



*Journal of Economics and Business*  
Volume XIV – 2011, No 2 (23-39)

---

## **RESTRUCTURING A FISCAL POLICY ENCOURAGES ECONOMIC GROWTH – A CASE OF SELECTED AFRICAN COUNTRIES**

---

**Ravinder Rena<sup>1</sup>**  
Polytechnic of Namibia, Namibia

**Ghirmai T. Kefela**  
DTAG INC., USA

**ABSTRACT:** Fiscal governance is strong only when governments can deliver their fiscal policy in a sustainable way, and are efficiently applied to the provision of public goods and services. This paper introduces the topics of fiscal policy and its potential effects on economic activity. The paper delves the economic roles and potential methods of domestic and foreign debt financing. It focuses on the methodology of fiscal policy for calling and assessing the impacts of alternative tax policies, and debt management requirements. The paper also covers the basic theory, policy and practice of public finance including decentralization and intergovernmental fiscal relations in developing and transitional economies of Africa.

**KEYWORDS:** Fiscal adjustment, tax policies, domestic and foreign debt, economic growth.

**JEL Classification:** E60, E62, H2, H62

---

<sup>1</sup> Email: drravinderrena@gmail.com; rravinder@polytechnic.edu.na

## Introduction

This paper introduces the important topics of fiscal policy and potential effects on economic activity. The two main instruments of macroeconomic policy are monetary and fiscal policies. Fiscal policy is the means by which a government adjusts its levels of spending in order to monitor and influence a nation's economy (Rena, 2006). It is the sister strategy to monetary policy, with which a Central Bank influences a nation's money supply. These two policies are used in various combinations in an effort to direct a country's economic goals. 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. The governance of fiscal policy affects aggregate demand, the distribution of wealth, and the economy's capacity to produce goods and services. Effective debt and fiscal management is widely accepted form of tools of macroeconomic stability. It ensures the efficient allocation of public resources, and serves as a precondition for economic growth. There is also broad-based agreement on what constitutes sound fiscal management (Campos & Pradhan, 1996). Yet it is neither possible – nor desirable – for budgeting and financial management to be completely insulated from political influence. The challenge is to manage the interface between budgeting and politics by designing and implementing institutional and legal frameworks, which will improve the quality of political participation and promote fiscal responsibility. This paper summarises 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 economies. It focuses on “governance” or “constitutional” frameworks rather than ongoing “political” decision-making which takes place within these frameworks (Schick, 1998). The Government of developing countries should take significant steps to strengthen the framework for sound fiscal policy. Fiscal policy is a tool to direct firmly towards maintaining sound public finances over the medium term, based on strict rules. This sound fiscal policy together with a monetary policy frameworks provide the platform of stability necessary for achieving the Government's central economic goal and sustainable levels of employment (Rena, 2011). 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.

Fiscal governance is strong only when a Government can deliver their fiscal policy in a sustainable way, and are efficiently applied to the provision of public goods and services (Rena, 2011). The external drivers of a good corporate governance are laws, rules and institutions that provide a competitive playing field and discipline

the behaviour of insiders, whether managers or shareholders. Experience in a developed market economies indicates that the legal framework for competition policy, the legal framework for enforcing shareholders' rights, systems for accounting and auditing, a well-regulated financial system, the bankruptcy system and the market for corporate control are among the institutions that will provide proper directions and put the corporations in discipline (Bird and Oldman, 1990).

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 are put down the foundations for a stronger, more productive economy (Shome, 2004; Rena, 2011). Globally, all countries could face the challenge of fiscal adjustment, particularly in response to un-anticipated shocks, economic mismanagement, or long-term structural changes in the economy. Fiscal adjustment is effected through the composition of expenditures required shifting from direct provision of most goods in addition, services and central planning, to more selective provision or financing of only public goods and services and ensuring distributive justice (Bougrand, Loko and Mlachila, 2002). Budgets had to adjust rapidly to the changing economic realities, required a massive reorientation of the role of the state, and had as pervasive influence on the economy strengthen revenue mobilization, and improve resource allocation and efficiency, often through institutional and structural reforms (Campos and Pradhan, 1996; FitzGerald, 2003). In the case of Ghana in 2001, "the tax revenue base becomes less than 20 percent of gross domestic expenditure. It was further reduced as the tax-payers compliance is less than perfect" said then Finance Minister Osafo-Mafo<sup>2</sup>. 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 (Governor of Bank of Ghana, 2001).

