

# ROLE OF THE PUBLIC FINANCIAL MANAGEMENT ON THE GOVERNMENT FINANCIAL PERFORMANCE IN DEVELOPING COUNTRIES

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## ABSTRACT

*The study of public finance refers to the responsibilities and role of the government towards the economy of the country. In this branch of the study of economics, revenue and expenses of the government are assessed by the public authorities, and in order to achieve the desirable effects and to avoid the undesirable ones, adjustment is done of one or the other. Though in the set of rules there is no 'one size fits all', to evaluate public finance institutions and structures a framework has been developed in terms of both public revenue and spending also the fiscal balance is carried out, few key arenas are - earmarking, income taxes, tax evasion, VAT and administration, and revenues from non-tax such as natural resources, monopolies of government and borrowing - as discussed. Fiscal decentralization points are reviewed to enhance efficiency gains and from improved local - accountability and taking into consideration knowledge as the main benefit if the local government's fiscal powers are amplified and for greater dependability suggestions are given to promote fiscal discipline In individual revenue, another benefit is that is can compensate losses such as loss of some macro-economic control and also possibly uneven priorities of investment. Increased globalization is one of the major challenges to national -tax bases, and a brief discussion has also been done on the possibility of global taxes in order to finance global public goods, in developing countries, there is need to enhance local fiscal expertise and institutions.*

**Keywords:** *Developing countries, Public financial management, government.*

## I. INTRODUCTION

In economics, public finance is another branch of study. IT comprises of two terms – public and finance. Public refers to government, and finance refers to the science of money management. In literal terms, we can define public finance as the branch of study that deals with allocating economic resources to accomplish the goals of public-affairs. Therefore, the study of management and allocation of resources and the use of technology to achieve the goals of public institutions is known as public finance. With time the scope and definition of public finance are widening, but still, it has a narrow meaning. Governments' finances are studied

in public finance. Therefore, the main query that arises that how Government, in order to meet the ever rising expenses, manages to raise its capitals.

The role of government towards the economy of the country is also a part of the study of public finance. In this branch of the study of economics, revenue and expenses of the government are assessed by the public and in order to achieve the desirable effects and to avoid the undesirable ones, adjustment is done of one or the other. As per Dalton, the main concern of public finance is the income and expenses of public – authorities and adjustment of one another. Public finance also comprises of expenditure of the government, the impact of taxation, deficit financing and borrowing by the public.

“Public Finance is the study of effects of budgets on the economy, especially the effect on the accomplishment of the major economic objects like equity, economy, efficiency and growth “Professor Otto Eckstein has written this. Also, the fiscal policies that can be employed to accomplish certain objectives like economic growth, more equal distribution of income, price stability are dealt with here. With changes in the economic situation from time to time, economic thinking is also developing and transforming about the roles that are expected from public finance to play.

During the thirties, the western industrialized nations starved under the Great Depression. Public finance played a significant role in raising enough resources for taking forward the functions of Government’s civil administration and safeguarding from for foreign nations. The classical economist during that period stated that in order to keep the expenses minimum and to avoid taxing of the people as much as possible, public finance was necessary.

Also, balancing the Government budget is necessary. Mainly for production purposes, public burrowing was recommended. It was considered legal, especially during the wartime, but it was thought that the debt should either be reduced or repaid by the government as early as possible.

## II. IMPORTANCE OF PUBLIC FINANCE

For the growth and development of the country, public finance plays a significant role. A country’s government can carry forward the economic and industrial development of the nation, make available opportunities for employment, encourage savings and investments towards the direction desired and social benefits can also be increased via public-expenditure. Therefore the overall social and economic system of the country is affected. Below importance of public finance has been mentioned.

### A. *Economic Stability*

Fiscal tools are used by the government to stabilize the economy. At the time of prosperity, more tax is imposed by the government and the internal public debt is raised. This amount is utilized in repaying loans taken from foreign countries. There are reductions in internal expenditures. The case reverses at the time of recession.

### ***B. Equitable Distribution***

In order to reduce inequality, the government uses expenditures and revenues that it owes. More income tax is imposed on properties and profits of rich people and even on the goods that they consume, at the time of high disparity. Through allowance, subsidies and many other types of direct and indirect benefits are provided for benefitting the poor, and these are provided from the money collected.

### ***C. Steady State Economic Growth***

To accomplish a sustainable economic growth, public finance is mandatory. To enhance both aggregate demand and supply, fiscal tools such as public expenditure, public debt and taxes are used.

