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Full Length Research Paper

Reforming tax polices and revenue mobilization promotes a fiscal responsibility: A study of east and West African states

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The primary objective of this paper is to prepare a case study on tax policy reforms and its impact, with the specific objectives of examining the main tax reforms of Ethiopia; Kenya, Uganda and Ghana. It views tax policy from a variety view points, which focuses on broad based of tax revenues and on designing certain selected major taxes, This paper will cover the theory of fiscal responsibilities under which the government uses its revenue and expenditure programs to produce desirable effects on national income, production and practice of public finance. In most of the emerging or developing countries one of the factors lacking the economic growth is lacking of revenue to finance the economic development. Highlighting tax revenue profile and composition; and discussing major problems that could prevent by implementing an effective tax polices in those countries. There is a wide gap between total investment needs and domestic resource mobilization (Sachs et al., 2004). Sachs suggested that sub-Saharan Africa (SSA) would need an additional ODA per year of about $25 billion to meet the MDGs.

Key words: Fiscal adjustment, tax policies, resources mobilization, domestic and foreign debt.

INTRODUCTION

This paper introduces the important topics of fiscal policy and potential effects on economic activity. Sound fiscal responsibility is central to achieving macroeconomic stability and ensuring that the benefits of economic growth. On the revenue side, the Government must continue its efforts to broaden the tax base through tax policy reforms and modernization of domestic tax and custom administration. The analysis focuses on how government expenditure was used as a policy instrument for fiscal adjustment in the face of external shocks and the consequent fiscal imbalances. The analysis indicates that fiscal policy responded to external shocks in a fairly large number of countries. In particular, fiscal policy responses to unexpected shocks were stronger than the responses to anticipated ones. On the expenditure side, the Government must seek to improve the efficiency, quality and transparency of delivery of public services through fundamental reforms of the public financial management system. The real tax system facing people and businesses in most developing countries is not how the tax law is designed but rather the outcome from how that system is actually put into practice and very importantly how the tax administration and its role impacts the tax reform. As Tanzi (1991) has pointed out, tax administration has a crucial role in determining the real (or effective) tax system, as opposed to the statutory tax system. There is a growing conviction among tax policy specialists in developing countries that "policy change without adminis-trative change is nothing" (Bird, 1989) and that it is critical to ensure that "changes in tax policy are compa-tible with administrative capacity" (World Bank, 1991). Only very few developing countries have managed to establish their tax systems in such a way as to achieve an appropriate level of revenue and to keep tax-generated misallocations within tight bounds. In most other countries, neither has it been possible to ensure the financing of public expenditure nor have the tax systems operated in conformity with economic policy objectives.

A broaden tax base through tax policy reforms and mobilizing a domestic resources is absolutely essential for sustaining poverty reduction over the longer run. The informal sector being effectively immune from taxation, governments of developing countries have fewer tax instruments than rich countries. By imposing taxes on some branches of the economy and not on others they create high economic distortions. Economic growth is not a guarantee of poverty reduction, unless we have a well designed pro-poor tax policy in place which helps to generate more income-earning opportunities so that poor people can engage in productive and well-paid work. The average taxation ratio of developed countries as a proportion of GDP lay between 29 and 32%, whereas the corresponding range for developing countries in the medium-income category was from 17 to 22%. The average taxation ratio in the poorest countries lies between 13 and 16%. The problem is a vast gap exists between the tax payments required by law and those actually surrendered to the state. The taxation authorities - often inadequately staffed, institutionally weak and lacking in political support - are not in a position to collect the amounts outstanding (Menck, 1992). In a very real sense, "tax administration is tax policy" (Casanegra de Jantscher, 1990).