Ghana's tax reforms constitute the major policy instrument needed to accelerate growth and poverty reduction (Osei, 2006). Ghana's major changes in tax administration fiscal policies played a key role in improving the country's revenue

---

<sup>2</sup>Yaw Osafo-Mafo is a former Member of Parliament for Akim Oda, Ghana. He was appointed Minister of Finance in February 2001 and later held Minister of Finance and Economic Planning until January 2005. At the Ministry of Finance he oversaw the dramatic turnaround of the Ghanaian Economy. In November 2001 he was named Finance Minister of the year with his Canadian counterpart Paul Martin by the World Economic Forum and Finance Minister of the year 2001, Africa, by the "Banker Magazine" a Financial Times publication.

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 administration. If tax administration is to become effective in developing countries, enormous combination of qualitative human and material resources needed to perform as the professional roles of revenue institutions (Fjeldstad, Odd-Helge, 2006; Rena, 2011). Designing a suitable medium-term fiscal 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 domestic 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, depends on the cost (interest rates), maturity structure, and risks.

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 per cent of GDP in 1991 to around 12 per cent 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 (Kaweesa, 2004).

### **The research questions**

- 1) How fiscal policy does stabilize the economy and decrease a public debit?
- 2) Does a revenue mobilization and tax reforms influence a fiscal policy and eliminate corruption?
- 3) Reform a fiscal policy How to increase private capital flows to Africa?

## Research Methodology

The article is based on secondary data collected from the reports of the World Bank, International Monetary Fund (IMF) and the government reports of the selected African countries. The researchers attempted to analyze the data by means of descriptive approach and content-analysis. The researchers also reviewed the pertinent literature on the subject matter particularly on the macroeconomic framework. The article has been divided into 5 sections. The first section provides introduction, research questions and methodology. Second section devoted to provide the review of literature. Section three analyses the fiscal policy through taxation. Section four deals with the fiscal policy and economic growth issues of selected African Countries. Section five summarizes the findings and last section provides the concluding remarks of the study.

## Literature Review

### *Fiscal Implications on domestic and foreign Debt financing*

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 (Rena, 2011). 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 developing countries of Africa like: Ghana, Uganda, and Kenya with a limited tax base, tight budgets, and high government spending is a serious issue and should not be underestimated. Generally, developing countries are expected to face a scarcity of capital, will acquire an external debt to supplement domestic saving. The rate at which they borrow abroad—the "sustainable" level of foreign borrowing—depends on the links among foreign and domestic saving, investment, and economic growth. The main lesson of the standard "growth with debt" literature is that a country should borrow abroad as long as the capital thus acquired produces a rate of return that is higher than the cost of the foreign borrowing (Terkper, 1994; IMF, 2006; Rena, 2011). In that event, the borrowing country is increasing capacity and expanding output with the aid of foreign savings.

When the government's fiscal position is unsustainable that may lead to a higher cost of borrowing and/or credit rationing, this process is costly and it makes less attractive foreign borrowing to fund government investment. The economic literature often argued that foreign direct investment (FDI) might ease these governments' fiscal constraints by bringing in capital resources. However, this is

one of the reasons policy makers in countries on study must ease restrictions on inward FDI and provide special incentives for FDI.

Until recently, the capital markets in Ghana, Uganda, Nigeria 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 (Dailami and Atkin, 1990; Ademola, 1997). The study recommends a campaign to promote investment and educate the public about the financial market. It is an established fact that a well organized capital market is crucial for mobilizing both domestic and international capital. In all these regions, the capital market has not yet played its role in mobilizing the capital, though it could be a source of capital if properly organized. If the government expected to fund a fiscal deficit through excessive money creation the inflation is likely to rise, depreciation in the exchange rate of domestic currency and, contributes for the capital flight. 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. In 2001, the decisive factor in Ghana's economic difficulties was when the government expenditures are more than the revenue with debt service being the single largest expenditure item. To reverse the economic difficulties the government introduced various budget measures to reduce expenditures and increase revenues. The government frozen all the expenditures, with the exception of wages, salaries and their related items to have a better performance of the finances and obligations of the state, and bring the budget to levels that are more realistic. The Government improved its financial position with the banking system to the tune of some \$551 billion by the first half of May 2003. However, the domestic public debt stock rose by 3.9 percent in the first quarter of 2003 compared to an increase of 8.5 percent in the same period 2002 (Bank of Ghana, 2003).

