development; Unemployment; Economy; Security; Environment.*

### **INTRODUCTION**

Nigeria is part of the NEKS countries; an acronym for Nigeria, Egypt, Kenya and South Africa, described by analysts as nations with huge untapped markets for foreign direct investment (FDI) in Africa (Adebakin and Raimi, 2012). At independence and several years after, the country was perceived as a relatively secured nation in the West African sub-region because of its steady economic growth and leadership role in the Economic Community of African States (ECOWAS). However, this has been challenged by recent continuous insecurity such as kidnapping, bombing, hostage taking of foreigners etc. Insecurity such as kidnapping, bombing, assassination and act of terrorism has effect on all activities including economic activities and investment from outside the nation. Ngwama (2014) asserts that the widening scale of insecurity in Nigeria is a cause for concern as all are affected by it. Churches, mosques, markets, schools, homes and the highway, all are susceptible to this menace. The abductees and their families are traumatised by the ordeal of kidnapping. Foreign investors are scared away from Nigeria. Nigerians are paying the price of poor governance and failures of leadership.

The combination of the activities of the oil companies and the government especially in the oil rich Niger Delta region of Nigeria, led to emergence of various armed groups operating under such names as Egbesu Boys, Movement for the Survival of the Ijaw Ethnic Nationality (MOSEIN), Joint Revolutionary Council, MENBUTU,

Arogo Freedom fighters, Niger Delta Volunteer Force and the Movement for the Emancipation of the Niger Delta (MEND). The activities of these groups which have included kidnapping of foreign nationals working with the oil companies have created a state of general insecurity in the region. This has negatively impacted the monolithic Nigerian economy as it has affected the inflow of foreign direct investment which is needed to achieve economic growth and development (Nwogwugwu, Alao and Egwuonwu, 2012).

The primary role of government is the provision of security for its own people. In Nigeria this role has been largely ignored. The Nigerian state no longer provides security for the Nigerian people let alone foreigners. Nigerians have compulsorily become religious as whole families barricade themselves at night in prison-high walls and pray for that God protection. But kidnapping as a variant of armed robbery is infinitely more disturbing as it often occurs in the open among persons going about their normal business not excluding foreigner who came for expertise work (Ngwama, 2014). Hostage taking of these foreigners will, in no small measure has significant effect on the foreign investment of the country.

Foreign Direct Investment (FDI) has been described as investment made so as to acquire a lasting management interest (for example, 10 percent of voting stock) and at least 10 percent of equity shares in an enterprise operating in another country other than that of the investor's country. Policy makers believe that FDI produces positive effects on host economies. Some of these benefits are in the form of externalities and the adoption of foreign technology (Alfaro *et al*, 2006 cited in Egwaikhide, 2012). According to Tang, multinational enterprises (MNEs) diffuse technology and management know-how to domestic firms. When FDI is undertaken in high risk areas or new industries, economic rents are created accruing to old technologies and additional management styles (Egwaikhide, 2012).

## **STATEMENT OF THE PROBLEM**

The piece by an erstwhile head of the State, Abdulsalami Abubakar, *on the challenges of security in Nigeria* (2004) cited in Adagba, Ugwu and Eme (2012), which came from an address given at NIPSS in 2004, clearly shows that the greatest threat to the current civilian dispensation is insecurity. As he rightly observes, in addressing the challenge to the survival of democracy in Nigeria, it is pertinent to consider security issues and problems that have affected the attitude, confidence and cooperation of all groups and segments that make up the Nigerian federation. Oyebode (2011) seems to echo this position of Abubakar in his piece on 'the imperative of insecurity'. He declares: "it is self-evident that without security, hardly is anything possible." He nevertheless counsels that "security should go beyond law and order by encompassing meaningful existence for the generality of the populace" (Oyebode, 2011).

Putting it more succinctly, Ezeoha (2011) in 'Causes and effects of insecurity in Nigeria' declares that "Security means stability and continually of livelihood, predictability of relationships, feeling safe and belonging to a social group. He argues further that one sure way of tackling the insecurity situation in Nigeria is to accord the



field of psychology a pride of place in policy formulation and implementation to promote national cohesion and integration (Adagba, Ugwu and Eme, 2012).

It is established that there is a strong correlation between the growth situation in developing countries and their success attracting Foreign Direct Investment. Unlike other sources of foreign investment, Foreign Direct Investment is accompanied by the following benefits; the provision of managerial knowledge and skills including organizational competence and access to foreign market; it provides an array of goods and services to residents in the recipient country; it enables the transfer of technology to occur from developed economies (Taiwo, Achugamonu, Okoye and Agwu, 2017). Achievement of the above depends on the security situation in the country, especially the absent of hostage taking in the benefitting country. It is unlikely that foreigners will continue to invest in a country where their security and that of their investment is not guaranteed. From the foregoing, this study tends to examine the effect of hostage taking on Foreign Investment in Nigeria, to provide an empirical explanation on effect of hostage taking on foreign investment in Nigeria between 2010 and 2015. The main objective of this study is to examine the effect of hostage taking on Foreign Investment (FI) in Nigeria. The specific objective is to; identify the effect of hostage taking on foreign investment in Nigeria; and suggest possible way of preventing hostage taking in Nigeria.

## **LITERATURE REVIEW**

### **Hostage Taking in Nigeria**

Kidnapping can be seen as false imprisonment in the sense that it involves the illegal confinement of individuals against his or her own will by another individual in such a way as to violate the confined individual's right to be free from the restraint of movement. This involves taking away of person against the person's will, usually to hold the person in false imprisonment or confinement without legal authority. This is often done for ransom or in furtherance of another crime. No one is free from being kidnapped. In Nigeria, the kidnapers are everywhere targeting both foreigners and non-foreigners alike with little or no resistance from our law enforcement agents. Nigerian security system has been weakened in the face of this confrontation, a little has been done to find the socio-economic and underlining factors precipitating this crime.

Kidnapping and hostage taking has been a major tactic of the militant groups with foreign nationals working with oil companies as primary targets. In January 2006, Hostage taking of oil workers started in Bayelsa after the declaration of 'operation orido danger' by MEND with the kidnapping of four set of hostages. Over two hundred expatriates had been kidnapped, although most have been released within weeks in exchange for ransoms, typically hundreds of thousands of dollars (Amaize, 2006 cited in Nwogwugwu, Alao and Egwuonwu, 2012). Though casualty figures from kidnapping by militants operating in the Niger delta has been low, reportedly put at about fifteen. However, the implication of the kidnappings which involved mainly foreign workers and development partners on Nigeria's economic development has been enormous. It succeeded in scaring away potential development partners and robbed the Nigerian state

of the benefit of such development alliances and opportunities. The state of insecurity has led to a reduced volume of investments and capital flow to the region (Nwogwugwu, Alao and Egwuonwu, 2012; Saturday Punch, 2007).

### **History of Kidnapping in Nigeria**

Kidnapping has now become a generic word both in public and private discuss going by its prevalence in the country. Literarily, the word, which has become notorious, putrid and nauseating in the ears of virtually everyone is derived from "kid" meaning; child and "nab" which means; to snatch. Adewale (2009) cited in Ngwama (2014) pointed out that kidnapping now appears to be an emerging concern in Nigeria though it is not a new phenomenon. It is as old as the word itself. But the motive may vary from country to country. Since 1673 the unfriendly world has been used to the practice of stealing of children for use as servants or labourers in the American colonies. So it has come to mean any illegal capture or detention of a person or people against their will, regardless of age. The kidnapers, who can be very erratic, have been found to engage in the criminality for several complex motives ranging from unemployment, idleness, vengeance, rituals, monetary gains and political reasons (Ngwama, 2014).

The first act of kidnapping in Nigeria started 2006 when the militants of the Niger Delta took total hostage to protest the inequality in the region. According to the militants, Nigeria is built at the expense of the region which serves as the cash cow for the whole country. The action which started from the kidnapping of government expatriates has moved to men of God and their children, Nigerian politicians and their children, and religious leaders. Reuters (2009) cited in Ngwama (2014) pointed out that a total of 512 kidnapping cases have been reported so far this year, up from 353 for all of 2008. Virtually, all of the kidnappings this year occurred in the south-east and Niger Delta regions, which harbour the Africa's biggest oil and gas industry. Most of the hostages are released unharmed after payment of ransom. South-Eastern Nigeria (Abia State) in particular had most incidents with 110 people taken hostage; all of them have been released while police have arrested 70 suspects in connection with the kidnapping. Gangs have taken advantage of the breakdown in law and order to target any high profile expatriate or Nigerian that could provide them with a large ransom.

### **Incidents of Kidnapping/Hostage Taking in Nigeria**

There are cases of hostage taking in Nigeria, occurring at different time in the history with significant effect on foreign investment. In December 2009, Police Affairs Minister, disclosed that 512 cases of kidnapping had been recorded from January 2008 to June 2009 against 353 recorded in 2008. Rundown of the statistics indicates that Abia State led the pack with a total of 110 kidnapping incidents: Imo: 58,109 arrests, 41 prosecution and one is dead, Delta recorded 44 kidnap cases, 43 releases, 27 arrests, 31 prosecuted and one death, and Akwa Ibom recorded 40 kidnap cases, 418 arrests and 11 prosecutions .The report added that between July/September 2008 and July 2009, over 600 million was lost to kidnapers. But beyond statistics being available, it is a known fact the most kidnap cases are never reported to the police authority for the fear of murder of the victims hence most families prefer to pay ransom to losing one of its own. For

instance, in Kano, N80 million ransom was allegedly paid to kidnappers for the release of Kano -base multi- millionaire businessman, without a recourse to the police authorities; an industrialist in Nnewi paid 70 million to regain his freedom from his captors; another multi-millionaire businessman was kidnapped and released after he allegedly paid a ransom without recourse from the police (Ngwama, 2014).

The Associated Press in its report of August 27, 2008 stated that “more than 200 foreigners have been kidnapped in two years of heightened violence across Nigeria” restive South, the victims are normally released unharmed after a ransom is paid, although several have been killed during botched seizures or rescue attempts “Victims are maimed, raped and manhandled in such a manner that the stigma remains almost perpetually. The families and associates are knocked down by intractable trauma”. On Sunday, July 11, 2010 four journalists and a driver travelling in a convoy of buses from a conference in Uyo, Akwa-Ibom State, were kidnapped in Abia State on their way back to Lagos. From their hideout, the abductors demanded a ransom of N250 million, and later reduced it to N30 million. A torrent of protests, condemnations and threats, greeted the action of the kidnappers and they were forced to let go of their victims. However, the police did not make a clear statement whether ransom was paid or not. In Idah, Kogi State, the mother of the former President of the Nigeria Football Federation (NFF), was also abducted. In Kano, a businessman was forcibly abducted in the presence of his family. The criminals were apparently looking for dollars; not finding it, they shot and injured his three children and still made off with him. In Akwa-Ibom State where as many as ten medical doctors were kidnapped, staff at the University Teaching Hospital went on an indefinite strike following the failure of kidnappers to release their latest victim, a consultant pediatric surgeon. As a consequence, medical services at the specialist hospital were paralysed and patients were stranded. Also 26 UK nationals were kidnapped in Nigeria in between 2006 and 2007 (Ngwama, 2014).

The oil-rich Niger Delta region of Nigeria has seen an explosion in the number of foreigners kidnapped for financial or political gain. Seven foreigners were reported kidnapped in Nigeria in 2005. That figure increased to 72 in 2006 and 223 in 2007. This exponential increase has been largely the result of activity by the Movement for the Emancipation of the Niger Delta (MEND) and other armed militant groups. 26 of the hostages were UK nationals. Of the 295 foreigners kidnapped in 2006 and 2007, five died as a result of injuries sustained during their abduction - including a Briton killed when the kidnappers’ boat was attacked by the Nigerian Navy. One Syrian hostage died of illness very shortly after his release (Ngwama, 2014).

If you analyse the political, economic and security issues present in the Niger Delta and then look at the terrain, which favours the militants, the conclusion must be that kidnapping will continue. Nigeria may be a special case but expatriate staff is at risk of kidnapping where judicial and police systems are weak or corrupt, there is a huge disparity between rich and poor coupled with political and economic breakdown.

## **CONCEPT OF FOREIGN INVESTMENT**

One of the major factors that determine the economic growth of any nation is investment. For an economy to grow some of its current resources must be diverted from consumption to investment to ensure capital growth. Most poor countries of the world suffer from a shortage of savings and lack of accumulation of capital that could be channelled into investment purposes. The alternative open to such countries is to attract foreign investment to make up for the shortage of domestic savings or capital. Foreign investments occur “when foreigners either wholly or jointly with local investors establish their physical presence in another country through the acquisition of physical assets such as factories, buildings, plants, machineries, etc.” (Nwogwugwu, Alao and Egwuonwu, 2012).

Foreign direct investment contributes to the growth and development of the host country in diverse ways, these include; (a) contributing to the growth of the real output direct investment in the production of tangible goods, (b) generation and expansion of business through stimulation of employment, raising of wages and replacement of declining market sector, (c) support of overseas affiliates by the parent company through provision of appropriate human and material resources, (d) reduction of the host countries propensity to import and efficient allocation of production resources, among others (Bakare, 2010; Oke, 2007; Nwogwugwu, Alao and Egwuonwu, 2012).

According to the IMF and OECD definitions, *foreign investment* reflects the aim of obtaining a lasting interest by a resident entity of one economy (direct investor) in an enterprise that is resident in another economy (the direct investment enterprise). The lasting interest implies the existence of a long-term relationship between the direct investor and the direct investment enterprise and a significant degree of influence on the management of the latter. Direct investment involves both the initial transaction establishing the relationship between the investor and the enterprise and all subsequent capital transactions between them and among affiliated enterprises, both incorporated and unincorporated. It should be noted that capital transactions which do not give rise to any settlement, (e.g. an interchange of shares) does not amount to FI. Financial Times Magazine defines FI as an Investment from one country into another (normally by companies rather than governments) that involves establishing operations or acquiring tangible assets, including stakes in other businesses. It is the purchase or establishment of income-generating assets in a foreign country that entails the control of the operation or organization (Taiwo, Achugamonu, Okoye and Agwu, 2017).

## **IMPACT OF INSECURITY/HOSTAGE TAKING ON FOREIGN INVESTMENT**

Foreign Investment (FI) is getting leaner, and international oil investors are diverting to cheaper/safer environments, thereby denying the Niger Delta the chance for more investments that can provide jobs and boost local economy. Analysts have identified insecurity in the Niger Delta and weak fiscal policy as key reasons why investors are beginning to leave for more stable business opportunities in Africa. An ominous sign for Nigeria’s production is slumping international investment. Foreign

investment, mostly in the petroleum sector, sank to \$5.85 billion last year from \$13.96 billion in 2006, according to a recent United Nations report (Swartz and Connors, 2010; Nwogwugwu, Alao and Egwuonwu, 2012).

As a result of the activities of militants in the Niger delta region, “SPDC retrenched 3,500 workers in September 2007” (Punch Newspapers, 2007). Indorama Petrochemical Company shut down its operations thereby rendering over 3, 000 youths jobless and aggravating the unemployment situation (Sunday Trust Newspaper, 2007). Restiveness has reduced growth in the business sector. As a consequence of militant activity Royal Dutch Shell has seen its production dropping from one million bpd to about 380,000 bpd at its Bonny terminal in the South of the Delta. Exxon has also experienced increased insurgent activity in its Nigerian operations. Nigeria is already suffering from production slow down due to militancy, currently the Niger Delta is only exporting 1.8 million bpd, compared with a targetted 2.2 million bpd.

In Rivers state, over 80% of the companies have stopped operations, as expatriates have either gone to their home countries or relocated to safer environments. The MTN had 43 base stations shut down as militant activities made them inaccessible (Punch Newspapers, 2007).

## **EFFECTS OF KIDNAPPING/HOSTAGE TAKING ON NIGERIA ECONOMY**

Some recent studies have confirmed that, the control of kidnapping has been hindered by prolonged persistence of unemployment, worsening political instability, internal grievances, get rich quick syndrome, and perceived weakness of the state security (Ezeibe & Eze, 2012; Caplan, 2011).

*Unemployment* - The youth unemployment has been implicated as one of the strongest Impediments for the solution of kidnapping behaviour (Inyang, 2009 and Dode, 2007). In a study conducted by Adegoke (2015), unemployment was by a wide margin of 88% identified as the contributory factor for the youths engaging in kidnapping operation. To solve this problem, job creation must be in the frontline as some of the unemployed youths are university graduates and able-bodied individuals who are virtually frustrated with lack of employment opportunities. Inyang (2009) states that a graduate, who is unable to secure employment is bereft of possible means of economic survival. The aftermath of such deprivation is psychological developmental stage of negative behaviour against the status-quo and socio-system. The negative developmental behaviour emerges as resistant tool against the social norms that may demand individual social compliance of the normative rules of the society. Curing this social ill; would close down the social destructiveness that kidnappers are trapped (Inyang and Abraham, 2013). The perpetrators of kidnapping choose their victims based on their ability to cough out the money (Tzanelli, 2006). The problem of unemployment has become a national ‘thorn in the flesh’ in Nigeria. Ejimabo (2013) argues that “Nigeria needs problem-solving skills of leaders to help fight fraud and corruption in the country”, otherwise, issues such as job creation and worsening political crisis would continue to be impediments to the control of crimes and delinquencies in the country. Job creation, along with other economic incentives would magnetize the youths’ interest to abandon the illegal commercialization

of human commodity. Kidnapping has been commercialized, whereby, even the most revered clerics and clergies of religious bodies have fallen victims to the crime.

*Worsening Political Instability* - Kidnapping in Nigeria, before the oil exploration, has its origin within the village clans and village rivalries. The indigenous hate-rivalry was enough to capture human and carry the person away for humiliation and elimination. With the advent of civilian democracy, political undertone adopts the indigenous hate-system of 'capture and carry away'. During the political season, it is easy for an opponent to vanish without a trace. In this method of kidnapping, politicians are linked to this behaviour as unemployed youths are deployed as political thugs against their political opponents, and sometimes, they are empowered to kill their opponent (Effiong, 2009). Kidnapping is no longer focused on the oil companies alone, it has taken a broader tone as business enterprising, spreading from political opponents, rivalry revenges, hatred, business ventures, to ethnic disagreements in all corners of the country. Relatives of politicians are usually abducted for political motives. Sometimes, politicians under-mind the criminal law, indulge in 'do or die' political games in their local politics, provide arms and ammunitions to their political thugs, and eventually kidnap and destroy their political opponents in the process (Badiora, 2015; Effiong, 2009). Political kidnapping involves political concessions or demands that require government's attention (Uzorma & Nwanegbo-Ben, 2014). In fact, they mobilize political thugs with weaponry. The mobilization of political thugs with weapons during election process makes weapons available for further commission of other types of crime after the election. Ikpang (2009) states that such weapons are usually not withdrawn from their political thugs after the election, creating more impediment for the control of kidnapping behaviour. When criminals are armed with sophisticated assault weapons in society, removing them from their hands are obstructed.

*Internal Grievances* - The Nigerian communities are blessed with the abundance of mineral resources and crude oil reserves, especially in the Niger Delta Regions. The contemporary crime of kidnapping the expatriates and the staff of the oil companies slowly began with the communities' grievances against the Federal government and the oil companies for usurping their mineral resources without compensations. The oil companies such as the Exxon Mobile, Shell Exploration Company, Agip, and others, have tapped their resources, polluted their environments, and generally neglected their communities where those mineral reserves are located. The environmental degradation was quite obvious and offensive to the communities. This negligent behaviour ignited aggression against the oil companies and expatriates. The unemployed youths in the communities formed internal militant organizations as a means of drawing national and international attention to their demands for compensations. As a result, ethnic militias such as MEND was formed by the Ijaw Youth Council (IYC), Niger Delta Vigilante (NDV), the Bush Boys, the Dodan Barrack Group, the Ogoni Movement (MOSOP), and the Titanians sprang up soliciting for their rights and kidnapped the expatriates working at the oil wells. These organizations were made up of youths who were virtually unemployed, poor and frustrated with the system of government that exploits their resources, pollute their environment and leave their areas underdeveloped. The indigenes expected adequate compensations with infrastructural developments such as good roads,

hospitals, good schools, modern commercial trading centres, good drinking water, and even award scholarships to the indigenous sons and daughters for further studies as remuneration for the minerals extracted from their communities. The failures to reward those communities plus the stench from unemployment ignited and heightened the internal grievances against the Federal Government and the oil companies. The crime of kidnapping cannot be halted easily without meeting the demands of the kidnapers. The inability of the government and oil companies to meet the demands of the kidnapers has become a frustrating impediment to the solution of the crime of kidnapping in the nation. Because kidnapers owned the means of assessing their potential victim, they are also able to exert almost total control over social domain of the crime, the limitation of their victim and criminal justice system (Akanni, 2014; Ezeibe and Eze, 2012).

*Poorly Developed Communication Networks* – One of the prominent methods of locating abducted victims is through tower communication device. Idachaba (2011) states that “kidnapping in Nigeria is fuelled by the inability of security agencies to quickly identify the location of the kidnapped persons” (p.56). The inability of the law enforcement authorities to comprehend the complexity of the Global Positioning System (GPS) is a serious impediment to the control of kidnapping activities. According to Idachaba (2011), the GPS Module is configured as a data pusher in that it sends the position data of the tracked object through a GSM Network. This transmission is facilitated by the use of a GSM Modem and microcontroller. The module stores the location data and sends it at predetermined intervals. The complexity of the communication device is an impediment to the control of kidnapping in the nation.

*Get Rich Quick Syndrome* - In Nigeria society, some people just emerge rich anyhow without anybody asking question how such individuals got their money. In this contemporary society, everybody is a businessman; nobody questions the nature of the business or how some people acquire their wealth (Inyang, 2009). It is easy in Nigeria to see a poor young college dropout today build a ‘Ten Storey-Building’ without the government or private citizens questioning how such a youth made that kind of money. Therefore, the kidnapers are not afraid of demanding excessive ransom payment, knowing that nobody would dare question its sources. In a comparative analysis, nations such as United States and United Kingdom would maintain registration of every building structure, and use internal revenue services (IRS) to police, track down individual incomes and investments to ensure accountability. If a poor college dropout buys an expensive vehicle in cash of \$10,000 and above in United States, such an individual would be interrogated by the internal revenue services to account for such cash payment. In fact, the inconsistency between economic transparency and accountability in normal government affairs and the desire to amass wealth among the general public contribute to the leverage among the kidnapers (Inyang, 2009). Therefore, lack of effective systematic model of checks and balances is a major impediment to the control of kidnapping behaviour in the country.

## **THEORETICAL FRAMEWORK**

Renewed research interest in Foreign Investment (FI) stems from the change of perspectives among policy makers from “hostility” to “conscious encouragement,” especially among developing countries. Foreign Investment had, until recently, been seen as “parasitic” and retarding the development of domestic industries for export promotion. However, Bende-Nabende and Ford (1998) submits that the wide externalities in respect of technology transfer, the development of human capital and the opening up of the economy to international forces, among other factors, have served to change the former image. Caves (1996) observe that the rationale for increase efforts to attract more FI stems from the belief that FI has several positive effects. Among these are productivity gain, technology transfers, and the introduction of new processes, managerial skills and know-how in the domestic market, employee training, international production networks, and access to markets. Carkovic and Levine (2002) notes that the economic rationale for offering special incentives to attract FI frequently derives from the belief that foreign investment produces externalities in the form of technology transfers and spill-over. According to Althukorala (2003), FI provides much needed resources to developing countries such as capital, technology, managerial skills, entrepreneurial ability, brand and access to markets which are essential for developing countries to industrialize, develop, create jobs and attack the poverty situation in their countries. Dauda (2007) argues that FI is generally believed to propel economic growth in developing countries as it makes significant contributions to the host country’s development process especially through easing of the constraints of low levels of domestic savings and investment as well as foreign exchange shortages. He further argues that FI increases the GDP and generates a stream of real incomes in the host country. The increased productivity benefits local income groups through higher wages and expanded employment, lower product prices paid by consumers, rent to local resource owners, and high tax revenue or royalties to the government.

## **RESEARCH METHODOLOGY**

The research design involves descriptive research design of the critical examination of effects of hostage taking on foreign investment in Nigeria. The study population involves all 248 staff of Federal Ministry of Finance, South West Regional Office, Nigeria. Simple random sampling which gives all respondents equal chance of being selected was employed. Therefore, 15% of the total population, which equals 37 staff, was selected for questionnaire purpose. Descriptive statistical package was employed analysing the data collected. Such parameter as means, frequency distribution tables, percentages and Chi-square were employed to show the significant effect of variables that will help to explain the effect of hostage taking on foreign investment in Nigeria.



**DATA ANALYSIS**

Effects of Hostage Taking on Foreign Investment in Nigeria

The tables below examine the Effect of Hostage Taking on Foreign Investment in Nigeria.

**Table 1 Hostage Taking prevent foreign investor from investing in Nigeria**

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid Strongly Agree	16	45.7	45.7	45.7
Agree	15	42.9	42.9	88.6
Disagree	4	11.4	11.4	100.0
Total	35	100.0	100.0	

Source: Field Survey, September, 2017.

Table 1 above shows the analysis of hostage taking preventing foreign investor from investing in Nigeria. It shows that 88.6% of the respondent agreed that hostage taking prevent foreign investor from investing in Nigeria, while 11.4% of the respondents disagreed with the statement.

**Table 2 Hostage Taking resulted in poor or low exportation of Nigeria Product**

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid Strongly Agree	9	25.7	25.7	25.7
Agree	20	57.1	57.1	82.9
Disagree	6	17.1	17.1	100.0
Total	35	100.0	100.0	

Source: Field Survey, September, 2017.

Table 2 above shows the analysis of hostage taking resulted in poor or low exportation of Nigeria product. The result shows that 82.8% of the respondents agreed that hostage taking resulted in poor or low exportation of Nigeria product, while 17.2% of the respondents disagreed with the statement.

**Table 3 Hostage Taking has effect on exchange of technological knowledge with advanced nations**

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid Strongly Agree	6	17.1	17.1	17.1
Agree	19	54.3	54.3	71.4
Disagree	8	22.9	22.9	94.3
Strongly Disagree	2	5.7	5.7	100.0
Total	35	100.0	100.0	

Source: Field Survey, September 2017.

Table 3 above shows the analysis of Hostage Taking has effect on exchange of technological knowledge with advanced nations. It shows that 71.4% of the respondents

agreed that Hostage Taking has effect on exchange of technological knowledge with advanced nations, while 28.6% of the respondents disagreed with the statement.

**Table 4 Hostage Taking resulted into poor revenue generation for the government at all levels**

	Frequency	Percent	Valid Percent	Cumulative Percent
Strongly Agree	7	20.0	20.0	20.0
Agree	6	17.1	17.1	37.1
Valid Disagree	15	42.9	42.9	80.0
Strongly Disagree	7	20.0	20.0	100.0
Total	35	100.0	100.0	

Source: Field Survey, September 2017.

Table 4 above shows the analysis of Hostage Taking resulted into poor revenue generation for the government at all levels. Again, 37.1% of the respondents agreed that Hostage Taking resulted into poor revenue generation for the government at all levels while 62.9% of the respondents disagreed with the statement.

**Table 5 Hostage Taking affect development of Indigenous companies**

	Frequency	Percent	Valid Percent	Cumulative Percent
Strongly Agree	2	5.7	5.7	5.7
Valid Agree	16	45.7	45.7	51.4
Disagree	17	48.6	48.6	100.0
Total	35	100.0	100.0	

Source: Field Survey, September 2017

Table 5 above shows the analysis that Hostage Taking affect development of Indigenous companies. It shows that 51.4% of the respondents agreed that Hostage Taking affect development of Indigenous companies while 48.6% of the respondents disagreed with the statement.

**Table 6 Hostage Taking resulted into increase in security budget at the expense of infrastructural development**

	Frequency	Percent	Valid Percent	Cumulative Percent
Strongly Agree	8	22.9	22.9	22.9
Valid Agree	19	54.3	54.3	77.1
Disagree	2	5.7	5.7	82.9
Strongly Disagree	6	17.1	17.1	100.0
Total	35	100.0	100.0	

Source: Field Survey, September 2017

Table 6 above shows the analysis of Hostage Taking resulted into increase in security budget at the expense of infrastructural development. Again, 77.2% of the respondents agreed that Hostage Taking resulted into increase in security budget at the

expense of infrastructural development, while 22.8% of the respondents disagreed with the statement.