The governance of fiscal policy is a powerful instrument for stabilizing the economy, which controls over the amount and structure of taxes, expenditures and the debt management. It ensures the efficient allocation of public resources and serves as a precondition for economic growth (Campos and Pradhan, 1996). A recent cross-country study of 75 nations by Djankov et al. (2000) indicates that the official cost of setting up a firm entails fees worth at best 1.4% of GDP per capita in Canada and at worst 260% of GDP per capita in Bolivia. On the top of this official monetary expense the authors show that registering a business can be very complicated and time consuming. In the best case establishing a new firm requires 2 steps and 2 days in Canada and in the worst case it requires 20 procedures and 82 business days in Bolivia. The study by Djankov et al. (2000) concludes that firm entry barriers are higher in countries with lower GDP per capita. Thus the main reason why many micro-enterprises stay informal in developing countries is because becoming formal involves large fixed costs, most of them sunk. Official registration is simply beyond the reach of poor entrepreneurs. This paper will summaries the various approaches used in developing countries in their public sector reform proposals and will explore to what extent similar institutional controls and incentives could be established in emerging economy. It focuses on restructuring tax policies and resources mobilization frameworks and decision-making which takes place within these frameworks. The Government of developing countries should take significant steps to strengthen the framework for sound fiscal policies parti-cularly, on tax reforms which constitute the major policy instrument needed to accelerate growth and eliminate poverty and promoting a better tax system to mobilize more revenue.

It is possible to achieve considerable improvement in tax administration, policies have to go beyond the purely economic to focus on the needs of the poor-to ensure minimum social standards and universal access to basic social services - with less complicity but effective.

Reducing the number of income tax deductions, for instance, permitted in some of these countries to eliminate filing requirements for most wage earners, thus greatly reducing the administrative burden, since withholding alone then will be sufficient to enable most income taxpayers to fulfill their obligations. There is no single set of direction that, once introduced, will ensure improved tax administration in any country. Developing countries exhibit a wide variety of tax compliance levels, reflecting not only the effectiveness of their tax administrations but also taxpayer attitudes toward taxation and government in general and the value attached to government activities. Government policies affecting any of these factors may thus influence taxpayer attitudes and hence the observed level of taxpayer compliance.

The key to successful public finance management is a matter of governance to balance the economic, managerial and political roles of public finances. When fiscal governance is poor has a little chance of succeeding the fiscal policy objectives. The Government will also pursue comprehensive civil service reforms aimed at improving the efficiency of delivery and quality of public services, improving taxation through payroll management and enhancing a regular auditing to create a further fiscal space. It is viewed that in most emerging economies fiscal governance is reflected only in how deep a country can cut into its fiscal deficit, rather promoting a better tax system to mobilize more revenue to prevent it (IMF, 2008). The first level concern is to design the general legal framework - not only how the tax laws to be administered but also a wide range of important procedural features. Once this general structural tax reform is designed, the administrators take over and set up the specific organizational structure and operating rules for the tax administration. Finally, once the critical institutional infrastructure has been upgraded, the tax managers actually can do their jobs efficiently and let alone suggest how to improve it within which it has been equipped. The only way to secure that taxpayers receive real value for their money is when the government established a long-term goal through investment and tax reform. Strong and dependable public services are vital to extend the economic growth, tackle social exclusion and improve people’s quality of life. Investment and tax reforms will encourage the foundations for a stronger and more productive economy. As emphasized above, an important element in any successful administrative reform is simplicity and enforceable laws to administer. In addition, it is equally important to simplify procedures for taxpayers, for example, by eliminating demands for unnecessary information in tax returns and payment invoices. Once procedures are simplified, the tax administration can then concentrate on its main tasks: facilitating compliance, monitoring compliance and dealing with non-compliance. The job is particularly difficult in developing countries with large informal sector, low levels of literacy and public morality, poor salary structure for public servants, poor communica-tions, malfunctioning judicial systems and entrenched interests against radical reform. The tax burden is lower in developing countries and the barriers to entry into the formal economy are higher. We show that raising barriers to entry is consistent with a deliberate govern-ment policy which aims to maximize state revenue. Barriers to entry into the formal sector generate market power and hence profits, for the permitted entrants. These profits can be readily confiscated by the government through entry fees and taxes (Auriol1 and Warlters, 2002).

Despite such handicaps, the experience of several countries in recent years shows that substantial improvement can be achieved with determined effort and an appropriately designed strategy. What a tax administration can do, however and how it can best be reformed depends largely upon the environment in which it operates. In the context of enlarging the direct taxation base it is crucial to understand the determinants of formal/informal sector formation. Enste and Schneider's (2000) cross-country study, confirmed by all existing evidence, reveals that the increase of the shadow economy in OECD countries is best explained by an increasing burden of direct taxation and social security contributions, combined with rising state regulatory activities. If these factors play a role in developing countries, the excess burden of taxation would have been proportional to the tax revenue and tax revenues could have been higher in developing countries. Similar arguments apply that, there is rarely a formal system of social security in developing countries; tax revenue is raised to finance essential public goods only rather than for redistribution purposes. In the case of Ghana year 2001, the tax revenue base becomes less than 20% of gross domestic expenditure. It is further reduced as the taxpayers compliance is less than perfect (Osafo-Maafo, 2001). Hence, as the government of Ghana wants to rely more on the tax revenue over time, it launched a tax reform more aggressively to broaden the base and enhance compliance. Such policies may required harder political choices and spend resources to enhance the effectiveness of the tax administration, as it plays a major role to enhance the tax revenue.

