EFFECT OF POLITICAL FACTORS ON TAX NONCOMPLIANCE BEHAVIOUR AMONG LIBYAN SELF-EMPLOYED TAXPAYERS

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ABSTRACT

The current study attempts to empirically examine the effect of political affiliation and political instability on tax noncompliance behaviour among self-employed taxpayers of Libya. A self-administered questionnaire was distributed to the 498 Libyan self-employed. Total 312 questionnaires were fully completed that were used in the final data analysis. A structural equation modeling approach was employed using PLS-SEM 3.2.7. Results reveal that both political affiliation and political instability have a significant effect on tax noncompliance among self-employed Libyans.

Keywords: Tax Noncompliance, Political Affiliation, Political Instability, Libya.

INTRODUCTION

Tax authorities around the world are facing the challenges of fiscal issues pertaining to performance in the collection of tax revenue as an important source of domestic resource mobilization. Tax noncompliance behaviour is translated into tax gap in the national accounts that is the difference between statutory and actual tax revenue collection. According to Fuest and Riedel (2009), a tax gap is tax revenue losses due to tax avoidance and tax evasion. All revenue authorities around the globe are confronting tax noncompliance problem. Tax noncompliance problem has, even more, the worst effect in the developing country due to the scarcity of the domestic resources (Kim, 2008). Libya’s official management facing two severe issues in term of its tax system a tax collection in the post-revolution 2011.

First, according to Libyan Audit Bureau (LAB, 2015), being developing country, Libya is facing tax evasion stemming from tax noncompliance behaviour of taxpayers. Second, Libya faces the issue of a narrow tax base due to dependence on oil revenue that affects the revenue due to fluctuation in the oil prices and the level of oil production (Mansour, 2015). The largest share of the fiscal revenues in Libya comes from sales in the oil industry that is utilized to support the budgetary expenditures. The fiscal vulnerability and imbalance rising in the wake of the political turmoil after the 2011 revolution have made these revenue-related more salient (Finger & Gressani, 2014; IMF, 2014; Mansour, 2015). According to Mansour (2015), this situation has created the need for structural fiscal reforms to increase the tax collection efforts. Moreover, Bureau of Audit (LAB, 2015) mentions that tax noncompliance is one reason for the low tax revenues collection in Libya and thus points to the prevalence of tax noncompliance among taxpayers according to Saidi and Prasad (2015). In addition, the statistics on the tax collection trend from 2009 to 2015 by the LAB report of 2016 describes the large decline in the
tax collection during the period. Tax collection declined from LYD 38.1 million in 2009 to LYD 5.4 million in 2015 by self-employed taxpayers in Libya. Such a dismal picture of tax revenue collection by self-employed taxpayers points to the need for probing determinants of the compliance behaviour of individuals.

Moreover, the prior literature indicates the political factors as key antecedents that may affect tax noncompliance behaviour (Zafarullah, 2018; Kareem et al., 2017; Chiang & Hsu, 2017; Demirtas et al. 2017; Abodher et al., 2016; Ayenew, 2016; Zandi & Elwahi, 2016; Nyarko et al., 2016; Ho et al., 2016; Onakoya and Afintinni, 2016; Mohanty et al., 2016; Rauf, 2016; Duru and Christian, 2014; Congdon et al., 2009; Katz & Owen, 2009; Gerber & Huber, 2009; Grossman 1994; Webley, 1991). For instance, Congdon et al. (2009) concluded that “tax noncompliance behaviour depends on how the taxpayer perceives the government and its politics”. While policy uncertainty affects taxpayers willingness to pay tax in a various way such as whether or not coming government democratic or not, whether or not coming to the government is corrupt and whether or not coming government would invest in infrastructure development an to pursue economic growth (Katz & Owen, 2009). Moreover, Abodher et al. (2016) recommended that “existing theories and models of tax compliance need to be adapted to incorporate political factors in wake of political turmoil in countries facing issues of tax noncompliance”. However, the previous literature reveals scant empirical studies that examine the association among political factors like political affiliation and political instability and tax noncompliance in the context of Libya. Therefore, current study attempts to empirically examine the effect of political affiliation and political instability on tax noncompliance behaviour of self-employed in Libya. The subsequent sections highlight the literature review, methodology and tools that are employed to ensure the reliability, validity and hypothesis testing. In addition, thorough discussion about results is provided. Last section concluded the whole study including policy implications and recommendations.

LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

Political Affiliation and Tax Noncompliance

Tax noncompliance behaviour has impacts on the economy and affects the overall equity and efficiency of the tax system and changes the resource allocation within the economy. So, this is the reason that the economists are always keen to study the tax noncompliance behaviour due to its huge impact on the overall economy. Cullen et al. (2018) argued that when a higher fraction of county residents hold a positive view of government, a lower fraction of individual income tax is evaded. Gerber and Huber (2009) argued that taxpayer will usually decide about his taxpaying behaviour on the basis of how the taxpayer perceives overall government spending and this may affect taxpayers affiliation toward government. Political affiliation is defined as the identification of a citizen with a particular political party of the political system (Edwards, 2007). Further, experimental economists have found that individuals would pay more tax an value public goods when thy themselves have selected the government (Alm et al., 1992). Hanousek and Palda (2004) found that when individuals find public services at the lower side and do not have any political affiliation with the current government are more likely to report tax noncompliance behaviour. Alm et al. (2016) found that political affiliation had a significant negative impact on tax non-filing compliance. Moreover, when people perceive that tax system is fair, people follow tax compliance (Cummings et al., 2009). Other studies have also looked at political ideology, tax compliance, and political affiliation. Lozza et al. (2013) explored the
relationship between political ideology and tax noncompliance behavior among self-employed taxpayers in Italy. The study incorporates the Slippery Slope Framework and, on the basis of quantitative and qualitative results, suggested that political affiliation can directly affect the tax compliance behavior. Van Lange et al. (2012) studied 401 survey respondents comprising mostly university students, professionals, and employees. They found that interpersonal orientation affected the level of political affiliation. The study also showed that the personal interest is not the only factor that created the political affiliation of an individual but that concern for others was important as well. Thus, political affiliation can directly affect the tax non-compliance behaviour. Moreover, Cullen et al. (2018) found that when individuals are of the same political party as the incumbent president, they express less negative views on government tax and spending policies and likely to show more tax compliance behaviour. Therefore, this study can hypothesise that

**H1: Political affiliation has a significant effect on tax noncompliance.**

**Political Instability and Tax Noncompliance**

Political instability is defined as the “propensity of a change in the executive, either by ‘constitutional’ or ‘unconstitutional’ means” (Alesina et al., 1996). Frequent changes in the government create political instability in the country. Consequently, a rapid change occurs in the political, social and economic policies of governments. Evidence exists that economic policy changes impact business decision makers. According to Grossman (1994), each taxpayer is forced to make economic decisions relating to the knowledge of which government will come into existence or changes in the policies of existing government. A taxpayer must choose whether or not to shelter some funds out of the reach of the tax authorities to compensate for the uncertainty he faces. In choosing whether or not to hide funds from taxation, and how much to hide, a taxpayer needs certain information. Furthermore, political stability may contribute to enhance taxpayer’s trust in government and strengthens the relationship with the government. A taxpayer needs to know, among other things, the probability that each government would come into existence and what each of the governments would do if it did come into existence. Knowing these things, each taxpayer makes his economic choices, and collectively these choices yield both the tax revenue that would go to the ensuing government and the level of tax noncompliance behaviour. It is in this context that the role of uncertainty becomes especially important for taxpayers in the economies in transition. The uncertainty concerning the various possible future policy choices of the government not only affected the economic decisions of the taxpayers but also created political pressures in support of different governments. Also during this time, and as a consequence of taxpayers’ economic decisions, the economies in transition exhibited generally heightened, albeit varying, levels of tax evasion as well as capital flight. Because of the policy uncertainty during this period, taxpayers were forced to make decisions in the absence of knowing whether the next government would be more or less benevolent, more or less democratic, more or less corrupt, or more or less able and willing to pursue economic growth and infrastructure development (Katz and Owen, 2009). Furthermore, Kirchler et al. (2008) explained in the Slippery Slope Framework that a synergistic climate is considered to be an ideal situation wherein the tax authority and taxpayer have a good relationship, and the taxpayer is willing to pay tax because he has trust in the government. A high level of trust ensures high tax compliance behaviour among taxpayers. However, political instability can cause a reduction in the trust level for tax authorities as political instability indicates a rapid change in
policy matters including tax policies. In this way, D’Attoma (2018) concluded that individuals’ relationship to their states shapes these behavioral differences in tax compliance, if this relationship is strong that likely to influence tax payer to avoid tax noncompliance. Moreover, political instability likely to affect state’s institution to work effectively that ultimately urge tax payers to avoid tax. There is a litany of literature demonstrating that the quality of institutions matters, and taxpayers will be more willing to pay their taxes if they perceive their institutions to be efficient and effective (Filippin et al., 2013). Thus, this study may posit that:

H2: Political instability significantly affect tax noncompliance.