**Table 7 Hostage Taking has contributed to increase in unemployment**

	Frequency	Percent	Valid Percent	Cumulative Percent
Strongly Agree	14	40.0	40.0	40.0
Agree	15	42.9	42.9	82.9
Valid Disagree	4	11.4	11.4	94.3
Strongly Disagree	2	5.7	5.7	100.0
Total	35	100.0	100.0	

Source: Field Survey, September 2017

Table 7 above shows the analysis that Hostage Taking has contributed to increase in unemployment. It shows that 82.9% of the respondents agreed that Hostage Taking has contributed to increase in unemployment while 17.1% of the respondents disagreed with the statement.

**Table 8 Hostage Taking has contributed to poor standard of living of Nigeria Populace**

	Frequency	Percent	Valid Percent	Cumulative Percent
Agree	21	60.0	60.0	60.0
Valid Disagree	8	22.9	22.9	82.9
Strongly Disagree	6	17.1	17.1	100.0
Total	35	100.0	100.0	

Source: Field Survey, September 2017

Table 8 above shows the analysis that Hostage Taking has contributed to poor standard of living of Nigeria Populace. It shows that 60.0% of the respondents agreed that Hostage Taking has contributed to poor standard of living of Nigeria Populace while 40.0% of the respondents disagreed with the statement.

**Table 9 Hostage Taking has resulted into close down of foreign companies**

	Frequency	Percent	Valid Percent	Cumulative Percent
Strongly Agree	7	20.0	20.0	20.0
Agree	19	54.3	54.3	74.3
Valid Disagree	7	20.0	20.0	94.3
Strongly Disagree	2	5.7	5.7	100.0
Total	35	100.0	100.0	

Source: Field Survey, September 2017

The table 9 above shows that Hostage Taking has resulted into close down of foreign companies. The result shows that 74.3% of the total respondents agreed that Hostage Taking has resulted into close down of foreign companies, while 25.7% of the total respondents were disagreed with the statement.

**Table 10 Hostage Taking can be eliminated through Amnesty Programmes**

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid Strongly Agree	8	22.9	22.9	22.9
Agree	12	34.3	34.3	57.1
Disagree	15	42.9	42.9	100.0
Total	35	100.0	100.0	

Source: Field Survey, September 2017

Table 10 above shows that Hostage Taking can be eliminated through Amnesty Programmes. The result shows that 57.2% of the total respondents agreed that Hostage Taking can be eliminated through Amnesty Programmes, while 42.9% of the total respondents disagree with the statement.

**Table 11 Quality and Affordable education will reduce or eliminate Hostage Taking**

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid Strongly Agree	2	5.7	5.7	5.7
Agree	22	62.9	62.9	68.6
Disagree	8	22.9	22.9	91.4
Strongly Disagree	3	8.6	8.6	100.0
Total	35	100.0	100.0	

Source: Field Survey, September 2017

Table 11 above shows the Quality and Affordable education will reduce or eliminate Hostage Taking. It shows that 68.6% of the total respondents agreed that Quality and Affordable education will reduce or eliminate Hostage Taking, while 31.4% of the total respondents disagree with the statement.

**Table 12 Involvement of Traditional Rulers in Governance will eliminate Hostage Taking**

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid Strongly Agree	2	5.7	5.7	5.7
Agree	22	62.9	62.9	68.6
Disagree	8	22.9	22.9	91.4
Strongly Disagree	3	8.6	8.6	100.0
Total	35	100.0	100.0	

Source: Field Survey, September 2017

The table 12 above shows that Involvement of Traditional Rulers in Governance will eliminate Hostage Taking. The result shows that 68.6% of the total respondents agreed that Involvement of Traditional Rulers in Governance will eliminate Hostage Taking, while 31.4% of the total respondents were disagreed with the statement.

**;Table 13 Government Accountability will reduce Hostage Taking in Nigeria**

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid Strongly Agree	14	40.0	40.0	40.0
Agree	14	40.0	40.0	80.0
Disagree	7	20.0	20.0	100.0
Total	35	100.0	100.0	

Source: Field Survey, September 2017

Table 13 above shows that Government Accountability will reduce Hostage Taking in Nigeria. The result shows that 80.0% of the total respondents agreed that Government Accountability will reduce Hostage Taking in Nigeria, while 20.0% of the total respondents disagree with the statement.

**Table 14 Table of Variable**

	SA	A	U	D	SD	Total
Variable 1	16	15	4	0	0	35
Variable 2	9	20	0	6	0	35
Variable 3	6	19	0	8	2	35
Variable 4	7	6	0	15	7	35
Total	38	60	4	29	9	140

**Table 15 Chi-Square Analysis Table of Effects of Hostage taking on Foreign Investment**

O	E	O-E	O-E) <sup>2</sup>	O-E) <sup>2</sup> /E
16	9.5	6.5	42.25	4.45
15	15	0	0.00	0.00
4	1	3	9.00	9.00
0	7.25	-7.25	52.56	7.25
0	2.25	-2.25	5.06	2.25
9	9.5	-0.5	0.25	0.03
20	15	5	25.00	1.67
0	1	-1	1.00	1.00
6	7.25	-1.25	1.56	0.22
0	2.25	-2.25	5.06	2.25
6	9.5	-3.5	12.25	1.29
19	15	4	16.00	1.07
0	1	-1	1.00	1.00
8	7.25	0.75	0.56	0.08
2	2.25	-0.25	0.06	0.03
7	9.5	-2.5	6.25	0.66
6	15	-9	81.00	5.40
0	1	-1	1.00	1.00
15	7.25	7.75	60.06	8.28
7	2.25	4.75	22.56	10.03

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				56.94
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Source: Field Survey, 2017.

Level of Significance is 0.05

Summary of Chi-Square Analysis

$$X^2 = \sum \frac{(O-E)^2}{E} \text{ Therefore, } X^2 = 56.94$$

Decision Rule: Reject Null hypothesis if calculated  $X^2$  is greater than tabulated  $X^2$

The study attempted to validate the hypothesis that claim there is no significant effect of hostage taking on foreign investment in Nigeria. Since calculated  $X^2_{cal} > X^2_{tab}$  ( $X^2_{cal} = 56.94$ ,  $X^2_{tab} = 16.92$  df=9). This further substantiates findings discovered to fulfilment of related research objective. Therefore, the study affirms that there is significant effect of hostage taking on foreign investment in Nigeria.

### Discussion of Findings

The findings revealed that hostage taking which results from insecurity in the country have significant effect on the foreign investment in Nigeria. In the opinion of technocrats in the Ministry of Finance, it was unanimously agreed that if the foreign investment, which will improve the economic standard of this country, like other developing economy around the world, different mechanism must be put in place to prevent kidnapping of foreigner within the territory of Nigeria, to boost the confidence of investing in the country numerous opportunities.

### CONCLUSION

Hostage taking has been a serious challenges affecting foreign investment in Nigeria, especially in the area of oil exploration in the Niger Delta. This has negatively affected the basis of evaluating economic development such as employment rate, standard of living, exchange rate, revenue generation of government at all levels and security challenges in the country. Hostage taking has resulted into foreigners' fear of coming to Nigeria for investment and resultant effect on the economic growth and development of the country. These problems must be addressed; if there will be improvement in the revenue generation of the government and security of the country.

Based on the foregoing assessment of effects of hostage taking on foreign investment in Nigeria, the following recommendations will be important in improving the negative effects of hostage taking on foreign investment in Nigeria.

Government should ensure strict sanction for any person found guilty of kidnapping or related act. There should be clear government policy on revenue sharing and revenue allocation to resources region. Government should improve on its accountability to ensure that all parties felt satisfied by the government actions. There should be quality and affordable education for all citizen to prevent people from partaking in hostage taking and kidnapping.

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## **DOES HAVING WOMEN ON BOARDS IMPROVE MONITORING ROLE: THE IMPACT OF CONTROL-OWNERSHIP WEDGE IN TURKEY**

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**Abstract:** *Many government sought to enforce gender equality on the corporate boards, but the implication of doing it are not obvious and might harm economies and firms. We underline this topic by conceptualizing the relationship as corporation and board-specific and embedded within specific contexts. The theory is developed with reference to developing countries, and tested on Turkish firms. The result reflects that female directors improve monitoring mechanism for some firms and reduce it for others. The influence is different across various monitoring indicators, control-ownership wedge, and board structure. The impact varies across different audit quality indicators. The findings call for nuanced responses in relation to women's nominations from both governments and firms.*

**JEL Classifications:** *M48, M42, M41*

**Keywords:** *Female Directors, Control-Ownership Wedge, Audit Quality and Turkey*

### **INTRODUCTION**

Governments around the world are adopting regulations designed to improve female involvement in corporate boards. These regulations suggest that female participation has a positive influence on the role of board and firm strategic decision in term of monitoring function. This argument is aligning with that of theory and empirical evidence, meanwhile, is inconclusive. Previous studies propose that female distinctive management style enhance board monitoring mechanism (Shamsul N Abdullah, Ismail, & Nachum, 2016), while others find that weak experience of female in leadership undermine their effectiveness as board members (Dargnies, 2012). In the same line of the theoretical ambiguity, there is inconsistency in the empirical studies examined the relationship between female directors and audit quality, even in studies addressed same

context (Ararat, Aksu, & Tansel Cetin, 2015a; Mustafa, Che-Ahmad, Chandren, & Sitraselvi, 2017). This inconclusive state of knowledge, at a time when governments are introducing affirmative action policies that require firms to nominate women to boards, is troubling, makes the understanding of the consequences of female's presence on boards timely and important.

We propose that the theoretical ambiguity and inconsistency of previous empirical evidence is a reflection of the complex relationship between female directors and audit quality that have not been counter for. To grasp this complexity, we develop a theory of monitoring function by female directors that extend existing theory. We propose that the processes of female selection and the consequence of their selection depend on firms characteristics, and therefore the implication of their involvement on corporate board are firm specific (Alfraih & Alfraih, 2016).

Emerging market has been used to develop our theory, and the influence of female directors on monitoring function is conceptualized as determined by the structure of corporate governance and the social perspectives toward gender equality in these contexts (Black, Jang, & Kim, 2006). Based on available literature this study is the first to examine theoretically and empirically the relationship between female directors and audit quality in emerging country.

We examine the theory on a data set of 146 Turkish firms listed in Bursa Istanbul (BIST) for the period of five years between 2011 and 2015. The finding supports our theory, that the relationship between female directors and audit quality contingent on control-ownership wedge. These findings are robust across different measures, enhancing the confidence in their stability. We place Turkey in comparative perceptions with reference to corporate governance structure and culture, and use this comparative approach to demonstrate the wider validity of the study. The outcomes of this study have implications for future government policies because they indicate that women directors could be a desirable to strengthen the monitoring role of the board.

## **THEORY AND HYPOTHESES**

The presence of women in board leads to gender diversity. Women involvement align with the logic of the major theories that address the performance implication of board structure- agency theory (Jensen & Meckling, 1976) and resource dependency theory (Salancik & Pfeffer, 1978) in two aspects. First, female directors behave differently than men directors because they view their role and behave in society differently than men directors. Female perceptions of themselves effect their occupation selections and determine the magnitude and quality of the pool of female candidates for board nominations (Barbulescu & Bidwell, 2013). Second, Firms' stockholders remark female presence differently than men in the corporate boards. This impact on firms demand for female directors and the corporate environment they experience as board members (Ishak, Amran, Manaf, & Bahrain, 2015). These aspects drive females' involvement in corporate boards and it is influence on firms' strategic decision (Ding, Murray, & Stuart, 2013). Gender influence is designed by the institutional context in which they take place particularly, corporate governance structure (Doidge, Karolyi, &

Stulz, 2007) and culture (Hofstede, 1998). Studies illustrate these contextual attributes have important influence on the variations of female presence in the corporate boards in terms of monitoring function (Desender, Aguilera, Crespi, & García-cestona, 2013; Terjesen & Singh, 2008).

The theory is derived on the assumption that the influences of female involvement on boards are inextricably embedded in an institutional context and shape the configuration of the culture and institutional fabric of this context. We sought to address this institutional embeddedness in one setting that has not studied sufficiently particularly emerging market. This definition is suitable for this study because the institutional setting is a core driver of the relationship addressed in this study. The development of theory is based on institutional environment present in these countries.

We start by anticipating differences in the influence of female directors on monitoring function in emerging countries, differentiating between audit quality proxies for instance Big4 auditors and client industry concentration. Previous research in emerging countries treated these audit quality indicators as different operation proxies of the same theoretical construct and proposed that they make little variances for the outcomes (Craswell, Francis, & Taylor, 1995; Mustafa et al., 2017). We propose and that those indicators considers theoretically different of board monitoring creation by female directors. Big4 auditors are expected to have stronger incentives and greater competencies to provide high audit quality (DeAngelo, 1981). Client industry concentration is expected to have greater competencies and stronger reputation incentives to provide high audit quality.

There are many reasons to suggest that female directors in the corporate board in emerging countries will exercise a positive influence on board monitoring function. First, female's excellence in creating relationships and in cooperative work is of high value for the group work that describes boards' activity (Dargnies, 2012). Also, female directors tend to excel in monitoring function and to hold management accountable for activities misalignment with firm interests (Triana, Miller, & Trzebiatowski, 2013). We propose that these behavioral characteristics are of specific value in developing countries. Studies explains that the influence of monitoring mechanism on performance is valuable in the presence of weak corporate governance systems(Adams & Ferreira, 2009), which is often the case in developing countries. The lack of strong external monitoring mechanism to oversight management behavior, for instance the market for corporate control, further highlights the value female monitoring abilities (Morck, 2000). Researches in developing countries explains that the existence of female directors in the corporate board reduce accounting manipulation and earnings management, and improve the informativeness of the accounting numbers (Shamsul Nahar Abdullah, Ismail, & Izah, 2017).

Second, the career aspirations of female directors often result in various occupational profiles than male directors (Barbulescu & Bidwell, 2013), and as a consequence their existence on corporate board improve the diversity of functional background. Substantial studies on developed countries recognize diversity as a significant driver of board effectiveness because it connects companies to different external resources. Board diversity has particular value in developing countries, because it mirrors the high level of diversification typical of developing country firms. Diversified

firms are subject to the demands of multiple and diverse environmental dependencies and need varied capabilities to manage them (Salancik & Pfeffer, 1978). Female directors are effective to make vast network with resource controlled by female, and in assisting them to retain female employees (Hillman & Dalziel, 2003). This is likely to be of substantial value in developing countries, where the gender divide inhibits the capability of male directors to improve connect with female directors.

Third, drawing on the female portion of the population, which is often excluded from the pool of candidates for board nominations, is likely to improve the quality of board members. Excluding segments of the population on discriminatory grounds is costly for firms, particularly when the excluded groups are large, as is the case for women (Ding et al., 2013). The board proportion of female directors in developing countries is 7.4 percent compared to developed countries that is about 11.8 (Gladman & Lamb, 2013). It is lags far behind female's education achievements and their performance in the labor market. The benefits of drawing on this group are thus specifically notable in developing countries (Siegel, Pyun, & Cheon, 2014). Formally:

*Hypothesis 1: There is a relationship between female directors and audit quality.*

### **MODERATING EFFECTS: CONTROL-OWNERSHIP WEDGE**

The firms' attributes drive the likelihood of nominations of female and the criteria utilized in their selection. In addition, they shape the corporate governance environment in which women director operates and their capability to impact boards' functioning and monitoring. Thus, the influence of female directors on board monitoring is contingent on the attributes of firms (Hillman, Shropshire, & Cannella, 2007). Remarkably, between these characteristics is the control-ownership wedge.

There are many reasons for expecting the impact of female directors on board monitoring will be weaker in wedge firms. For example, risk-averse and conformist family firms are likely to occupy female directors because female nominations consider a deviation from societal norms and are high-risk moves (Litov, Moreton, & Zenger, 2012).

The averseness to nominate female deprives wedge firms from the potential economic benefits of female directors. To the extent that wedge firms nominate female, they display preference for selections from within their circles as a means of decreasing risk. Female director nominations based on such relationship are highlighted in developing countries; this is because business relationships are influenced by personal ties to a greater extent than in emerging countries. Corporate board directed by large numbers of group of directors pursue firms agendas that misalignment with that of shareholders' interests and this unfavorable for shareholders, negatively influence board monitoring. The case is differing when ownership is highly concentrated for instance; the interests of controlling shareholders who nominated the board member are closely aligned. Female director improve board monitoring function, a behavioral characteristics that is likely to be valued by controlling shareholders whose large proportion in the company increases their incentives and abilities to monitor management activities (Shleifer & Vishny, 1986). Therefore, they provide an environment that is encouraging for female directors to enforce themselves and make an influence. Consistently, minority

shareholders valued female's monitoring skills in the presence of high concentrated ownership, this is because improve minority shareholders protection. Previous studies in developing countries explain that concentrated ownership is positively influence on management manipulation.

In addition, the misalignment of interest between management and shareholders improve in the presence of diffused ownership while this is not the case with high concentrated ownership. Therefore, high concentrated ownership provide suitable environment that is more encouraging for female to demonstrating their tendencies for conflict avoidance and consensus. The moderating influence of control-ownership wedge is likely to be notable in developing countries particularly Turkey, in the presence of high concentrated ownership (Ararat et al., 2015a). The power of concentrated ownership tends to be greater than their equity ownership, as a result of complicated cross-holding and pyramidal ownership in developing countries. Hence,

*Hypothesis 2: Control-ownership wedge moderates the relationship between female directors and audit quality.*

## **METHODS**

The population of this study on concentrates on Turkish listed firms. Hence, Financial institutions and banks are excluded from the sample because they are following various corporate governance principles (Zulkarnain, 2009). Turkey provides an interesting context for our study. The new Turkish commercial code has been issued, effective from July 1, 2012 to improve corporate governance, financial reporting and auditing. Thus, to evaluate the influence of corporate governance in 2012, our study covers the five-year period starting from 2011 to 2015. Also, the Capital Market Board of Turkey (CMBT) promotes firms to employ women in business, including on boards, and has made considerable steps in advancing women. As part of these gender advancement initiatives, in 2013 the CMBT has revised its recommendation by asking the companies to set and disclose a voluntary target level of women on boards, which should not be less than 25%, by a target date they specify. The first Asian government to do so, pioneering among developing countries. Turkey therefore provides a rich context for the study of the monitoring consequence of female directors in developing countries. In Addition, Turkey considers a corporate governance context that is common in Europe countries, but it is unfamiliar in a global perception. This offers a fruitful context for our research, and provides the opportunity for theoretical extensions. Lastly, Turkey is interesting also in regards to gender equality. It is notable in its institutional commitment to gender equality and the advancement of women and at the same time deeply rooted cultural resistance to women advancement. This provides an interesting setting for examining the interaction between institutional characteristics for instance, control-ownership wedge in the influencing the relationship we study. Turkish publically listed firms are employed as unite of analysis, this is because these firms are statutory required to report their annual reports. This facilitates the accessibility to firms' annual reports via the BIST. The original sample is consisting of 411 firms, including financial institutions and banks.

Table 1 shows the procedures followed to determine the final sample of firms employed in the study.

**Table 1 Procedure of Sample Selection**

Firms	No. of firms
Firms listed on Borsa Istanbul Webpage in 2015	411
Less: financial institution and holding	142
Less: firms with missing corporate governance information	15
Less: firms with missing directors' profiles	70
Less: firms with missing interlocking directors' information	38
Final sample observations	146

The study excludes 142 non-financial firms and 123 firms due to missing information and weak corporate governance and lower quality auditors. The final sample of this study comprises 146 firms listed on the BIST. BIST consist of 9 two digit industries with more than ten observation firms. The large representation of firms listed on BIST is explained in Table 2 for the nine industries.

**Table 1 Data Composition**

Industry	No. of firms
Food, beverage and tobacco	18
Textile, wearing apparel and leather	12
Paper and paper products, printing and publishing	10
Chemicals, petroleum rubber and plastic products	27
Non-metallic mineral products	15
Fabricated metal products, machinery and equipment	25
Information technology	14
Construction and public work	10
Wholesale and retail trade, hotels and restaurant	15
<b>Total</b>	<b>146</b>

Source: KAP

The larger industry is chemicals, petroleum rubber and plastic products with 27 firms and smaller industry is for construction and public work. To determine the value of SPECLST\_MS this study follows Jones, Krishnan, and Melendrez's (2008) study to deduct industries comprising less than ten firms from the final sample of the study. The empirical analysis based on data collected from firms' annual reports, complemented by DataStream (for audit quality indicators) and Bursa Istanbul (BIST). Table 3 shows the variables in the model, their operation measures, descriptive statistics, and Pearson coefficient to provide a useful discussion and to afford meaningful information, untransformed variables are utilized.

**Table 3 Descriptive Statistic and Univariate Analysis of Continuous Variables**

	Mean	Min	Max	Std.Dev	Big4 firms N=419		Non-Big4 firms N=305		Big4 firms vs. non-Big4 firms		1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20		
					Mean	Std.Dev	Mean	Std.Dev	t-stat	P-value																						
1.SPECLST_MS	0.167	0	0.98	0.23	-	-	-	-	-	-	1																					
2.Big4	0.527	0	1.00	0.50	-	-	-	-	-	-	0.45	1																				
3.FEMD	0.73	0	4.00	0.80	0.78	0.76	0.68	0.85	-1.61	0.11	0.17	0.11	1																			
4.AGE1	-	-	-	-	-	-	-	-	-	-	-0.15	-0.11	0.11	1																		
5.AGE2	-	-	-	-	-	-	-	-	-	-	-0.04	0.07	-0.04	-0.03	1																	
6.AGE3	-	-	-	-	-	-	-	-	-	-	0.11	0.16	-0.08	-0.17	0.32	1																
7.AGE4	-	-	-	-	-	-	-	-	-	-	0.14	0.04	0.08	-0.18	-0.43	-0.1	1															
8.AGE5	-	-	-	-	-	-	-	-	-	-	0.18	0.23	0.07	-0.13	-0.3	-0.1	0.17	1														
9.INTD	3.875	0	12.00	2.67	4.81	2.68	2.84	2.25	-10.64	<b>0.00</b>	0.20	0.3	0.15	-0.06	-0.15	0.17	0.22	0.29	1													
10.EDUC	2.303	0	8.00	1.85	3.06	1.80	1.46	1.51	-12.83	<b>0.00</b>	0.29	0.43	0.16	-0.09	-0.12	-0.2	0.27	0.39	0.29	1												
11.BSIZE	6.783	2	15.00	2.13	7.51	2.35	5.97	1.48	-10.46	<b>0.00</b>	0.20	0.36	0.07	-0.07	-0.19	0.43	0.46	0.48	0.41	0.1	1											
12.BINDE	1.812	0	5.00	0.91	1.92	0.91	1.69	0.90	-3.44	<b>0.00</b>	-0.06	-0.05	0.01	-0.04	0.06	0.07	0.01	-0	-0.1	0.1	-0.08	1										
13.BMEET	24.211	3	146.00	13.28	24.08	15.28	24.36	10.64	0.29	0.77	0.05	-0.01	0.12	-0.02	-0.07	-0	0.02	-0.1	0.06	0	-0.16	-0.04	1									
14.CSIZE	2.045	1	5.00	0.27	2.08	0.35	2.01	0.12	-3.47	<b>0.00</b>	0.23	0.12	0.01	-0.02	-0.04	0.2	0.09	-0.1	0.05	0	0.18	0.01	-0	1								
15.CNDE	1.661	0	3.00	0.76	1.72	0.71	1.59	0.81	-2.28	<i>0.02</i>	-0.04	0.06	-0.06	-0.04	0.01	-0.1	0.1	0.13	0.08	0.1	0.15	0.63	-0	-0.15	1							
16.CMEET	4.393	0	7.00	1.27	4.37	1.03	4.42	1.49	0.61	0.54	-0.07	-0.02	0.02	0.02	0.02	-0	0.11	0.08	-0	-0.1	0.17	0.04	-0	-0.08	0.04	1						
17.WEDGE	-	-	-	-	-	-	-	-	-	-	-0.21	-0.28	0.02	0.17	-0.1	0.02	0.03	-0.1	-0.1	-0.1	-0.02	-0.01	0.06	-0.01	0.06	-0.1	1					
18.FSIZE*	1.904	1.433	2.61	1.78	2.03	1.60	1.88	1.68	-1.16	<b>0.00</b>	0.34	0.39	0.09	-0.18	-0.13	0.2	0.18	0.3	0.27	0.1	0.4	-0.03	0.07	0.2	0.07	0.05	-0.22	1				
19.LEVE	0.482	0	1.71	0.28	0.52	0.30	0.43	0.24	-4.42	<b>0.00</b>	-0.02	0.16	-0.05	-0.07	0.01	0.09	-0.1	0.1	0.01	0	0.05	0.02	-0	0.06	0.03	-0.04	-0.13	0.24	1			
20.FAGE**	33.825	1	80.00	15.86	37.66	16.01	29.54	14.55	-7.12	<b>0.00</b>	0.27	0.25	0.07	-0.11	-0.04	0.05	0.11	0.15	0.06	0.1	0.2	0.04	0.09	0.08	0.11	0.01	-0.15	0.1	-0.06	1		
21.AAGE***	52.428	35.4	68.00	5.58	52.83	5.34	51.98	5.82	-2.06	<i>0.04</i>	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	

Notes: two-tailed, bold = significant at the 1% level, italic = significant at the 5% level, bold and italic = significant at the 10% level

This study used panel data analysis instead of cross-sectional or time-series data analysis to gain the inherent benefits of using this approach. Logistic regression is employed for Big4 measured by binary measurement (Gujarati & Porter, 2009), and linear regression model is utilized for SPECLST\_MS measured by continues measurement (Schneider, Hommel, & Blettner, 2010).

Our study follow Pallant (2011) to employ assumptions applied in logistic regression: 1) sample size, 2) multicollinearity and 3) outliers. The sample size of this study is 146 firms with an average of 14.6 ~ 15 firms for each independent variable. The proper ratio required is about 10 observations for each explanatory variable according to Pallant (2007). The Variance Inflation Factor (VIF) results of all independent variables and control variables are not greater than 5, and far below the threshold value of 10, as proposed by (Hair, Anderson, Babin, & Black, 2010), as a result this assert to the absence of multicollinearity problem. Outliers represent a unique combination of values across a number of variables or observations that are unusually low and high value on a variable that will distort statistics (Hair et al., 2006). Standardized residual cases of less than -3.3

and more than 3.3 are considered outliers (Pallant, 2007). In this study, the minimum standard residual is -2.38 and the maximum standard residual is -2.40 and this indicates that this study does not have any outliers.

To conduct linear regression analyses effectively, several regression diagnostic tests need be performed to avoid misleading results. Our study outlines the issues related to outliers, normality, linearity, multicollinearity, heteroscedasticity and autocorrelation for the linear regression model. Outliers multicollinearity tests are of the assumptions that must be met for logistic regression, and this test was done for this study. Normality and linearity tests are not conducted because, under panel data analysis, normality and linearity are not major concerns because the standard least squares assumption is not applicable in panel data (Gujarati & Porter, 2009). The results of the Breusch-Pagan/Cook-Weisberg test show p-value of the model SPECLST\_MS is significant at 1%. Thus, the null hypothesis of homogeneity of variance (error variances are all equal) could be rejected proposing that the data are heteroscedastic. Consequently, feasible GLS is used in this study to tackle the heteroskedasticity problem as Wooldridge (2002) proposed. The Wooldridge Test for Aurocorrelation displays that it is possible to reject the null hypothesis because F value of the test is below the 5% significant level. This indicates the autocorrelation problem is present. According to the results of univariate test, the Hausman test, Bseusch-Pagan/Cook-Weisberg test and the Wooldridge test, FGLS is able to reweight the error variance and to correct autocorrelation and heteroskedasticity problems (Adkins & Hill, 2008;Gujarati & Porter, 2003).

## **RESULTS AND DISCUSSION**

FEMD has negative influence of 0.9% on Big 4 (Model1). This suggests that for every single increase in FEMD on the board of directors, the impact on the Big 4 auditor falls by 0.9%. However, this relationship is not significant ( $t = -0.87$  &  $p = 0.384$ ). Previous studies by Kibiya, Che-Ahmad, and Amran (2016) and Mustafa, Che-Ahmad, and Chandren (2017) on this relationship provide support in line with this study. Nevertheless, the insignificant relationship is not surprising because of the negligible proportion of FEMD on Turkish corporate boards. Typically, male directors have dominated the composition of the corporate boards in the most parts of the world. Turkey, in particular, traditions, socio-cultural and religious restrains limit women from occupying board memberships (Torun, 2010).