HOW TAX REFORMS IMPACT

REVENUE Ghana tax reforms

Ghana's tax reforms constitute the major policy instrument needed to accelerate growth and poverty reduction (Osei, 2006) . Ghana's major changes in tax adminis-tration fiscal policies played a key role in improving the country's revenue mobilization and overall fiscal health. The prime factors cited for the increase in revenue are the expansion of tax base, the structure of taxation; and re-organization of the tax administer. If tax administration is to become effective in developing countries, enormous combination of qualitative human and material re-sources needed to perform as the professional roles of revenue institutions. Designing a suitable medium-term fiscal is framework that fosters a sustainable delivery of better public services and infrastructure while maintaining a credible commitment to fiscal prudence confronts many challenges. The main task of fiscal administration in these ministries tends to be virtually coordinated with expenditure allocation and control by the budget division. However, as revenues, policy is compromised and the actual supervision of revenue performance becomes relaxed, leading to ineffective administration and loss of revenue. Bougrand, Loko and Mlachila (2002), found that foreign loans are still the most attractive way to finance budget deficits, while a significant devaluation risks and a high levels of dome-stic interest rates are involved. Generally, the deficit leads to a change in government net assets and can be financed by either drawing down assets or incurring new liabilities of both domestic and foreign nature. The choice between foreign and domestic borrowing, it depends on the cost (interest rates), maturity structure and risks.

Restructuring Ghana's revenue administration

The administrative reforms in Ghana centered on removing the revenue institutions from the Civil Service and granting them operational autonomy, with a view to improve efficiency through enhanced work and employment conditions. Two practical steps were taken in Ghana in 1985 to strengthen revenue administration in the country. These were the establishment of the National Revenue Secretariat (NRS) and the creation of the two major revenue organizations, the Customs, Excise and Preventive Service (CEPS) and the Internal Revenue Service (IRS), as autonomous institutions outside the civil service (Terkper, 1994). The three factors primarily cited for the increases in revenue are: the expansion in the bases of taxation as a result of liberalizing the economy; the changes made to the structure of taxation; and the extensive reorganization of the institutions that administer taxes in the country.

Uganda tax reform

A key element of the administrative reform was to move the existing revenue department out of the Ministry of Finance into a semi-autonomous revenue authority overseen by an independent Board of Directors. The philosophy behind this move was mainly to provide incentives for the staff to improve their performance and thereby increase revenues. The reform appeared to be a success in URA's (Uganda Revenue Administration) first years of existence. Reported revenue increased sharply - from 7% of GDP in 1991 to around 12% in 1997 (Fjeldstad, 2003). Corruption also seemed to decline. During this period, many observers referred to the URA as a model for other sub-African countries. These circumstances led policy makers to pursue a rapid increase in domestic revenue and a corresponding increase in public services; and rebuilding of government's revenues base has been on of the key features of Uganda's economy recovery. Uganda Revenue Authority (URA), established in 1991, as the result, domestic revenue were more than doubled during the first half of the 1990's and was about 11.3% of GDP of 1996.

What do we learn from Uganda?

The Uganda Revenue Authority, established in 1991, is the oldest integrated revenue authority in sub-Saharan Africa. The revenue authority model aimed to limit direct political interference in day- to-day operations by the Ministry of Finance and to free the tax administration from the constraints of the civil service system, especially by paying salaries above civil service pay scales and to more easily recruit, promote and dismiss staff. Such steps were expected to provide incentives for greater job motivation and less corruption. After marked success in the first years after its creation, revenue has dropped as a share of GDP and corruption is believed to be pervasive. People in such positions of power are expected to use that influence to help their kin and com-munity of origin. This implies that such social relations may rule out the formal bureaucratic structures and posi-tions. If these problems are rooted in social norms and patterns of behavior by administrative officers, as a consequence, reforms that otherwise seem consistent with principles of good public administration may be undermined (Fjeldstad, 2006). By the time URA was established, the total tax revenue collection was barely U Shs. 134 Billion per annum (11Billion per month) equivalent of 5.5% of GDP in 1990/91. By 2003, total revenue had risen to U shs1, 410 Billion per annum (116.8 Billion per month) equivalent of 13% of GDP (Kaweesa, 2004).