If the deficit is to be financed from the foreign reserves of a country by means of borrowing the deficit would obviously be unsustainable. It would pose less of a threat to solvency if it were financed with direct equity investment as it brings advantages of technological transfer, employment creation and managerial skills. The other option for a sustainable current account deficit is a long-term loan with low interest rates, in most cases it is to produce well evidenced, consistent and probably answers to their fiscal deficit threat. Bank of Uganda faced with those challenges for Balance of Payments took certain steps and learned a lesson that larger liabilities lead to higher net interest payments, in turn which must be financed by a trade surplus. Merwe argued that it might be wise to neutralize

surpluses on the current account owing to sharp improvements in terms of trade by encouraging capital outflow given the difficulties that could arise in the management of domestic liquidity. Uganda's 2001 large account deficit has continued to be largely financed by donor inflows and to a lesser extent by Foreign Direct Investment (FDI) (Merwe, 2002).

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. Most of the developing countries domestic resources do not support the national development efforts. External funding is needed to supplement domestic resources and must have ceilings to avoid high and unsustainable debt levels. In 2002, Nigeria external resource mobilization led to the creation of unsustainable debt burdens, largely due to inappropriate financing and use of funds (IMF, 2005). The fundamental challenge facing Nigeria and most African nations is the irregularity between its growing needs and shrinking resources. Through our research and finding, it is conceivable to have an effective resource mobilization strategy (Ademola, 1997). In the case of Uganda will not be different need to obtain improved revenue resources and use it effectively. Despite several proposals that have been put forward for Uganda and other developing countries have continuously encountered numerous constraints in putting together an accurate and reliable policies (Fjeldstad, Odd-Helge, 2006). 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.

#### *Foreign borrowing against domestic*

Governments may also have other means at their disposal to reach at least some of the goals which domestic debt instruments were designed. There are no much choices for developing countries or emerging economies, if they have to eliminate foreign borrowing, must develop the domestic market in government securities. If foreign borrowing by the government is excessive, domestic interest rates will fall too far, and fiscal policy will suffer (Montiel, and Reinhart, 1999). This will lead in turn to an outflow of funds, causing more foreign borrowing to support the country's external reserves at the central bank. If external debt exceeds 20-25 per cent as a proportion of GDP, it is likely to be counterproductive, international standards requires 9% foreign debt as a proportion of GDP (IMF 2006; Rena, 2011). Further foreign borrowing would question the country's credit standing; would increase the foreign debt service payments; and expose the country to any sudden external shocks.

The key point for long-term borrowing is to overcome the problem of large tax distortions by mobilizing fiscal resources from the domestic economy. Foreign Borrowing is attractive if savings are low, and to avoid the crowding out of the private sector's use of available domestic savings. As stated earlier, that the choice between foreign and domestic borrowing, depends on the cost (interest rates), maturity structure, and risks. Domestic debt can also be used to achieve monetary policy targets. This is particularly the case in countries with large balance of payments surpluses, created by large aid inflows or oil exports. In those situations, the inflows of foreign exchange increases liquidity, which could undermine macroeconomic stability and the central banks often, decide to intervene by selling government or central bank bills to stem inflationary pressures from excess liquidity (Dieterich, 2004). Foreign exchange inflows are welcome in developing countries, but also create challenges for domestic policy makers. Thanks to foreign capital inflows, investment is no longer limited by domestic constraints. In particular, low and middle-income transition economies with limited scope for domestic savings, but prospects of high return on investments, can achieve higher investment through capital inflows. Capital inflows also allow economies to smooth the consumption pattern over time. For transition economies, it is the early generation is that bears a large share of the costs of transition. Increasing consumption for this generation can help maintain the political support necessary for economic reform. Finally, cross-border flows can reduce the portfolio risk through diversification (Montiel and Reinhart, 1999).

### **Fiscal policy through taxation**

Setting up an efficient and fair tax system in developing countries is far from simple, unless their economies are integrated with the international economy. Taxation is the only rational means of raising the revenue to government spending on the goods and services. The absolute tax system in those countries should raise essential revenue without excessive borrowing, and discouraging economy activity (Rena, 2011). 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 seen in developing countries are puzzling on many dimensions: revenue/GDP is surprisingly small compared with that in developed economics. Taxes on labour income play a minor role, and poorer/developing 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; Rena,2011).