The regression result of female directors is highly significant at the 1% level of s ( $t = 3.75$ ;  $p = 0.000$ ) (Table 4) Model2. From Table 4, the result of the regression shows that the impact of female director is 0.59% and for every change in female directors of 1 unit, industry specialist auditor (SPECLST\_MS) will rise by 0.59%. According to resource dependency theory, various attributes of board could demonstrate the variation in the demand for strong monitoring mechanism. Previous evidences by Chapple et al. (2012a), Gul et al. (2008), Gavius et al. (2012), and Kuang (2011) provide support for this relationship. For instance, Kuang (2011) argues that female directors have a positive influence on improving the effectiveness and efficiency of the board. Similarly, Broadbridge et al. (2006) document that gender diversity has an essential impact on



enhancing the corporate governance role. Consequently, the addition of women to the board improves the board monitoring function (Carter, Simkins, & Simpson, 2003). One reason is that female directors are more conscious in protecting their reputational capital and maximizing shareholders' interests (Gul et al., 2008).

Another reason is that female directors are more conservative with respect to the financial reporting process than their male counterparts, and this positively impacts the board's demand for a high audit quality. Chapple et al. (2012a) find that board gender diversity improves the board monitoring function and reduces the odds of receiving a qualified opinion from the external auditor. This conclusion is based on the notion that firms employing female directors on their boards has enough capability to handle their operational risks. In addition, female directors are more active, more risk-averse and more conservative towards litigation risks and want to maintain their reputational capital. The finding partially supports Hypothesis 1. Even though not significant, the moderating effects of wedge with female directors (FEMD) on Big 4 strengthens the variation of audit quality to 13.2% proposing that the FEMD explained 13.2% of the Big 4 Model1. Table 4 results shows that, when the FEMD increases on the board of directors, they affect the Big 4 positively due to wedge. In both cases the relationship is not significant.

The result is, however, not supported by Ararat et al. (2015b) in the area of firm performance who examined the relationship between FEMD and board monitoring intensity. However, this result is supported by the empirical studies of Kibiya, Che-Ahmad, and Amran (2016) and Mustafa, Che-Ahmad, and Chandren (2017) indicating that FEMD has no significant influence on the demand of clients for high quality audit services. However, the insignificant relationship is not unexpected because of negligible proportion of female directors in Turkey at the corporate board level. This infers that a substitution influence exists between board demographic diversity in terms of female directors and audit quality in the presence of a wedge in the Turkish environment. This study is the first to examine the moderate role of wedge on the relationship between these two variables. Desender, Aguilera, Crespi, and GarcÍacestona (2013) study results provide a support for this study results. They argue that a substitution impact exists between board composition and ownership structure when it comes to monitoring.

**Table 4 Results of Regression analysis**

Item	Model1				Model2			
	Big4		SPECLST_MS		Big4		SPECLST_MS	
	Coefficient	Standard Errors	Coefficient	Standard Errors	Coefficient	Standard Errors	Coefficient	Standard Errors
FEMD	-0.090	0.104	0.059***	0.015	-0.131	0.109	0.097	0.066
AGE1	-0.025	0.157	-0.025*	0.013	0.024	0.170	-0.022	0.013
AGE2	0.662***	0.129	-0.001	0.009	0.729***	0.133	0.005	0.009

AGE3	0.263**	0.109	0.001	0.008	0.273	0.113	0.001	0.008
AGE4	0.019	0.140	-0.008	0.064	0.023	0.143	-0.008	0.065
AGE5	0.360**	0.122	0.016*	0.008	0.403**	0.128	0.017*	0.009
INTD	0.177***	0.047	0.007*	0.003	0.176***	0.048	0.009**	0.003
EDUC	0.539***	0.118	0.199**	0.058	0.554***	0.124	0.133**	0.064
BSIZE	-1.097***	0.293	-0.022	0.021	-1.200***	0.320	-0.015	0.021
BINDE	-0.452**	0.172	-0.086	0.076	-0.364**	0.172	-0.012	0.078
BMEET	0.002	0.007	0.009	0.012	0.003	0.007	0.005	0.012
CSIZE	0.938*	0.449	0.160***	0.030	0.840	0.677	0.118***	0.030
CINDE	0.610*	0.358	-0.010	0.028	0.495	0.379	-0.040	0.028
CMEET	-0.242**	0.073	-0.018**	0.006	-0.190*	0.098	-0.014*	0.007
WEDGE	-0.821***	0.200	-0.059***	0.016	-0.885***	0.209	-0.050**	0.016
FEMD*WEDGE	-	-	-	-	0.132	0.109	0.006	0.008
AGE1*WEDGE	-	-	-	-	-0.429**	0.194	-0.003	0.013
AGE2*WEDGE	-	-	-	-	-0.670**	0.220	-0.028	0.018
AGE3*WEDGE	-	-	-	-	-0.647**	0.243	-0.019	0.020
AGE4*WEDGE	-	-	-	-	-0.416*	0.229	-0.007	0.019
AGE5*WEDGE	-	-	-	-	-0.348**	0.174	-0.029*	0.014
INTD*WEDGE	-	-	-	-	-0.191*	0.099	-0.002	0.008
EDUC*WEDGE	-	-	-	-	0.348**	0.132	-0.008	0.009
BSIZE*WEDGE	-	-	-	-	-0.207*	0.109	0.007	0.009
BINDE*WEDGE	-	-	-	-	-0.432**	0.148	-0.019**	0.009
BMEET*WEDGE	-	-	-	-	-0.074	0.103	-0.009	0.008
CSIZE*WEDGE	-	-	-	-	-0.160	0.136	-0.037***	0.008
CINDE*WEDGE	-	-	-	-	0.398**	0.154	0.015*	0.008
CMEET*WEDGE	-	-	-	-	0.143	0.105	0.005	0.009
FSIZE	0.392	0.071	0.028	0.004	0.418***	0.096	0.031***	0.005**
LEVE	0.921	0.386	-0.065	0.028	0.811**	0.364	-0.058**	0.028**
FAGE	0.661	0.166	0.053	0.012	0.662***	0.181	0.050***	0.012**
R <sup>2</sup>	0.3359				0.3635			
Prob> chi <sup>2</sup>	0.000				0.000			

Notes: \* = significant at 10%, \*\* = significant at 5% and \*\*\* = significant at 1%.

The moderating effects of a wedge on female directors have a lower and an insignificant impact even though the impact is positive ( $t = 0.75$ ,  $p = 0.455$ ) Model2. A few previous studies support this relationship. Kibiya, Che-Ahmad, and Amran (2016) and Mustafa, Che-Ahmad, and Chandren (2017) report that an insignificant relationship between FEMD and the demand of clients for high quality audit services. Additionally, the insignificant relationship is not surprising because of the low proportion of female directors serving on the corporate boards of Turkish firms. Consistently, the Deputy Prime Minister of Turkey responsible for the economy has stated that the number of

female in work life whether as a business owner, manager and worker is far from satisfying. The finding does not support Hypothesis 2.

## CONCLUSIONS

Our study outcome is conclusive in validating that board demographic proxied by women directors reduce Type II Agency Problems via hire strong monitoring mechanism, which align with agency-dependency theory. Our study offers unique insights and improve the understanding of the impact of control-ownership wedge on the clients to demand for strong monitoring function, specifically in a setting of developing countries, the lack of strong corporate governance code in the Turkish environment. Consistently the general notion and the stream of outcomes of studies of the control-ownership wedge, the adverse impact of control-ownership wedge on board demographic and audit quality is proven by the outcomes of our study. This designates that control-ownership wedge declines the clients demand for strong monitoring function, a result which will be unfavorable to minority shareholders. Consequently, further advances in enactment of the Corporate Governance Code (CGC) to address the distinctive features of control-ownership wedge firms are still required.

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## **FISCAL ILLUSION – AN ACTUAL PERSPECTIVE**

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**Abstract:** *The ongoing pro-development strategies that countries are promoting in the current era are based on the idea of finding as much public financial resources as possible to cover the growing financial needs. The more citizens understand less the financial / tax-related changes, the more they will transfer a larger part of their income or wealth to the state. This creates the phenomenon of "tax illusion" first developed by Italian economist Amilcare Puviani in 1903.*

**Keywords:** *fiscal illusion, fiscal sociology, fiscal policy.*

### **5. INTRODUCTION**

After more than a century, governments behave in the spirit of this concept, making non-transparent public financial decisions that lead to an increased size of government and imprudence in the tax matters. Thus, taxpayers are in the situation of not fully understanding the tax burden related to the income earned as a result of truncated information transmitted by public decision makers and uncorrelated fiscal measures proposed and applied by governments. In this sense, a fiscal measure that wants to have a positive impact on the disposable income of individuals, such as the reduction of the income tax of individuals, becomes, in fact, a tax illusion, since it is accompanied by a transfer of social contributions from the employer to the employee, which thus cancels out the effects of a supposed measure to stimulate consumption/saving taxpayer decisions.

With these terms, Puviani wanted to point out the opacity that could be administered by public decision-makers in the imposition of taxes or in public spending management. These kinds of illusions are the product of a relationship between electors and rulers; therefore they can only be studied considering both sides (Mourao, P., 2007). Jensen and Vestergaard in 1999 define fiscal illusion as a situation where public decisionmakers (namely, the European Union, EU) only incorporate a part of the costs incurred by the constituents (the Member States).

## 6. STATE OF THE ART

Some studies (Wagner in 1976 and Baker in 1983) have analyzed the concept of tax illusion by linking it to the level of complexity of the tax system. Thus, the more complex a system of public revenues is, the more it is possible to experience this phenomenon of tax illusion, because it is difficult for the individual to identify the price of the economic activities and actions expressed in taxes he pays and then he underestimate the final global fiscal burden. Another form of fiscal illusion derives from the income elasticity of the revenue system. Thus, as the public revenue system is characterized by a high level of revenue elasticity, the level of public spending will increase more (Oates in 1975).

“A further form of fiscal illusion is the flypaper effect (Dougan and Kenyon, 1988), which holds that a tendency exists for categorical lump-sum grants to increase public expenditure by more than an equivalent increase in income from other sources” (Mourano, 2007). Another form of fiscal illusion refers to the fact that an increase in a jurisdiction's proportion of renters will increase the level of expenditures (Bergstrom and Goodman, 1973). In addition, we can discuss another form of fiscal illusion, recognized in the specialized literature as debt illusion, that is, financing public programs through loans can lead to an altered image of the cost of public services offered to citizens.

## 7. FISCAL ILLUSION AND THE ELECTORAL CYCLE

In other terms, Downs in 1957 concludes that politicians have no reason to correct the tax illusion, but rather, they want to spend as much as possible to win the election in the future. In fact, observing the level of public expenditures in Romania in previous years, it is easy to accept this principle regarding decisions that only concretize political opportunism and influence the outcome of elections through fiscal-budgetary measures whose impact is not previously determined.

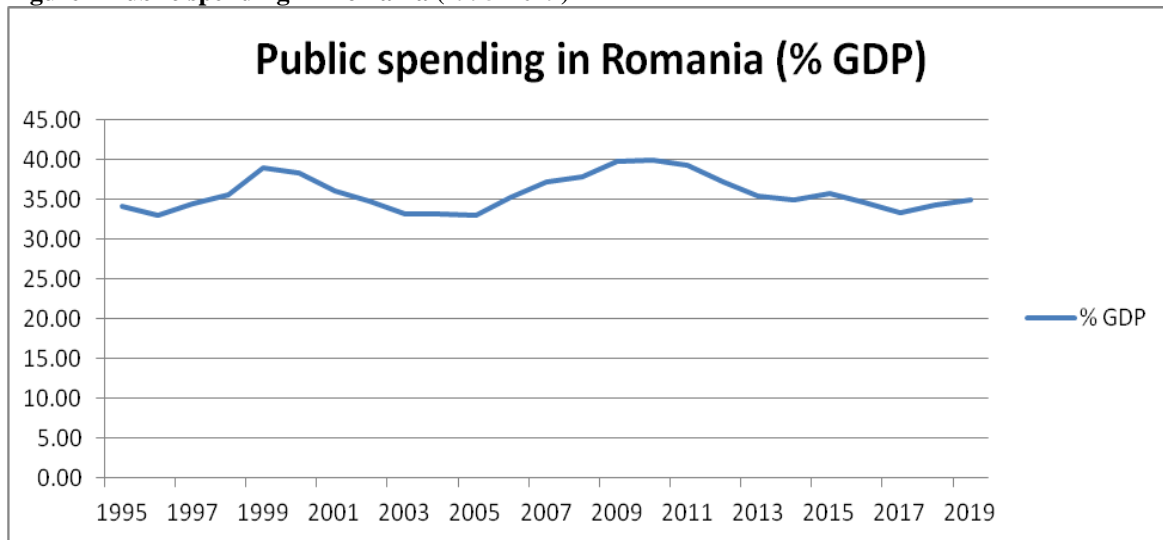
**Table 1 Public spending in Romania (1997-2017)**

Country	Romania	
1997	34.39	
1998	35.58	
1999	39.00	pre-election year
2000	38.34	elections
2001	36.04	
2002	34.81	
2003	33.14	pre-election year
2004	33.25	elections
2005	33.08	
2006	35.21	
2007	37.19	pre-election year
2008	37.77	elections
2009	39.70	elections
2010	39.88	
2011	39.34	pre-election year

2012	37.23	elections
2013	35.38	pre-election year
2014	34.96	elections
2015	35.76	pre-election year
2016	34.62	elections
2017	33.37	

Source: [http://ec.europa.eu/economy\\_finance/ameco/user/serie/ResultSerie.cfm](http://ec.europa.eu/economy_finance/ameco/user/serie/ResultSerie.cfm)

Figure 1 Public spending in Romania (1995-2019)



Source : [http://ec.europa.eu/economy\\_finance/ameco/user/serie/ResultSerie.cfm](http://ec.europa.eu/economy_finance/ameco/user/serie/ResultSerie.cfm)

In addition, Alesina and Perotti (1996) show some practices through which politicians can make public and less transparent budgets, such as incorrect forecasts and macroeconomic estimates generated by fiscal decisions, the use of multi-annual budgeting, and others actions.

## 8. FISCAL ILLUSION INDEX FROM MOURANO'S PERSPECTIVE

Some authors (Mourao, P.R., 2007) have built an index of the value of the fiscal illusion, using data series belonging to a number of 68 democratic countries. The purpose of creating this index was to create the necessary framework for assessing political performance and democratic quality. It is important to note that fiscal illusions can be created by handling both sides of the budget: tax revenue and public spending, with public decision-makers thus minimizing the resistance to the dominant category through various tactics used to manipulate them.

Some economists (Alesina and Perotti, 1996) highlight the fact that politicians tend to use techniques to minimize the level of transparency of public budgets; in fact, these politicians are supported by agencies responsible for producing official statistics and studies on the possible effects of fiscal-budgetary policy changes on public revenues or expenditures. The authors chose 26 variables to make the fiscal illusion index, taking



into account elements related to the literature that defines the analyzed concept and elements related to the materialization of the effects and the factors that ensure the consistency of the country-wide concept. Thus, the variables envisaged belong to the following domains and ensure a clearer picture of the level of the tax illusion.

**Tabel 2: The dimensions of the fiscal illusion index**

	Focused Dimensions
1	Composition of Public Revenues
2	Money creation
3	Public Debt
4	Composition of Public Debt
5	Relevance of certain revenue sources
6	Political strategies of the ruler group
7	Public expenditure manipulation
8	Governmental discourse manipulation and electorate believes
9	Different objectives of governmental agents
10	Immaturity of the democracies
11	Composition if the public capital outlays
12	Government rent-seeking
13	Relevance of trade taxes
14	Interaction between interest groups and political behavior
15	Real public budget
16	Composition of public expenditure
17	Electorate preference on national issues

*Mourão, P., 2007. Towards a Fiscal Illusion Index, MPRA Paper 9760, University Library of Munich, Germany, revised 28 Jul 2008.*

As a result of his research, the author published the index of the fiscal illusion for all the analyzed country's tax, presenting the value for 1960 and 2006, the higher values of the index denoting a higher level of fiscal illusion in the respective countries. As a general observation, the published data show that the value of the index is decreasing for all the analyzed countries, which demonstrates that the maturing of democracies is an important factor in the level of the tax illusion.

**Tabel 3 Fiscal illusion index -selection**

Country	Fiscal Illusion Index 1960	Fiscal Illusion Index 2006
Bulgaria	0.477	0.283
Italia	0.811	0.312
Polonia	0.986	0.767
Romania	0.863	0.646
Rusia	0.999	0.830
USA	0.381	0.219

*Mourão, Paulo, 2007. "Towards a Fiscal Illusion Index," MPRA Paper 9760, University Library of Munich, Germany, revised 28 Jul 2008.*

From the above table (which is an extract from Maurao's research) we can see that in countries such as Romania, Poland and Russia this index is still very high (at the time of the analysis), which shows that in these countries the level of manipulation through

fiscal-budgetary decisions is a higher one, and from our experience, we find that these practices persist over time, generating a series of pressures on the sustainability of public finances.

## **9. THE LINK BETWEEN FISCAL ILLUSION AND FISCAL SOCIOLOGY**

Conceptually, fiscal illusion can be attached to the concept of fiscal sociology. Thus, fiscal sociology, which concretizes the relationship between the state and the citizens by the virtue of the socio-economic relations carried out in the double-sense, in which both parts, the citizens and the state, are in the position of receiving and paying certain amounts, definitive most of the time, may become a land of manifestation of the tax illusion. It is important, however, to observe the one-way sense of tax illusion in relation to the bidirectional sense of fiscal sociology. Thus, only the state can become the initiator of procedures that lead to tax-illusion effects, while fiscal sociology takes into account the overall fiscal relationships of the state-citizen relationship.

Identifying this link between fiscal sociology and tax illusion is a new approach to economic theory, and I think it needs to be carefully analyzed in the future. The nature of taxes set up in a certain tax system, through the traditional features of taxes, creates a situation where citizens who bear them do not know how much they will receive from their relationship with the state or how much they will pay / contribute. Even if the public financial activity is officially undergoing a process of transparency, assuming a real presentation of all revenue-generating and public spending decisions, the tax illusion takes place in certain situations.

## **10. CONCLUSIONS**

The present paper had as its starting point the proposals for amendments to the tax legislation, some put into practice, announced by the representatives of the Romanian political power in recent years. Apart from the fact that many of these proposals did not have an applicable character, which demonstrates some awkwardness in the knowledge of the public decision-maker, many of the measures applied have had a competitive character, either canceling each other or leading to hidden effects in the economy, which led to an amplification of the state of fiscal illusion.

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# **LEADERSHIP AND FISCAL IMBALANCES IN LOCAL GOVERNMENT: THE MEDIATION ANALYSIS OF BUDGET INCREMENTALISM**

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**Abstract:** *Policy, practice, and past research are largely inconclusive on what explains fiscal imbalances in local government. While leadership attributes; political functionality, managerial and technical capacity, and civic participation are often empirically-cited as dominant imbalances predictors, budget incrementalism also features as instrumental to leadership-fiscal imbalances linkages. This study employs situational, managerial, participative, and fiscal imbalances theoretical perspectives to examine budget incrementalism mediation on the leadership-fiscal imbalances relationship in local governments in Uganda, East Africa. Structural equation modeling results reveal that while political functionality and civic participation leadership explain the imbalances, managerial and technical capacity leadership does not. Besides, budget incrementalism mediates the leadership-fiscal imbalances relationship. Findings implications and future research direction bridging leadership-budget incrementalism-fiscal imbalances are discussed.*

**KeyWords:** *Local Government; Leadership; Fiscal Imbalances.*

## **1. INTRODUCTION**

With recent rapid developments in the public fiscal environment in response to global decentralization, fiscal imbalances have received surmountable attention in both research and practice (Dahlby & Wilson, 2003; Jin & Zou, 2002). Empirical findings consistently suggest that imbalances are remarkably rampant in local governments compared to other levels of government. Majority of this research (e.g. Bird & Tarasov, 2004; Sepulveda & Martinez-Vazquez, 2011) examines the local entity fiscal imbalances problem from the central government patronage context. For instance, Sepulveda and Martinez-Vazquez (2011) consider that view rational on grounds that it is the center which is largely responsible for the national fiscal resource distribution and allocation rather than sub-national entities. Specifically, central government formulates the fiscal policy required for resource allocation at the local community level albeit through the local agencies (Arikan, 2004; Sepulveda & Martinez-Vazquez, 2011).

One notable challenge the center often encounters in combating locality fiscal disparities, notwithstanding its vantage point, is that it should only play a very peripheral role in the allocation configuration. For effectiveness reasons, local governments require sufficient autonomy; legally, politically, and most importantly in fiscal-functionality terms, in order to manage the allocation mandate proficiently (Arikan, 2004; Jin & Zou, 2002).

Besides, Lessman and Markwardt (2010) observed that for local units to allocate resources transparently, it is their leadership aptitude that counts and not necessarily central patronage. This is consistent with earlier evidence (Brown & Oates, 1987) which associates fiscal imbalances in local entities with various leadership traits like political functionality, managerial and technical capacity, and civic participation.

Some scholars (e.g. Afonso, Luca & Furceri, 2010; Eyraud & Lusinyan, 2013), are also of the opinion that much as leadership-fiscal imbalances causality relationship subsists, budget incrementalism is a decisive factor in the relationship. Various referred to as supplementary budgeting, additional budgets, or soft fiscal constraints (Dahlby & Wilson, 2003; Eyraud & Lusinyan, 2013; Kornai, Maskin & Roland, 2003), budget incrementalism is said to exacerbate not only local government fiscal imbalances but also those of other sub-national agencies. Regrettably, various localities especially in the resource-constrained Sub-Sahara Africa treat such budgets as a fiscal right. Ideally, supplementaries are only meant to supplement conventional transfers for budget performance purposes (Ministry of Local Government, 2017; Eyraud & Lusinyan, 2013). This research takes an in-depth examination of the leadership-fiscal imbalances relationship in African-based local governments. In particular, budget incrementalism; a factor often ignored by previous studies, is investigated as a probable mediator in the relationship. Local government fiscal activities in Uganda, an East African country applauded for its fiscal federalism system, are used as proxy. Besides, being a behavioral science-public finance inquiry; situational, managerial, participative, and fiscal imbalance theoretical perspectives are adopted to guide the theoretical-hypotheses development direction.

## **2 THEORETICAL FRAMEWORK AND HYPOTHESIS DEVELOPMENT**

### **2.1 Fiscal Imbalances**

The concept of government fiscal imbalances resides in three dimensions closely linked to expenditure (amount and type selection) criteria (Jin & Zou, 2002; Livingstone & Charlton, 2001). Firstly, fiscal imbalances relate to expenditure-benefit relationship of specific government programs. The program, however desirable it is, whose costs exceed its benefits is considered unsustainable (Arikan, 2004; Livingstone & Charlton, 2001). Secondly, imbalances guide expenditure-adjustment policies relevant for recession conditions in the Keynesian economic stabilization model. Arbitrary expenditure fluctuations retard economic growth and may curtail community welfare (Afonso et al., 2010; Bird & Tarasov, 2004; Kornai et al., 2003). Thirdly, and possibly the most ideal imbalances trait (MacKinnon & Reinikka, 2002; Sepulveda & Martinez-Vazquez, 2011), imbalances steer long-term spending. Governments are therefore obligated to seriously appreciate the strategic fabric of their expenditure-revenue generation-debt policy (Sepulveda & Martinez-Vazquez, 2011). As its central thesis and special contribution to published knowledge, this study explores local fiscal imbalances from this long-term expenditure perspective.

MacKinnon and Reinikka (2002) posit that majority government fiscal policies focus on evaluating long-term microeconomic benefits associated with the various

programs. But since conventional imbalances seem to reside in gross expenditure sustainability plans, these fiscal disparities tend to largely affect recurrent spending (Albouy, 2012; Musgrave & Musgrave, 1973). On this basis, practice and empirical studies (e.g. Afonso et al., 2010; Brown & Oates, 1987; Sepulveda & Martinez-Vazquez, 2011) are of the view that governments, whose fiscal policies are in balance and are effective, should maintain them indefinitely. Those with imbalance policies must endeavor to review theirs continuously until required standards are met (Sepulveda & Martinez-Vazquez, 2011).

Fiscal imbalances fall into two notable categories: vertical fiscal imbalances and horizontal fiscal imbalances (Dahlby & Wilson, 2003; Eyraud & Lusinyan, 2013). According to the vertical fiscal imbalances theory (Oates, 1968; Musgrave & Musgrave, 1973; Tiebout, 1956), these imbalances are closely linked to the extent sub-national expenditure is financed by local revenue and self-incurred debt. At local government level, vertical discrepancies often ignite budget incrementalism (Eyraud & Lusinyan, 2013). Incrementalism is notable for creating distorted fiscal performance incentives which eventually compels central government to increase grant transfer amounts. Recurrence of scaled-up fiscal releases leads to fiscal over-reliance, misappropriations, over-spending and tax collection laxity in susceptible localities (Dahlby & Wilson, 2003; Sepulveda & Martinez-Vazquez, 2011). Additionally, budget incrementalism that arises from vertical imbalances compromises LG budget-donor support perceptions. In the Sub-Saharan Africa, where several LGs rely heavily on donor aid, such imbalances do not only restrain aid flow, but escalate debt and its cost (Arikan, 2004; Kornai et al., 2003; Onyango-Delewa, 2016b).

In sum, vertical fiscal imbalances constitute a structural concern requiring an equally complex approach to measure and correct it. In practice, jurisdictions of most local entities lack the required both the measurement and corrective capacity (Albouy, 2012; Dahlby & Wilson, 2003).

Horizontal fiscal imbalances are imbalances that are common with various but similar levels of government, say, local governments (Dahlby & Wilson, 2003; Kornai et al., 2003). Sometimes referred to as regional disparity, horizontal imbalances arise from divergences in resource endowment and variations in local revenue raising capacity. Kornai et al. (2003) also associate these divergences with entity net-fiscal-benefit variations related to taxation. Thus, to measure and correct such imbalances effectively, the magnitude of inter-LG net-fiscal-benefits divergences must be considered (Albouy, 2012; Kornai et al. (2003). From a public policy perspective, restraining horizontal imbalances is often a diminutive effort given the imbalances endowment foundation. Thus, most jurisdictions resort to equalization grants financing as a mitigation alternative (Lessman & Markwardt, 2010). In Sub-Saharan Africa; Ghana, Kenya, Nigeria, Senegal, South Africa and Uganda, peg their regional development equilibrium agenda on maximizing equalization payments.

Respective parliaments execute grant allocations to local entities in consideration of: population size, geographical location, development level, past resource-utilization track record, budget performance, and accountability record (Livingstone & Charlton, 2001; MacKinnon & Reinikka, 2002). For instance, in Uganda, districts such as Buyende,

Iganga, Kabale, Kampala, Mpigi, and Wakiso are heavily populated relative to Kaabong, Kodito, Nakapiripirit, and Moroto in its Karamoja sub-region. Thus, resources are allocated not only on the basis of entity population and level of development, but past budget performance and accountability record, and notably fiscal imbalances status (MacKinnon & Reinikka, 2002; MoLG, 2017; Onyango-Delewa, 2016a).

## **2.2 Leadership and Budget Incrementalism**

Leadership literature (Chen, Kirkman, Kanfer, Allen & Rosen, 2007; Jung, Bass & Sosik, 1995; Yammarino, 2013) consistently recognizes the important role leaders play in organizational survival and performance. The influence of leadership in local government fiscal imbalances management is thus no exception (Afonso et al., 2010; Brown & Oates, 1987; Oates, 1968). According to Afonso et al. (2010), local entity leaders require appropriate empowerment in order to motivate peers, subordinate workers, and community representatives. Empowered leaders do not only augment their own roles but also ably take on risky assignments (Chen et al., 2007; Yammarino, 2013). Moreover, empowerment makes locality leadership fiscally-accountable. Accountability is a function of behavioral characteristics like power sharing, delegating, and attaching great importance to performance (Afonso et al., 2010; Albouy, 2012).

Empowered leadership promotes decision-making participation and autonomy from entity bureaucracy. In most localities, leaders responsible for making fiscal resource allocations and imbalances decisions include: administrators, heads of department, central government representatives, and community representatives (Afonso et al., 2010; Livingstone & Charlton, 2001).