Ethiopia tax reform

After the 1992 liberalization, investment grew rapidly. But this increasing level of investment could not be financed by domestic resources alone. Savings declined sharply in 1990/1 (a period of violent change in the government). Since then, there has been some recovery, only to de-cline further by the end of the 1990s. Public saving has shown quite a remarkable recovery in the 1990s. Thus, in this respect the government's fiscal policy seems promising. However, total domestic saving was far below the level of investment and this resulted in a government deficit of about 10% of GDP per annum in the last decade (Geda, 2005). The current government has registered modest achievement in terms of fiscal policy, chiefly through revenue generation. The subsequent taxing system in Ethiopia can be divided into three broad categories: (I) taxes on income and profits, (ii) taxes on goods and services and (iii) taxes on international trade.

Ethiopia's administrative reform

The current tax-to-GDP ratio of about 13.7% calls for reform not only on the tax rates but also on its administration. Tax reform began in 1999 and one of the changes was to scale up the 'revenue board' to ministerial level to become the Ministry of Revenue. This ministry controls the three revenue collection institutions: Federal Inland Revenue (FIR), Ethiopian Custom Authority (ECA) and the National Lottery Administration (NLA). Major components of the reform focused on reducing corporate income tax from 35 to 30% and the maximum income tax rate applicable to a sole proprietor from 40 to 35%. The new income tax law also allowed deductions for business expenditures such as tax pay-ments, land lease payments, interest payments on loans, insurance premiums and other expenditures, which previously were not deductible from taxable income. It also provided provisions for loss carry-forward and capital gains as well as withholding taxes (MoR, 2003). In conjunction with this reform, the Ministry of Revenue re-organized the FIR by introducing and improving opera-tional programs, systems and procedures. The other reform measures include the establishment of additional branch offices, training and recruitment of qualified personnel, introduction of performance and accountabi-lity measures, setting up a taxpayer education program and similar initiatives aimed at implementing the new income tax, VAT, turnover tax and excise tax proclama-tions. The government is currently in the process of upgrading its computer system, implementing the use of a tax identification number for the enforcement, verification and processing of sales tax and VAT refund claims (MoR, 2003). Not withstanding this positive trend, the actual figure, which is about 14%of GDP for the year 2000/01, is far below the corresponding figure for other developing countries. Ethiopia, like most countries in Africa, has been making considerable efforts in recent years to restructure its tax system with a view to increase tax revenue as well as reduce distortions in the economy. The impact these reforms have had on the poor is of considerable importance to policymakers, given that the poor and the vulnerable constitute a significant majority of the population in Ethiopia.

Kenya tax reform

One of the key reasons for undertaking tax reforms in Kenya was to address issues of inequality and to create a sustainable tax system that could generate adequate revenue to finance public expenditures. In understanding the tax reform experience in Kenya, in practice, the role of the tax system have three common objectives of a tax system: (a) to raise revenue to fund government operations; (b) to assist in the redistribution of wealth or income; and (c) to encourage or discourage certain activities through the use of tax provisions. Unlike many other Sub-Saharan countries, Kenya is a high tax-yield country with a tax-to-GDP ratio of over 20%. Kenya is able to finance a large share of its budget, while external donor finances are used to cover a much smaller share than in other countries of the region. Like most developing countries, it has had to challenge with the common problems of tax systems (i) with rates and structures that are difficult to administer and comply with; (ii) that are unresponsiveness both to growth and discretionary tax measures hence offering low tax productivity; (iii) that raise little revenue but introduce serious economic. They attempt to use income taxation to address equity objectives; however, Kenya fell into the same trap as many other countries that had hoped to use income taxation for redistributing purposes (Karingi1, Wanjala2, 2005). Many governments-including Kenya-considered personal income taxation (PIT) the most convenient and visible instrument to show concern for inequality issues. In this respect, Kenya introduced many tax brackets as an indication of the progressives of PIT and between 1974 and 1986 there were eight tax brackets in effect. Table 1 shows the country’s PIT system with a very high top marginal tax rate.