### ***D. Infrastructural Development***

In the construction of infrastructures, the amount is spent from the revenues collected by the government. It also ensures security, justice and peace. It also makes sure to bring about socio-economic reformation. As fiscal tools, the expenditures and revenues are utilized.

### ***E. Balanced Development***

In order to eliminate the gap between urban and rural and agricultural and industrial sectors, revenues and expenditures are used by the government. Budget is allocated by the government for infrastructural development in rural regions and direct economic benefits to the rural populace.

### ***F. Price Stability***

To overcome inflation and deflation public finance is used by the government. Indirect taxes and expenditures are reduced during inflation, while direct taxes and capital expenditure increases. Investment is mobilized, and internal public debt is collected. This policy gets reversed when there is deflation.

### ***G. Proper Allocation of Resources***

For proper utilization of manmade, human and natural resources, it is mandatory for the government to finance. MORE tax is imposed by the government on goods that are produced less and are less desirable, and less tax is imposed on goods and subsidies that are more desirable.

### ***H. Promotion of Export***

Government promotes and imposes less tax on export or exemption form of the taxes or provides subsidies to the goods that are export-oriented. At the subsidized price, it might supply the inputs. More tax is imposed on import.

### ***I. Development Taxation: Advice and Practice***

Regarding development taxation, many changing messages have been heard by the developing countries. The academic ideal was a broad-based progressive personal income tax about fifty years ago capital gains was also included and to minimize the distortions induced by taxation in the economy it was incorporated with the corporate income tax [1].

### III. PUBLIC FINANCE IN DEVELOPING COUNTRIES

In public finance, it is solely not about money. It also includes the finances of the public sector, but also the structure of fiscal and public sector institutions also the broad - objectives and to rationalize the activities of the government. Emphasis is laid on how resources are raised by the government for financial disbursements, not considering where finance is spent. Still, the opportunities are large, though, for a better understanding of the financing resources, some analysis of nature and public spending efficiency is a must.

A complex interaction between interests, ideas and organizations result in the formation of public finance policy. In any country, the best public finance system is the one that reflects the structure of the economy, needs of the public services, its ability to govern the public finances, and its accessibility to various sources such as debt, aid or taxation. In any country the public finance is context-specific and also path-dependent, also reflects the effects of complex political and social exchanges in a specific institutional context in between different groups that have been established by the capacity of the state administration and history. However, in one direction, the influence does not flows, both the context and nature and also the outcomes of such interactions are influenced by how the public finance is operated. Although economists have dominated from a long time, both administrative and political aspects are also necessary for studying public finance, and in the recent times they aspects have gained enough attention from historians and all those are concerned about enhancing the outcomes of the policy in developing nations. Adopting such a tax was advised by foreign professionals to developing nations as a necessary evil indirect taxes are considered. Taxes on international trade (imports and exports), regional and local (sub-national) taxes were in general ignored. It was thought by most advisers that high tax –GDP ratios were required to finance development - expenditure. For further income redistribution at some cases, high marginal tax rates were also recommended.

During 1970 -1990, sea change' in tax thought and tax advice appeared to have had some impact. As per (Peter, Buttrick and Duncan, 2010) in many developing nations, not only did VAT became important but also the rates of income tax declined nearly everywhere [2]. In some aspect, the developing nations by now would have considered taxing "better". Ever since the average tax-GDP ratio hardly moved during the past 30 years, these countries are not taxing more. Long time back, Kaldor (1963) noted that in the levels of tax this striking inertia reflected not much inherent difficulty of effectively raising the taxation level as the corresponding persistent reality that is rarely in favour of the interest of the elites of politics in doing so [3].

#### *A. Public Finance Principles and Institutions*

There is much more in public finance other than the array of services and goods that are provided publicly, and across countries, these taxes vary widely. It depends on things such as development level and preferences. Nevertheless, three commonly accepted principles of good public finance have been produced across the globe after a century of thought and practice.

Firstly, public services are financed using these resources and must not lead to the sacrificing of the private values higher than the value produced by the public services. Thus In other terms, resources last unit is transferred to the public-sector - the Marginal Cost of Funds (MCF) for the public – services In terms of private goods - with expenditure on public services it must not equate with the marginal social benefit. With the practical budgetary principle of maintaining aggregate fiscal discipline, over time, this rule is closely

associated. It makes sure that the government must not spend the resources that residents (who get the benefits from these expenditures) through the political process are willing to allocate. There will be a huge budget deficit if the countries do not maintain fiscal discipline because of these deficits grave problems that are underlying will be reflected. Further, these problems will become worse, and longer time will be required to correct them. In the present time, many nations have gone through such experiences and by establishing such fiscal institutions likewise they have tried to reduce the future indiscipline as more budgets which are transparent and comprehensive and also fiscal rules such as fiscal responsibility laws as stated by Liu and Webb in (2011), this restrains the nature and level of government's borrowing [4].