In Uganda, prominent local government administrators are the resident district commissioner (RDC) and local council 5 (LC5) chairperson (political functionality); chief administrative officer (CAO) and heads of department (managerial and technical capacity); and community representatives (civic participation) (MoLG, 2017; Onyango-Delewa, 2016a b). The RDC is a presidential-appointee tasked to oversee administrative activities and ensure budget compliance (Livingstone & Charlton, 2001).

Local Council 5 chairpersons are the people-elected representatives at the district level to help advance their development and service delivery concerns (MacKinnon & Reinikka, 2002). Both leaders play a political leadership role consistent with situational leadership theory (Bowers & Seashore, 1966; Coch & French, 1948) which posits that good political leadership must easily adapt to varying situations, take instant control, and influence their constituents. Quite often, the RDC-LC5 mandate is interpreted as politically-supervisory to that of the chief executive (CAO). This conception usually generates operational tensions in the CAO-LC5-RDC triangulation. Livingstone and Charlton (2001) associate some budgetary and fiscal performance dysfunctions and related budget incrementalism to this leadership mishap. Situational theory recommends flexibility and resilience as panacea to conventional leadership complications (Bowers & Seashore, 1966; Coch & French, 1948). From the foregoing leadership-imbalances analysis, the following can therefore be proposed:

*Hypothesis 1: Political functionality leadership is positively related to fiscal imbalances.*

The chief administrative officer is the principal executive officer at district level in Uganda. The district constitutes the main LG administrative unit in the country's fiscal decentralization structure (MoLG, 2017). Managerial leadership theory (Tannenbaum & Allport, 1956; Tannenbaum & Schmitt, 1958), recommends application of appropriate technical and managerial skills to run and account for available fiscal and other resources. Besides, the managerial theoretical perspective requires managerial leaders to take concern for workers and their input based on a reward-punishment basis (Tannenbaum & Schmitt, 1958; Uhl-Bien, 2006). In public jurisdictions, the reward-punishment approach has been commended for resource allocation efficiency and mitigation of leadership-related fiscal imbalances and budget incrementalism (Dansereau, Alutto & Yammarino, 1984).

A noteworthy challenge faced by most Sub-Saharan Africa local governments in managing fiscal resources is lack of technical know-how (Arikan, 2004; Sepulveda & Martinez-Vazquez, 2011). Manpower deficiency is exacerbated by the reality that the few available are often sourced based on tribalism, nepotism, and partisan politics. This makes it quite difficult for authorities to execute disciplinary measures to curb corruption and resource misappropriation instances (Obwona, Steffensen, Trollegaard, Mwanga, Luwangwa, Twodo, Ojoo & Seguya, 2000). Thus, Uganda's chief administrative officers often adopt a technical team approach to achieve the required level of efficiency. The team comprises the chief finance officer, planning officer, procurement officer, and other heads of department. In entities with competent and autonomous management, such as Bushenyi, Mbale and Mukono few cases of fiscal imbalances and budgetary performance dysfunction flourish (MacKinnon & Reinikka, 2002; MoLG, 2017). Thus from a managerial-technical capacity leadership standpoint, it is postulated that:

*Hypothesis 2: Managerialism-technical leadership is positively related to fiscal imbalances.*

The essence of decentralization is to enable central government bestow some of its powers to sub-national entities (Arikan, 2004; Bird & Tarasov, 2004; Lessmann & Markwardt, 2010). Common entities include regions, provinces, states, and local governments depending on the political jurisdictional framework. Broadly, decentralization falls into two major dimensions: political-administrative decentralization to promote sub-national elections, and fiscal decentralization to nurture sub-national revenue resource accessibility and management (Arikan, 2004; Lessmann & Markwardt, 2010).

In the developing world, particularly the African region, decentralization in whatever form, is faced with multiple challenges. Dominant ones include resource scarcity, corruption, inadequate skills, and leadership incapacity. Such constraints are largely responsible for rampant fiscal imbalances which often compromise service delivery to the local community. Thus, some scholars (e.g. Obwona et al., 2000; Sepulveda & Martinez-Vazquez, 2011) and public policy recommend community representation and inclusive participatory planning and budgeting as a remedy to this complex fiscal configuration.



In Uganda, the core community representatives at district level are the local councilors drawn from sub-counties. These civic leaders participate in planning and budgetary activities essentially to underscore areas of relevant development concerns and ensure effective and transparent budget implementation (MacKinnon & Reinikka, 2002; Obwona et al., 2000). Civic leadership involvement in local budgetary and planning endeavors adapts to the participatory leadership theoretical proposition (Coch & French, 1948; French, Israel & As, 1960; Tannenbaum & Alport, 1956; Tannenbaum & Schmitt, 1958). This theory requires organizational leadership to always take other people's input into account. Moreover, leadership participation and group member contributions should enhance member relevance and commitment. This augments decision-making (Coch & French, 1948; Tannenbaum & Alport, 1956).

Some districts in the country like Bushenyi, Kampala, and Mbale boast of scanty instances of fiscal imbalances and budget incrementalism due to dynamic budget civic participation and the confidence the center attaches to their operations (MoLG, 2017). To examine the notion of locality civic participation more effectively, it is proposed as follows:

*Hypothesis 3: Civic participation is positively related to fiscal imbalances.*

Finally, a number of scholars (e.g. Albouy, 2012; Jin & Zou, 2002; Kornai et al., 2003) argue that budget incrementalism is the most incredible force in the entity leadership-fiscal imbalances formation. Weak leadership structures, typical of resource-strained entities in developing world jurisdictions, spark-off budget incrementalism which in turn ignites fiscal imbalances (Albouy, 2012; Jin & Zou, 2002).

If, for instance, local administrators and civic leaders ensured budget ceiling-bound expenditure, fiscal bail-outs (budget incrementalism) could be avoided (Jin & Zou, 2002; Kornai et al., 2003; Obwona et al., 2000). Moreover, Kornai et al. (2003) advice that local governments should often reinforce internal tax capacity in order to enhance local revenue. A strong local revenue base; commonly linked to focused leadership, not only relieves the center of burdensome grants, but raises their trust in their fiscal fabric. Such policy action can tremendously restrain vertical fiscal imbalances (Kornai et al., 2003; Obwona et al., 2000).

Previous studies (e.g. Brown & Oates, 1987; Oates, 1968; Musgrave & Musgrave, 1973) also provide evidence that adherence to budgetary law and regulation (budgetary institutionalization) can significantly stimulate fiscal discipline. Fiscally-disciplined entities tend to circumvent budget incrementalism practices and the resultant fiscal imbalances effects (Brown & Oates, 1987). Entities susceptible to fiscal imbalances (vertical or horizontal), are common victims of supplementary budgeting. For instance, districts such as Amolatar, Budaka, Kaabong, Kasese, Koboko, Mayuge, and Yumbe in Uganda frequently request for supplementary budgets due to their horizontal fiscal imbalances make-up. Majority entities believe they are fiscally-disadvantaged and therefore must be entitled to the soft budget (MacKinnon & Reinikka, 2002).

Public finance policy has long regarded local entity supplementary budgets a constraint to national fiscal structure and a habit that should not be tolerated. Central government should therefore endeavor to work closely with local entity leadership to minimize budget incrementalism practices and fiscal imbalances incidences (Oates, 1968;

Spulveda & Martinez-Vazquez, 2011). The foregoing empirical deliberation suggests that in local government, budget incrementalism links leadership to fiscal imbalances. Much as previous research may have paid relatively little attention to this proposition, the following hypothesis is posited:

*Hypothesis 4: Budget incrementalism mediates the leadership-fiscal imbalances relationship.*

### **3 METHODS**

#### **3.1 Sample**

Data were collected from randomly and purposively selected (Kenny, 2008; ShROUT & Bolger, 2002) 21 districts and 4 municipalities in north-western and eastern regions of Uganda. The regions host localities susceptible to supplementary budgeting and fiscal imbalances (MacKinnon & Reinnika, 2002; MoLG, 2017). A total of 280 structured surveys were distributed to various administrators and heads of department while civic leaders were interviewed. The survey contained statement items in regard to study variables and constructs built on a 5-point Likert scale. The scale was anchored on a “Strongly Disagree-Strongly Agree” configuration (Barret, 2007; ShROUT & Bolger, 2002). The response rate from the unit of analysis; a district, perspective was 100 percent given that at least a questionnaire was received from each entity. A total of 267 questionnaires were returned; denoting an 87% unit of inquiry response rate. However, only 255 of them were adopted for hypothesis testing due to missing data and response inconsistency concerns (Kenny, 2008; Nevitt & Hancock, 2001).

The study reveals that 58% of the participants are male and in the 31-40 year age bracket. Most of them (64%) are married, educated to the level of Bachelor’s degree (43%), and have served in their respective positions for at most five years. Consistent with previous studies (Mackinnon & Reinikka, 2002; Obwona et al., 2000), these findings suggest that budgetary and fiscal activities in Uganda’s local governments are run by a fairly young and quite inexperienced male workforce. Besides, it is a workforce whose managerial and technical capacity is largely feeble (Livingstone & Charlton, 2001; Onyango-Delewa, 2016b).

### **4 MEASURES**

#### **4.1 Fiscal Imbalances**

The variable fiscal imbalances were operationalized by vertical fiscal imbalances and horizontal fiscal imbalances (Bird & Tarasov, 2004). Vertical fiscal imbalances were assessed by scales adapted and modified from Sepulveda and Martinez-Vazquez (2011) ( $\alpha = 0.879$ ). Sample statements: “This entity receives adequate central government grants relative to local revenue collections.”; “The grants are remitted promptly.” Horizontal fiscal imbalances were measured by modified versions of scales employed by Kornai et al. (2003) ( $\alpha = 0.902$ ). Sample statement: “...LG generates same local revenue like others in the region.”

## **4.2 Leadership**

Notable leadership indicators include: political functionality, managerial and technical capacity, and civic participation (Jung et al., 1995; Yammarino, 2003). Political functionality was measured by means of a customized scales in Jung et al. (1995) ( $\alpha = 0.798$ ). Sample statements: “Political leaders interfere with the LG fiscal operations.”; “Development programs have succeeded because of political oversight.” We assessed managerial and technical capacity using guidelines in the work of Chen et al. (2007), and Yammarino (2003) ( $\alpha = 0.913$ ).

Sample statements: “...LG lacks the right managerial and technical capacity to run mandated fiscal resources.”; “Sourcing manpower is done transparently with no regard to tribe or political affiliation.” In order to evaluate civic participation attribute, scales in Uhl-Bien (2006) ( $\alpha = 0.861$ ) were adopted and tailored. Sample statement: “Civic leaders have the capacity to understand and technically participate in fiscal management.”

## **4.3 Budget Incrementalism**

Budget incrementalism is the study’s purported mediating variable between leadership and fiscal imbalances in local government. It was assessed by means of modified scales in Dahlby and Wilson (2003) and Lessman and Markwardt (2010). The content items exhibited ( $\alpha = 0.917$ ). Related sample statements: “...LG requests for supplementary budgets from central government.”; “In the LG, supplementary budgets are considered a fiscal right.”; “Supplementary budgets do not in any way affect the LG-center fiscal relations.”

## **5 CONTROL VARIABLES**

Four participant demographic variables: gender, education, position, and tenure were included in the study model as control variables. Previous studies (Albouy, 2012; Eyraud & Lisinyan, 2013) suggest that such biographical factors are related to and tend to influence fiscal imbalances decisions in local entities. Thus, in order to control for their influence, gender was assessed dichotomously (0 = Female, N = 108; 1 = Male, N = 147). Educational status was coded as (1 = Secondary Level, N = 37; 2 = Diploma, N = 94; 3 = First Degree, N = 85; 4 = Other Qualifications, N = 39). Job position was coded by (1 = RDC, N = 28; 2 = CAO, N = 28; 3 = LC5 Chairpersons, N = 28; 4 = Heads of Department, N = 39; 5 = Councilors, N = 42). Tenure in respect to the entity and serving under current supervisor were noted in years within a range of (up to 2 – 11 plus) years. Additionally, we also adopted and controlled for one latent factor to enhance statistical analysis required for Harman’s One Factor validity testing. Simulation research (e.g. Nevitt & Hancock, 2001; Preacher & Hayes, 2008) recommends that such a factor must be controlled to suppress its potential hypothesis testing and outcome negative effects.

## **6 ANALYTICAL STRATEGY**

Structural equation modeling (SEM) (AMOS v.20) (Barrett, 2007; Preacher & Hayes, 2008) was used to test the study hypotheses. According to Barrett (2007), SEM

provides a reliable evaluation of composite-variable systems in hypothesized models. Such evaluation is capable of effectively revealing the model data's compliance level.

The study data were tested through a dual step analytical strategy, recommended for achieving model evaluation effectiveness (Barrett, 2007; Nevitt & Hancock, 2001). In Step One, a measurement model with no control variables in it was tested using confirmatory factor analysis (Nevitt & Hancock, 2001; Preacher & Hayes, 2008). Its output; whose contents should only have higher-order-term latent construct items, facilitated the construction of a structural model required for hypothesis testing in Step Two (Nevitt & Hancock, 2001).

Step Two constitutes the desired structural model in which both direct and mediation effect estimation is exhibited. Kenny (2008) and Shrout and Bolger (2002) suggest that in situations where only one item is displayed for each control variable latent construct error variances, the variances should be fixed to zero. Thus, all the study control variable latent constructs and their model paths were loaded on both the mediating variable (budget incrementalism) and the dependent variable (fiscal imbalances) as suggested by simulation research (Nevitt & Hancock, 2001; Preacher & Hayes, 2008).

## **7 RESULTS**

### **7.1 Descriptive Statistics**

Means, standard deviations, variable inter-correlations, and reliability coefficients computed with (SPSS V.19) are presented in Table 1. It can be observed that budget incrementalism is associated with the political function ( $r = -.203$ ,  $p < 0.01$ ) and to managerial and technical capacity ( $r = .314$ ,  $p < 0.05$ ). It relates with civic participation to the extent of ( $r = .163$ ,  $p < 0.05$ ) but to the entire LG leadership ( $r = .235$ ,  $p < 0.01$ ). Leadership as whole associates with vertical fiscal imbalances and horizontal fiscal imbalances to magnitudes ( $r = -.228$ ,  $p < 0.05$ ) and ( $r = .296$ ,  $p < 0.01$ ) respectively. In entirety, leadership associates with the entire fiscal imbalances structure is ( $r = .173$ ,  $p < 0.05$ ). Finally, fiscal imbalances as a whole also relate with budget incrementalism to ( $r = .216$ , ns). These results suggest close inter-variable and construct relationships.

Item	M	SD	1	2	3	4	5	6	7	8
1. PF	3.03	1.905	(.798)							
2. MTC	2.96	2.030	-.301	(.913)						
3. CP	3.08	2.051	-.222	.359	(.861)					
4. LP	8.96	2.935	.456**	.503**	.559**	(.839)				
5. BI	3.07	2.011	-.203**	.314*	.163*	.235**	(.917)			
6. VFI	3.22	1.874	.369	.426*	-.522	-.228*	-.427	(.879)		
7. HFI	3.15	2.118	-.204*	.139	.362**	.296**	-.305	.224	(.902)	

8. FI	5.78	2.074	-.331	.446*	.249	.173*	.216	.544**	.589**	(.815)
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Table 1. Means, Standard Deviations, Inter-Variable Correlations, and Reliabilities

Notes: M=Mean; SD=Standard Deviation; \*p < 0.05; \*\*p < 0.01 (two-tailed); N=255; Reliabilities in parenthesis; Main variables in bold; PF=Political Functionality; MTC=Managerial -Technical Capacity; CP=Civic Participation; LP= Leadership; BI=Budget Incrementalism; VFI=Vertical Fiscal Imbalances; HFI=Horizontal Fiscal Imbalances; FI=Fiscal Imbalances.

## 8 HYPOTHESIS TESTING

Before testing the study structural model, the two step strategy measurement model was first appraised for possible infiltration of common methods variance (CMV). Thus, confirmatory factor analysis was executed to evaluate both CMV and also establish the status of construct and discriminate validity of the 5-point scale employed (Barrett, 2007; Preacher & Hayes, 2008). Common methods variance was tested using a five-factor model comprising constructs: political functionality, managerial and technical capacity, civic participation, vertical fiscal imbalances, and horizontal fiscal imbalances. Its output was then compared with the contents of the single latent factor theoretically-generated (Harman's One Factor) model for validity assessment (Nevitt & Hancock, 2001; Preacher & Hayes, 2008).

Harman's One Factor model goodness-of-fit indices must be poor relative to those of the five-factor model to signify absence of a common methods variance threat to the research data (Shrout & Bolger, 2002). The five factor model goodness-of-fit indices ( $\chi^2 = 9.823$ ;  $df = 12$ ;  $\chi^2/df = 0.819$ ; IFI = 0.976; TLI = 0.989; CFI = 0.975; RMSEA = 0.041) compared better to those of Harman's model ( $\chi^2 = 11.514$ ;  $df = 18$ ;  $\chi^2/df = 0.640$ ; IFI = 0.852; TLI = 0.917; CFI = 0.893; RMSEA = 0.172). The results suggested no variance risk to the dataset (Kenny, 2008; Shrout & Bolger, 2002).

Moreover, confirmatory analysis output exhibited quite large and statistically-significant factor loadings. Equally, internal-consistence (reliability) alpha coefficients for most constructs ( $> 0.52$ ;  $p < 0.01$ ;  $\alpha \geq 0.700$ ) were also big. Barrett (2007) and Kenny (2008) associate such results with strong inter-construct items and thus an assurance for both construct and discriminate validity. Besides, absence of the variance hazard and validity confirmation, provide a good foundation for hypothesis testing upon whose findings can be relied (Kenny, 2008; Preacher & Hayes, 2008).

As indicated earlier, structural equation modeling (SEM) (Barrett, 2007) was used to test the proposed hypotheses direct and indirect (mediation) effects based on the structural model. In compliance with previous simulation studies advice on generating credible output (e.g. Nevitt & Hancock, 2001), data were further subjected to multicollinearity verification before carrying out a full SEM hypothesis testing. All items tolerance values (TVs) and variance inflation factors (VIFs); conventional multicollinearity measurements, met the ( $< 1.00$ ;  $< 10.0$  respectively) (Table 2) condition required to show absence of multicollinearity threat to the data (Kenny, 2008). Besides, the structural model whose goodness-of-fit indices were quite ideal; ( $\chi^2=0.928$ ;  $df=5$ ;  $p=0.731$ ;  $\chi^2/df=0.186$ ; NFI=0.981; IFI=0.963; TLI=0.955; CFI=0.972; RMSEA=0.027), was used in testing both direct and indirect effects (Table 2).

**Table 2. Multiple Regression Coefficients and Structural Equation Modeling**

HYP	Model	Unstandard Coefficients		Standardized Coefficients		CR (t-value)	Sig.	Collinearity Statistics		95% CI	
		$\beta$	SE	$\beta$				TV	VIF		
SEM	Constant	5.297	.394	-		13.458	0	-	-		
	Pf	-.032	.073	.030		-.438	*	.999	1.001		
	Mtc	.147	.068	.145		2.144	*	.999	1.001		
	Cp	.045	.070	.044		.649	*	.998	1.002		
	R <sup>2</sup>				.752			*			
	Adj.R <sup>2</sup>				.629			*			
	<i>Direct Effects</i>										
H1:	FI ← Pf			.950		3.529	**				
H2:	FI ← Mtc			-		-1.788	*				
H3:	FI ← Cp			.389		2.213	**				
	<i>Indirect Effect</i>			.638							
	LD ←										
	BI ←										
H4:	FI			.441		1.593	*			[-.112; -.012]	
	FI			.130		.728	*				

Notes: HYP=Hypothesis; CR=Critical Ratio; TV=Tolerance Value; VIF=Variance Inflation Factor; CI=Confidence Interval; Pf=Political Functionality; Mtc= Management and Technical Capacity; Cp=Civic Participation; FI=Fiscal Imbalances; LD=Leadership; BI=Budget Incrementalism; \*p < 0.05; \*\*p < 0.01. Hypotheses Status: H<sub>1</sub> (Supported); H<sub>2</sub> (Not Supported); H<sub>3</sub> (Supported); H<sub>4</sub> (Supported); LD, BI, and FI are the study variables.

**8.1 Direct Effect Tests**

Direct effect results indicate a positive and significant relationship between political functionality and fiscal imbalances ( $\beta=.950$ ,  $p < 0.01$ ). Thus Hypothesis 1 is supported. In Hypothesis 2, it had been proposed that management and technical capacity relates positively and significantly with fiscal imbalances. The data could not support that hypothesis ( $\beta= -.389$ ,  $p < 0.05$ ). However, data support Hypothesis 3 which stated that in local government, civic participation (Cp) has a positive and significant relationship with fiscal imbalances ( $\beta=.639$ ,  $p < 0.01$ ). These findings are further substantiated by the significant regression output ( $R^2 =.752$ ; Adjusted  $R^2 =.629$ ,  $p < 0.05$ ).

**8.2 Indirect (Mediation) Effect Test**

Hypothesis 4 stated that budget incrementalism has a mediating influence on the leadership-fiscal imbalances relationship. In order to explain this paradoxical influence, empirical support (Kenny, 2008; Nevitt & Hancock, 2001; Preacher & Hayes, 2008; Shrout & Bolger, 2002) was invoked. Kenny (2008) suggests mediation if independent-mediating variable and the mediating-dependent variable relationships are statistically significant. Mediation is still assumed no matter whether independent-dependent variable relationship is direct or not (Shrout & Bolger, 2002). The results ( $\beta=.441$ ;  $\beta=.130$ ,  $p < 0.05$ ) suggest data support Hypothesis 4.

Moreover, based on the SEM bootstrapping mediation methodology (Nevitt & Hancock, 2001; Preacher & Hayes, 2008), the system (AMOS) invokes the *boot* bundle in [R] to fully-explore the hypothesized mediation model. The idea is to generate a set of confidence intervals (CIs) necessary for assessing the required mediation status (Preacher & Hayes, 2008). A total of 2500 bootstrap samples were engaged in order to test the mediation effect. An (0.10) effect size and 95% bias-corrected CIs [-.112; -.012] were generated.

These results also exhibited a statistically significant relationship in that no zero value arose within the CIs [-.112; -.012] values. Thus, the bootstrap results further authenticate data support to Hypothesis 4 (Nevitt & Hancock, 2001; Preacher & Hayes, 2008). From a statistical analysis context, a notable finding from this study is that: leadership in local government has some causality influence on fiscal imbalances. That influence is, however, tenable only when budget incrementalism activities mediate the relationship.

## **9. DISCUSSION**

While some of the findings from this study reinforce previous empirical evidence, others are quite novel. Hypothesis 1 stated that political functionality leadership relates positively with fiscal imbalances. The hypothesis was affirmed by data. These results corroborate previous evidence (Albouy, 2012; Dansereau et al., 1984; Jin & Zou, 2002) that acknowledges political influence on local entity fiscal activities. Albouy (2012) recommends for political patronage to spur accountability and transparency necessary for ironing out horizontal fiscal imbalances. Hypothesis 2 suggested that managerial and technical leadership has a positive association with fiscal imbalances.

Contrary to managerial leadership theory and conventional western-based empirical findings (Walumbwa, Avolio, Gardner, Wersing & Peterson, 2008), the hypothesis did not secure data support. In Sub-Saharan Africa and Uganda in particular, weak budgetary institutionalization, tribalism, and nepotism augment fiscal imbalances despite managerial and technical proficiency. Finance and planning functions manpower is sourced locally largely on the know-who basis and with little consideration for technical competence

Hypothesis 3 indicated that in local entities, civic participation relates positively with fiscal imbalances. It was confirmed by data reinforcing past research (Uhl-Bien, 2006) that posits that especially in resource-strained African-based localities, participatory planning and budgeting involving community representatives is instrumental in ironing out fiscal imbalances. However, participants must be skilled (Uhl-Bien, 2006; Walumbwa & Lawler, 2003).

It was postulated in Hypothesis 4 that budget incrementalism mediates the leadership-fiscal imbalances relationship. With data support, it implies that if leadership has to wield any influence on fiscal imbalances, then budget incrementalism is foreseeable. The finding concurs with the positing in recent studies (Kornai et al., 2003; Sepulveda & Martinez-Vazquez, 2011) that fiscal imbalances expose local agencies to budgetary incrementalism. Budget incrementalism is often exacerbated by weak

leadership exercised in equally weak budgetary regulation settings (Albouy, 2012; Sepulveda & Martinez-Vazquez, 2011). In Uganda, incrementalism practices thrive due to weak budgetary regulation compromised by partisan politics. This renders fiscal imbalances mitigation efforts fruitless (Obwona et al., 2000).

## **10. IMPLICATIONS FOR THEORY AND PRACTICE**

Several important theoretical and practical implications emerge from this research. First, its findings corroborate situational-political functionality-civic participation leadership theoretical views (Coch & French, 1948; Tannenbaum & Allport, 1956; Yammarino, 2013). Local governments require active, respectful and participatory leadership in order to combat the leadership-budget incrementalism-fiscal imbalances complexities effectively. However, in contrast to managerial leadership theory that associates managerialism with suppressed fiscal imbalances (Tiebout, 1956; Musgrave & Musgrave, 1973), the findings suggest a very mild managerial and technical competence-fiscal imbalances connection. This outcome may be possible in Africa-based entities which benefit from weak regulation, partisan politics, tribalism, and nepotism (Bird & Tarasov, 2004; Mackinnon & Reinikka, 2002).

From practice standpoint, the study findings are in tandem with past empirical perspective (Kornai et al., 2003; Sepulveda & Martinez-Vazquez, 2011) that mitigating local fiscal imbalances requires serious central government attention. Majority budgetary institutions authorize central government to hold the largest portion of national fiscal resources; arguably, for effective policy execution. These excess resource balances often breed centre-locality vertical fiscal disparities (Dahlby & Wilson, 2003; Lessmann & Markwardt, 2010; MoLG, 2017).

Fiscal federalism policy also compels central government to extend similar spending mandate to local governments. When executed, the mandate often breeds vertical fiscal imbalances at the local level (Arikan, 2004; Sepulveda & Martinez-Vazquez, 2011). Thus, since the center is partially responsible for local imbalances, it may set fiscal regulations tailored to the entities revenue-spending realities. Such regulations should be easy to implement and enforce.

The implication for practice in respect to locality leadership varies from one leadership attribute to another. Consistent with previous research (Jin & Zou, 2002), the current study reports that political functionality is indeed vital for addressing fiscal imbalances. However, when political intervention is divisive and excessive, it may instead yield negative repercussions to planning and budgeting (Walumbwa et al., 2008).

Managerial and technical leadership is has for long been considered a panacea to deep-rooted fiscal discrepancies in public institutions (Brown & Oates, 1987; Eyraud & Lusinyan, 2013; Tiebout, 1956). Even in apparently weak resource-constrained and nepotism-driven African local entities, technical capacity can be fruitfully exploited. Much as the current study found a mild managerial and technical leadership-fiscal imbalances association, practice still benefits. For instance, African-based entities should opt for sourcing finance personnel from the center to avoid tribal, sectarian and partisan politics interference. This enhances easy staff transfer and development flexibility crucial



for accountability and transparency in managing fiscal imbalances (Dahlby & Wilson, 2003; Jin & Zou, 2002).

Civic participation ensures communities accessibility to public goods and services often prescribed in the fiscal federalism framework (Bird & Tarasov, 2004). This research advocates for fiscally-sensitized and experienced civic representatives in order to secure quality service delivery. Moreover, it has been found that in local government, budget incrementalism mediates the relationship between leadership-fiscal imbalances. It is therefore suggested that there is need for practitioners to address incrementalism meaningfully. Measures such as adequate grant allocations, monitoring resource application, and instituting effective regulatory mechanisms (Afonso et al., 2010; Dahlby & Wilson, 2003; Obwona et al., 2000) may be helpful.

## **11. LIMITATIONS AND FUTURE RESEARCH DIRECTION**

Much as this research provides a number of new perspectives for local governments on their leadership-budget incrementalism-fiscal imbalances equation, it is not without limitations. First, the study employed a cross-sectional research design. This one-point-in-time data collection approach limits the confirmation of results-causality that may lead to wrong conclusions and impair future policy decisions (Kenny, 2008; Shrout & Bolger, 2002). Random sampling-based experimental or time-lagged longitudinal inquiries are recommended for addressing inter-variable causality effectively (Shrout & Bolger, 2002).