High personal income taxes, especially the top marginal rates, have a negative effect on savings. Kenya gradually decreased its top marginal tax rate from 65% to the current 30% to provide personal incentive to save and to stimulate enterprises by creating a savings pool. This, it was hoped, would improve the performance of the economy and enhance job creation.

How Kenya impacted by tax reforms

Having an equitable tax system was one of the objectives of Kenya’s tax modernization program. Therefore, in assessing the outcomes of the tax reform in both theory and practice, tax instruments vary greatly in their ability to redistribute wealth or income. Individual income taxes and wealth taxes are the primary instruments to achieve redistribution. Whether taxes in Kenya, particu-larly during and after reforms, have aided in the redistribution of income or in providing targeted relief is difficult to answer. Addressing poverty concerns through the design of specific tax instruments looks sometimes promising but this has not been a key feature of Kenya’s taxation. Tax instruments differ in their effectiveness in reducing the tax burden of the poor. The commitment of the Kenyan government to tax reforms can largely be described as having been positive. As indicated revenue adequacy is not an issue of concern in Kenya, as maintaining a 22% revenue-to-GDP ratio is the official policy. Consequently, the key issues concerned with the improvement of tax mobilization are related more to administration than policy. The appropriate recom-mendations in this respect have already been identified by the government and are outlined in a study entitled Economic Recovery Strategy for Wealth and Employment Creation (GoK 1993).

FISCAL IMPLICATIONS ON DOMESTIC AND FOREIGN DEBT FINANCING

Fiscal policy plays a crucial role in domestic resource mobilization. Domestic resource mobilization has two important elements. The first is enhancing government revenue (public savings) and the second is increasing private savings. Consequently, governments as well as individuals and firms must be important actors in any effective resource mobilization process. While mobilizing domestic resources is desirable, the benefits are not automatic. They accrue to countries that take adequate steps to exploit them. This literature highlights key issues of domestic and foreign debts of governments and provides possible suggestions. A government's stock of debt should not grow beyond the point where the debt to GDP ratio is too high for debt servicing payments to be made. The fiscal sustainability depends on the current level of debt (domestic and foreign) and the government's willingness to tax and impose aggressive measures as necessary in order to service debt. In poor countries (Ghana, Uganda, Ethiopia and Kenya) with a limited tax base, tight budgets and high government spending this cost should not be underestimated. When the government's fiscal position is unsustainable will result in a higher cost of borrowing and/or credit rationing. This process is costly and it makes less attractive foreign borrowing to fund government investment.

To date, capital markets in Ghana, Uganda and Kenya have not been able to provide effective support for the private sector because they are small, underdeveloped and have limited activity. The existence of a stock market in some of these countries may provide additional channels through which the effects of fiscal policies could be transmitted to the aggregate economy. If the government expected to fund a fiscal deficit through excessive money creation the domestic rate is likely to rise and inflation, currency depreciation and, capital flight are also slanted to stimulate. Dailami and Atkin (1990), describe the provision of funds to finance domestic capital formation is a key factor in the prospects for long-term economic growth in developing countries. Borrowing abroad is a wise choice as long as the capital acquired produces a rate of return that is higher than the cost of the foreign borrowing. The fundamental challenge facing most African nations is the irregularity between its growing needs and shrinking resources. Through our research and finding, it is a conceivable to have an effective resource mobilization strategy. To avoid a foreign borrowing a country should live within own means of resources and ensuring that the current account position is consistent with the available sources of financing is essential.

Table 1. PIT progressivity in Kenya.

1974 - 1981		1982 - 1985	
Annual taxable income Kshs	**Rate (%)**	**Annual taxable income (Kshs**	**Rate (%)**
1 - 24,000	10	1 - 30.000	10
24,001 - 48,000	15	30,001 - 60,000	15
48,001 - 72,000	25	60,001 - 90,000	25
72,001 - 96,000	35	90,001 - 120,000	35
96,001 - 120,000	45	120,001 - 150,000	45
120,001 - 144,000	50	150,001 - 180,000	50
144,001 - 192,000	60	180,001 - 240,000	60
Over 192,000	65	Over 240,000	65

Source: GoK (various years).

