

The Role of Small and Micro Enterprises (SMEs) on Government Revenue

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Abstract

Small and Micro Entrepreneurs (SMEs) pay tax to the government. They thus become important actors for income poverty reduction strategies of the government authorities and donor agencies. Service delivery from the government depends on their revenue collection which large part comes from tax. Tax revenue of the government depends on different factors namely, the taxable capacity of the tax payers and the tax base. Entrepreneurs are critical stakeholders of poverty reduction in any country as they form a large tax base and their capacity (revenue) is important for the government to have high taxable capacity which in turn enables the government to provide services to the public. This paper intends to examine the role of entrepreneurs who pay their tax and the capacity of Government to provide services which in turn reduce poverty.

Keywords: SMEs, poverty reduction, tax base, taxable capacity, and Tanzania

1. Introduction

In three-sector neo-classic model for equilibrium level of income and output, at equilibrium level, savings must be equal to investment and the government expenditure must be equal to taxes (Bahigwa & Economic Policy Research Centre, 2004). At the macro level, most basic models of aggregate demand, explains that spending determines output and income, but output and income also determine spending. Income determines consumption, and aggregate demand is increased by increase in consumption. When autonomous spending increases, the rate of increase in output increases more than the rate of increase in autonomous spending (multiplier effect). The size of multiplier depends on the marginal propensity to consume and on tax rates. In return government spending always increase aggregate demand and therefore, tax collections.

When tax collection rate is lower than government spending, the a budget deficit is obvious (Donbusch, 1998). With huge deficit on government budget, which is financed by bank borrowing, the government cannot deliver services effectively. This affect the wellbeing of its people and as a consequence the level of poverty goes higher. The government may resolve budget deficit by applying monetary policies strategies, which in turn may result into inflation that reduces purchasing power of the country's currency. Service delivery at high inflation level is made possible only through donor dependences. This kind of strategy has led into many African countries to become Heavily Indebted Poor Countries (HIPC). The donor dependences are likely to result into pilling of debts.

Taxes are compulsory charges imposed by the government to its people so it can finance its expenditures on public good. Taxes have no direct benefit to tax payers (Non quid Pro quo Base), which entail don't expect the same benefits as how much you pay through tax (Mponguliana, 2004). Tax provide much of Government revenue (Musgrave, et.al. (1989:212). These collections, enables the government deliver public goods (services smoothly) as the responsibility of the government to its people is to provide effective services. The rest of the paper is arranged as follow section two is about the role of the government, section three data and methodology, section four findings and discussion and finally section five is about conclusion and recommendation.

2. The Roles of the Government

The central role of the government is to keep rules and orders, which go together with taking care of welfares of the people in their boundaries of jurisdiction. For service delivery role of the government comprise of education, health, security and defense and social service (utilities). This responsibilities are confined with the duty to construct

and maintain infrastructure (schools, hospitals, health centre, roads, parks and recreational centers like areas for sports and games). To provide these services effectively, there is huge demand of financial resources which the government should collect to manage. Government expenditure has a composite of how it collects its tax as the large base of its expenditure is a result of tax collection.

Citizen have to rely on government on their dealings of everyday. Starting a business, owning properties (assets like houses and vehicles), traveling beyond country borders and the like all are in uniformity of requesting government permission. It is in line with the argument placed long time ago by Louis Rose that 'To develop land it is usually necessary to obtain the permission of government. (Louis, 1973). This is known to the people and they know it is the service they deserve from their government.

There are different financial sources of local government, but in this paper the assumption has been based on taxes from entrepreneurs. The motive behind focusing this is, to analyze the contribution of entrepreneurs in financing government expenditure through tax. This paper has a local view in Tanzania but its impact has the same phenomena worldwide.

2.1 SMEs in Tanzania

In Tanzania, the SME sector is an outcome of structural adjustment policy rather than design. It is a product of the failure of African socialism, which led to the economic crisis of the 1970s and the early 1980s. In Socialism framework, the private business sector was actively discouraged in favor of public enterprises, which were government owned, community based, or cooperative owned ventures (Rugumamu and Mutagwaba 1999). To insist that, different regulations were introduced to restrict civil servants, government officials, and political leaders from engaging in business activities. Since almost all educated people were members of the civil service at that time, it is obvious that business activities (within centralized framework) were left to people who had no education at all.