Second, being a simulation investigation, its models may have been over-simplified. Interpretation of such models tends to overlook intended inter-variable relationships because they oscillate around model conditions and properties (Barrett, 2007; Preacher & Hayes, 2008). Future studies can avoid over-simplification by adopting models with new appropriate variables for better theoretical composition and enhanced methodological stance (Barrett, 2007).

Data were sourced from various entity units; administrators, managers, and civic leaders, in order to avoid possible self-rated bias. But since the variables were measured through a survey, data were potentially exposed to common methods variance risk. Future studies can employ other data collection methods such as face-to-face interviews or use panel data to generate better comparable results (Shrout & Bolger, 2002).

## **12. CONCLUSION**

The concern about leadership and fiscal imbalances in local government especially in Africa dominates recent empirical and policy debate. As imbalances perpetually gain ground, there is need for their in-depth and meticulous investigation. In order to overcome past research fractious explanations to fiscal imbalances, this research invoked three outstanding leadership attributes; political functionality, managerial and technical capacity, and civic participation. It stimulates further analysis of fiscal imbalances and its antecedents by demonstrating that budget incrementalism mediates the leadership-fiscal imbalances relationship.

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## **EFFECT OF PETROLEUM PROFIT TAX AND COMPANIES INCOME TAX ON ECONOMIC GROWTH IN NIGERIA**

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**Abstract:** *Sustainability of economic growth and development which remains the true essence of governance is threatened in Nigeria due to insufficient fund caused by declining petroleum revenue upon which the country relies for development. This over reliance had placed the country in a position as at now in which the entire petroleum revenue is used for recurrent items by the government. It is against these setbacks that this study is design to evaluate the effect of petroleum profit tax and company income tax on Nigerian economy growth. Fully Modified Least Square (FMOLS) Regression Technique was used to estimate the model over a 34 years period (1981-2014) while Augmented Dickey Fuller Unit Root Test and Single Equation Co-integration Test were carried out. It was found that petroleum profit tax (PPT) and company income tax (CIT) have positive significant impact on gross domestic product (GDP) in Nigeria with the Adjusted R<sup>2</sup> of 87.6% which directly enhanced growth in Nigeria. The study then concluded that PPT and CIT serves as the major source of revenue to the Nigeria economy, and contribute to the growth of Nigeria economy. Based on these findings, the Study recommends that government should transparently and judiciously account for the revenue it generates through petroleum profit tax by investing in the provision of infrastructural facilities, FIRS should properly monitor the activities of companies to achieve optimum collection of taxes payable to the government as CIT. Revenue accrue to government through PPT and CIT should be judiciously used to develop the economy.*

**Keywords:** *Company Income Tax, Petroleum Profit Tax, Taxation*

### **1. BACKGROUND TO THE STUDY**

Provision of basic infrastructure is quite necessary for the growth and development of any economy. This perhaps explains why the government shows great concern for sources through which funds can be made available to achieve their set goals for the society (Fagbemi & Noah, 2010). Government needs money to be able to execute its social obligations to the public and these social obligations include but not limited to the provision of infrastructure and social services. Meeting the needs of the society calls for huge funds which an individual or society cannot contribute alone and one medium through which fund is derived is through taxation (Murkur 2001).

Tax is therefore a major source of government revenue all over the world. It is an opportunity for government to collect revenue needed in discharging its pressing

obligations. It has a bearing on the Gross Domestic Product (GDP) which is the standard indicator for measuring the economic wellbeing of a nation (Okafor, 2012). Sanni (2007), advocate the use of tax as an instrument of social engineering, to stimulate general and/or sectoral economic growth. A tax system offers itself as one of the most effective means of mobilizing a nation's internal resources and tends itself toward creating an environment conducive to the promotion of economic growth (Azubike, 2009).

According to Emmanuel (2010), many developed and developing economies around the world had experimented and proven that no nation can truly develop without developing its tax system. Consequently, many countries have embarked on tax reforms and restructuring with a view to developing a tax system that maximizes government revenue without creating disincentiveness for investment. Basically, there are two ways of financing government expenditure in Nigeria; which are oil revenue and non-oil revenue sources, the Nigerian government derives a large proportion of its total revenue from oil (Bawa & Mohammed, 2007). According to Ogbonna and Ebimobowei (2012), from 1970 – 2009, the petroleum industry generated 82 per cent income for Federal Government of Nigeria, while only 18% came from non-oil revenue.

Apparently, oil is the dominant source of government revenue, accounting for about 90 percent of total exports, and this approximates to 80% of total government revenue (Ogbonna & Ebimobowei, 2012). The importance of taxation on petroleum profits cannot be overemphasized as tax revenue derived from taxing petroleum profits contributes largely to the total tax revenue available to the Nigerian government. According to the Oil Market Report (OMR) of the International Energy Agency (2012), Nigeria has been seen to be the largest oil producing country in African and the eleventh in the world. The major investors in the petroleum industry are the international oil companies (IOCs), the principal legislation governing petroleum operations in Nigeria is the Petroleum Profit Tax Act (PPTA) of 2007. Its main fiscal instrument is the Petroleum Profit Tax (PPT). The PPT Act provides for the imposition of Petroleum Profits Tax on the chargeable profits of companies involved in the upstream activities of exploration, drilling, extraction and transportation of crude oil. From inception in 1959, the Act has undergone series of amendments culminating in the Petroleum Profits Tax (Amendment) Act of 2007. According to Ilaboya and Ofiafor (2014), Petroleum Profits Tax is chargeable at the rate of 65.75% for the first five years of taxable operation and 85% thereafter. The Petroleum Profits tax rate was as low as 18.9% in 1970 after which it rose astronomically to 80.7% between 1971 and 1974. The rate was 82.3% from 1975 to 1989 and it peaked at 85% in 1990 till date. Nigeria appears to have the highest Petroleum Profits tax rate in the world (Appah, 2010).

The defense for this high rate is the need to capture the resource rent tax from the operations of the oil companies. Some other countries charge resource rent tax separately thereby reducing the Petroleum Profits tax rate. For example, South Africa charge 30% Petroleum Profits tax and 40% resource rent tax. Uganda has Petroleum Profits tax rate of 30% and resource rent tax of 0-80%; Malaysia has Petroleum Profits tax rate of 38% and resource rent tax rate of 70%. South Africa, Ghana, Uganda, Tanzania and Zambia appears to be the only African oil producing nations with resource rent rate (Sunley, Baunsgaard & Simard, 2002).

It is necessary to develop ways to harness and distribute resources, especially with Nigeria present financial problems resulting from volatility of oil prices because government responsibilities are on the increase. Hence, government evolves different mechanisms for generating additional revenue to meet these needs. This search for diversification will impact on development planning and poverty reduction in the long run. This study gives Company Income Tax (CIT) a place among alternatives from non-oil income. Taxation of companies was retained as a federal matter (1954 ordinance), direct taxation, a regional matter (1943 ordinance). Companies are taxed under the Companies Income Tax Act introduced in 1961 with modification in 2007. The administration of the companies' income tax in Nigeria is vested on the Federal Inland Revenue Services. The tax is payable by all companies at the rate defined by the Companies Income Tax Act (CITA).

The Company Income Tax (CIT) has become a major source of revenue in many developed countries (Ajakaiye, 2000). Companies Income Tax (CIT) is charged on the profit or gain of any company accruing in, derived from, brought into, earned in or received in Nigeria. The company income tax rate has been 30% and it is applied on the total profit or chargeable profit of the company (Adegbe & Fakile, 2011). According to Gwangdi and Abubakar (2015), recognizing the need for improved and sustained efforts by government to raise revenue in Nigeria as a matter of urgency; certain offences have been created by the CITA the breach of which makes a company liable to stated penalties. This is as a result of the large number of companies not capture in the tax net and even those captured there are incidence of tax evasion and avoidance hence having adverse consequence on revenue.

## **1.2 STATEMENT OF THE PROBLEM**

Nigeria is Africa's most populous nation and the largest economy in the continent, with the highest growing GDP rate in Africa and world's eighth-largest oil exporter. Yet, more than sixty percent of the population lives in extreme poverty, youth unemployment is close to eighty percent, coupled with the daily violence in the north, where the rebel group Boko Haram is fighting for a state governed by Sharia (Margaret, Charles & Gift 2014). There is chronic power shortage, which reduce the cost of doing business in Nigeria. According to EIA (2015) the electrification rate in Nigeria is estimated at 41% leaving approximately 100 million people in Nigeria without access to electricity. Despite the fact that Petroleum Profit Tax has been the main source of income to the Nigerian economy and Company Income Tax being the major source of income from non-oil revenue for example in 2014, Petroleum Profit Tax generated ₦2,453,947 trillion and Company Income Tax generated ₦1,173,491 trillion (CBN Statistical Bulletin, 2014). The economy is still faced with poor performance of national institutions such as road, transportation, politics, and financial systems (Afuberoh & Okoye 2014).

The Niger Delta area where oil and natural gas industry is primarily located has been a source of conflict. Local groups seeking a share of the wealth often attack the oil infrastructure, forcing companies to declare force majeure on oil shipments (a legal clause that allows a party to not satisfy contractual agreements because of circumstances

that are beyond their control). At the same time, oil theft leads to pipeline damage that is often severe, causing loss of production, pollution, and forcing companies to shut in production (EIA 2015). Petroleum profit tax which is supposed to be a source of finance for economic development has turned out to be a bone of contention between many interests groups precisely the government, the oil and gas companies and various researchers (Attamah, 2004).

The administration of the companies' income tax in Nigeria is vested on the Federal Inland Revenue Services. The tax is payable by all companies at the rate defined by the Companies Income Tax Act (CITA). However despite there being regulation on Companies Income Tax in Nigeria, low tax compliance has become a matter of grave concern in Nigeria because it limits the capacity of the governments to raise revenues for development purposes. According to Naomi and Sule, (2015) Companies Income Tax has significant impact on the economy of any nation because it serves as a stimulus to economic growth in the areas of fiscal and monetary policies. But the Nigerian case is difference because the revenue derived from CIT has been grossly understated as a result of several challenges. The factors responsible for the poor performance of CIT revenue in Nigeria include: high rate of tax evasion and avoidance by companies, poor tax administration, poor taxpayers education, inconsistent government policies, and lack of adequate statistical data, inadequate manpower and corruption among tax officials.

According to Iweala, (2013), about 75% of registered firms were not in the tax system and 65% of them had not filed their tax returns in the last 3years. Over ₦80billion was lost monthly from these companies, estimating the total Company Income Tax leakages in that period to about \$250million. Therefore, it is pertinent to evaluate the effect of petroleum profit tax (PPT) and company income tax (CIT) on the economic growth of Nigeria.

### **1.3 RESEARCH QUESTIONS**

Based on the statement of problem of this study, the following research questions were raised:

*To what extent does the petroleum profit tax affect the gross domestic product in Nigeria?*

*In what way does company income tax affect the gross domestic product in Nigeria?*

### **1.4 OBJECTIVES OF THE STUDY**

The main objective of this study is to assess the effect of petroleum profit tax and company income tax on economic growth in Nigeria. Other specific objectives are to:

- examine the effect of petroleum profit tax on gross domestic product in Nigeria;
- assess the effect of company income tax on gross domestic product in Nigeria.

### **1.5 RESEARCH HYPOTHESES**

*H<sub>01</sub>: Petroleum Profit Tax has no effect on gross domestic product in Nigeria.*

*H0<sub>2</sub>: Company Income Tax has no effect on gross domestic product in Nigeria.*

## **1.6 JUSTIFICATION FOR THE STUDY**

Appreciable efforts have been made on empirical studies carried out by researchers on effect of petroleum profits tax on economic growth and or effect company income tax on economic growth like; Kamiar and Hashem (2013), Keightley (2014), Baranova and Janickova (2012), and particularly in Nigeria by Attamah (2004), Adegbe and Fakile (2011), Nwachukwu and Ebimobowe (2012), Abdul-rahamon, Taiwo and Adejare (2013), Abdullahi, Madu and Abdullahi (2015), Naomi and Sule (2015), Gwangdi and Abubakar (2015) to mention a few. It has been identified that none of the existing studies relate both the petroleum profit tax and company income tax to the economic growth of Nigeria. Thus, this study is timely and appropriate due to the situation of the economy in which most of the states cannot afford to pay their workers salaries and the issue of federal government bailout fund does not seem viable enough to solve the problem. This study will be of benefits to policy makers and those in academics. The outcome derived from this study will equally serve as basic reference for future research, as well as add to the existing literature on the analysis of the effect of petroleum profit tax and company income tax on Nigeria economy.

## **1.7 SCOPE OF THE STUDY**

The time frame covered by this study is from 1981 to 2014 with a view to trace the effect of petroleum profit tax and company income tax over the years when increases and reductions occurred. This enable the study get the effect of petroleum profit tax (PPT) and Company Income Tax (CIT) on the country's economic growth.

## **2.1 CONCEPTUAL ISSUES**

### **An Overview of Taxation**

Tax is a compulsory contribution imposed upon persons and firms by a public authority to cover government expenses (Attamah, 2004). Attamah opined that tax is a good source of revenue to government, as it is regularly imposed annually or as government thinks fit. He affirmed that income from taxes on people and firms play critical roles in any nation's economic growth and development. Tax administration and collection is a major problem facing taxation world wide. Bad administration and collection of tax has led to tax evasion. Udabah (2002) referred to tax as an evil necessary to meet the cost of those services a society wishes its government to provide.

According to Udabah, tax is an obligatory transfer from tax payers to the public authority. Udabah argued that taxation was originally formulated to raise revenue so as to cover the state expenditure. Today however, it has been assumed to play a more far reaching role which includes curtailing the consumption of harmful commodities, to regulate the production of certain commodities. It is used as an instrument of economic policy, to control monopoly, curb inflation, to protect infant industries, etc. The Institute



of Chartered Accountants of Nigeria (2014) and the Chartered Institute of Taxation of Nigeria (2002) defined tax as an enforced contribution of money to government pursuant to a defined authorized legislation. New Webster Dictionary also defines it as a charge imposed by government authority upon property, individuals or transactions to raise money for public purposes.

### **2.1.1 Petroleum Profit Tax in Nigeria**

Petroleum taxation is the instrument of choice for sharing wealth between host governments and international oil companies. It is a direct tax, levied annually on net profit of a petroleum tax payer, who is carrying on the business of petroleum exploration and production (Evans & Hunt, 2011). Petroleum taxation has some particular features as a result of oil industry's unique characteristics: the huge central contribution of revenue to the economy, the volatility of oil prices, the large operating and development costs, the high uncertainty associated with petroleum geology, the specific characteristics of individual oilfields, and the possibility of re-investment. The cost of petroleum projects tend to be incurred up-front and the time lags between the discoveries of oil or gas reserves to the time of first production can be significant. This adds to the challenge of designing and implementing appropriate petroleum tax system aimed at achieving a balance between both government and industry interest (Evans & Hunt, 2011). A variety of tax instruments have been used to capture the economic rent from oil activity over the years namely; gross royalty, brown tax, resource rent tax (RRT) and income tax. Royalty is an output-based tax because it is levied on the unit or value of production, whereas the other three instruments are profit based or cash flow taxes, because they are imposed on net profit or operating income after capital investment (Saheed, Abarshi & Ejide, 2014). One of the sources of revenue to the government is petroleum income as available statistic shows that the Nigeria has proven oil reserves of 36 billion barrels, condensate of 4 billion barrels, proven gas reserves of 187 trillion cubic feet and the present average daily production of oil is put at 2.6 million bbl/b (Agbogun, 2004; Egbogah, 2006; EIA, 2015). Petroleum Profit Tax has been defined as a legislation which imposes tax upon profits from the mining of petroleum in Nigeria and provides for the assessment and collection thereof and for the purposes connected therewith (Attamah, 2004).

Accounting for income from oil and gas producing activities differ in many respects from financial accounting (Gallun & Stevenson, 1986). Odusola (2006) defined petroleum profit tax as a tax applicable to upstream operations in the oil industry. It is particularly related to rents, royalties, margins and profit sharing elements associated with oil mining, prospecting and exploration leases. Attamah (2004) asserted that Petroleum Profit Tax is the most important tax in Nigeria in terms of its share of total revenue contributing 95 and 70 percent of foreign exchange earnings and government revenue respectively. According to Jakir (2011), Nigerian law by virtue of the Petroleum Profits Tax Act (2004) which was further amended in 2007 requires "an Act to impose a tax upon profits from the winning of Petroleum in Nigeria, to provide for the assessment and collection thereof and for purposes connected therewith".

Adigbe (2011) further stated that the taxable income of a petroleum company comprises proceeds from the sale of oil and related substances used by the company in its

own refineries. Adereti (2011) explained that the taxable income of a petroleum company is subject to tax at 85 per cent, but this percentage is lowered to 65.75% during the first 5 years of operation but where oil companies operate under production sharing contracts they will be liable to tax at a rate of 50 percent.

Due to the importance attached to oil exploration and production by the Federal Government of Nigeria, the taxation of profit of companies engaging in such operation became inevitable under a tax Act different from the companies income tax Act (Success, Success & Ifurueze, 2012). According to Success *et al.*, this Act became effective 1st January, 1959 since export of oil to the international market started in 1958. This ordinance under which petroleum profit is taxed is referred to as the Petroleum Profit Tax Act (PPTA). It was first amended in January 1967 by the Federal Military Government through decree No 1 of 1967.

There have been further amendments since the last amendment in 1967. The principal Act governing the taxation of profits from petroleum in Nigeria is the Petroleum Profits Tax Act 2007. Section 2 of the PPTA defines petroleum operations as “the winning or obtaining and transportation of petroleum chargeable oil in Nigeria by or on behalf of a company for its own account by any drilling, mining, extracting or other like operations or process, not including refining at a refinery, in the course of a business carried on by the company engaged in such operations and all operations incidental thereto and any sale of or any disposal of chargeable oil by or on behalf of the company”. The purpose of this legislation is to regulate and control the procedure of taxation of petroleum companies which involves petroleum exploration, development, production and sale of crude oil. However, Section 8 of Petroleum Profit Tax Act (PPTA) states that every company engaged in petroleum operations is under an obligation to render return, together with properly audited annual accounts and computations, within a specified time after the end of its accounting period.

Petroleum Profit Tax involves the charging of tax on the incomes accruing from petroleum operations (Nwezeaku, 2005). It was further noted that the importance of petroleum to the Nigerian economy gave rise to the enactment of a different law regulating the taxation of incomes from petroleum operations. The petroleum profit tax is charged, assessed and payable upon the profits of each accounting period of any company engaged in petroleum operations during any such accounting period, usually one year (January to December) (Anyanwu, 1993).

According to Ofe, Onyemachi and Caroline (2008), the administration of PPTA is under the care and management of the Federal Board of Inland Revenue. The tax laws according to Adekanola (2007), have vested the authority to assess, administer and collect all taxes from corporate entities on the Federal Inland Revenue Services. Taxes administered at the Federal level include the Petroleum Profits Tax, Companies Income Tax, and the Value Added Tax as well as the Capital Gain Tax, when such capital gains are generated by corporate entities. The administration of taxes in Nigeria has also been focused on revenue generation to the detriment of stimulating economic development (Adekanola 2007).

### **2.1.2 Effect of Petroleum Profit Tax on the Economy**

The tax system in Nigeria is made up of the tax policy, the tax laws and the tax administration. All of these are expected to work together in order to achieve the economic goal of the nation. According to the Presidential Committee on National Tax Policy (2008), the central objective of the Nigerian tax system is to contribute to the well being of all Nigerians directly through improved policy formulation and indirectly through appropriate utilization of tax revenue generated for the benefit of the people. In generating revenue to achieve this goal, the tax system is expected to minimize distortion in the economy. Other expectations from Nigerian tax system according to the Presidential Committee on National tax policy (2008) include:

- encourage economic growth and development;
- generate stable revenue or resources needed by government to accomplish laudable projects and or investment for the benefit of the people;
- provide economic stabilization;
- to pursue fairness and distributive equity; and
- correction of market failure and imperfection.

Azaiki and Shagari (2007) opined that countries blessed with petroleum resource, can base their development on this resource. Azaiki and Shagari (2007) also asserted that the presence of petroleum resource in a country has the potential benefits of enhanced economic growth and the creation of jobs, increased government revenues to finance poverty alleviation programme, the transfer of technology, the improvement of infrastructure and the encouragement of related industries.

Ogbonna (2009) expressed the view that the administration of Petroleum Profits Tax in Nigeria has mainly been focused on revenue generation to the detriment of stimulating economic growth and development. According to Nwete (2004) the following are the objectives of petroleum taxation in Nigeria:

- To achieve government's objective of exercising right and control over the public asset, government imposes very high tax as a way of regulating the number of participants in the industry and discouraging its rapid depletion in order to conserve some of it for future generation. This in effect will achieve government aim of controlling the petroleum sector development.
- The high profit profile of a successful investment in the oil industry makes it a veritable source for satisfying government objective of raising money to meet its socio-political and economic obligations to the citizenry.
- To re-distribute wealth between the wealthy and industrialized economic represented by the multinational organizations, who own the technology, expertise and capital needed to develop the industry and the poor and emerging economies from where the petroleum resources are extracted.
- The high potential for environmental pollution and degradation stemming from industry activities makes it a target for environmental taxation, as a way of regulating its activity and promoting government quest for a cleaner and healthy environment.
- Cleaner production may be achieved by imposing tax on it for pollution and environmental offences. Under the Petroleum Profits Tax Acts of 1959, an oil

company in computing its taxable profits from petroleum operations is entitled to deduct all outgoings and expenses which are wholly, exclusively and necessarily incurred by such company for the purpose of such petroleum operations.

### **2.1.3 Company Income Tax in Nigeria**

A Company is defined by Section 93 (1) of the Companies Income Tax Act CAP 60 Laws of the Federation of Nigeria (LFN), 1990 as “any company or corporation other than a corporation sole, established by or under any law in force in Nigeria or elsewhere”. The registration of limited liability companies is being carried out by the Corporate Affairs Commission (CAC) in Nigeria. The word Limited (Ltd) or Public Company (Plc) is expected to end each name of a registered company. According to (CAMA), a company duly registered in accordance with the provision of the Companies and Allied Matters Act (hereinafter referred to as CAMA) or any enactment replaced by it is what the Act recognizes as a company in Nigeria. Although CAMA defines a foreign company to mean company incorporated elsewhere than in Nigeria, it does not recognize its existence in Nigeria for business activities. It only defines it for the purpose of identifying it to comply with the mandatory incorporation processes before carrying on business in Nigeria and to benefit from exemption from registration. Section 54(1) CAMA provides that:

*Subject to Sections 56 - 59 of this Act, every foreign company which, before or after the commencement of this Act, was incorporated outside Nigeria, and having the intention of carrying on business in Nigeria shall take all steps necessary to obtain incorporation as a separate entity in Nigeria for that purpose, but until so incorporated the foreign company shall not carry on business in Nigeria or exercise any of the powers of a registered company and shall not have a place of business or an address for service of documents or processes in Nigeria for any purpose other than the receipt of notices and other documents as matters preliminary to incorporation under this Act.*

However, the Companies Income Tax Act (CITA) defines 'company' in a broader sense. It defines a company as: "any company or corporation (other than corporation sole) established by or under any law in force in Nigeria or elsewhere".

Looking at this definition, the CITA recognises both Nigerian companies and foreign companies for the purpose of tax though on different basis. It should however be noted that the mandatory statutory provision of CAMA is clearly unambiguous in prohibiting the existence of a foreign company in Nigeria for any purpose (including carrying on business to make profit. In fact, any violation of the provision is banded with a penalty.

The CITA on the other hand permits the existence of foreign companies and charge their profits derived from Nigeria to tax. John (2011), argued that both Acts of the National Assembly made to serve economic and fiscal purposes. While CAMA regulates incorporation, control and management of companies, CITA charges to tax the profits of these companies. Before CITA can be effective, there must be in existence companies brought into being by CAMA. When CAMA prohibits the existence of a class of company can CITA permit or legalize it? This question according to John (2011), brings about two conflicting public interest. He said:

“One is the prevention of proliferation of foreign companies, unless registered as Nigerian company. The second is the revenue generation from the profits of companies including foreign companies.” The two according to John (2011), constitute key components of Nigerian economic policy and needs to be reconciled and harmonized. It is important to state that the definition of company above analysed is the same under the Petroleum Profit Tax Act.

It is submitted that Nigerian system of taxation does not operate in isolation from the rest of the world. Some foreign companies operate globally and render returns on global basis. The profits made by these foreign companies cannot be ignored. In this regard, the definition of 'company' by CAMA cannot be accurate for tax purposes.

The CITA however, exempts the profits of any company engaged in ecclesiastical, charitable or educational activities of a public character in so far as such profits are not derived from a trade or business carried on by such company; What constitutes a 'trade or business' is however, not defined or described in the CITA (as amended). Orojo (2005), referred to the decision in *Arbisco v FBIR* where the Supreme Court applied the dictionary meaning which is that a trade or business is:

“The practice of some occupation, business or profession habitually carried on especially when practiced as a means of livelihood’ It was also decided in this case that the question of whether the activity in question is a trade or business is a matter of fact and not of law”.

CITA also exempts the profits from taxation of any company formed for the purpose of promoting sporting activities where such profits are wholly expendable for such purpose. Company limited by guarantee may be exempted upon an application to the president for an order for exemption. Companies' Income Tax is a compulsory levy by government on the profits made by the registered companies. This type of tax is a subset of direct taxes because the incidence of payment and burden of the companies' income tax are borne by the companies and not transferable to third parties (Naomi & Sule 2015). The relevant tax authority charged with responsibility of assessing and collection of companies income tax among others is the federal Inland Revenue service (FIRS) under the supervision of a board called Federal Board of Inland Revenue (FBIR).

According to Ariwodola (2000), Companies Income tax is chargeable on:

- The global profits of Nigerian companies irrespective of whether or not they are brought into or received in Nigeria.
- The portion of the profits of non-Nigerian companies derived from such companies operations in Nigeria.
- Dividends, interests or royalties due to non-Nigerian companies which are assessed at ten percent (10%) withholding tax rate.

Company Income tax is chargeable on the income of all companies operating in the country except those specifically exempted under the Act. There is some emphasis in the Act on the distinction between Nigerian and non-Nigerian companies. A Nigerian company is defined as one incorporated under the Companies and Allied Matters Act, or any enactment replaced by that Act. The total profits of such company are assessable to Nigerian tax irrespective of whether or not all the profit have been derived from, brought into or received in Nigeria.

According to Gwangdi and Abubakar (2015), A foreign company (non-Nigerian company) is defined as any company or corporation established by or under any law in force in any territory or country outside Nigeria, that is a company that is not incorporated under the Companies and Allied Matter Act. The profits of a non-Nigerian company shall be subject to Nigerian tax only to the extent to which such profits are attributable to the company's operations in Nigeria subject to provisions in the respective double taxation agreements if any is available with the country where the foreign company is registered.

#### **2.1.4 Custom and Excise Duties**

Customs duties in Nigeria are the oldest form of modern tax revenue. Their introduction dates back to 1860 known as import duties, which represents taxes on imports into Nigeria, charged either as a percentage of the value of imports or as a fixed amount of contingent on quantity (Buba 2007). Customs duty is a major source of revenue for the Federal Government which is payable by importers of specified goods (Buyonge 2008). According to Buba (2007), excise duties were also introduced on several goods to broaden the revenue base in Nigeria in 1962. Customs and excise duties is an important component of the non-oil revenue and has remained an important source of revenue before and after discovering of oil in Nigeria and over the years contributed significantly to national development. He further stated that the Nigeria custom service is saddled with the responsibility of collecting duties, excise, fees, tariffs, and other levies imposed by the Federal Government on imports, exports and statutory rates. It is a crucial facilitation of trade and key instrument of state sovereignty.

#### **2.1.5 Economic Growth**

According to Olopade and Olapade (2010), growth means an increase in economic activities. Jhigan (2004) defined economic growth as the process whereby the real per capita income of a country increases over a long period of time. However, it can also be seen simply, as the increase over time of an economy's capacity to produce those goods and services needed to improve the wellbeing of the citizen in increasing numbers and diversity. It is the steady process by which the productive capacity of the economy is increased over time to bring about rising level of national income (Anyanwu & Oaikhenan, 1995). Economic growth is primarily driven by improvement in productivity, which involves producing more goods and services with same input of labour, capital, energy and materials. However, economist draws a distinction between short term economic stabilization and long term economic growth. Economic growth is primarily concerned with the long run. The short run variation of economic growth is termed the business cycle (Devaranjan, Swaroop & Zou, 1996). A country's economic growth is a long term rise in capital to supply increasing diverse economic goods to its population (Oremade, 2006).

