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TAXATION IN DEVELOPING ECONOMIES

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ABSTRACT

Taxation is one of the primary means through which a government can finance development, promote equity, and improve governance. However, in developing economies, tax systems are generally characterized by structural weaknesses such as low tax-to-GDP ratios, large informal sectors, administrative inefficiencies, and high levels of tax evasion. The excessive dependence on indirect taxes, coupled with the limited capacity for enforcement, impairs fiscal stability and, at the same time, increases inequality. Besides, globalization makes revenue mobilization more challenging through issues such as transfer pricing and profit-shifting by multinational corporation

This article moves from identifying the problems of taxation in a developing economy to the possibilities of reform. It includes a wider tax base, the introduction of progressive taxation, and the use of digital technologies to facilitate compliance. The paper draws on the reform initiatives in South Asia, Africa, and Latin America, which reflect different strategies for tax reforms and examples of India's Goods and Services Tax and Africa's digital reforms in tax administration. The results indicate that efficient taxation is not only about raising revenue but also the foundation of state legitimacy and long-term economic growth.

KEYWORDS: Taxation in developing economies, Tax-to-GDP ratio, Informal sector and taxation, Tax evasion and avoidance, Indirect vs. direct taxes, Fiscal capacity, Revenue mobilization.

INTRODUCTION

People often view taxation as a basic building block for economic growth and creating strong states. In places where economies are still developing, it does more than just bring in money. It helps create fairness, improves how governments work, and builds trust among people in society. Scholars say the story of how states raise money is really the story of how states themselves have changed over time. Taxes give governments the power to provide essential services, construct roads and other facilities, and work toward goals that last for years. When governments cannot tax well, they find it hard to gather resources from inside their own countries. They end up relying too much on help from outside,



and they hit roadblocks in reaching steady progress.

Taxation matters a lot, but in developing countries, it runs into ongoing problems that set it apart from what happens in richer nations. The amount of taxes collected compared to the size of the economy is usually low. It stays under 15 percent in many cases, while it reaches 30 to 40 percent in places that have advanced further. This shows deep issues in how they gather funds. A big part of the economy operates informally in these countries. In some spots, it makes up over half of all business, and it stays out of reach for tax collectors. That means governments miss out on a lot of money they could use. Problems like poor management skills, dishonest practices, and a lack of modern tech make collecting taxes even tougher. On top of that, people and companies dodging taxes weaken the overall money situation and make folks doubt the government more.

One key thing about taxes in these developing setups is how much they depend on indirect types. Things like value-added tax, fees on specific goods, and charges at borders get used a lot. These are simpler to handle from an administrative side. Still, they tend to hurt poorer families the most, since they take a bigger bite from small incomes. That makes unfairness in society worse. Taxes that hit people and businesses directly, such as on personal earnings or company profits, do not get used as much. Enforcement is not strong enough, and not many people are even signed up to pay them. Meanwhile, the world getting more connected and big companies operating everywhere have made issues like moving profits around and shrinking the tax base even bigger. Firms find ways to slip through gaps in global rules to avoid paying what they owe. All this leads to massive amounts of lost money that could have helped, and it squeezes the room governments have for spending.

Taxation opens doors for changes and new ideas too. Lately, there has been a push to bring digital tools into how taxes are managed. Things like smart computer systems, secure digital ledgers, and ways to analyze huge sets of data help get people to follow rules better and cut down on dodging. Steps are underway to expand who pays taxes by bringing informal businesses into the open, making online services pay up, and including workers in short-term jobs. Working together across countries, especially through projects like the one from the OECD on stopping profit shifting and base erosion, has created fresh ways to handle tax dodging that crosses borders.

Reforms that fit specific countries show both the good sides and the tricky parts of updating tax systems. In India, the change to a goods and services tax tried to pull together a bunch of scattered indirect taxes into something smoother and clearer. Even so, getting everyone to follow it remains a challenge. Countries in Africa are turning more to digital methods for taxes to collect better and rely less on money from donors. In Latin America, efforts at taxes that favor the less well-off aim to fight unequal wealth, but the outcomes vary. All these stories from different places highlight why changes



need to match local situations, even as they draw from strong ideas used worldwide. This paper examines the built-in problems with taxes in developing economies. It also covers chances for improvements. By looking at examples from various countries and new policy ideas, it seeks to figure out how taxes can turn into a solid tool for growing the economy, spreading fairness, and improving how governments run. In the end, the study argues that taxes in these economies go beyond just handling money matters. They act as a powerful changer. They can build up what states can do, push for justice in society, and set the stage for progress that lasts.

LITERATURE REVIEW:

1. Revenue performance and structural constraints

Comparative analysis reveals that developing economies systematically report lower tax-to-GDP ratios compared to advanced economies, partly reflecting larger informal sectors, narrower bases, and administrative constraints. Systematic reviews show how different levels of effectiveness prevail across settings: in developed countries, compliance is higher and the mix between direct and indirect taxes is more balanced because of stronger institutions and information systems; whereas in developing countries, consumption taxes are relied on more since they are easier to administer. The revenue gap is further widened by limited third-party reporting, fragmented registries, and weaker audit capacity, which reduce the reach of direct taxes in the low-capacity contexts.