Furthermore, this African socialism policy was based on a top-down approach to decision making and the government was the only organ which made all the decisions for its citizens, including matters such as who should go to which school or college, who should work and live where, and how much one should earn in terms of wages (Olomi 2009). The reliance on government discretion in decision-making has resulted in a culture of dependency on government among most Tanzanian people to date (Rugumamu and Mutagwaba 1999). In fact, this approach has contributed to the stifling of the development of entrepreneurial values such as the need for achievement, personal initiatives, creativity, willingness to take risks and related behaviors (Olomi 2009). The socialism approach recorded marked achievement in social development in the 1970s and early 1980s, particularly in primary education, health service delivery as well as in water supply and sanitation (Temu & Due 2000; and Baunsgaard & Keen, 2010).

In 1967 after Arusha declaration, was followed by mass Nationalization i.e all privately business entities were taken over by the government and all services became centrally provided by the government itself. However, nationalization of the private sector led to a poor economy marked by a number of macro-economic imbalances, and consequently, an economic crisis that lasted for over a decade (Kanaan, 2000). This crisis also led to the erosion of purchasing power among salaried people (Olomi 2009). Thus, Tanzanian people were forced to establish small businesses to supplement their meager incomes. Some of the people engaged themselves in dubious activities such as smuggling goods from neighboring countries and selling them at premium prices in Tanzania. These kinds of businesses were against the government's policies that considered such businesses as being in conflict with the country's ideology (Maliyamkono and Bagachwa 1990).

Succumbing to pressure from the World Bank, the Tanzanian government changed its policy from a state-led economy to a market-driven economy. In fact, the final reform took place in 1991, leading to privatization of most public enterprises (Rutashobya and Olomi 1999). The privatization of state enterprises and the disengagement of the government from some activities resulted in the retrenchment of salaried employed workers from the public sector and, as a result, most of these workers turned to micro enterprises for survival (Olomi 2009). In light of the above experience, the SME sector has recently become a very significant agenda in the Tanzanian economy. Indeed, it is well accepted that the SME sector has an important role to play in terms of income and employment generation.

2.2 Government Revenue and Expenditure

Empowerment of people is an important agenda to enable them take charge of their own development. Development

intervention should foster social, legal, and policy frameworks that enable them effectively influence public decisions that confront them. Political environment should also ensure that the public/private investments are financed and provided in a decentralized and participatory way. The government authorities operating within the rural areas, cities and municipality have the responsibility for empowering people. Their power that can make them implement planned poverty strategies originated on revenues collected, and revenue collected depends on tax base as well as taxable capacity. In the study Aizenman et.al. (1999) on financial sector inefficiencies and coordination failures implications for crisis management, they found that higher contract enforcement and verification costs, lower expected productivity and this might shift the economy to the wrong side of the intended trend, output losses and unemployment.

Government authorities have power to collect revenues and expand them for development and provision of services under their jurisdiction. It is supported by literature that, the major source of government revenue comprise of: taxation, development levy, house rent for council buildings, fines, license fees, business licenses, property tax, and grant from central government (Warioba, 1999; Nissanke, 2003). He continues to argue that Local Governments own source of revenues has been unsatisfactory with some reasons such as; tax compliances, poor transport, less education of tax payers, and poor voluntary fund raising strategies.

2.3 Needs for Taxation, Taxable Capacity and Tax

Adam Smith (1910) stated that the subjects of every state ought to contribute toward the support of the government, as nearly as possible in proportion to the revenue, which they respectively enjoy under the protection of the state. The expense of the government to individuals of a great nation is like the expense of management to joint tenants of great estate, who are obliged to contribute in proportional to their respective interest. According to (Creedy, 1988), the ability to pay approach has the merit of recognizing the compulsory nature of the taxation.

So the taxable income was defined as the clear income above the subsistence, and must be equitable. Tax equity generally means fairness of justice in the distribution of burden of taxation (Prest, 1960). Equity means the treatment of people in similar and dissimilar circumstances. The similar circumstances means implies those who equally well off from economic point of view should pay equal amount of taxes. This is called the horizontal equity. The person from dissimilar circumstances should be subjected to dissimilar treatment. That is the person who are better off should pay more taxes than others and the worse off should pay less tax than others.

Musgrave et.al. (1989) argues that in order to provide equitable distribution of income as well as tax equitably, the real ability of taxpayer should be estimated. The real ability of taxpayer can be estimated by estimating the earned income of individuals. The earned income is represented by the personal income. Estimating the windfall gains, if any, transfers and bequests can estimate the unearned income. The wealth can also be from the earned income and unearned income. Therefore to measure the real ability to pay the optimum ability need to be known. It is called taxable capacity. Tax Base according to Karla (1990), whenever tax is imposed, it is on some base. It may be income of the person or on price of goods.