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. Domestic financial markets are, furthermore, critically important for reducing information problems in investment decisions. 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 than establishing a rational, modern and efficient tax system. The magnitude of government surplus or deficit is probably the single most important statistic measuring the impact of government fiscal policy on an economy. The problem is that many central governments are engulfed in a systemic financial crisis and are desperately exploring strategies for reducing their expenditure commitments (Seidman, 2003). One outcome is that revenue transfers are often irregular or fall much below the levels of expenditure decentralization, leading to serious fiscal gaps at the local level. In addition, the channels through which the effects of policies are transmitted to the economy may have some bearing on the relative importance of one policy over the other. 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. This is the genesis of the idea of a "single tax," that emerged mainly in most of Sub Saharan, though the idea has certainly not been confined to this part of the world alone. Within such a framework, small taxpayers would have to pay only one tax, combined from various taxes that larger taxpayers would have to pay separately. Because of the introduction of such a composite tax, many tax administrators have argued that tax evasion among small taxpayers has gone down. However, the argument that tax evasion by small taxpayers has gone down is due to the simplified regimes tend to require less revenue from them compared to their revenue potential (Shome, 2004).

Economic management in dependent open economies is dominated by stabilization policy and structural adjustment. Capital markets do not like surprises. They value sound and transparent macroeconomic policies and political stability. Developing countries are faced by an exogenous and changing set of world prices and demand schedules on the one hand, and rationed global credit markets whose dynamic is determined by financial cycles in the core economies on the other. In consequence, demand stabilization in response to unexpected temporary shocks and supply adjustment to permanent ones determines the growth path, rather than the process of inter-temporal optimization by private and public sectors (FitzGerald, 2005).

We argue that such 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 key areas of public expenditure measures are health and

education. With a constrained budget, it is difficult to meet the public demand, and is very common in poorer/developing countries. There is a need for fiscal policy not only by reducing expenditure, 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. A persistent revenue shortfall arising is a common experience from an ill-structured tax system. Simply by cutting the expenditure only without developing an effective tax system will undermine 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; Gordon and Li, 2005).

### **Experiences of African countries**

#### *Kenyan taxation structure*

The current tax structure comprises two main direct taxes (individual income and corporate tax) and three main indirect taxes (Value Added Tax, excise and customs duties). A look at the relative use of these instruments over time reveals that the importance of income tax has been declining, though it still plays an important role in its contribution to total tax revenue (Rena, 2011). According to various Economic Surveys, income taxes accounted for an average of 44.6 percent over the period 1968/69-1972/73, but declined to an average of 35.8 percent over 2001/02-2005/06. Corporate taxes accounted for a bigger proportion than individual income taxes until 1997/98, when individual taxes became more important. For instance, in 2005/06, income taxes accounted for 38.5 percent of total tax revenue, of which 54.4 percent were individual income taxes, while corporate taxes accounted for 45.6 percent. Value added taxes have gained importance over time, while trade taxes have had a declining role. Over 2001/02-2005/06, VAT accounted for an average of 27.5 percent, excise taxes accounted for 20.1 percent, while customs duties accounted for about 13.0 percent. These taxes have evolved over time from an initial tax structure that was inherited from the British system (Wanjala & Bernadette, 2006).

#### *Uganda Tax System*

Uganda's tax system on 1990-2004 has undergone dynamic reforms over the past fourteen years both in terms of policy and administration. Prior to 1991, administration of Central Government taxes was a direct function of the Ministry responsible for finance (Kaweesa, 2004). The public sector was much bigger than

the private sector and yet contributed very little to the tax base. The private sector had low revenue productivity, which was dominated by subsistent agriculture (about 60 percent of GDP). In addition, the commercial sector was largely informal and difficult to tax. Uganda's tax base has remained significantly narrow since independence leading to inadequate tax revenue. To date the ratio of tax revenue to GDP is just about 13 percent compared to the sub-Saharan Africa's average of 18-20 percent. By 1989 the ratio of tax revenue to GDP was a miserable 4 percent. Also the composition of tax revenue was predominantly importing dependent. Over 60 percent of the total tax revenue was raised from taxes on imports with less than 40 percent contribution from Domestic taxes (Bird and Oldman, 1990; Wanjala & Bernadette, 2006; Seidman, 2003). This scenario was attributed to a number of factors.

#### *Ghana Tax System*

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. Income tax was introduced in Ghana under the Income Tax Ordinance in 1943 (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. It is widely acknowledged that reforms in tax administration are relevant or virtually indispensable to the process of effective reform of the structure of taxes in any country.