Fiscal policy through taxation

Setting up an efficient and fair tax system in developing countries is far from simple, unless their economy is integrated in the international economy. Taxation is the only rational means of raising the revenue to government spending on goods and services. The absolute tax system in those countries should raise essential revenue without excessive borrowing and discouraging economy activity. Most workers in Sub-Saharan Africa are employed in agriculture or in small enterprises, as a result raising revenue, income taxes and consumer taxes, play diminished role in those economics. Tax policies in developing countries are puzzling on many dimensions: revenue/GDP is surprisingly small compared with that in developed economics. Taxes on labor income play a minor role and poorer countries collect on average only two-thirds or less of the amount of tax revenue that richer countries do, as a fraction of GDP (Gordon and Li, 2005). Reforming an efficient tax administration is not an easy process for an emerging economy, when the tax officials' wages are low, without an efficient computerized operation system and well-trained staff. Much of Africa's growth potential remains locked away, because we have been unable to develop rapidly enough and extensively enough the needed infrastructure links, particularly in transport and communications. At the result, most Sub-Saharan Africa governments forced to take a system that allows them to exploit whatever option available, rather then establishing a rational, modern and efficient tax system (Shome, 2004). The other side of strengthening this argument is that small taxpayers cannot be expected to pay tax based on a complex tax structure and that a simplified tax regime needs to be set up for them.

We argue that low expenditures in developing countries are the result of the pattern of taxation. If the pattern of taxation were changed, the expenditures would also change. The pattern of taxes in different countries varies, reflecting such factors as economic structure, history and the tax structures found in neighboring coun-tries. The key areas of public expenditure measures are health and education. Unless tax revenues grow sufficiently to finance desired services over the long term, governments must reduce expenditures, raise tax rates, or alter other structural characteristics of the system. As a working rule, revenue growth should be roughly equal to the overall economic growth rate. With a constrained budget, it is difficult to meet the public demand and is very common in poorer countries. There is a need for fiscal policy not only by reducing expen-diture, but also by tax reform. We should also point out that the tax system in many African countries is neither well structured nor as effective as a source of revenue and has made it virtually impossible to recover from the downward economy. Simply by cutting the expenditure only without developing an effective tax system will undermines the growth and the construction of effective state institutions. As for the promotion of confidence in a strong and stable domestic economy, a stable currency is essential for price stability through a different control of mechanisms (FitzGerald, 2003).

Fiscal policy through decentralization

The main goal of fiscal decentralization is to move governance closer to the people and this does require strengthening local government finances. The idea is to give local governments some taxing power and expenditure responsibility and allow them to decide on the leveland structure of their expenditure budgets. In this way, people at the lowest level of government will be able to choose the kind of government they want and will actively participate in governance. Fiscal decentralization requires local governments with some autonomy to make independent fiscal decisions. Fiscal decentralization is also defined as a transfer of responsibility, resources and accountability to a local community could considerably enhance levels of participation by citizens in governance. When a local government was able to make innovative decisions its positive impact on equity is one of the notable effects of decentralization per capita expenditures. Same patterns of decentralization are observed in the second set of studies that included -- the Philippines, Ghana, Uganda and Zambia. The Philippines had the highest degree of decision space partly because of the country's institutional capacities as well as the form of decentralization (Bossert, 2002).

DISCUSSION OF RESEARCH FINDINGS

The analysis has thrown some light on the efficiency of tax administration and fiscal polices in those countries. In general, the results reflect the effect of administrative lags and lapses in the implementation of fiscal and tax-related policies. Modern public finance has generally evolved in the direction of tax reform with broadly two objectives: first, to generate additional tax revenues and achieving simplicity in the tax structure by reducing tax rates and number of taxes levied. There is an urgent need to adopt new methods in order to mobilize more tax revenue to enhance the tax- GDP ratio. There are two factors which we would like to suggest about the tax/GDP ratio, if we raise more revenue, tax/GDP ratio goes up; the second factor is that the tax/GDP ratio is likely to be higher in countries with higher per capita income only. When there are a large number of populations like in Ethiopia, Kenya, Uganda and Ghana - with low per capita income, to that extent the taxation potential will be less. The ratio of tax revenue to GDP in Ethiopia is 11.6%, Ghana, 20.8%, Kenya 18.4%, Uganda 12.6% (Heritage foundation, 2009). Given the negative impact of persis-tent unsustainable fiscal deficits on the most developing countries economy, we suggest three approaches for this purpose: increase in revenue, reduction in expenditure, or a continuation of both. One way to get an idea of what matters in tax policy is to look at tax regimes around the world. On average, the tax ratio -- taxes as a share of GDP -- was a bit less than one-fifth of GDP (18.8%) for 168 countries included in a recent study (Fox and Gurley 2005).