2.4 Government and service delivery

Delivery of services in Tanzania can be done through different government organs as parastatals, service firms, local government, financial intermediary firms like pension schemes and other sub-contracted firms and institutions. Effective and reliable service delivering depends on financial capacity from different

sources. In 1996 the government of Tanzania prepared the Local Government Reform Agenda. Different government reforms make government authorities democratically elected and put into power by people that empower people to make decision. They make their own decision about human financial and physical resource allocations in a transparent manner, and be accountable to the local electorate (Friedman, 1971 and URT, 2000).

These sources are council locally generated funds, block grant, sector reform funds, local government reform funds, donor funds, central government capital grant, road funds, local authority loans board, district road improvement program, non-governmental organizations (NGOs), quasi government donor organizations, bank loan and bonds.

Though other source of funds are important for enhancing government service delivering, however, locally generated funds are most important for financial resources sustainability. Individuals not only defend their home but

also defend their territory and or in protecting their countryside. Such common interests and values may give rise to common wants i.e. wants which individuals feel obliged to support as members of the community. These wants results in the goods that Musgrave & Musgrave (1989:57) refers to Merit goods. Local governments as need to create own sources of funds so as to satisfy merit goods in their areas of jurisdictions.

Government grant is necessary for satisfying social goods, which are important by not easily to be paid for by the individuals. For example offering defense, maintaining laws and orders and railway construction. There is market failure in provision of such social goods. Market can function only in a situation where “exclusion principle” applies. Market exchange cannot occur with ought property rights, and property rights requires exclusion (Masgrave & Masgrave, 1989; Mithani, 1993).

Herber (1999:335) shows the importance of government as machinery for provision of public goods. He classifies public goods into national, quasi-national, and non-national (sub national, local) in nature. A national public good may be defined as one whose benefits are consumed on joint and equal basis by all residents of a nation. Meanwhile, quasi-national public good is characterized by joint, but unequal consumption of goods benefits across political jurisdictions. In effects, this means externalities spill over from the political jurisdictions which initially supplies the goods to other residents of other jurisdictions. Moreover the spillover effects might be bad rather than good. Just as private externalities, there will be tendency to undersupply the goods or oversupply the bad. Education exemplifies such a quasi-national public good and government caused water pollution such a quasi-national public bad. Finally, a non-national public good is characterized by joint and essentially equal consumption on a sub national basis that is within a local government political jurisdiction. The protective benefits provided by a state highway patrol or by local fire department would exemplify such a non-national public good with minimal inter-jurisdiction externalities.

2.5 Entrepreneurship Development

An entrepreneur is person who assumes the risks of becoming owner-manager of a firm and he is a job creator. The entrepreneur, with his/her dream, to conquer adversity, to achieve success for its own sake, he contributes in economic development (Schumpeter 1934). Furthermore, the entrepreneur as a gap filler and input completer is probably the prime mover of resources in more productive techniques. Nafziger (1986) also insists on what enhances entrepreneurial behavior of developed economies. Many studies of industrial entrepreneurs in developed countries indicate that trade is the major prior occupation. A background in trade gives the entrepreneur a familiarity with the market, some general management and commercial experience, sale outlets and contacts, and some capital. A number of formal traders enter manufacturing to ensure a regular source of supply or as a result of increasing opportunities for profits in industry relative to trade. Frequently a major catalyst for entrepreneurial development was government policy following independence from colonial control to encourage import substitution in manufacturing through high tariffs, tighter import quotas, and industrial policy to encourage the use of domestic inputs.

Contrary to the developing nations the policies have been formulated towards development of agricultural industry without taking much attention on development of trading ability (Kahama, 1990). Trading ability can be enhanced by enhancement of entrepreneurship ability among the local people. When local people are innovative, it is more likely to increase country ability to trade. However, external costs, which are embedded in the trade development, may decelerate the efforts to develop entrepreneurial behavior. Musgrave & Musgrave (1989:53) uses Coase’s Law to demonstrate the concept of transaction cost and external costs. For example an airplane flying at night over a city, or a chimney causing air pollution, may impose external costs on many people. Yet it is impracticable for each of them to negotiate with the offender. ‘Transaction costs’ are too high. When the rules and regulations are not clear or the laws governing businesses are not well stipulated and not enforceable, there will be high transaction costs to investors. Too high transaction costs is assumed to hamper entrepreneurial development in different local government localities. Hampered entrepreneurship ability will lead into less ability to trade, low tax base, taxable capacity and hence less revenues accruing to the local government.