Countries with low and intermediate levels of income will have low levels of redistribution. The countries whose incomes exceed the intermediate levels of income will have high levels of redistribution, of which the high-income economies will have the largest levels of redistribution. The income redistribution from the private sector to the government is an increase in taxation. In coordination with the government expenditures is an increase in capital formation (Bird and Oldman, 1990; Rena, 2011). When a country improves its fiscal policy by reducing tax, tariffs or other barriers to trade, it advances its integration into the world economy. Some of the developing countries are dependent on foreign aid for half of their national budgets and hence the capital formation in those countries will be difficult. One of the reasons have not been able to overcome the obstacles to expanding and diversifying their exports, tariffs rate is high and failed to fuel their economic growth and keep up with changes in international demand. Given

the negative impact of persistent unsustainable fiscal deficits on the emerging economy, there is now a consensus among interested parties on the need to address the problem effectively (Seidman, 2003; Gordon and Li, 2005). The literature suggests three approaches for this purpose: increase in revenue, reduction in expenditure, or a continuation of both. Mostly an appraisal of the budgetary process shows that annual expenditure proposals are always anchored on projected revenue, thus the accuracy of revenue projection is a necessary condition for devising an appropriate framework for fiscal deficit management in any given country. It also suggests that a significant reduction in public expenditure and prudent management of financial resources are the most feasible solutions to the problem of unsustainable fiscal deficit. (Ariyo, 1997)

In the case of Ghana, during the 1990s, the fiscal position of the central government has strengthened considerably. The economic performance continued to improve in Ghana during the first half of 2006, supported by strong macroeconomic policy implementation and a favorable external environment. The economic growth is relatively strong, inflation is falling, and the external position has strengthened considerably, allowing a buildup of international reserves that provides a cushion against shocks. Ghana's program implementation during the PRGF-supported program has been satisfactory. During the 1990s, the overall fiscal deficit (including grants) averaged about 9 percent of GDP, but it has declined steadily since then to about 3½ percent of GDP in 2004. This improvement is partly attributed to strong growth, but new tax measures, enhanced revenue administration, and expenditure discipline have all played a role (Governor of Bank of Ghana (2001). The tax revenue is at its highest level at about 24 percent of GDP, and this has allowed recurrent expenditure to rise to more than 20 percent of GDP. On present estimation, the government achieved its medium-term objective outlined in the Ghana Poverty Reduction Strategy, of halving the ratio of domestic debt to GDP from the end-2002 level by end-2005 (about 11½ percent of GDP) (IMF, 2006). Fiscal policy appears on course in 2006 to deliver the targeted reductions in the ratio of domestic debt to GDP. The fiscal consolidation that has occurred during the PRGF-supported program has resulted in a significant reduction in domestic debt service and allowed the crowding-in of private sector investment through continuing declines in interest rates, while increasing poverty-related spending.

#### *Debt Management requirements*

This research aims to discuss the common concern of foreign and domestic debt management, and the application of performing auditing concepts in evaluating the effects of reform measures. The cost of proposed debt for achieving these

objectives is to generate a quantitative data to measure achievements and national development objectives. The chief causes of debt crises are weak economic performance, inaccurate revenue and expenditure projections, and tax and expenditure policies (Governor of Bank of Ghana (2001; IMF, 2006). Debt management reform has indeed been in the agenda of developing countries and international financial institutions for many years, with some success in removing economic distortions (Terkper, 1994). Yet many problems remain unsolved while structural changes, like decentralization, have added new pieces to the public finance puzzle. Expenditure cuts that concentrate on the investment programs and social services may be not only unsustainable but can also put a threat to the effectiveness of public policies. In the case of social programs, this may also harm the ability of governments to perform their debt management role (Fiszbein, 1997). But what we have yet to do in Africa in any sustained way is to ensure that financial services to governments, firms and households are done in the most cost-effective way given appropriate regulatory considerations. Well-developed financial and capital markets reduce the cost of borrowing by the private and public sectors, making the short-run borrowing strategy more cost effective and easier to finance over the long-term. It deserves a special significance in the context of identifying major issues and constraints of resources management and offering recommendations for improvement. Due to lack of adequate number of qualified personnel, consistency in policy issues, formal debt management planning process and inadequate authority attention is basic external challenges (IMF, 2006). Delays in furnishing financial information and unwillingness to provide performance reports have caused difficulties to evaluate performance of debt management.

