Restructuring A Fiscal Policy Encourages Economic Growth - A Case of Selected African Countries

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ABSTRACT

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. 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. This 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. This paper also covers the basic theory, policy and practice of public finance including decentralization and intergovernmental fiscal relations in developing and transitional economies. The magnitude of government surplus or deficit is probably the single most important statistic measuring the impact of government fiscal policy on an economy.

KEY WORDS : Fiscal adjustment, tax policies, domestic and foreign debt, economic growth.

1. INTRODUCTION:

This paper introduces the important topics of fiscal policy and its 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. 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 "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 policyThis 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. 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. We viewed 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.

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

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selective provision or financing of only public goods and services and ensuring distributive justice. Budgets had to adjust rapidly to the changing economic realities, required a massive reorientation of the role of the state, and had as pervasive an influence in the economy strengthen revenue mobilization, and improve resource allocation and efficiency, often through institutional and structural reforms. In the case of Ghana year 2001, the tax revenue base becomes less than 20 percent of gross domestic expenditure. It is further reduced as the tax-payers 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.

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 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 resources needed to perform as the professional roles of revenue institutions. The main task of fiscal administration in these ministries tends to be virtually coordinated with expenditure allocation and control by the budget division. 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.

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?

2. 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. 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, and Kenya) with a limited tax base, tight budgets, and high Government spending this cost should not be underestimated. Generally developing countries, 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.

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. Our literature often argued that foreign direct investment (FDI) might ease these Governments' fiscal constraints by bringing in capital resources.

To date, 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. 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. In 2001, the decisive factor in Ghana's economic difficulties was when the Government expenditures are more than the revenue. 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. 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 last year (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. The other option for a sustainable Current Account deficit is a long-term loan with low interest rates. 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. 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) (Van der 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 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.

Foreign Borrowing Against Domestic Borrowin:

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. If foreign borrowing by the Government is excessive, domestic interest rates will fall too far, and fiscal policy will suffer. 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. Further foreign borrowing would question the country's credit standing; 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. 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 (Christensen, 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.

3. 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 the goods and services. The absolute tax system in those countries should raise essential revenue without excessive borrowing, and discouraging economic activities. 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 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. 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).

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 which is very common in poorer 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 undermines the growth and the construction of effective state institutions.

4. EXPERIENCES OF AFRICAN COUNTRIES

Kenya Tax Structure:

The current tax structure comprises two main direct taxes (individual income tax and corporate tax) and three main indirect taxes (Value Added Tax, Excise and Custom 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. According to various Economic Surveys, income taxes accounted for an average of 44.6 percent over the period 1968-69 to 1972-73, but declined to an average of 35.8 percent over 2001-02 to 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 to 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 (Wanjala1 & Bernadette, 2006).

Uganda Tax System:

Uganda's tax system on 1990-2004 has undergone dynamic reforms over the past thirteen 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 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. 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, 1994a). 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.

In the case of Ghana, during the 1990s, the fiscal position of the Central Government has strengthened considerably. Economic performance continued to improve in Ghana during the first half of 2006, supported by strong macroeconomic policy implementation and a favorable external environment. 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 3.5 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. 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 11.5 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 chief causes of debt crises are weak economic performance, inaccurate revenue and expenditure projections, and tax and expenditure policies. 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. Yet many problems remain unsolved while structural changes, like decentralization, have added new pieces to the public finance puzzle. In the case of social programs, this may also harm the ability of Governments to perform their debt-management role. 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. 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. Fiscal decentralization requires local Governments with some autonomy to make independent fiscal decisions 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.

5. RESEARCH FINDINGS AND DISCUSSION

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. 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. 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.

6. CONCLUSION:

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. 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 plays a potential role for in developing economies.

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