Economic growth represents the expansion of a country's potential GDP or output. Rostow-Musgrave model (1999) conducted a study on growth of public expenditure where Rostow-Musgrave focused mainly on the utilization of taxes as the major revenue source. The study concluded that at the early stages of economic

development, the rate of growth of public expenditure will be very high because government provides the basic infrastructural facilities (social overheads) and most of these projects are capital intensive, therefore, the spending of the government will increase steadily. Investment in education, health, roads, electricity, water supply are necessities that can launch the economy from the practitioner stage to the take off stage of economic development, making government to spend an increasing amount with time in order to develop an egalitarian society.

### **2.1.6 Gross Domestic Product (GDP)**

According to World Bank Report (2011), GDP at purchaser's prices is the sum of gross value added by all resident producers in the economy plus any product taxes and minus any subsidies not included in the value of the products, It is calculated without making deductions for depreciation of fabricated assets or for depletion and degradation of natural resources. The Central Bank of Nigeria (2010) defined GDP as the money value of goods and services produced in an economy during a period of time irrespective of the nationality of the people who produced the goods and services. It is usually calculated without making any allowance for capital consumption (or deductions for depreciation).

## **2.2 THEORETICAL FRAMEWORK**

The only theory identified provides a link between tax revenue generation and economic growth is expediency theory.

### **2.2.1 Expediency Theory**

This theory asserts that every tax proposal must pass the test of practicality. It must be the only consideration weighing with the authorities in choosing a tax proposal. Economic and social objectives of the state and the effects of a tax system should be treated irrelevant (Bhartia, 2009). Anyafo (1996) explained that the expediency theory is based on a link between tax liability and state activities. It assumes that the state should change the members of the society for the services provided by it. This reasoning justifies imposition of taxes for financing state activities by inferences, provides a basis, for apportioning the tax burden between members of society. This proposition has a truth in it, since it is useless to have a tax which cannot be levied and collected efficiently. In addition, the administrative set up may not be efficient to collect the tax at a reasonable cost of collection. Tax revenue provides a powerful set of policy tools to the authorities and should be effectively used for remedying economic and social ills of the society such as income inequalities, regional disparities, and unemployment and so on. Accordingly, a tax system should not be designed to serve individual members of the society, but should be used to cure the ills of the society as a whole. This theory relates to a normal development process and represents a bench mark against which country specific empirical evidence may be compared.

This study therefore focuses on the expediency theory which enables us to assess the extent to which the Nigeria tax system conforms to this scenario where the link

between tax liability and economic activities are linked. If applicable, such a characterization will enhance accurate tax revenue projection and targeting specific tax revenue sources given an ascertained profile of economic development. It will also assist in estimating a sustainable revenue profile thereby facilitating effective management of a country's fiscal policy, among others. This is because the expediency theory focuses on the fact that taxes are collected to achieve economic objective which enhances the growth and development of a country in all its spheres.

### **2.3 EMPIRICAL EVIDENCE**

Eyisi, Chioma and Bassey (2015) examined the effect of taxation on the macroeconomic performance in Nigeria using ordinary least squares regression method from 2002 to 2011 and found that revenue generation from taxation has a positive effect on the macroeconomic performance of the Nigerian economy. The study concluded that change in taxation will lead to high standard of living, provision of employment and reduction in interest rate.

Kamiar and Hashem (2013) examined the impact of oil revenues on the Iranian economy for the period 1908 to 2010 and found that although oil has been produced in Iran over a long period, its importance in the Iranian economy was relatively small up until early 1960s. It was concluded that oil income has been both a blessing and a curse. In terms of maintaining and sustaining GDP growth, oil income has been a blessing. But it has also been a curse in inducing excess inflation, exchange rate volatility and macroeconomic inefficiencies, with adverse political and institutional implications and recommendation were made that appropriate policy responses are needed to deal with the large swings in oil revenues that Iran has been facing, particularly over the past three decades.

Abdullahi, Madu and Abdullahi (2015) examined the evidence of petroleum resources on Nigeria economic using simple linear regression model from 2000 to 2009 and found that petroleum has a direct and positive significant relationship with the Nigeria economy and therefore concluded that petroleum has been the mainstay of Nigeria economy since its discovery and it constitutes the major source of our foreign reserves and main source of development capital. They showed no evidence of whether a unit root was conducted, and as such one would not be inclined to affirm a generalized statement as claimed by them.

Adegbite (2015) examined the effects of corporate income tax on revenue profile; it also determined the impact of corporate tax revenue on economic growth in Nigeria using multiple regression analysis method from 1993 to 2013 and found that there is a positive significant impact of corporate tax on revenue in Nigeria. The study concluded that government should reduce corporate income tax rather than eliminate corporate tax in Nigeria; lower corporate tax will increase the demand for labour which will in turn raise wages and increase consumption.

Afubero and Okoye (2014) also studied the impact of taxation on revenue generation in Nigeria for the period 1994 to 2004. Using petroleum profit tax, education tax and personal income tax as proxy for taxation (independent variables) and gross



domestic product as the dependent variable. Regression analysis was employed by the researcher to analyse the data used in the study, and discovered that taxation has a significant contribution to revenue generation and that taxation has a significant contribution on Gross Domestic Product (GDP).

Naomi and Sule (2015) studied the company income tax in the light for alternative financing for sustainable development in Nigeria. The study employed Ordinary Least Square (OLS) method and Co integration Test over the period 1987 – 2013 to analyse the long run relationship between company income tax and revenue generation in Nigeria. The study concluded that there is a positive and significant relationship between company income tax and revenue generation in Nigeria. It has been identified that none of the existing studies relate the petroleum profit tax and company income tax to Nigeria economic growth in terms of the ability of the government to meet its capital and recurrent expenditures which will in turn increase gross domestic product. The task of filling this gap is undertaken in this study.

### 3.1 MODEL SPECIFICATION

Guided by the perceived functional relationship between the matrix of economic growth (GDP) with PPT, CIT and CED revenue, a link is forged among the 4(four) variables. From sub-macro and micro economic perspectives, the model for this work states that economic growth (GDP) depends on PPT, CIT and CED revenue. The model which is in line with the work of Ogbonna and Ebimobowei (2012) is a modified form of the model specified by Anyanwu (2007) in his study of Nigeria's tax efforts and economy development. Thus, the functional relationship and the resultant models are as specified below:

$$ECOG_t = f(PPT_t, CIT_t, CED_t)$$
$$\log ECOG_t = \alpha + \beta_1 \log PPT_t + \beta_2 \log CIT_t + \beta_3 \log CED_t + U_t$$

Where;

ECOG= Economic growth (dependent variable)

Economic Growth; EGOG is measured using Gross Domestic Product at a given time

PPT= Petroleum Profit Tax (independent variable)

PPT; is measured using PPT at a given time

CIT= Company Income Tax (independent variable)

CIT is measured using CIT at a given time

CED= Custom Excise Duties (control variable)

CED is measured using CED at a given time

U= Error term

*A priori* expectation is that  $\beta_1, \beta_2$  and  $\beta_3 > 0$

Since the data to be used for the analysis is time series, we employed co-integration tests to avoid spurious regression. The first step would be a diagnostic test of each of the variables for stationarity. This study employs the Augmented Dickey - Fuller test for unit root. If any of the series found to be integrated, then a cointegration test conducted using Johansen Cointegration Test.

### 3.2 RESEARCH DESIGN

A time series research design is adopted in this study due to the nature of the variables under study. Because the variables assume different values at different times, data at different times extracted from relevant sources.

### 3.3 NATURE AND SOURCES OF DATA

Secondary data is extracted from various reports of the Federal Inland Revenue Service (FIRS) and the Central Bank of Nigeria (CBN) statistical bulletin 2014, Federal Ministry of Finance and Nigerian National Petroleum Corporation Annual Statistical Bulletin 2014 were used in this study. This is because the estimation of the model in the study requires the use of time series data. The macroeconomic data consist of Petroleum Profit Tax (PPT), Company Income Tax (CIT) and Economic Growth (EG) between 1981 and 2014 in Nigeria. Regression technique was adopted as our tool of analysis as it was found appropriate for the data analysis.

### 3.4 ESTIMATION TECHNIQUE

The study adopts a time series data analysis research method but were estimated using Fully Modified Least Square (FMLS) Regression Technique. The data were analyzed using Eviews version 7. The steps includes the testing of the series individually for stationarity using the Engle and Granger (1987) two step approach to determine the order of integration of the variables using the Augmented Dickey-Fuller (ADF) set of unit root test. After that we proceeded to search for the existence of long-run equilibrium casual relationship among petroleum profit tax, company income tax, custom excise duties and the economic growth variables.

## DATA PRESENTATIONS, RESULT AND DISCUSSIONS

### 4.1 Preliminary Analysis:

**Table 1 Augmented Dickey-Fuller (ADF) Unit Root Test**

Variables	t-statistic	Prob @ 5% sig level	Order of integration
GDP	-5.376609	0.0001	I (1)
PPT	-5.627098	0.0001	I (1)
CIT	-9.308161	0.0000	I (1)
CED	-3.411061	0.0179	I (1)

*Source: Author's Computations 2016*

Table 1 shows the result of unit root test with the use of augmented dickey-fuller (ADF). The result shows that all the variables are stationary after first difference I (1) this means that there is present of unit root in the variables that is, there is present of short term variance among the variables. Since there is present of short term variance among the variables, this will lead to the test for long term variance through the use of is co-integration test.

**Table 2: Co-integration test (Johansen Co-integration)**

Date: 03/16/16 Time: 17:00  
 Sample (adjusted): 1983 2014  
 Included observations: 32 after adjustments  
 Trend assumption: Linear deterministic trend  
 Series: GDP CIT PPT CED  
 Lags interval (in first differences): 1 to 1

Unrestricted Cointegration Rank Test (Trace)

Hypothesized No. of CE(s)	Eigenvalue	Trace Statistic	0.05 Critical Value	Prob.**
None *	0.929864	155.4513	47.85613	0.0000
At most 1 *	0.819250	70.41708	29.79707	0.0000
At most 2 *	0.376621	15.67661	15.49471	0.0469
At most 3	0.017145	0.553411	3.841466	0.4569

Trace test indicates 3 cointegrating eqn(s) at the 0.05 level  
 \* denotes rejection of the hypothesis at the 0.05 level  
 \*\*MacKinnon-Haug-Michelis (1999) p-values  
 Source: Author's Computations 2016

Table 2 presents the result of Johansen co-integration. Trace statistic values are compared to the critical values at 5% and the null hypothesis of no co-integrating or the existences of almost one co-integration vector were rejected, the result shows that there is present of co-integration in the model at most one. Therefore, a long run relationship exists in at most one the variables.

**4.2 Hypothesis Testing:**

**Table 3: Effect of petroleum profit tax and company income tax on gross domestic product in Nigeria**

Dependent Variable: LOG\_GDP  
 Method: Fully Modified Least Squares (FMOLS)  
 Date: 03/16/16 Time: 17:03  
 Sample (adjusted): 1982 2014  
 Included observations: 33 after adjustments  
 Cointegrating equation deterministics: C  
 Long-run covariance estimate (Bartlett kernel, Newey-West fixed bandwidth = 4.0000)

Variable	Coefficient	Std. Error	t-Statistic	Prob.
LOG_PPT	0.352882	0.129313	2.955590	0.0022
LOG_CIT	0.771234	0.368483	2.093000	0.0452
LOG_CED	0.103788	0.390334	0.265896	0.7922
C	0.965199	0.183325	5.264964	0.0000
R-squared	0.876171	Mean dependent var		6.363435
Adjusted R-squared	0.834741	S.D. dependent var		1.058380

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S.E. of regression	0.130741	Sum squared resid	0.495703
Durbin-Watson stat	1.856493	Long-run variance	0.029975

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Source: Author's Computations 2016

Table 3 shows the linear relationship between petroleum profit tax, company income tax and gross domestic product in Nigeria with the use of fully modified co-integration regression analysis. The result obtained from the static model indicates that the overall coefficient of determination R-squared ( $R^2$ ) shows that the equation has a good fit with 87.6 percent of variations in gross domestic product is explained by the variables in equation. In terms of the sign of the coefficient which signify the effect of petroleum profit tax and company income tax on gross domestic product, the result shows that the three variables PPT, CIT and CED concur with *a priori* expectation with positive sign, this means that there is direct relationship between petroleum profit tax, company income tax, custom excise duties and gross domestic product the findings is in line with the result of Ogbonna and Appah (2012).

In terms of the magnitude of the coefficient that signifies the first objective of the study which state that Petroleum Profit Tax has no effect on gross domestic product in Nigeria. The coefficient PPT clearly has significant effect on gross domestic product as indicated by coefficient (0.3529) with prob (0.0022) at 5% level of significant. Thus, the null hypothesis was rejected; means that 1% increase in the petroleum profit tax will induce 0.35% increase in gross domestic product and also 1% decrease in the petroleum profit tax will induce 0.35% decrease in gross domestic product. Also in term of the magnitude of the coefficient that signify the second objective of the study which state that company income tax has no effect on gross domestic product in Nigeria. The coefficient CIT clearly has significant effect on gross domestic product as indicated by coefficient (0.7712) with prob (0.0452) at 5% level of significant, the null hypothesis was rejected, this means that 1% increase in the company income tax will induce 0.77% increase in gross domestic product and also 1% decrease in the company income tax will induce 0.77% decrease in gross domestic product. The was also evident in the study of Ola (2006) and Naomi and Sule (2015) where each study shows that company income tax has a positive impact on Nigeria's gross domestic product.

Finally, in term of the magnitude of the coefficient of the control variable CED clearly has no significant effect on gross domestic product as indicated by coefficient (0.1038) with prob (0.7922) at 5% level of significant. This signifies that as the custom and excise duties increases, the goods entering the country will decrease because the business men and women will be discouraged and this will have a negative effect on the economy of the country. The result here does not agree with the study conducted by Adegbe (2011) which state that a strong relationship exists between custom and excise duties and the economic growth of Nigeria. However it agrees with the study of Buba (2007).

## **5. CONCLUSION AND RECOMMENDATIONS**

### **5.1 Summary of findings**

This study has been able to analyze the effect of petroleum profit tax and company income tax on economic growth in Nigeria. Section one introduces petroleum profit tax and company income tax. Section two extracts the relevant work of other researchers who have carried out research relating to petroleum profit tax and company income tax. Section three is based on the methodology which focuses on the sampling technique that was used by the researchers in solving the hypotheses. A time series research design was adopted by the study, data was obtained from Central Bank of Nigeria Statistical Bulletin 2014, Federal Ministry of Finance and Nigerian National Petroleum Corporation Annual Statistical Bulletin 2014 and co-integration regression analysis was adopted. Based on the result of the study below:

### **5.2 Conclusion**

This study has been able to describe the roles that petroleum profit tax and company income tax play in the economic growth in Nigeria. Nigeria has the potential to build a prosperous economy, reduce poverty significantly, and provide the health, employment generation, education, and infrastructure services to its population needs. Considering the positive and significant relationship between petroleum profit tax, company income tax and economic growth in Nigeria, there is an urgent need for government to prioritize her needs as petroleum revenue continues to decrease and a situation where most of registered firms were not in the tax system. Economic growth cannot be achieved in a country where vast majority of her populace living below expectation, a situation similar to what is being experienced in the country where, capital expenditure is wholly financed through debt and the entire oil revenue for the federal government is used for recurrent items.

### **1.3 Recommendations**

Based on the findings made in the course of this study, it is recommended that:

- Government should expand the tax yield through improved tax system administration. This is because of the danger of over-reliance on crude oil export receipts to drive the economy.
- Government should transparently and judiciously account for the revenue it generates through petroleum profit tax and company income tax by investing in the provision of infrastructural facilities. It is expected that the more effectively and efficiently revenue is utilized by government to create employment opportunities, satisfy the basic needs of her population, sustain her quest for the development.
- Government should try to diversify the economy. In so doing, revenue accrue to government through petroleum profit tax should be judiciously used to develop other sectors, especially in developing other mineral resources and agricultural sector since the country has what it takes in terms of fertile land, favourable climate and manpower which will lead to economic growth.

In addition to this, government policy should be directed towards creating conducive or investment friendly environment that will attract foreign investors into the country, any increase in investment has the potential of creating job opportunity for the citizens. It is of the view that government should minimize or find ways of eliminating totally the widespread corruption and leakages in the petroleum profit tax and company income tax administration.

The Federal Inland Revenue Service (FIRS) should properly monitor the activities of companies to achieve optimum collection of taxes payable to the government as Company Income Tax (CIT) is a potential source of alternative income as well as improve condition for companies to flourish.

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***LAW***



## GOOD GOVERNANCE AND THE RULE OF LAW- MAJOR PILLARS OF ECONOMIC EFFICIENCY

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**Abstract:** *The period after 1990 has been characterized through major changes at political and economic level for most regions of the world and the manner in which power is exercised in the management of a country's economic and social resources lead to a new specific notion of modern democracy and gain the sense of good governance. The essence of democracy consists in a system of government that is for people and the process of decision-making, the course by which decisions are implemented, partly implemented or not implemented at all, would be pointed out by the process through which public institutions perform public activities, manage public resources and guarantee the respect for the rights of the citizen in a free manner, without abuse and corruption, paying special attention to the rule of law. On the basis of a case study in Romania, the paper argues that in order to achieve good governance, the public authorities need to focus on eight key dimensions: rule of law, participation, consensus oriented, responsibility, transparency, sensibility, effectiveness and efficiency, equity and inclusion. Based on these findings, the paper analyzes specific interferences between good governance and the rule of law, their dimensions but also the manner in which a good cariees to respect the principles of good governance could lead to achieaving the desired goals of economic efficiency in our country.*

**Keywords:** *good governance, rule of law, modern democracy*

### I. INTRODUCTION

After the Second World War, but with preponderance in recent years, on the background of institutional changes induced by globalization as well as the enlargement of the European Union, concepts as they are governance, globalization, global governance, global public goods, good governance, good administration, national sovereignty, democracy, are brought to the main plain of political life, economic and social issues, public administration being the main pillar of their implementation in society. Thus, in the context in wich civilization has developed, were formed two theories regarding the concept of good governance (Burns and Stalker, 1961):

- In the light of *mechanistic theory*, the governance has a significant role to maintaining order in society. In this concept, the state is reflecting through the expression of the law, and the law is an exact transposition of rationality.

There must be a strong hierarchy so that general interest is not dominated by individual interests.

- The *organic theory* of good governance refers to a guid path to a better order. This concept leads to the creation of better conditions.

The term of good governance is explained by World Bank as a core element of development Strategy which captures the manner in which power is exercised in the management of a country's economic and social resources for development, being a multifaceted concept. Through good governance we understand transparency, efficient public services, assuming certain risks, compliance with the law and enforcement of the regulations, citizen participation and their word representing a major importance in policy formulation and decisions. Terminological differentiations are generated by the following factors: 1. level of approach (for example, World Bank defines the principles of good governance through the idea of their own programs and policies, as well as United Nations Organisation), 2. the genesis of the principles of good governance which could have determined a regional structure, how is it for example, European Union, to embrace them, but with adaptation to their own needs and ideologies (what it confers, besides, these multidisciplinary principles character), 3. the novelty of concepts in some administrative areas (for example, Romania) while explaining too many essential concepts, such as „the governance” and „the government” in specialized works (explanatory dictionaries).

The good governance fades corruption, stakes also on taking in consideration the minority opinions, such that the most vulnerable category of society to make part in public decisions-making. The good governance is receptive to the needs of citizens. Moreover, analyzing the concept of governance, it has three pillars:

- *The technical pillar*: deals with the economic aspect of governance, transparecny of government responsibilities, the management efectiveness of public resources, stability in private sector activity.
- *The social pillar*: suppose construction, training and promotion of democratic institutions and tolerance at society level.
- *The political pillar*: concerns legitimacy of the government/governance legality, responsibility of political decisions and respect for human rights.

Making a retrospective of informations and experiences accumulated by developed countries, identifying the foundation of good governance, is to encourage dialogue on a large scale about ideas, actions and options. The main factor is participation and involvement of citizens, they have a power that can influence the formulation of policies and projects through elected representatives, through membership in committees or through the actions of the memorandums. So, it results that this notion has a direct connection with the rule of law, and specific interests can lay the foundation of what it means economic efficiency.

## **II. THE MAIN FEATURES OF GOOD GOVERNANCE AND THE INTERFERENCES WITH THE RULE OF LAW**

In the specialty literature, the term of good governance is not so unique and completely, how it is not the primary objective which would lead to a more universal definition. However, the good governance it is expressed by respecting all human rights, the State must to guarantee the supremacy of law, a more productive and efficient participation, legitimacy, acces to information, efficient public sector, education, equity, the existence of development strategies, highlighting values and people who promote the responsibility, solidarity and tolerance. The democracy is mainly defined as an autonomous system of government, in which all citizens are equal, and political decisions are taken by majority, respecting the rights of citizens and minorities. According to american senator's Daniel Webster wording (1830) and taken over 33 years later by Abraham Lincoln, the governing system for democracy is based on „the government of people, made by the people for people and answering in front of the people”. An important rol in the governance system it is the law. By law, the democratic society can manifest itself so as to protect the state values, the fundamental rights and freedoms of citizens. The law must be as stable as possible to help develop domains (economic, social, educational, health, financial etc.) and then the law is not stable and undergo frequent changes, is in the process of being created a weakness and insecurity of the state manifested by all the plans.

In the political systems undergoing democratization, governments exist in order to fulfill vital functions such as: maintaining security, provisions of public services and ensuring treatments according to the laws in force etc. The features of these functions may vary, but they form the components of the contract between the people who are governed and the people who govern. This contract exists at various levels, the Constitution is that which broadly defines the principles of this contract, while through the legal framework created is becomes operational at the local level. The citizens participate to the guvernance to define the contract, to administer and monitor it (Deaconu, 2003). The population, by vote, appoints elected officials with confidence which must be rewarded with honesty and transparency in the governance process (Licht et al, 2007). Also, citizens must be given, a role in the governance process. Promoting citizen involvement in the governance process is a duty of democratic institutions and representative for the people, but assume and the responsibility on the part of citizens to find solutions in these oportunities. Thus, at European level is being pursued achieving an effective policy for citizens by establishing a close connection between them and Europe (Guy Hermet, 2006)..

Pierre Laudell-Mills and Ismael Serageldin (1991) define the governance as being „the use of political authority, the exercise of control over a company and resource management for economic and social development”. Detailing the dissemination of governance by the doctrine of constitutional law, it is worth nothing that, as stated in the doctrine Rousseau, J.J. 1762), in the classic constitutional concept, administration is the action of executive power, based on a public power processes. In this optics, the administration represents a way of working which returns exclusively to the executive,

the principle of separation of powers in the state having a main consequence- the fact that administration can't be exercised neither by the judiciary, neither by legislative power. Equally, the administration isn't the only task of executive, this having a series of extra administrative tasks exercised in constitutional reports with Parliament or in international relations. The current doctrine of administrative law defines in differentiated mode the concept of executive power, as follows:

- according to an opinion (A. de Laubadere (1980), we distinguish between the executive power and administrative activity of the state, showing that in time when the executive activities have a political dimension belonging exclusively to the power of the state, the administrative activities haven't necessarily a political dimension, even if most are found in the sphere of the executive power.

- In another point of view (Drăganu, T. 1998), the sphere of the executive power authorities is wider than the sphere of the public administration organs, which constitute only one element of the executive power system authorities. You can't to govern if you don't have the power, but if you have it, you need to have knowledges how you can use it effectively for satisfy the citizens needs (Merry et all, 2015). In a State with a solid rule of law, the power is held and exercised only in base of legitimacy.

So, Montesquieu, in his work "De l'espirit des lois" (Charles de Montesquieu, 1964) he realizes a type of political regime in which was put in worth a moderate governance, by securing the separation of powers and the political freedoms.

John Locke approaches the governance by creating in the year 1660 a modern term of executive power, in his work entitled „The second treatise of civil government” (Locke, J., 1960)

Promoting on the same line principle of separation of powers in the state, Jean Jacques Rousseau in his work entitled „The social contract” show that "it's not good that who makes the law to execute it" whereas this way can lead to „government without governance”.

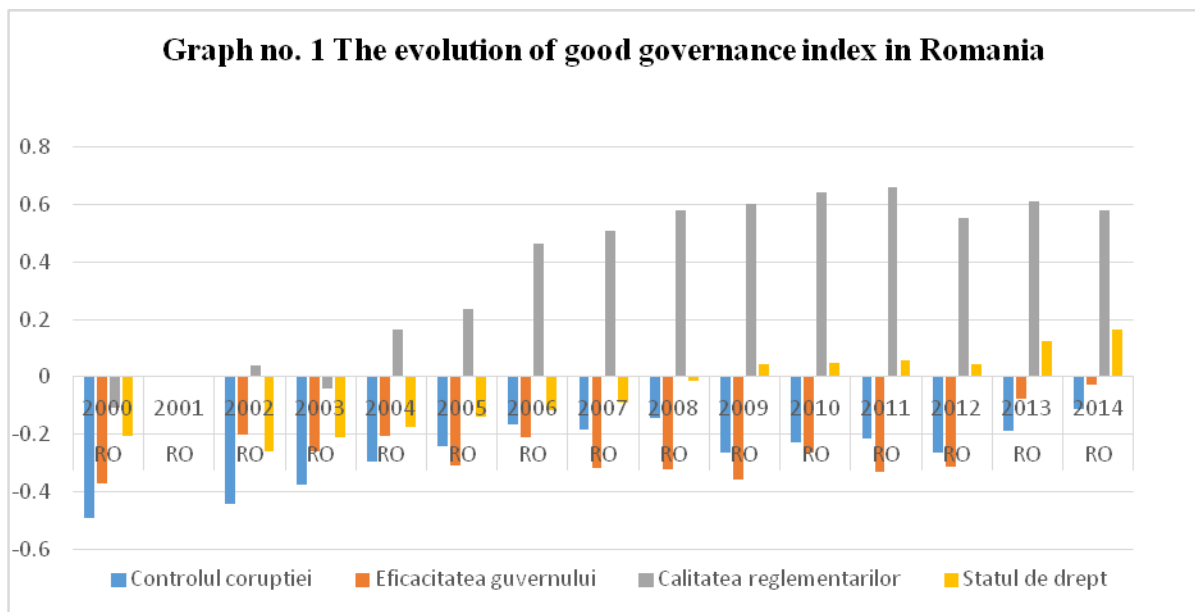
According to Robert Charlick, Good governance represents „the effective management of public affairs by generating a set of rule, in order to promote and strengthen the values of the society searched by individuals and groups”. The term of „good governance” origins in the year 1980, being used for the first time by The World Bank and The International Monetary Fund in a project on helping developing countries. As we have noticed, the main concept of good governance has several concepts, both at level of country, and international, all involving the same substrate.

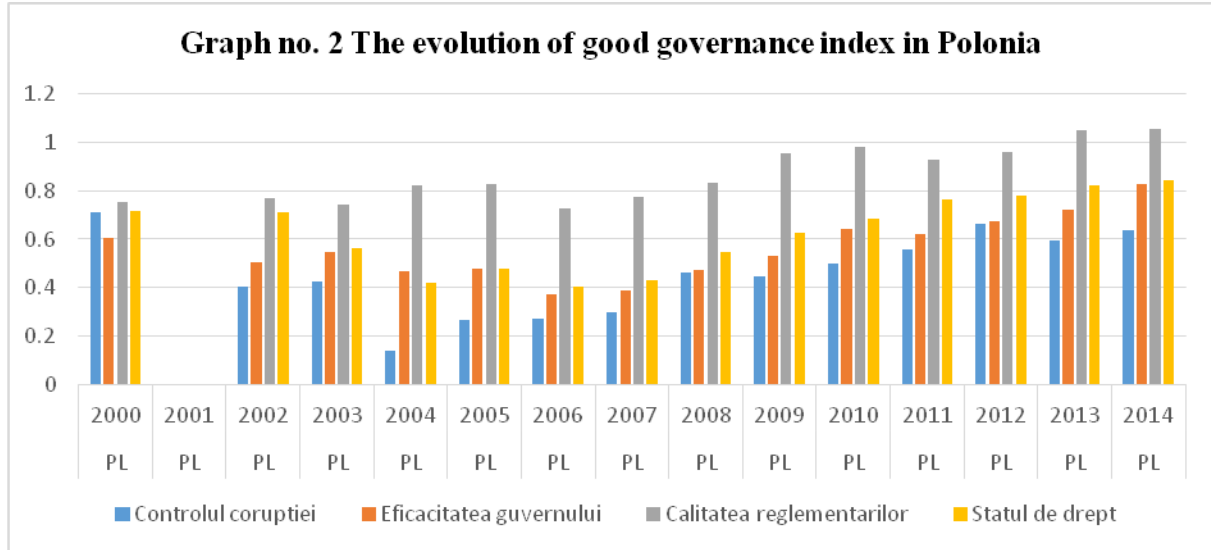
The term of „good governance” appeared at national level through a series of official documents, most labeled being Chapter 3 of The Government program 2009-2012, called The Commitment for good governance of Romania, approved by the Romanian Parliament in the year 2008. Also, The Supreme Council of Defence of the country uses the phrase of „good governance” in a national security strategy of the country by the Judgement no. 62 from 7 april 2006.