Secondly, in order to maximize the national economic welfare, the benefits that are received should equal to the last dollar spent on every public service. Whereas it is not possible to allocate the budgetary resources with that much perfection both as well-being with such precision cannot be measured. As this is not clear how we can meaningfully compare the last dollar spent on the army to those spent on health, this ideologically is correct and clear. In the developing countries, these resources are scarce; therefore wasting and spending these resources on things that are not worthy will lead to pretty bad loss a lot of opportunities. By measuring and accessing both the performance and economical cost of the public services as well and as transparently as possible, these are the best ways of improving the allocation of public resources. The economic values of resources used are reflected, and outputs are produced, accrual accounting needs to be used by the government (usage of capital goods is given due recognition) as in most countries these private sectors must do. Even today, the majority of these developing countries have cash-based government accounts also institutions are very weak for financial, budgeting and performance auditing. As good electoral systems are needed for strengthening the development, there is also need of institutions that promote accountability and transparency of outcomes that are associated with the public services.

Thirdly, in order to secure a level of acceptance of operational efficiency and effectiveness, there is need of such institutions. The services promoted, provided intended for the social outcomes should be (effective) and leakage or wastage should be as little as possible (efficiency). Such institutions are already present in a few developing countries. Though organizations such as the World Bank and IMF try to provide the best technical assistance in the development of such institutions in some of the countries, yet it is evident that much success has not been achieved. Also, establishing a practical definition of the public sector is waste - with respect to the want of public finance in the conservation of energy, energy is needed is another important issue.

### ***B. Some Issues in Development Finance***

Though to some extent these tax regimes were adopted by many countries after the second wave of development tax, the countries which are economically more sensible in many important ways adopted these, as a consequence, there was a shift in attention towards tax consumption as less focus was towards equity issues. Through taxation, few countries did much redistribution thus partly neglecting this as per Chu, Davoodi and Gupta (2000) and also many believed that dealing with the redistribution on the spending side of the budget was way more effective and efficient. As usual, still, both advice from expert and practices varies with respect to space and time; thus, the whole story is still not discussed [5].

### ***C. Non-Tax Revenues***

Revenue collected from various other sources other than taxes, certain countries that produce oil their tax revenues do not exceed non – tax revenues. Still, astonishingly small efforts have been taken to consider considering these issues of revenue in a systematic way. Few points are apparent. For instance, when the government is the monopolistic provider (of such as assets, use services or rights) and voluntarily consumption, in order to make sure that there should be least efficiency loss, the principle prices should be set. The sources of revenue should be exploited to that point only where it equalizes MCF with every other source (as per the mentioned overall revenue requirements) like, exploitation of forests, lease or sale of mining rights, and spectrums of airwave also of seignorage. In the majority of the countries, the government is the sole supplier of capital, and it gains revenue- seignorage - from doing so as per Buiter (2007) and might, principally also levy inflation tax – a tax imposed on money holders at such a point that MCF equals to other sources of revenue [6].

### ***D. The VAT***

As mentioned by Ebrill *et al.* (2001) though, VAT was implemented widely, all those principles that advocate VAT was not adopted and followed widely [7]. A broad base was encompassing sales of both goods and services and goods (with rare exclusion) in between the retail sales and businesses. Still, few of them are imposed above the threshold with a single rate small business are excluded, and solely on consumption these do not fall ( that is for capital goods purchases full tax credits are provided and also for transactions of cross border, zero-rating of exports. However, Bird and Gendron (2007) mentioned that regarding the design and effects of VAT, there is still a need for learning in developing countries [8].

### ***E. Tax Administration***

In the presence of sound tax administration, tax evasion can be controlled at the end. With development, the economy keeps on changing; therefore, tax administration is a must. With the adoption of IT (information technology), there has seen drastic changes with regard to automating the majority of the tax records and processes also in between the tax administration and taxpayers it can become the main interface. At a rapid rate, nations are adopting systems that are web-based for filing and payment and are making the most of the usage of IT TO develop and implement risk-based systems of audit that allows them to lay focus on the resources of administration that are scarce and can cause difficulties on those activities and taxpayers, also strengthens the internal systems of control to make sure that with the taxpayers the tax officials behave appropriately.