METHODOLOGY

Data Collection and Sample

The data were collected through self-administered questionnaire. The questionnaire was distributed among 498 self-employed taxpayers of the capital city of Libya that is Tripoli through simple random sampling technique due to three reasons. First, to consider the whole Libya is difficult due to political unrest and insecurity in some cities and other determining factors. Second, Tripoli is the highest populated city in Libya, with an estimated population of nearly two million persons out of six million of whole Libya (Zidan, 2015). Third, Tripoli city has the largest number of taxpayers compared to other taxpayers across Libya cities. According to Libyan Tax Authority 2015 the individual taxpayer in Tripoli, almost 16,543 Libyans are a self-employed taxpayer, including informal sole traders and small retail premises (Masoud, 2015). Data were analysed by employing structural equation modeling approach through Partial least square (PLS-SEM 3.2.7).

Measurement of Variables

Hasseldine and Hite (2003) defined tax noncompliance as the failure of a taxpayer to meet tax obligations whether the act is done intentionally or unintentionally. The scale of tax noncompliance behaviour will assess the views, behaviours, and attitudes of citizens toward paying taxes. This study has adapted Robert’s (1994) scale to measure tax noncompliance behaviour. Political affiliation is defined as the identification of a citizen with a particular political party of the political system (Edwards, 2007). The political affiliation measurement assesses the intensity of one’s association with a political group. Scales on political affiliation are almost non-existent, the author of this current study, therefore, developed items based on prior literature (Gerber and Huber, 2009); Palda, 2004; Alm et al. (2016) that could specifically measure the political affiliation in the Libyan context. Alesina et al. (1996) defined political instability as “the propensity of a change in the executive, either by ‘constitutional’ or ‘unconstitutional’ means”. The measurement of political instability will assess one’s perception of uncertain governance in the country (Abidin & Haseeb, 2018; Haseeb et al., 2014; 2017). Current study adopts three items scale developed by Grootel (2010). However, these items are insufficient to measure a whole conceptual domain of political instability. Therefore, author derived further three items from the relevant literature.
RESULTS

Discriminant Validity

Discriminant validity was assessed through Fornell and Larcker (1981) criterion. Hair Jr, et al. (2016) elucidates discriminant validity as the “extent to which a construct is truly distinct from other constructs by empirical standards” thereby it intends to examine whether or not the study constructs distinct from each other. Thus, establishing discriminant validity implies that a construct is unique and captures phenomena not represented by other constructs in the model. Table 1 show that the square root of each constructs’ Average Variance Extract (AVE) is greater than its highest correlation with any other construct in the model. Thus, it ensures the discriminant validity.

Table 1
<table>
<thead>
<tr>
<th>Variables</th>
<th>P Affiliation</th>
<th>P Instability</th>
<th>Tax Noncompliance</th>
</tr>
</thead>
<tbody>
<tr>
<td>P Affiliation</td>
<td>0.859</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>P Instability</td>
<td>0.690</td>
<td>0.853</td>
<td>-</td>
</tr>
<tr>
<td>Tax Noncompliance</td>
<td>0.559</td>
<td>0.782</td>
<td>0.890</td>
</tr>
</tbody>
</table>

Convergent Validity

Convergent validity is also an important step prior to hypothesis testing. Hair et al. (2016) defined convergent validity as “extent to which a measure correlates positively with alternative measures of the same construct”. The current study examines convergent validity to identify whether measures are positively correlates with alternative measures of the current study. The current research model has all reflective measures it is, therefore, necessary to ensure the AVE and Composite Reliability (CR) to determine the convergent validity (Hair et al., 2016). Table 2 shows the result of convergent validity. It shows the values of CR and AVE above the threshold values 0.70 and 0.50 respectively as recommended by Hair et al. (2016). Few items showed factors loadings less than 0.7 has been deleted before conducting the hypothesis testing.

Table 2
<table>
<thead>
<tr>
<th>Variables</th>
<th>Items</th>
<th>Factor Loadings</th>
<th>CR</th>
<th>AVE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Political Affiliation</td>
<td>PA1</td>
<td>0.701</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>PA2</td>
<td>0.885</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>PA3</td>
<td>0.912</td>
<td>0.933</td>
<td>0.737</td>
</tr>
<tr>
<td></td>
<td>PA4</td>
<td>0.894</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>PA5</td>
<td>0.883</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Political Instability</td>
<td>PI2</td>
<td>0.868</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>PI3</td>
<td>0.866</td>
<td>0.914</td>
<td>0.728</td>
</tr>
<tr>
<td></td>
<td>PI4</td>
<td>0.882</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>PI5</td>
<td>0.794</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tax Noncompliance</td>
<td>TN1</td>
<td>0.887</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>TN2</td>
<td>0.902</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>TN3</td>
<td>0.904</td>
<td>0.958</td>
<td>0.791</td>
</tr>
<tr>
<td></td>
<td>TN4</td>
<td>0.899</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>TN5</td>
<td>0.917</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>TN6</td>
<td>0.827</td>
<td></td>
<td></td>
</tr>
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</table>
Hypothesis Testing

Hypothesis testing was done using bootstrapping method through PLS 3.2.7. Table 3 shows the results of hypothesis testing. It shows that political affiliation has a significant effect on tax noncompliance (p<0.05) therefore it is supported hence, accepted. Moreover, political instability also has a significant effect on tax noncompliance (p<0.001) thus, supported, therefore, accepted.