International Monetary Fund and United Nations Economic and Social Council have identified eight key-dimensions taking part in a good governance:

- *Equity and inclusion.* All members have the right and role to be included in the main layer of society leading to prosperity. This offers the chance of vulnerable social groups to improve its well-being.
- *Equity and efficiency.* The public resources must be used efficiently, in such a way that their use to be sustainable and to protect environment, to solve mainly the citizens needs by the public institutions.
- *Responsibility.* All decisions must be taken with responsibility and in report to the supremacy of the law.
- *Participation.* Is produced by the institutions, legitimate representatives and civil society, al three having to be informed and well-organised.
- *Rule of law.* The good governance must to respect the citizens rights and in particular those of minorities. Impartial implementation of legislation provides an independent justice and an incorruptible and impartial character of police bodies.
- *Transparency.* It can be transposed like the top of a hierarchical pyramid what represents the democracy and combating corruption and inefficiency. It involves the free circulation of information and her implementation on the decisions in question.
- *Responsiveness.* This implies that public institutions to be concentrated on the fulfillment of people’s needs.
- *Consensus oriented.* This refers to the mediation of all interests who are in society to get to the end, to a consensus for the good of society.

To create an overview on the motivation of this work and to highlight the link between the rule of law, good governance and economic efficiency, we can refer to the tables below where a series of indicators are presented. Processed on the World Bank website, we show how things evolved both on the profile of our country but also on the profile of a state considered to be lately a succesful model, respectively Poland.





Source: own processing based on the data offered by The World Bank

As we can be seen from the graphs no. 1 and 2, things differ significantly from one country to another, if on the profile of Romania we find negative values for three of the four indicators, in the situation of Poland we report, lately, to a successful model intensively publicized and reported as being a good example of economic and political governance.

In another work, the good governance has the following features (Bouckaert, Geert, and Steven Van de Walle, 2003):

- *Legitimacy*, through public acceptance to those who hold power, the existence of a set of rules, processes and imposed procedures.
- *Responsibility*, because the legitimacy of governments acts will be perceived as legitimate only through their responsibility, responsibility is ensured by selecting those who hold the power and through citizens consultation procedures targeting the adoption process of public decisions and their effects.
- *Efficient management*, through the capacity of public administrations to transform public resources in the services and infrastructure that responds to real needs. Performance oriented and transparent procedures are the key factors of effective public management. Citizens must be offered opportunities to express their preferences for the quality and nature of the services. As much as the activity of the local administration is perceived as useful and responsible, the citizens will be more and more willing to provide resources for services and infrastructure. Through a transparent process of decision-making and through efficient management, the governance will demonstrate the responsibility towards citizens.
- *Acces to information*, as the main link between civil society and governors which allows citizens to judge the efficiency of the governors and their activity, the acces to information about laws, procedures and results, forms the citizens' ability to participate and monitor the activity of governors and their degree of responsibility.



As can be seen, all these features take into consideration the suggestions and opinions of minorities, delimiting the most vulnerable opinions which may have an impact on the decision-making process, diminishing the phenomenon of corruption. In other words, it is not necessary to treat distinctly the notion of rule of law with highlighting the importance of democracy, the rule of law, or others, being fully clear the fact that notion of good governance involves defense mechanisms, strengthening the rule of law. The difference lies in the way of implementation and manner in which are respected or not the principles of good governance.

### **III. A SHORT APPROACH TO THE CONCEPT OF GOOD GOVERNANCE AS AN EXERCISE OF ECONOMIC AUTHORITY – CASE STUDY-THE CIUGUD COMMUNITY**

Taking into consideration the notion of economic efficiency and the analysis of the concept of good governance in relation to this aspect, we consider that the idea of good governance can be seen as an exercise of economic authority. The economic efficiency, through its content, express a relation of double relativity: obtaining maximum economic effects with a maximum consumption of resources, and on the other hand with minimum resources consumption, presupposes obtaining best results. So, if the ideas treated in the previous paragraphs shows us that good governance can be seen like the exercise of the economic authority, political and administrative to manage the country's affairs at all levels, then this exercise through specific mechanisms and specific institutions manages achieving the desired goal of economic efficiency.

To demonstrate in this work that good governance can have effects on economic efficiency, we chose a case study on the Ciugud community, from the Alba district, „the main character” being the governance mode which it exerts and the factors that determined the increasing quality of local governance and the succes of the good governance. Succes which resulted with a positive effect on the community, that took part in obtaining viable performances with minimum resources consumption.

To test practically the methodology described in previous pages, we selected the Ciugud community from the Alba district by geographical location, size and teritorial-administrative typology.

#### **1. The Ciugud community**

The Ciugud community is seated in the Transylvanian Plateau, in the Alba district. Is bordering on the north with Sântimbru and Berghin communities, to the south with Oarda de Jos community, to the west with Alba-Iulia city and to the east with Daia Română community. The Ciugud community has a population of 3000 inhabitants and it is composed from the following villages: Ciugud, Șeușa, Limba, Drâmbar, Teleac and Hăpria. The Ciugud village is situated at 9 kilometers from the Alba-Iulia city. The dominant relief form is the hill and the meadow.

The existence of good governance at Ciugud community level is due to Damian Gheorghe Mayor which in 15 years he managed to become a model of development of

rural areas in Romania” through non-reimbursable funds granted by European Union, „local authority took, until today, over 27 million euros, european money” but also creating a site through which the citizens brings into discussion the problems from the community, can be informed or can make known the opportunities for development and or improving the quality of life.

*„Before to accession of Romania at European Union is being discussed very much about the fact that local public administration must to lodge projects, to raise funds for the community. This fact could be achievable if we prove that we have the possibility to support financially a part of project. We got it and we set the foundation of the Drâmbar Industrial Zone, furnished on a surface of 23 hectares, as a financial engine of the community.” (Gheorghe Damian Mayor)*

Twelve years ago, at Ciugud, a community near by Alba-Iulia, dozens of hectares of land were covered with weeds. Now, the pastures became the economic engine of the community after the area has been transformed in an „Industrial Park”. Half of the annual budget of the Ciugud community is collected from taxes levied from investors of the industrial area. One million of euros goes annually in the community vault from companies who developed their businesses here, money which ensures funds for investments, but also co-financing for european projects. From 2015 and until now, about 20 investors with 700 employees bought or have rented land.

In 2004-2005, the community has a budget of 15000 euros on year, and in the year 2017, the community has arrived to a budget over 2 million euros with the help of investors but also local taxes from citizens.

*„The team of professionals which I have attracted in the community has made the possible to approval of funds for the community and so, through joint effort and patience, we have developed six major projects with a cumulative value of 16 millions euros, in such areas as: infrastructure, energy, environment protection, culture and agriculture. All these projects has been run with grants funds, what allowed us to use the local budget funds for the renovation of schools from the community.*

*From starters, we focused on infrastructure. In a few years I have paved the roads, I founded the sewer network and the sewage treatment plant serving the six villages of the community. A later project has lead to 26 kilometers of the agricultural road which make the link between the Ciugud community and Berghin and Daia Română communities. Being constantly threatened of the danger created of the neighborhood with the Mureş River. I succeeded, with european money to equip the community with a backhoe loader, two motor boats, a motor pump of high capacity, a hundred life jackets and transmitter stations. The environment appear as a multidimensional reality because, as militants for sustainable development of the community, I succeeded to forest, with the support of volunteers, nine hectares of land; more, through a partnership with Polytechnic University from Timișoara City, I realised a funded project by the Norwegian Government and I installed a wind farm in the Șeușa village and seven photovoltaic panels.” (<http://primariaciugud.ro>).*

## 2. The official site of the Ciugud Village Hall

*„This site is adressed to all wishful persons to find out informations about the past and the future of this community, the history, the traditions and the spirit of the community, as well as plans for the future... This site gets the voice of local government to citizens, but at the same time, becomes a way to make the community known to the general public, regardless of whether is romanian or foreign. The site wants to put to disposition the all informations which targets the citizens and the problems with which he is confronted, to let them know the development and revitalization opportunities of the village and improving the quality of life inside it. In this period driven by technology we are proposing, by patience and professionalism, to offer the best electronic support to all those interested by the evolution of local government, the documents of public interest, the forms or investment projects which unfolds within the community.”*

The Ciugud Village Hall approve a series of articles through **„The decision on information of public interest managed by the Ciugud Village Hall, which they can be communicated and the exceptions to communication”**:

**„Article 1.** Is approved the list of informations produced and/or managed by the Ciugud community, set out in the Annex no. 1 (see the site <http://primariaciugud.ro>).

**Article 2.** Is approved the list of public interest informations communicated ex officio, according to Article 5 of the Law no. 544/2001, looking the free access at the public interest informations, set out in the Annex no. 2.

**Article 3.** Is approved the list of public interest informations communicated on request, according to Article 6 of the Law no. 544/2001, set out in the Annex no. 3.

**Article 4.** Is approved the list of informations excepted from communication, for to respect the principle of confidentiality, set out in the Annex no. 4.

**Article 5.** The terms for written communication of an answer to public informations seekers are:

- a) 10 work days for to communicate the required public interest information, if this has been identified in this term.
- b) 10 work days for to announce the applicant that initial term provided at point a. Was not enough to identify the requested information.
- c) 30 work days for to communicate the public interest information identified over the term provided at point a.
- d) 5 work days to transmit the refusal of communication of the requested information and the motivation of refusal.

**Article 6.** Periodic activity report shall be drawn up annually.

**Article 7.** From the date of adoption of this activity on information of public interest will be carried out by The Public Relations Departament within The Association of communities from Romania Rucăr- The Alba Subsidiary, that was concluded the cooperation agreement through The Local Council Decision of the Ciugud community no. 97/27.12.2012.

**Article 8.** Monitoring the compliance of provisions of this decision returns to the Mayor of the Ciugud community.”

The previously presented articles are respected by The Village Hall by clear evidence of a „*Evaluation Report of the implementation of the Law 544/2001 in year 2015 centralized*”. In this report was highlighted the fact that the city hall communicated informations through its own website, by displaying at The Village Hall and through an information point who was visited about 1200 citizens. The Village Hall has already received some requests (on the use of public money, legislation/regulations and how to accomplish the attributions of the public institution) from individuals and legal entities which have been resolved.

#### **IV. CONCLUSIONS**

This analysis highlight that on the Ciugud community profile we can talk about good governance because she can rivals with many cities from Romania in view of the fact that the population is growing from year to year, all houses have utilities, are paved roads even between agricultural parcels, free internet in public areas, bicycle tracks and public lighting obtained aeolian and with solar panels, the most important being „The industrial park from Drâmbar” plus others investments (education, health and infrastructure). The basic idea is that the notion of good governance can mean much more on a large scale as the previous paragraphs have shown, is materializes in capacity to manage efficiently the country’s affairs, with the compliance of the law and the rule of law, with the desired goal of economic efficiency and improving administrative capacity.

Putting together the information and presented experiences in this work, we find that the only way which does the object of good governance is to encourage the ideas, the actions and options on a large scale. In this way, those who hold power, can make decisions which must to be understood by the citizens. The citizens are of great importance, they must to realize that without their participation and involvement, the process of good governance can not exist.

- ✓ The government is the servant of the citizen, but not vice versa.
- ✓ All citizens are equal in front of law, including those holding public functions or are leaders of some organizations.
- ✓ The act of governance must be clear to all citizens. ➡transparent.
- ✓ The public goods and services must be divided in a universal and non-discriminatory manner, without favoring politicians or certain groups/organizations. ➡universal, non-discriminatory.
- ✓ In order to achieve a sustainable and efficient economy, it is very important that those who have exercised governance allow citizens to develop their entrepreneurship, help them (reduce costs, simplify the system of taxes and duties, apply laws and rules without discrimination) so that companies that will develop much in the future will also support the country's economy.

Our findings suggest that in order to achieve good governance, the public authorities need to focus on some key dimensions, such as: rule of law, participation, consensus oriented, responsibility, transparency, sensibility, effectiveness and efficiency, equity and inclusion.

Morover, even if the definitions of the concept of „good governance” presented in this work, have different institutional priorities depending by the period in which they were born, visions and concepts, through which was examined the political and economic reality, it is clear that for a country, to have a good governance, must to exist a close and strong relation between The State and The Society, based on a mutual trust and without corruption.

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## **THE ROLE OF SECURITY IN CREDIBLE ELECTIONS AND SUSTAINANCE OF DEMOCRACY IN NIGERIA**

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**Abstract:** *Democracy is beneficial to people provided the democratic rule is adopted while democracy cannot be achieved unless there are periodic elections. Elections, though, considered as pre-requisite for good governance, however, mere elections without ensuring credibility is also tantamount to despotism. An election cannot be judged as credible, free and fair unless the following agents of democracy - security, media and civil society organizations – perform their constitutional roles. This paper focuses on the evaluation and dynamics of role of security, media and civil society organization in Nigerian democracy. It explores the pertinent roles of the security, media and civil society organizations to the conduct of credible elections which in turn may beget true democracy. The existing literatures have drawn the linkage between security democracy and elections. However, this paper does not only argues that security men, press men and civil society organizations have not done well in the conduct of elections in Nigeria but also highlights some other core issues that have dominated the discourse and explores the challenges on democratization process in Nigeria. Finally, a recommendation is made that all stakeholders should be honest and moral in discharging their duties.*

**Keywords:** *Election, Democracy, Nigeria, Security, Media, Civil Society Organization*

### **1. INTRODUCTION**

Development history bears credence to the maxim that any democratic state cannot conduct free and fair elections unless if security officers, media practitioners and civil society organizations adequately perform their roles. It is quite unequivocal that developed countries are what they are today simply because everybody or agents in the polity perform their constitutional role to sustain democracy. Has any state developed without institutionalizing ways of conducting free and fair elections? In other words, failed states are often known through their inability to choose competent leaders in credible, free and fair elections. I mean the competent leaders, who can paddle the canoe of the state into Promised Land. African states are still wallowing in pathetic ocean of bad leadership due to their inept to conduct internationally acceptable elections. It is indeed, argued in this paper that any country cannot witness credible elections to sustain its democracy unless the security is ensured before, during and after elections. Thus, this paper is arranged to discuss, after introduction, conceptual clarifications, the role of the security during election in any democratic states. This section is followed by the assessment of the security in the Nigerian context. The last section gives summary, conclusion and recommendations.

## 2. CONCEPTUAL CLARIFICATIONS

### Concept of Democracy

Democracy (Greek *demos*, "the people"; *kratein*, "to rule") is a political system in which the people of a country rule through any form of government they choose to establish. In modern democracy, supreme authority is exercised for the most part by representatives elected by popular suffrage (Richard, 2009). To appadorai (1975:137) "*democracy may be described as a system of government under which the people exercise the governing power either directly or through representatives periodically elected by them.*" The representatives may be supplanted or uprooted by the electorate according to the legal procedures of recall and referendum, and they are, at least in principle, responsible to the electorate. The Heater goes to argue, as quoted by Anifowose, that *democracy is essentially a method of organizing society politically. There are, it is suggested, five basic elements without which no community can call itself truly democratic. These elements are equality, sovereignty of the people, respect for human life, the rule of law and liberty of the individual.*

From the Heater's definition deficiency is discovered since his definition does not address the role of both political parties and the interest groups. To take care of these shortfalls Larry Diamond's definition does justice to these points. He defined democracy to have consisted "*meaningful and extensive competition among individuals and organized groups, either directly or indirectly, for the major positions of governmental power*" (Diamond, 1988:4). This Diamond definition tremendously magnifies the importance of competition at the level of political parties and the role of people's participation at the level civil societies. In many democracies, such as the United States and Nigeria, both the executive head of government and the legislature are elected. In typical constitutional monarchies such as the United Kingdom and Norway, only the legislators are elected, and from their ranks a cabinet and a prime minister are chosen. Although often used interchangeably, the terms *democracy* and *republic* are not synonymous. Both systems delegate the power to govern to their elected representatives. In a republic, however, these officials are expected to act on their own best judgment of the needs and interests of the country. The officials in a democracy more generally and directly reflect the known or ascertained views of their constituents, sometimes subordinating their own judgment.

Democracy is generally traced to the rule by the people of the pre-Christian era. The democracies of the city-states of classical Greece and of Rome during the early years were direct democracies, in which all citizens could speak and vote in assemblies that resembled New England town meetings. Representative government was unknown and unnecessary because of the small size of the city-states. Europe first contact with democracy was in 1642, during the political and revolutionary action against autocratic European governments resulted in the establishment of democratic governments. Such action was inspired and guided largely by political philosophers, notably the French philosophers Montesquieu and Jean Jacques Rousseau, and the American statesmen Thomas Jefferson and James Madison. Before the end of the 19th century, every

important Western European monarchy had adopted a constitution limiting the power of the Crown and giving a considerable share of political power to the people. Later, the success of democratic institutions in the United States served as a model for many states. The conception of democracy in Nigeria could be traced to 1922 Clifford constitution. During this period the constitution allowed Nigeria citizens to contest for four reserved seats for Africans in the legislative house. Though the constitution restricted the franchise due to the monetary conditions attached to it. However, the constitution led to creation of the first political party in Nigeria in 1923 by Herbert Macaulay. Since then till now Nigeria had been a democratic state except in few years of military rules.

Finally, by the middle of the 20th century, every independent country in the world, with only a few exceptions, had a government that, in form if not in practice, embodied some of the principles of democracy. It should be noted here that, although, the ideals of democracy have been widely and commonly professed, the practice and fulfillment have been different in many countries.

### **Concept of Elections**

Election is a process and procedure through which the eligible citizens of a particular state choose their political representatives whom are expected to solve on their behalf the collective problems of the masses. It is a process through which representatives are emerged to direct the affair of the state. Put differently, election is considered to be the process of choosing the representatives of the people who are to be saddled with the clearly defined responsibilities of governance through the voting exercise. Election consists of all prerequisite exercises involved both pre and post. Benjamin (2009) defines election as *“a procedure that allows members of an organization or community to choose representatives who will hold positions of authority within it.”* Nwolise, (2007:155) and Bamgbose (2012:206) defined election to be *“a process of selecting the officers or representative of an organization or group by the vote of its qualified members.”* To Anifowose (2003:21), election is *“the process of elite selection by the mass of the population in any given political system.”* The most important function of any credible elections is to provide the people opportunity to select the leaders of local, states, and national governments. This chance participating in choosen the leaders at all levels serves as golden opportunity for the public to make choices about the policies, programs, and future directions of their government. At the same time, elections promote accountability. The threat of defeat at the polls exerts pressure on those in power to conduct them in a responsible manner and take account of popular interests and wishes when they make their decisions.

### **Concept of Security**

Security is a safety from harm; the degree of resistance to, or protection from harm. It applies to any vulnerable and valuable asset, such as a person, dwelling community, nation or organization. However, security as a word has different dimensions in psychology, public safety, defense and military matters, information etc. though is



used in different disciplines and to mean different things but general meaning is ‘to protect’ and to provide maximum protection for certain thing. Despite that we are only concerned with security during election; it is still pertinent to acknowledge the fact that it is used in other areas like computer security, Data security, information security, human security, personal security, national security, financial security, electoral security, to mention but few.

### **3. DEMOCRACY AND ELECTORAL PRACTICE: ANY ROLES FOR SECURITY**

The purpose of this segment is to critically analyse the pertinent roles of the security, media and civil society organisations to the conduct of credible elections which in turn may beget true democracy. To start with, it has been recognized all over the world that democracy is the best form of government. It is also generally held that elections are an important pillar of democracy. As explained above, election gives citizens choices of choosing among the contesting parties and candidates through voting. Under democracy, elections are supposed to be conducted to ensure that the winner reflects the intention of the voters.

To achieve this gargantuan task, the role of security is not subservient. Otiye (not dated: 6-8) argues that the success or failure of any election depends on the stakeholders performing their duties (INEC, Political Parties, Election Observers, Media and Security Agencies). He laments that *“the security agencies can make a difference in the outcome of elections. It is therefore important that security officers display the highest level of integrity, neutrality, professionalism and sense of duty. The protection of human life, voters, electoral materials and officials and the preservation of lawful and orderly electoral processes are necessary for credible, free and fair elections.”* Just like the way Lai (2013:xx) put it *“security is indispensable to the conduct of free, fair and credible election. From the provision of the basic security to voters at political party rallies and campaigns to ensuring that result forms are protected, the whole electoral process is circumscribed by security considerations.”* Thus, without adequate security, there cannot be credible, free and fair elections.

Some of the roles of security in elections are as follows: Providing security for candidates during rallies, congresses, conventions, electioneering campaigns and elections; safeguarding the lives and properties of citizens during the electoral process; ensuring and preserving a free, fair, safe and lawful atmosphere for campaigning by all parties and candidates without discrimination; maintaining peaceful conditions, law and order around the polling and collation ; providing security for electoral officials at the voting and counting centre’s; ensuring the security of election materials at the voting centre’s and during transportation; ensuring the security of all electoral material, personnel and citizens during registration of voters, update, revision and any other electoral event. In sum, the role of security is to ensure safety of electorate, electoral materials and electoral officers before, during and after elections.

To pinpoint the key lessons from this analysis, it is pertinent to acknowledge the roles of security in elections. All parties concerned must discharge their duties efficiently

ranging from police, military and other paramilitary corps. It is only a well secured electoral practice that can bring about a consolidated democratic rule.

#### **4. THE ROLE OF SECURITY IN DEMOCRATIC RULE AND ELECTORAL PRACTICE IN NIGERIA**

Without mincing words, Nigeria has witnessed the gigantic roles of the trio mentioned above in the area of democratic consolidation. Since Nigeria has gotten independence the foremost challenge that had confronted its political activities was its inability to conduct credible, free and fair elections. Scholars have argued that the only election that possessed such good attributes was June 12 general election in 1992. Unfortunately the then third republic was abortive. Thereafter, military rule ruled for other seven years before the regime was put to an end. Another election was conducted in 1999; new democratic dispensation-fourth republic started on May 1999. For more than a decade of this nascent democratic rule in Nigeria, it is quite unequivocal that free and fair election is still a mirage. Just like the way Joseph (2011: 246) put it *“in any credible democracy, elections constitute the soul of the democratic process”*. This segment wishes to enquire the role of the security, media, and civil society in ensuring free and fair and credible elections in Nigeria.

#### **SECURITY AND ELECTIONS IN NIGERIA**

The constitutional roles of security men in Nigeria during election are quite germane. Electoral security in Nigeria is primarily handled by police. In other words, the police are primarily saddled with the responsibility of making sure that people exercise their voting rights in an orderly manner with the help of other paramilitary organisations. But it got a level that military have to participate in this process. The participation of security men is now becoming more alarming. Since the situation has even degenerated to the level that hardly could Nigeria conduct any election without abundant of security men. In fact, it has now become a paradigm that election without security men in Nigeria is impossible. What could have led to this myopic view?

The answer is not farfetched. Security men generally, except few, have made themselves available for election rigging. What an insult? Security personnel that are expected to maintain laws are breaching them with impunity at this precarious time. In most of the previous elections, it is discovered that security men could not exonerate themselves from common scourge of corruption. One can even contend that police and others security officers can be easily pocketed by the politicians and most especially government in power. No wonder, it is popularly held that *“he who pays the piper dictates the tune”*. In short, corruption has been used to characterize the role of security men in elections in Nigeria.

Closely related to the above point is the issue of partisanship. The security men have been accused of belonging or being used by one or more political parties against others. The alleged *“sophisticated and professional rigging”* that took place in Ekiti has made some analysts to conclude that security men are not but the stooge of the ruling

party, PDP in Nigeria. The controversial tape released on internet which was said to have exposed the cruel deal that transpired between the head of police, head of military, and the PDP delegates on how they would rig the then election was a good example of such partisanship of security men.

Sometimes, security men are used to intimidate both electorates and the opposition parties. This phenomenon is becoming rampant in recent days in Nigeria. It was reported in daily news that police arrested some of the political gladiators of APC in Ekiti and Osun States on the eve days of elections. These arrests were later found illegal. Also, in some areas, the electorates were reported being afraid of the security men. This phobia and trepidation debar some voters from exercising their civic right. This was alleged to have reduced the turn-out of the electorates especially at the areas where supporters of APC were numerous.

Be that as it may, security men still have some positive impacts towards successful conduct of elections. This could be felt right from the period of campaigns. The politicians always like to jump the rules of the game unless there are security's controls and interventions. Another round of security role in election is in providing security for election materials, electorates, candidates, and the INEC officials. These have been their normal routine since the inception of democracy in 1999. While these roles are both constitutionally and morally commendable, the partisanship and corruption is highly condemnable both nationally and internationally.

## **5. CONCLUSION AND RECOMMENDATIONS**

The federal republic of Nigeria as a democratic state has been wallowing in pathetic ocean of backwardness, insecurity, corruption, and high level of poverty. The menace of these problems is often referred to as bad leadership. The realization of the fact prompted Nigerians to clamour for democracy. The logic is that democracy will allow them to choose good heads to paddle the canoe of this country. Quite unfortunate, since the inception of the present fourth republic, elections have not reflected the opinion of the voters. Scholars have suggested that inability of Nigeria to conduct free and fair elections is the cause of leadership crisis in Nigeria. Then, there is need for credible elections in Nigeria. Based on this background, what are roles of security, media, and civil society?

In this paper, an attempt has been made, after introduction, to briefly make conceptual clarifications. The paper draws the linkage between federalism, democracy and elections. This paper does not only analyse the roles of security, media and civil society in any democratic settings but also elucidates the roles of the trio in elections. Consequently, this paper makes a critical analysis of the aforementioned agents (security, media, and civil society) on elections in Nigeria. The main purpose is to examine the extent at which the three agents have performed their constitutional duties and /or rights. It is discovered that the security has tried in Nigeria to ensure safety of lives, properties and peaceful conduct of elections. However, it is also discovered that security men have truncated the efforts of Nigerians to choose good leaders and to let the results of the polls reflect the wishes of the voters. It has been discovered, in this paper, that media perform

tremendous roles. Media educate, enlighten, and monitor elections but some of these media are found biased and discriminative. Furthermore, it is discovered that in Nigeria civil society organizations perform great roles in educating the electorate through different means. They also serve as watch-dog during elections. However, different challenges usually confront civil society organizations ranging from financial and strategic challenges.

Finally we can then recommend that security is well fed and are given more autonomy to perform their constitutional duties without being induced by candidate, political parties, and government. Security men should also be moral in discharging their duties. Also, the media should improve their efforts in educating and enlighten the electorate but they should, by all means, jettison all forms of discriminations. For the civil society organisations, should be focused, financially independent, and always up and doing. On a final note, I would like to persuade the participants of this workshop especially the security men here present, journalists, and the representatives of civil society organisations to discharge their duties in the forthcoming elections as constitution dictates. I strongly believe that we will all learn more from our guest lecturers. I congratulate the organisers of this workshop for your usual efforts to educate, orientate and enlighten us all.