### ***F. Earmarking***

Though tax experts condemn earmarking taxes, it is still widespread. Globally particular activities are financed by earmarking taxes. If implemented and designed properly, the earmarked taxes can be at times be justified as a tax benefit that work as sort of collective user charge that is gasoline taxes - for the purpose of development revenue is collected. At this, from the spending the benefits, beneficiaries consider them worthy in terms of

payment of tax. As mentioned by Bird and Jun (2007), no such allocative function is served by earmarking [9].

### ***G. Income Taxes***

Rates of income tax have been lowered in the majority of the countries. IN MOST OF THE tax systems, personal income taxes although limited scope wise provides the most progressive element. Exemptions for saving and presumably other good things and tax from different sources, especially at different rates, types of capital income is provided in most of the countries. Bird and Zolt (2011) mentioned that horizontal inequitable treatment of taxpayers results from 'scheduler' taxation; it is more efficient administration wise and has a sound economic rationale [10].

### ***H. Tax Evasion***

In the developing countries tax evasion happens largely, consequences are negative for the efficiency of equity and economy. For different activities, tax rates differ because of evasion as a consequence, leads to resource misallocation and equity -violations. There are increased business risks. Detailed record keeping or improved tax investigation activity raise compliance costs of the taxpayer and efficiency losses are the responses of the administration. As mentioned by Alm, Martinez-Vazquez and Wallace (2004) Tax is not properly paid by small businesses, informal sector and agriculture a large part of the share is constituted by the potential tax base in the developing nations [11].

## **IV. FISCAL DECENTRALIZATION**

In many developing countries, Fiscal decentralization has become a concern in recent years. Increased efficiency is the major benefit from decentralization (welfare gain is also consequent) this happens when governance moves to people. Some of them moved further and debated that welfare can be improved by fiscal decentralization maybe not directly but also contributes in the development of the economy, mobilization of revenue, accountability of officials elected, innovation in the delivery of public services, development capacity of local government and participation of governance at grassroots levels.

In order to gain benefits from decentralization, the power to control the employees and local residents should be the power of the governments (generally through elections). Also, there should be enough accurate data that will allow the voters to assess the fiscal- decisions of their local - governments also incentives and interest should be sufficient enough for them to exercise their power correctly. Alas, in most of the developing nations, only a few conditions are fulfilled. In developing countries, in total taxes, the total tax share is less than half of the share in the countries that are industrialized in the last 30 years this has rarely changed as mentioned by Bahl and Bird (2008). In developing countries, the majority of the subnational spending is funded through transfers, and few of taxes that these subnational governments have are quite often difficult and costly to direct [12].

In the traditional theory of fiscal federalism, this is consistent, for the subnational governments a very limited tax base is prescribed. Taxes that can be administered easily are the good local taxes, and on local residents, these are solely or mainly imposed and In between subnational – local or regional - governments or between

subnational and national governments do not raise problems of harmonization or competition. Property tax is the major source of revenue that passes through these severe tests, taxes on vehicles is perhaps the secondary role and user fees and charges.

Why quite often the central governments are often hesitant to give much tax discretion to local governments for some good reasons. Resources can be shifted from the central governments by Fiscal decentralization that has capital spending rates higher In comparison to local and regional governments that relatively spend more on consumption services and goods, therefore harms the growth of the nation. Composition of public capital investments is swayed from national priorities by decentralization. Also, suppose the path of increasing reliance on own-source revenues is taken by fiscal decentralization. In that case, the greater fiscal capacity of the local governments like large cities in which there is a large tax base that is easily reachable. Better opportunities for enhancing the capacities of the administration for tax collection - there are chances of increase in majority gain and regional inequality. Administrative and compliance costs can be increased by revenue decentralization.

## V. CONCLUSION

In the past fifty years “No one size fits all” with respect to public finance in developing countries is one of the major lessons we have learned. In order to comply with the specific conditions of each country, Revenue analysis and prescription need to be tailored to fit in, taking into consideration the factors that are necessary for interaction in between taxes and other policies related to the public (also includes regulatory framework and transfers), the number of tiers of government and the organizations that shape the inter-governmental relations, and the scope of globalization. Environments reform and processes that are specific needs more emphasis and attention. Level of development and administrative quality are the chief considerations as is the extent of political -support for reformation and reformation by local ownership such as by shareholders as fiscal professionals - lawyers, accountants, economists; elites, taxpayers in general and, not the least, such kind of third parties who are involved in the taxing procedures like banks.

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