<table>
<thead>
<tr>
<th>Table 3</th>
<th>PATH COEFFICIENT</th>
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<tbody>
<tr>
<td>β</td>
<td>Standard Deviation</td>
</tr>
<tr>
<td>P Affiliation -&gt; Tax Noncompliance</td>
<td>-0.171***</td>
</tr>
<tr>
<td>P Instability -&gt; Tax Noncompliance</td>
<td>0.352***</td>
</tr>
</tbody>
</table>

**Significant at 0.05, *** Significant at 0.001

DISCUSSION

The basic objectives of the study were to examine the effect of political affiliation and political instability on tax noncompliance among Libyan self-employed taxpayers. The empirical results reveal that political affiliation has a significant effect on tax noncompliance among Libyan self-employed. This result is in line with the previous studies. Webley (1991) found a correlation between negative attitudes toward government and tax noncompliance behaviour. Similarly, Torgler (2003a) concluded that political affiliation with the government is significantly correlated with the reported compliance in surveys. The empirical result implicates that in the presence of political affiliation among Libyan self-employed they tend to be more tax compliant as the relationship depicted in the result of (H1) is negative that shows higher the political affiliation will cause lower tax non-compliance. It also means that when people indulge in the political movement and support and join political process it may reduce their tax non-compliance behaviour especially when people trust the government. Therefore, the Libyan government should encourage the political parties and its workers to strengthen the political process in the country. Although, political culture is weak in Libya due to the long totalitarianism rule of Ghaddafi that stifle the political culture. It means when people indulge in the political movement and support a join political process it may reduce their tax non-compliance behaviour. Therefore, Libyan government should encourage the political parties and its workers to strengthen the political process in the country.

Furthermore, the result also shows a significant relationship of political instability on tax noncompliance among Libyan self-employed taxpayers. This result is also similar to the previous studies. Kirchler et al. (2008) explained in the synergistic climate are considered to be an ideal situation wherein relationship is goo among taxpayers and tax authorities. Taxpayers trust in government tends to contribute towards tax compliance. However, political instability likely to reduce trust in government due to rapid change government policies thus causes noncompliance. The empirical finding implicates that in the presence of political instability self-employed people of Libya perceive that tax non-compliance may be prevalent in Libya. Therefore, political instability can cause a reduction in the trust level for tax authorities as political instability indicates more change in policy matters including tax policies. It is, therefore, necessitates that political stability should emerge as an integral element of the Libyan society. Political turmoil may contribute more tax non-compliance behaviour among people. One of the major antecedents of tax non-compliance in Libya is political instability as it has reduced the trust of government
and uncertainty among masses of Libya. It is, therefore, necessary for the Libyan government to ensure political stability to enhance tax compliance by eradicating two parallel governments in Libya and making one single government.

It is, therefore, implicates that political stability should emerge as an integral element of the Libyan society to create more political affiliation of Libya citizens. This political stability and political affiliation may lead to create more adherence to government policies especially tax noncompliance. Moreover, this political stability tends to create institutions that would function independently to implement effective tax system in Libya. It is recommended that political parties should emerge and encourage their affiliated people to pay taxes. It is also recommended that Libyan government should broader their tax base extended from individual tax payers to the corporate world. Moreover, most importantly, Libya currently has two parallel governments that had bifurcated the whole structure; therefore, it is strongly recommended that there should be a single ruling party in Libya to execute effective tax system.

CONCLUSION

Political factors are also important to consider while investigating the determinants of tax noncompliance behaviour. Political affiliation with certain political parties affects the opinion of an individual in making economic decisions in reference to the present government and same is true in the case of political instability. Political factors such as political stability and political affiliations affect the perceptions and behaviours of individuals on many levels including those of tax compliance. Tax non-compliance behaviour tends to damage the country’s overall revenue. It is, therefore, crucial to examine the factors that affect tax non-compliance behaviour. Current study empirically examines the political factors that affect tax non-compliance behaviour. Both factors (political affiliation, political instability) found to have a significant effect on tax non-compliance behaviour among self-employed Libyans. The study would provide fruitful insights to the policymakers to consider political factors as important antecedents to enhance tax revenues.

REFERENCES


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