3. Methodology and Source of Data

The research designs that were employed were explorative, descriptive studies and case study. The research strategy was to come out some answers on ; “How possibly Small and Micro Entrepreneurs (SMEs) can participate fully in local government service delivering through taxes. with the strategies that

can give the answer to our problem of how possible the local. Through triangulation the researcher employed qualitative methods where case studies, focus group discussions (FGD) and participatory action research techniques were used. We observed single group at a time as suggested by Tells, (1997); Yin, (1993), and Yin (1994).

This research was conducted in Tanzania Iringa in Iringa region with a view that the region has been parted into two (Iringa and Njombe) and “the new Iringa” is growing fast in business as the case requires authority to be able to provide services effectively. Data were analyzed using different computer package software like Ms Excel, SPSS and Ms Word.

4. Findings on Entrepreneurs Participation and Inclusion in Development

Tanzanian government has taken different efforts to develop SMEs. These efforts can be envisaged through the establishment of National Small Industries Corporation (NSIC), and the Small-Scale Industries Development Organization (SIDO) and other organizations, financial institutions, banks, Microfinance institutions and the like. On policy the government has been serious by making a number of policies and enacting different laws to mention few Bank and Financial Institutions Act, 2000, Microfinance Policy; SMES Policy, National Strategy for Growth and Reduction of Poverty (phase I&II) and Rural Development Strategy (URT, 2000, 2010,2006).

The turnaround situation due to reforms has resulted into retrenchment programs, liberalized domestic trade and markets, liberalized foreign trade, simplified formal business procedures, liberalized financial systems and increased tax burdens. This led into changes in livelihood security, increased competition, access to inputs, lower entry barriers (Olomi, 1999; Temu & Due, 2000). However, some institutions have not changed or are changing slowly. These include: the constitution, which is to date socialist, education system, family relations. It may correctly be argued that the economy is yet in the transition process, from planned to free market.

Entrepreneurs contribute a much to the effectiveness of government in service delivery through taxes (income tax, VAT), licenses and other properties (property taxes). The business licenses seemed to contribute about 7.33% which is higher than all other non tax collection of the government. This was confirmed by officials during interview.

On the other hand entrepreneurs at the town Market complained on the reluctant of the government authorities (Municipal council) to repair the market.

“We would like to have a modern big market” one said before interrupted by the other who complained on sewage disposal. “The business licenses and service fee have not taken into considerations of the levels of taxes and the value of the business.

Interviews with wholesale business owners in town revealed the almost the same problem

“ We need the Municipal government through tax revenue authority (TRA) to set transparent and clear tax charges. We normally see different people from different tax collecting agencies to collect taxes, if you are not kin enough you are likely to pay and repay the same tax more than once a month. Every tax collector comes with his/her own rules and regulations on the same type of tax”

Said the woman entrepreneur.

However, taxpayers are not given the priority the deemed to deserve. Priorities are given to the other services not on taxpayers in the actual sense.

“It is like “milking the cow without feeding it well” said one of entrepreneurs. So the taxes we pay has no meaning for us”. Simply finished.

4. Conclusion

Poverty reduction strategies are a political slogan which everybody in Tanzania is having sentiment about. There many papers in place such as PRSP, vision 2025 for sustainable development, and others alike. Those papers are there, but the problem is to put these papers into practice. The strategies are well known by the government officials but, the problem is how to put them in implementation. Information about awareness of poverty is crucial to be known by every official, there we can be in the move towards poverty alleviation.

The study was done in Iringa Tanzania, it implies that people (SMEs) understand and a ready to pay tax, but they are

not satisfied with what the tax is collected for as they don't see improvement in service delivery. This is to be known, tax is paid for government expenditure, the priority of the government usually are born from its people. But, it is the task of the government to allocate resources based on Effectiveness, Efficiency, and Economy to reflect value for money. However, the government has the duty to educate its people on how their tax is spend rather than doing things silently as it has revealed from this study.

Fairness in tax collection is a call of all entrepreneurs as this will have impact on their productivity which in turn raises their tax capacity. With large tax base, then government might be able to collect enough funds from tax for smooth and effective public service delivery.

Oooooopppp!!!!

Tax collectors know that, they commit fouls against tax payers, but they remember to ask forgiveness from God

From the book of Luke 19:13 "Meanwhile the tax man, slumped in the shadows, his face in his hands, not daring to look up, said, '*God, give mercy. Forgive me, a sinner.*'"

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