#### *Fiscal policy through decentralization*

Fiscal decentralization is a strategy followed by many countries in an effort to encourage economic development outside the major urban areas. 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 level and 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. The net result should be better local government services, and a more satisfied electorate. Fiscal decentralization requires local governments with some autonomy to make independent fiscal decisions (Fiszbein, 1997). 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. The most crucial is adequate human resource capacity to carry out decentralized powers and all the capacities required by local governments—especially as it refers to the technical aspects of decentralized functions and raising revenues. The transfer of skilled central personnel to Local Government (LGs) leads to conflict of interest for these officers between the center where they have been deployed and where all personnel decisions are made and the locality where they serve (Fiszbein and Campbell, 1997).

### **Discussion and conclusion**

The analysis has thrown some light on the efficiency of tax administration and fiscal policies in developing countries. In general, the results reflect the effect of administrative lags and lapses in the implementation of fiscal and tax-related policies. Given the negative impact of persistent unsustainable fiscal deficits on the most developing countries in Africa, there is now a consensus among interested parties on the need to address the problem effectively. The literature suggests three approaches for this purpose: increase in revenue, reduction in expenditure, or a continuation of both. An appraisal of the budgetary process in most of those countries shows that annual expenditure proposals are always anchored on projected revenue, thus the accuracy of revenue projection is a necessary condition for devising an appropriate framework for fiscal deficit management. In any way, the political, economic, and social environment shapes the public sector institutional context, including the government, legislature, judiciary, the civil service, and a host of quasi-governmental organizations. Generally, two types of external factors come into play. First, some factors, such as financial and economic conditions, determine the feasibility of service options by delimiting the overall level of 'resource endowment'. Second, other factors constrain or motivate service providers to use the resources available in the most efficient and effective manner. These include the political system, administrative and legal frameworks, the nature of civil society, and the nature of private–public sector interaction. The taxation of wealth and property income in those remains a challenge. If captured, taxation of wealth and property income is one of the ways through which income redistribution could be achieved.

Africa's economic progress and political stability are vital both for its citizens and for the rest of the world. Its success apparently depends primarily on actions that Africans themselves take to establish strong economic, legal, and political institutions and policies. Autonomy for the revenue institutions is the key element of the administrative reforms and should be carried out in all the countries under research. However, improving public sector efficiency, managing fiscal capabilities and monitoring a budget could play a major role in those economies. 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. The developing countries have increasingly grown to receive the flow of foreign direct investment that creates an important infrastructure, but will they have an ability to manage and response to international economic fluctuations. We agree in principle that a monetary policy is the primary instrument for macroeconomic stabilization. However, a fiscal policy can potentially play a stabilizing role in severe downturns and when inflation is very low. Poor financial and public enterprises performance raises the government-borrowing requirement, and imposes both a financial and economic burden on the economy. In the meantime, settling payment obligations in a timely manner, raising adequate revenues, and monitoring budget measures can help to stem the fiscal losses. In general, the inability to raise the adequate revenue makes it impossible to attain the equilibrium. Enhancing taxation system, labor and capital income, tariffs and other foreign taxes, would also play a potential role for in developing economies of Africa.

### References

- Ademola A., 1997, *Productivity of the Nigerian tax system: 1970–1990* AERC Research Paper 67 African Economic Research Consortium, Nairobi.
- Bank of Ghana, 2003, Press release of Monetary Policy Committee, available at [www.bog.gov.gh/privatecontent/File/MPAFSD/MPC%20Press%20Release%20May%202003.pdf](http://www.bog.gov.gh/privatecontent/File/MPAFSD/MPC%20Press%20Release%20May%202003.pdf) retrieved on 28 November 2009.
- Bird, R M., and O. Oldman, (eds.) 1990, *Taxation in developing countries*, Baltimore: Johns Hopkins UP.
- Bougrand, L., and Mlachila, 2002, *The choice between external and domestic debt in financing budget deficits - The case of Central and West African countries*, IMF working paper No. 02/79.
- Campos and Pradhan, 1996, *Budgetary institutions and expenditure outcomes: Binding governments to fiscal performance* a product of the Public Economics Division, Policy Research Department, available at <http://www.worldbank.org/html/dec/Publications/Workpapers/wps1646-abstract.html> retrieved on 25 November 2009.