Reforming tax system achieves the desirable effect

The key to successful public finance management is a matter of governance to balance the economic, mana-gerial and political roles of public finances. Through our research, we learned that in most emerging economies fiscal governance is reflected only in how deep a country can cut into its fiscal deficit, rather promoting a better tax system to mobilize more revenue to prevent it and design the general legal framework which benefits the public. In understanding the tax reform experiences in those countries have three common objectives: (a) to raise revenue to fund government operations; (b) to assist in the redistribution of wealth or income and (c) to encourage or discourage certain activities through the use of tax provisions. To do so, a broad tax base or de-signing a certain major taxes and mobilizing a domestic resource are absolutely essential for sustaining poverty reduction over the longer run. Most of those countries main factors lacking the economic growth is lacking of re-venue to finance the economic development.

This paper covered how the government has to continue its extensive effort to broaden the tax policy reforms and modernization of demotic tax and custom administration. Such measures will help to alleviate poverty and achieve to produce desirable effects on national income, production and good practice of public finance. The analysis focuses on how government expenditure was used as a policy instrument for fiscal adjustment in the face of external shocks and the consequent fiscal imbalances. Government must seek to improve the efficiency, quality and transparency of delivery of public services through fundamental reforms of the public financial management system. The real tax system facing people and businesses in most developing countries is not how the tax law is designed but rather the outcome from how that system is actually put into practice and very importantly how the tax administration and its role impacts the tax reform. Only very few developing countries have managed to establish their tax systems in such a way as to achieve an appropriate level of revenue and to keep tax-generated misallocations within tight bounds.

By imposing taxes on some branches of the economy and not on others they create high economic distortions. The taxation authorities - often inadequately staffed, institutionally weak and lacking in political support - are not in a position to collect the amounts outstanding. While in developed countries requires 2 steps and 2 days to establish a new firm, most of those developing coun-tries requires about 20 procedures and over 60 business days. Those are the main reasons why many micro-enterprises stay informal is because a formal sector involves a large fixed costs and time consuming. There-fore, the Government of developing countries should take significant steps to strengthen the framework for sound fiscal policies particularly, on tax reforms which constitute the major policy instrument needed to accelerate growth and eliminate poverty and promoting a better tax system to mobilize more revenue. Generally the tax burden is lower in developing countries, but the barriers to enter into the formal economy are higher. Our research shows that raising barriers to enter the formal sector must be easy and fast is the only way to secure that taxpayers receive real value for their money is when the government established a long- term goal through investment and tax reform. Strong and dependable public services are vital to extend the economic growth, tackle social exclusion and improve people's quality of life. Investment and tax reforms will encourage the foundations for a stronger and more productive economy.

CONCLUSION

Many such countries have large traditional agriculture sectors. Other significant components of the potential tax base are often in other equally "hard-to-tax" sectors such as small business and the informal or shadow economy (Bird and Wallace, 2004). Africa's economic progress and political stability are vital both for its citizens and for the rest of the world. Its success will depend primarily on actions that policy makers themselves take to establish strong economic, legal and political institutions and policies. While priority should be given to the revenue sector, the implementation of tax or fiscal measures ought to be distinguished as the core of fiscal policy. However, improving public sector efficiency, managing fiscal capabilities and monitoring a budget could play a major role in those economies. Poor financial and public enterprises performance raises the government-borrowing requirement and imposes both a financial and economic burden on the economy. In general, the inability to raise the adequate revenue makes it impossible to attain the equilibrium. Educating taxpayers reduces firms' misconceptions and confusion about tax policies and procedures and experience suggests that most firms will comply in paying taxes if they understand their obligations and if they see the tax administration is fair in handling non-compliance. Outreach activities including, TV and radio coverage, advertising and tax themed school programs are also helps children and adults to understand the civic responsibility of paying taxes. Nonetheless, the basic conclusion is clear: emerging countries face a very difficult task in designing and implementing suitable tax systems. Most of developing countries do not reform either its tax structure or its tax administration or challenges they face is because they could not create the human and institutional capacity they need in order to do so and they failed to engage the task of fitting their tax systems into the changing international setting.

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