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## **THE CONCEPT OF TERMINATION OF RIGHT IN RECENT EUROPEAN TAX LAW JURISPRUDENCE**

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**Abstract:** *The paper analyses the changes that have lately appeared in the legal regime of the termination of right, in the field of public law, in general, and for the tax law, in particular. We have found major mutation in this legal institution, in the sense of modifying the effects of prescription of this legal concept as a whole. It is not the first time when, solving cases that are subject to trial or answering questions raised in the preliminary procedure, the CJEU creates new legal rules, affecting principles of fundamental value that until recently have seemed untouchable. Thus, in the very recent opinion of this court, expressed in VAT matters, the right to reimbursement of the tax may also be invoked after the period of prescription has been fulfilled. The paper analyzes this jurisprudence by anticipating how it will modify the internal legal framework for institution of prescription in taxation. The prescription of material right to action is one of the institutions with a long influence in the history of legal sciences, equally marking all branches of law. The concept of prescription is analyzed in the doctrine of tax law, especially due to the particular nuances conferred by the legal nature of the tax law cases. The effects of the prescription have always been the same: the paralysis of the possibility to obtain the execution of a violated right uses the state's coercive force. Traditionally, the prescription of right was considered an absolute impediment, blocking not only court action to recover prejudice, but any other mean to obtain the enforcement of the law, except for the situation when the execution intervenes voluntarily. This regime has changed mainly on the impulse of the jurisprudence and the regulation in force is still adapting to the new status of the concept. Presently, new perspectives for research and development of tax law theory are opened at EU level and, consequently, in Member States' legislation.*

**Keywords:** *termination of right, fiscal law, relevant jurisprudence, recent CJEU approach*

**JEL Classification:** *K10, K34, K41*

### **1. INTRODUCTION**

The prescription is present in all legal systems and its purpose is to provide stability and certainty to legal relations by strengthening the legal status and sanctioning the lack of diligence to act for the recognition or realization of a right within a certain period of time. Extinctive prescription limits the time when an individual or legal person can take advantage of a right by constraint or by initiating an action. (Räuschi, 1993, p. 165) Extinctive prescription is a mean of extinguishing the right to action in a material sense, by failing to exercise that right within the time-frame set by law and it determines the holder of a subjective right or the creditor who has remained inactive for a certain period of time to lose protection of the right to bring an action in the courts. At the same time, the owner loses the possibility of obtaining enforcement of its correlative obligation by force. The literature on termination of rights analyzes not only prescription periods,

but also the time at which they begin to be calculated, in order to accurately identify the moment when the prescription is effective (Stătescu&Bîrsan, 1993, p.154).

The importance of the prescription as a legal institution is revealed by reference to its functions, starting with the educative and mobilizing function, in the sense that the holders of violated or unrecognized civil rights have to address to competent jurisdiction bodies to obtain the approval of their rights. Another function is the sanctioning function, in the sense that once the prescription of the right of action by the competent judicial body is found, the holder of the the breached or unrecognized civil right loses the legal option to obtain the necessary protection, which is a sanction for the negligence (Beleiu, 2007, p.185). In the international legal literature, the role of the prescription as a public policy, used by central governments to manage the crisis of overloading courts by solving too many cases in certain time periods, has also been revealed (Posner, 1992, p.579).

## **2. THE REGULATION OF THE EXTINGTIVE PRESCRIPTION IN THE ROMANIAN LAW**

In the current regulation of our country, the legal norms that form the institution of the extinctive prescription are contained mainly in Book VI of the Civil Code ("About extinction prescription, termination and calculation of deadlines"), Title I being entirely devoted to creating the general framework of this institution. From the point of view of its effects, the notion of prescription has two meanings, an acquisition prescription and an extinctive prescription (Beleiu, 2007, p.189). Starting from the provisions of art.2500 par.(1) of the current Civil Code, the extinctive prescription can be defined as the sanction consisting in extinguishing, under the conditions established by law, the material right of action not exercised in time. Article 2 (2) of the same article states that the right to action means the right to compel a person, by the enforcement of the public authorities, to execute a particular benefit, to comply with a particular legal situation or to bear any other civil sanction, as the case may be.

It should be noted that the law no longer regulates the extinctive prescription as a legal institution of public order, the new legal provisions conferring its character of private order. Specifically, unlike the legal framework granted to the extinctive prescription before (by Decree no.167/1958), at present, the competent jurisdiction body cannot apply the prescription *ex officio*, according to art.2512 par.(2) Civil Code. In fact, the norm in force, art.2512 par.(3) expressly provides that the prescription cannot be invoked *ex officio* even in those situations in which it would be in the interest of the State or its administrative-territorial units. Moreover, there is the possibility of waiving prescription, according to art.2507 - art.2511 from the Civil Code. Thus, according to the private order character of the prescription, art.2515 par.(3) of The Civil Code provides for the parties the full possibility to modify, by express agreement, the length of the limitation periods or the limitation period, fixing the starting point or modifying the legal grounds for suspension or interruption. We are therefore in the presence of a permissive rule of law (Popescu, 2014, p.39). With regard to the possibility of changing prescription periods by express agreement of the parties, paragraph 4 of the same article states that they may be reduced or extended, but within certain limits. Thus, in the case of legal

prescription periods of less than 10 years, the term negotiated by the parties may not be less than one year and not more than 10 years, and in the case of legal prescriptions of at least 10 years, parties may agree to terms up to 20 years.

However, according to art.2515 par.(5) of the Civil Code, no such change can be exercised in the case of the rights of action that the parties may not have, nor in the case of actions deriving from the adhesion, insurance and consumer protection laws. We consider this provision to give priority to the initial consent expressed in relation to the conclusion of the main contract, taking into account the specific nature of the initial legal relationship concluded.

Therefore, in the context of the codification (recoding) of the norms of law in our country, we also witnessed the substantive changes of the institution of the extinctive prescription, compared to the previous regulation, by changing the public character of this institution into a private law institution. The previous legal framework was governed by absolute imperative rules, which allowed no deviation from the law. According to art.1 last paragraph of Decree no.167/1958, "any clause which deviates from the legal regulation of the extinctive prescription is null." In other words negotiation by the parties and their agreement on other prescription periods than those expressly provided would have been hit by absolute nullity; identical, other causes of interruption or suspension of the limitation period than those established by law, which would determine the moment from which the prescription begins to run according to rules other than those established by the legal provisions, were of no effect whatsoever, being absolute zero.

Still, there are also legal provisions of public order, exception to the private character of the institution of extinctive prescription, as a whole. Thus, par.(2) of art.2515 of the Civil Code prohibits any clause by which either a direct or indirect action would be declared admissible, although the right is terminated under the rule of prescription, or vice versa, an action declared possible by the rule of law would be considered prescriptive. Also, par.(6) of the same article sanctions with absolute nullity any contrary convention.

There is a different regulation of the three-year, for private personas, and five-year time-limit for the prescription of the right to action, when the holder of the terminated right is the state, and it generates controversy over the violation of fiscal equity and respect for the principle of equality. The applied solution to this conflict of rules is to recognize the more favorable right (of a longer duration of five years) for the prescription of the substantive right to action in favor of all holders of rights subject to prescription, whether there are private persons or public authorities involved.

Apart from the limitation of substantive law, tax law also regulates the prescription in tax procedural law, namely the limitation of the right to demand execution of the enforceable decision issued for unpaid tax (Bugaru-Vidican, 2015, p.8). Thus, the right of the state to enforce the title of a fiscal debt owed to the state budget shall be extinguished by prescription, if it has not been exercised within the term stipulated by the law. Fulfillment of the limitation period of the tax obligation leads to the extinction of the state's right to pursue the collection of budgetary revenues. The general framework of the regulation of the extinctive prescription in the tax procedural law is found in the provisions of the Code of fiscal procedure, respectively articles 131,135.



The court of its own motion cannot invoke the prescription, but only by the one in whose favor it is flowing, without any additional condition. So prescription is no longer a concept of public order, as long as it cannot be invoked *ex officio*, not even in favor of the state or territorial administrative units. Therefore, in the Civil Code in force it is assessed that the extinctive prescription must start to run not from the date of the right of action, but from the date when the person concerned became aware or should, according to the circumstances of the case, be aware of the existence of this right. Of course, outside of this general rule, there are also assumptions or situations requiring the express determination of the starting point of prescription period, either to customize the general rule or to derogate from it, within certain limits, if there are any serious reasons for it. These are the so-called special rules on the beginning of the prescription, which have not only been retained in the new regulation, but have even been multiplied or, as the case may be, modified (Țândăreanu, 2010, p.3).

The new general rule on the beginning of the extinctive prescription has a mixed character, presenting the characteristic of setting - alternatively - two moments from which prescription begins to run, namely:

- a subjective, main moment, consisting of the date when the right to action was born; and
- an objective, subsidiary time, when the circumstance should have known the birth of this right.

We appreciate this context of the transformations of the institution of prescription in domestic law as welcomed and justified in the current European and global context, when we witness changes in the regulation of the fundamental institutions of law, in accordance with the rationality and specificity of the current legal relations. Of course, for Romanian law, the transformation of an absolute, public order institution into a private institution whose effects on public relations are to be determined conventionally is a major change. But the transformation process does not stop here. Analyzing the influence of EU law on national law, we must first point to the principle of the priority of the European law rule on the domestic legal framework and to take into account the effects of the CJEU jurisprudence for all branches of law. Equally valid are those statements in the area of fiscal law, whose legitimacy and position in the branches of law is greatly influenced by the casuistry of the European court. If for civil law, common law for all legal disciplines (Hamangiu et al., 1995, p.113), the principle of the prevalence of form over the fund is absolute (Article 1247 of the Civil Code), then we must recall here that European tax law enshrined the principle of the prevalence of the substance over the form (Tofan, 2017, p.508). However, this hazy situation has not been an isolated case, the recent case law on taxation demonstrating that there are other situations in which legal relations in the European context will continue to change the fundamental institutions of law for a correct management of tax cases.

Of course, we can not overlook the views of our colleagues (Păun, 2017, p.211) which states that there is no European tax law in the actual context, when each of the Member States of the European Union benefits from the sovereign veto in relation to the adoption of taxation uniform rules. But in our view, it is time to give Caesar what is Caesar's, and to observe, argued, that European Tax Law not only exists

autonomously from other branches of law, but it has an integrating role to be taken into account through substantive changes in traditional legal institutions and the provision of a current, identical and special character for all 28 Member States. Even reporting on the number of EU Member States makes it worth pointing out that we are able to write from the point of view of fiscal law 28, although BREXIT seems to be a certain event of the year 2019 (Hunt&Wheeler, 2018, p. 1), in question being only the procedural aspects. Equally, we can note that the European VAT split idea, still in the experimental phase and in search of a perfectly adapted legal framework for all Member States (whether regulation or directive, we will see) is, in theory, incapable to reach the UK regulatory framework. In practice, however, in March 2018, the UK government launched a public consultation on the possibility of introducing the separate payment procedure for amounts due for VAT purposes (<https://www.gov.uk/government/consultations/alternative-method-of-vat-collection-split-payment>), so there is a strong interest in implementing European measures that are no longer required to be implemented, particularly in the area of tax law.

### **3. THE LIMITATION OF THE RIGHT TO REIMBURSEMENT OF VAT IN THE RECENT JURISPRUDENCE OF THE ECJ - CASE C-533/16 VOLKSWAGEN AG**

In the surprising manner of the CJEU on the interpretation of tax rules at European level, two of this court recent decisions have highlighted that value added tax could be reimbursed after expiry of the limitation period. We are referring to Case C-533/16 Volkswagen AG concerning the refusal of the right to reimbursement of VAT on the grounds that the limitation period decided by the CJEU on 21 March 2018 and Case C-8/17 Biosafe, solved on 12 April 2018, when the CJEU discussed the same tax issues, but in the context of different questions.

The facts of the two cases are slightly different.

In Case C-533/16 Volkswagen AG, Advocate General CAMPOS SÁNCHEZ-BORDONA maintains in his opinion that the Court of Justice has examined the right to deduct value added tax several times, in response to requests for preliminary rulings. In the present case, the question referred by the national court refers to the time-limit for making that deduction and the problem faced by the national court results from the fact that between 2004 and 2010 Volkswagen AG received supplies from certain parties without VAT included in the relevant bills. Both parties wrongly assumed that the transactions in question constituted financial compensation and, as such, were not subject to VAT. When, in 2010, they realized their mistake, the suppliers charged VAT to Volkswagen and then issued the relevant invoices, mentioning the amount of owed tax. They also filed an additional VAT return and paid the tax to the Treasury. Volkswagen applied for VAT deduction but the tax authority admitted the claim only for a part of the requested period, rejecting the period for which the limitation for exercising the right (five years) had already been met. Therefore, the Court of Justice of the EU decided to what extent the deduction right applies, if VAT was not levied at the time of the initial

delivery of the goods and the subsequent adjustment affects tax periods for more than five years (termination of right period).

By reference to the formal requirements for the right to deduct, the Advocate General noted that, as a matter of urgency for the proper functioning of the VAT system, the obligations of the taxable person to be liable for VAT are invoicing and filing of declarations. In the preliminary proceedings, the most important of these requirements are on the invoice, since Article 178 (a) of the VAT Directive provides that, in order to exercise the right of deduction, a taxable person must hold an invoice drawn up in accordance with Section 3 to Section 6 of Chapter 3 of Title XI of the Directive. The factual situation implies that:

- the delivery of goods to Volkswagen was carried out, as reflected later in the corresponding invoice; and
- the invoice included all the information required by Directive 2006/112.

The material and formal conditions for the creation and exercise of the right to deduct VAT are therefore satisfied and Volkswagen is, in principle, entitled to exercise its right of deduction. Proof of this is ensured by the fact that the tax authority has recognized this right, albeit only for part of the tax periods for which it was exercised.

The home state Tax Authority (Slovakia) claims that repayment cannot be granted because it was requested outside the five-year limitation period. However, the Advocate General observed that the VAT Directive does not expressly refer to a time-limit for the exercise of the right to deduct. This, of course, does not prevent national legislation from laying down a time-limit on grounds of legal certainty, and the Court of Justice has held before that a limitation period whose expiry has the effect of penalizing a taxable person who was not diligent enough, applied for deduction of tax paid, can not be regarded as incompatible with the system laid down by the Sixth Directive. The limitation period applies in the same way to analogous tax rights, based on domestic law and to those based on EU law (principle of equivalence), that it does not make it virtually impossible or excessively difficult to exercise the right of deduction (principle of effectiveness). At the same time, the Advocate General stated that the setting of the starting date of the period for calculating the limitation period can not be exclusively related to the time at which the goods were supplied irrespective of any relevant factors. Although, under Article 167 of Directive 2006/112, the right to deduct arises at the same time as the tax becomes chargeable, Article 178 of that directive provides that it may be exercised only after the taxable person has an invoice, stating that the goods have been provided. The difference between the right to deduct and the exercise period is due to the way VAT operates:

When a taxable person obtains goods, this person pays (or at least is required to pay) the supplier of the goods in question a price including VAT for the products that will generally be used for the purposes of the taxable transactions

However, for the purposes of tax administration, the taxable person is entitled to deduct VAT already paid at a later date, when the person submits to the tax authorities the appropriate documents, which must include the corresponding invoices, a substantive evidential requirement for the deduction (or, as appropriate, of the refund).

In other words, the right to deduct is indissolubly linked to two VAT payments:

- the payment of the supply of goods, payment which is made by the taxable person to the supplier; and
- the payment made to the taxable person by the customer, when the taxable person supplies the customer with the products.

Invoices are proof of the fact that the respective transactions and payment of the price have actually taken place, which must include VAT at the corresponding rate. This VAT already belongs to the state / tax authority, which is why it becomes payable as soon as it is paid or should have been paid. The person issuing the invoice will cash VAT as an agent of the tax authority, in other words, assuming the role of VAT collector. It follows that the right to deduct arises at the same time as the taxable person must be able to prove that tax at the tax office. According to the Court, the deduction system allows intermediary links in the distribution chain to deduct from their tax base the amounts paid by each of its suppliers in respect of VAT for the corresponding transaction and thus transfer to the tax authorities the share of VAT representing the difference between the price paid of each supplier and the price at which he delivered the goods to the buyer.

This model is based on the principle of VAT neutrality, according to which taxation of all economic activities with value added tax occurs regardless of their purpose or results, provided that they are themselves subject to VAT. Under this system, the rules on deductions are intended to relieve the trader entirely of the burden of VAT due or paid. Thus, payment of the tax to the supplier by the taxable person is at the center of the right to deduct. It is not possible to separate the tax deduction: if the taxable person did not pay the tax, which generally appears in the invoice, there is no legal or financial basis to allow the exercise of the right to deduct. In Directive 2006/112, and in particular Article 167, the EU legislator refers to the normal circumstances in which the delivery of goods, the payment and the issue of the invoice indicating the value of VAT take place almost simultaneously. In such cases, it is logical that value added tax and the right to deduct occur simultaneously. On the other hand, a situation such as that at issue in the main proceedings may be regarded as exceptional or unusual in the light of VAT, since:

- when Volkswagen received the goods from the supplier, it did not pay any VAT, both parties considered that the transaction was not subject to VAT; and
- similarly, Volkswagen did not receive an invoice including VAT, which would have allowed it to exercise its right of deduction.

In those circumstances, the taxable person could not, of course, claim the right to deduct a sum of VAT which had not previously been paid. In other words, the applicant has expired from the limitation period not as a result of its own lack of diligence but as an effect of the fact that VAT was not paid once the invoices issued in the principal legal relationship had been paid. The Advocate General observed reasonably that the Slovak tax authorities apply the five-year term against Volkswagen, even though this period also works in terms of tax collection, in other words, in favor of Volkswagen, as the provision prevented the authorities from collecting the tax due if they have passed five years. If, after more than five years, the tax authority had been prepared to accept the VAT payable by Volkswagen for 2004, for example, then it should also accept that the taxable person has the right to deduct VAT paid similarly.

At the same time, Article 167 of Directive 2006/112 may be interpreted as meaning that, in circumstances such as those in the present case, a taxable person acting in good faith would not lose all the right to deduct VAT. The way in which national legislation has been interpreted by the practice of the Slovak tax authorities has led to the refusal to allow the exercise of this right, which runs counter to the principle of VAT neutrality. The Court of Justice has repeatedly stated that this principle must also prevail and that the right to deduct is part of the VAT mechanism and, as such, should not, in general, be limited. The principle of VAT neutrality imposes deduction of VAT on inputs where the substantive requirements are satisfied even if the taxable persons did not comply with formal requirements. The Court of Justice has clearly held the right to deduct as much as possible, for example, considering that Article 167, Article 178 (a), Article 179 and Article 226 (3) of the VAT national rules under which the correction of an invoice in relation to a particular item to be mentioned did not have retroactive effect, thus limiting the possibility of deduction of VAT due to the year in which it was corrected, and not the year in which the invoice was originally drawn up. If this restriction was considered to be contrary to Directive 2006/112 for the same reason, the approach taken by the Slovak authorities, which in practice renders impossible the exercise of the right to deduct in such cases, should also be considered contrary to it. It must be borne in mind that this right can only be exercised by one person after he knows that transactions are subject to VAT and not before and whether the person acted in good faith.

Moreover, the conduct at issue in the main proceedings is disproportionate. It is true that Article 273 of Directive 2006/112 allows Member States to adopt measures to ensure the correct collection of VAT and to prevent evasion. However, such measures - which, for reasons of legal certainty, include the setting of time limits for the exercise of the right of deduction - must not go beyond what is necessary to achieve those objectives and must not affect the neutrality of VAT. Having established that the taxable person acted in good faith and excluded tax evasion or tax advantage and given that adjustments had been made to the transactions, it would be disproportionate to deprive that taxpayer of the right to deduct only because he incorrectly believed that the transactions were not subject to VAT and that the period elapsed up to the time of the adjustment exceeded five years. Consequently, on the proposal of the Advocate General, the Court decided, by decision of 21 March 2018, that in circumstances where it was wrongly believed that a supply of goods was not subject to VAT and several years later an adjustment of the tax paid has been made late, the taxable person has the right to deduct (or, if appropriate, obtain a refund) the amount of VAT paid upfront paid for that transaction.

#### **4. BIOSAFE JURISPRUDENCE: CASE C-8/17 BIOSAFE / FLEXIPISO**

In Case C-8/17 Biosafe/Flexipiso, the CJEU was asked to answer preliminary questions about the following facts. Between February 2008 and May 2010, Biosafe sold Flexipiso, a company paying VAT, goods, to which Biosafe applied VAT at a reduced rate of 5%. Following the fiscal inspection in 2011, regarding fiscal years 2008-2010, the Portuguese tax authorities found that the standard VAT rate of 21% should have been

applied and imposed VAT revisions. Biosafe paid that amount and requested reimbursement from Flexipiso by sending accounting documents to that undertaking. Flexipiso refused to pay the additional VAT on the ground that it was not in a position to make a deduction because of the expiry of the four-year period laid down in the national legislation in force for operations carried out until 24 October 2008 and, because it was not responsible for the consequences of an error for which Biosafe was solely responsible.

Following that refusal, Biosafe brought an action requesting Flexipiso to reimburse the amount of VAT paid, together with the interest for late payment. This was rejected by the trial court and appellate court which found that although there is an obligation to pay VAT, the buyer of goods may be required to pay this fee only if invoices or equivalent documents were issued in time to deduct this charge. Portuguese courts have held that, regarding documents (debit notes) received by Flexipiso more than four years after the issuance of initial invoices, Biosafe could not transfer company Flexipiso VAT on these invoices, as the latter did not have the right to deduct VAT and the applicable tax rate applies to Biosafe.

Portuguese national court found that there is doubt regarding whether the Articles 63, 167, 168, 178-180, 182 and 219 of the VAT Directive and the principle of fiscal neutrality preclude national legislation which has the effect, in circumstances such as those in the main proceedings, that the period during which the purchaser may deduct additional VAT may begin to run from the date of issue of the original invoices and not from the date of issue or receipt of the corrective documents. In the view of that court, there is also a doubt whether the acquiring company may in such circumstances refuse to pay the additional VAT due to the impossibility of deducting it. Thus, the national court requested the CJEU to issue a preliminary ruling in order to clarify these issues.

In deliberation, the CJEU has held that the right to deduct VAT is subject to compliance with both the substantive requirements and the formal conditions and requirements or conditions, with reference to the judgment in Volkswagen, C 533/16, supra. As regards the material requirements or conditions, it follows from the wording of Article 168 (a) of the VAT Directive that, in order to be entitled to deduct, it is necessary

- an applicant, who is a taxable person
- the goods or services for which the right to deduct VAT is claimed are used by the taxable person in his activity
- these goods or services are provided by another taxable person

The formalities for the exercise of the right to deduct VAT provided by Article 178 (a) of the VAT Directive, say that the taxable person must hold an invoice drawn up in accordance with Article 220 (236) and Articles 238 to 240 of that directive direction. It follows that although Article 167 of the VAT Directive provides for the right to deduct VAT on the date on which the tax becomes chargeable, Article 178 of that directive makes the exercise of the right subject to the fact that, in principle, the taxable person holds an invoice. The right to deduct VAT is generally exercised during the same period as the one in which it was incurred, when the tax becomes chargeable. However, a taxable person may be authorized to make a deduction of VAT even if he has not exercised his right during the period in which the right arises, subject to compliance with

certain conditions and procedures laid down by national law (judgment of 21 March 2018, Volkswagen, C 533/16, reviewed supra).

However, the CJEU notes that the possibility of exercising the right to deduct VAT without a time limit would be contrary to the principle of legal certainty and a limitation period whose expiry would have the effect of penalizing a taxable person who was not diligent enough and did not request the deduction of VAT paid upstream by making it waive its right to deduct VAT is to be regarded as compatible with the system established by the VAT Directive. It is also the case when the limitation period applies in the same analogous rights in tax matters based on domestic law and those based on European Union law, in accordance with the effects of the principle of equivalence.

Under Article 273 of the VAT Directive, Member States may impose other obligations they consider necessary for the correct collection of VAT and the prevention of evasion. Preventing tax evasion, avoidance and abuse is a recognized objective and is encouraged by this directive. However, the measures Member States may adopt under Article 273 of that Directive must not go beyond what is necessary to achieve those objectives. They cannot therefore be used in such way as to systematically undermine the right to deduct VAT and, consequently, the neutrality of VAT. Since the denial of the right to deduct is an exception to the application of the fundamental principle constituted by that right, the competent tax authorities must establish, to a certain degree, which is legally sufficient, whether the objective evidence proves the existence of fraud or abuse. It is for the national courts to determine subsequently whether the tax authorities concerned have established the existence of such objective factors (C-332/15 Astue, 20 July 2016).

In the present case, it is apparent from the order for reference that, following a tax inspection carried out in 2011, the Portuguese tax authorities issued VAT adjusted VAT returns for supplies between February 2008 and May 2010 for which Biosafe applied incorrectly a reduced VAT rate instead of the normal rate. Therefore, Biosafe made a VAT adjustment by paying additional VAT and issuing debit notes, which, according to the referring court, constitute documents for rectifying the original invoices. The Portuguese Government considers that Biosafe and Flexipiso have systematically and consistently implemented systematic tax evasion and VAT avoidance practices for at least two and a half years. Indeed, the existence of such practices cannot be ruled out in such a situation. However, under the procedures provided for in Article 267 TFEU, which is based on a clear separation of functions between national courts and the Court of Justice, any assessment of the facts is a matter for the national courts. The Court of Justice is empowered to rule only on the interpretation or validity of European Union acts on the basis of the facts submitted by the national court (Danske Svineproducenter, Case C-491/06 and Order of 14 November 2013, Krejci Lager & Umschlagbetrieb, C 469/12). In the present case, the court states that the error in the choice of the applicable VAT rate is obviously attributable to Biosafe.

Against this background, it appears that it was objectively impossible for Flexipiso to exercise its right of deduction before the VAT adjustment made by Biosafe, since it did not have prior documents for rectifying the original invoices and did not know that it was due to additional VAT. It was only after that adjustment that the

substantive and formal conditions which led to a right to deduct VAT have been fulfilled and that Flexipiso can therefore claim the VAT exemption due or paid in accordance with the Directive VAT and the principle of fiscal neutrality. As a result, Flexipiso did not show a lack of diligence before receiving debit notes and there is no proven abuse or fraudulent understanding with Biosafe. Consequently, the CJEU notes that Articles 63, 167, 168, 178-180, 182 and 219 of the VAT Directive and the principle of fiscal neutrality must be interpreted as precluding legislation of a Member State according to which circumstances such as those at issue in the action the main right to deduct VAT following a tax adjustment has been paid for additional VAT and has been the subject of rectification of the original invoices several years after delivery of the goods in question on the ground that the period laid down by that legislation for the exercise of this right began to run from the date of issue of the original invoices and has expired. In such circumstances, a taxable person can not be denied the right to deduct additional VAT on the ground that the period laid down by national law for the exercise of that right has expired.

## **5. CONCLUDING REMARKS**

Under current Romanian law, a taxable person may deduct VAT from the moment that this right was born for five years or until the expiry of the limitation period. There is only one exception to the law on value added tax established during tax inspections. In these cases, suppliers may issue correction invoices after the tax inspection, but only within the limitation period, as extended, considering the duration of the tax inspection. Taking into account this situation, the right to deduct the appropriate VAT subsists even if the limitation period has expired, but only within one year after the receipt of the corrected invoice (withdrawal period). Thus, the novelty of European case law in relation to Romanian law is that the right to deduct VAT may also be exercised after the expiry of the limitation period, even if it did not result from a tax inspection.

We have to point out that according to the provisions of the Civil Code in force, under Romanian law the extinctive prescription must not start from the date of the right to action, but from the moment when the interested person became aware or should, after the circumstances of the case, become aware of the existence of this right. Therefore, without damaging the effects of the CJEU case law under consideration, we must note the accuracy of the general legal framework in our country.

In conclusion, European Union law must be interpreted as precluding legislation of a Member State under which, in circumstances where value added tax (VAT) was invoiced to the taxable person and paid after several years after the delivery, the right to reimbursement of VAT is refused on the ground that the period of limitation provided by the legislation for the exercise of that right began to run on the date of delivery of the goods and would have expired before the application for reimbursement was made. The CJEU also decided that Council Directive 2006/112 / EC of 28 November 2006 on the common system of value added tax and the principle of fiscal neutrality should be interpreted as precluding legislation of a Member State when, in circumstances which, following a tax adjustment, VAT additional has been paid to the State and it has been the



subject of rectification of the original invoices several years after delivery of the goods in question, the right to deduct is refused VAT on the ground that the period laid down by that legislation for the exercise of that right would have started to run from the date of issue of the initial invoices and it would have expired.

So, once again, we note that the European tax law acts like automotive towards other branches of law tends, and also it has integrating and pioneering legal valences in the interpretation and modification of the traditional rules, formulated and safeguarded by other branches of law.

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