- Dailami and Atkin, 1990, *Policy, research, and external affairs financial policy and systems* WPS 515 – Stock Markets in Developing Countries, World Bank's Financial Policy and Systems Division.
- Dieterich, C., 2004, Capital inflows sterilization, and commercial bank speculation policy options for managing foreign exchange inflows, African Department, IMF Working Paper No. 04/218 (November).
- Fiszbein, A., 1997, *Decentralization and local capacity: Some thoughts on a controversial relationship*, Technical Consultation on Decentralization by SD Diminstion publication.
- Fiszbein, A. and Campbell, T., 1997, Local government capacity: Beyond technical assistance”, *World Development*, 25(7):10-31.
- FitzGerald, V., 2003, *Global markets and the developing economy*, Basingstoke: Palgrave.
- FitzGerald, V., 2005, *Stabilisation policy and structural adjustment*, available at [http://www.valpyfitzgerald.com/files/handboo\\_.pdf](http://www.valpyfitzgerald.com/files/handboo_.pdf) retrieved on 29 November 2009.
- Fjeldstad, and Odd-Helge, 2006, Corruption in tax administration - Lessons from institutional reforms in Uganda, In Susan Rose-Ackerman ed. (2006) *International handbook on the economics of corruption*. Cheltenham, UK/Northampton MA, USA: Edward Elgar: 484-511.
- Gordon, R H. and Li Wei, 2005, *Puzzling tax structures in developing countries: A comparison of two alternative explanation*, NBER Working Paper No. W11661.
- Governor of Bank of Ghana, 2001, *Memorandum of economic and financial policies of the government of Ghana for 2001*, Ghana on IMF, (June).
- IMF, 2005, *Nigeria: Poverty reduction strategy paper - National economic empowerment and development strategy*, IMF Country Report No. 05/433.
- IMF, 2006, IMF Executive Board completes sixth and final review under Ghana's PRGF arrangement and approves US\$39 Million Disbursement”, Press Release No. 06/234, available at <http://www.imf.org/external/np/sec/pr/2006/pr06234.htm> retrieved on 22 November 2009.
- Kaweesa, C. K., 2004, Taxation and investment in Uganda structure and trends, Speech by Assistant Commissioner for Tax Education/Spokesperson Uganda Revenue Authority.
- Montiel, P. and Reinhart, C. M., 1999, The dynamics of capital movements to emerging economies during the 1990s. In Griffith-Jones, Montes (eds.), *Short-term capital movements and balance of payments crises*, Oxford: Oxford University Press.



- Osei, A., 2006, Speech delivered By The Commissioner Of Internal Revenue, At The Re-Launch Of The Tax Stamp, Thursday, 28th September 2006 available at <http://www.mofep.gov.gh/taxstamp.pdf> retrieved on 25 November 2009.
- Rena, R., 2006, *Financial institutions in Eritrea*, Dar-es-Salaam (Tanzania): New Africa Press.
- Rena, R., 2011, *Public finance and taxation*, Windhoek: Center for Lifelong Learning, Polytechnic of Namibia.
- Schick, A., 1998, *A contemporary approach to public expenditure management, Economic – ‘Prioritization and fiscal responsibility: How to involve politicians in expenditure management.*
- Seidman, L.S., 2003, *Automatic fiscal policies to combat recessions*, Armonk, NY: M.E. Sharpe.
- Shome, P., 2004, *Tax administration and the small taxpayer* IMF Policy Discussion Paper PDP/04/2 – presented at the workshop of Fiscal Affairs Department.
- Siegel, J.J., 1979, Inflation-induced distortions in government and private saving statistics, *Review of Economics and Statistics*, 61(1):83-90.
- Terkper, S. E., 1994, *Ghana: Tax administration reforms (1985-1993)* Presented by the Author who is an Advisor to the National Revenue Secretariat, Ghana and a Research Fellow at the International Tax Program, Harvard University.
- Van der Merwe, 2002, *Policy applications of balance of payments and IIP statistics prepared by the Bank of Uganda*, BOPCOM-03/37 Sixteenth Meeting of the IMF Committee on Balance of Payments Statistics Washington D.C., December 1–5, 2003.
- Kiringai J., Wanjala B. and Mathenge N., 2006, Feminisation of poverty in Kenya: Is fiscal policy panacea or Achilles’ heel?, 5<sup>th</sup> PEP Research Network General Meeting, June 18-22, Addis-Ababa, Ethiopia.