2. Administration and technology

A lot of research these days looks at how to modernize administration through digital tools. Things like digital filing, e-invoicing, data analytics, and info from third parties all work as ways to widen the tax net and improve compliance. When you pull together the evidence, it points to real benefits. These approaches can cut down on evasion, make VAT supply chains more solid, and ramp up how productive audits become. That holds especially true if you pair them with easier rules for small taxpayers, plus straightforward services for those folks. Other reviews stress the need for solid foundations first. You need reliable systems for identifying people, registries that connect smoothly, and tight controls on refunds along with risk assessments. Without those basics in place, pushing digitization does not deliver much.

Research Gap:

Although taxation in developing economies has been widely researched, there are a number of critical gaps in the existing literature that limit our broader understanding of its developmental role. Much of the scholarship has focused on revenue mobilization, often measuring success in terms of tax-to-GDP ratios, and there is limited empirical evidence on the distributional impacts of tax systems. In contexts where informality is high and indirect taxes, including VAT and excise duties, dominate, the burden of taxation often falls disproportionately on low-income households. Yet few studies provide robust



microlevel analyses of how tax structures affect inequality, consumption patterns, and poverty reduction. The lack of such evidence constrains policymakers from designing tax systems that strike a balance between efficiency and equity.

Integration of the informal sector into the tax net is another particular area where research remains considerably underdeveloped. Although the informal economy accounts for a significant share of GDP in many developing countries, strategies to formalize small enterprises or bring them under simplified tax regimes have not been systematically evaluated. The majority of existing studies focus on short-term compliance outcomes, leaving open key questions with respect to the longer-term sustainability of such measures and their impact on business growth, employment, and state legitimacy.

Similar to this, the increasing focus on digitalization of tax administration through e-filing platforms, blockchain-based systems, and AI-driven audits has not been adequately matched with comparative evidence in resource-constrained settings. While digital tools are often celebrated as solutions to evasion and inefficiency, there is little empirical work assessing their adaptability in environments with weak infrastructure, limited digital literacy, and governance challenges. That gap is particularly important, as many developing countries are currently investing heavily in such digital reforms without any clear evidence regarding their effectiveness or scalability.

Globalization further complicates the picture. While profit shifting and base erosion by multinationals have rightly been recognized as significant threats to domestic revenues, there is a need for more analysis of the practical ways in which developing countries, with their institutional constraints, might apply the OECD's BEPS measures. Most studies concern advanced economies, leaving a gap in the literature on how low-capacity administrations can effectively enforce transfer pricing rules, negotiate tax treaties, and share information with other countries.

The political economy of taxation also remains underexplored. Though compliance is often framed as a technical issue, citizen perceptions of fairness, trust in government, and the legitimacy of tax institutions make for a decisive role in shaping taxpayer behavior. With few exceptions, there is a general lack of research with respect to how political coalitions, governance quality, and accountability mechanisms influence the success or failure of tax reforms. This lacuna is important because taxation is not merely a fiscal tool but a social contract between the state and its citizens.

Finally, most of the existing studies have been based on single-country reforms, such as India's GST or Latin American VAT systems. Most cross-regional comparative analysis is relatively scant. Taking a more explicitly comparative perspective would show how cultural, institutional, and economic differences shape tax policy outcomes across Africa, Asia, and Latin America. This would support the



identification of common challenges and transferable lessons while recognizing the limitations and importance of context-specific solutions. Addressing these knowledge gaps would allow future research to move beyond a narrow, revenue mobilization-centered approach toward a holistic understanding of taxation as a developmental tool. This would also include a focus on its role in promoting equity, sustainability, and stronger state capacity while recognizing the interaction between technical reforms, political dynamics, and global economic pressures.

SCOPE OF THE STUDY:

1. Revenue Mobilization and Fiscal Capacity-

Examining the role of taxation in financing public goods, infrastructure, and social programs. Assessing tax-to-GDP ratios and identifying constraints that restrict revenue generation.

2. Tax structures and equity

Analyzing the balance of direct and indirect taxes in developing economies. Assessing the distributional effects of tax systems on inequality and poverty.

3. Informal Sector and Tax Compliance

Investigate the challenges regarding the integration of informal businesses into the tax net, reviewing simplified tax regimes and their sustainability in resource-constrained contexts.

4. Administrative Capacity and Digitalization

The impact of reforms in tax administration, including those related to e-filing, blockchain, and AI-driven auditing processes. How technology could enhance compliance and cut evasion in low-capacity settings.

5. Globalization and International Taxation

The impact of multinational corporations, transfer pricing, and base erosion on domestic tax bases; Studying the feasibility of implementing OECD BEPS measures in developing countries.

6. Political Economy and Governance

Understanding how trust, fairness, and governance impact taxpayer behavior and compliance. Analyzing the role of political coalitions and accountability in shaping tax reform outcomes.

7. Comparative and Regional Perspectives

Taking lessons from country-specific reforms like India's GST, African initiatives on digital taxation, and Latin American VAT systems. Making cross-regional comparisons to identify common challenges and context-specific solutions.

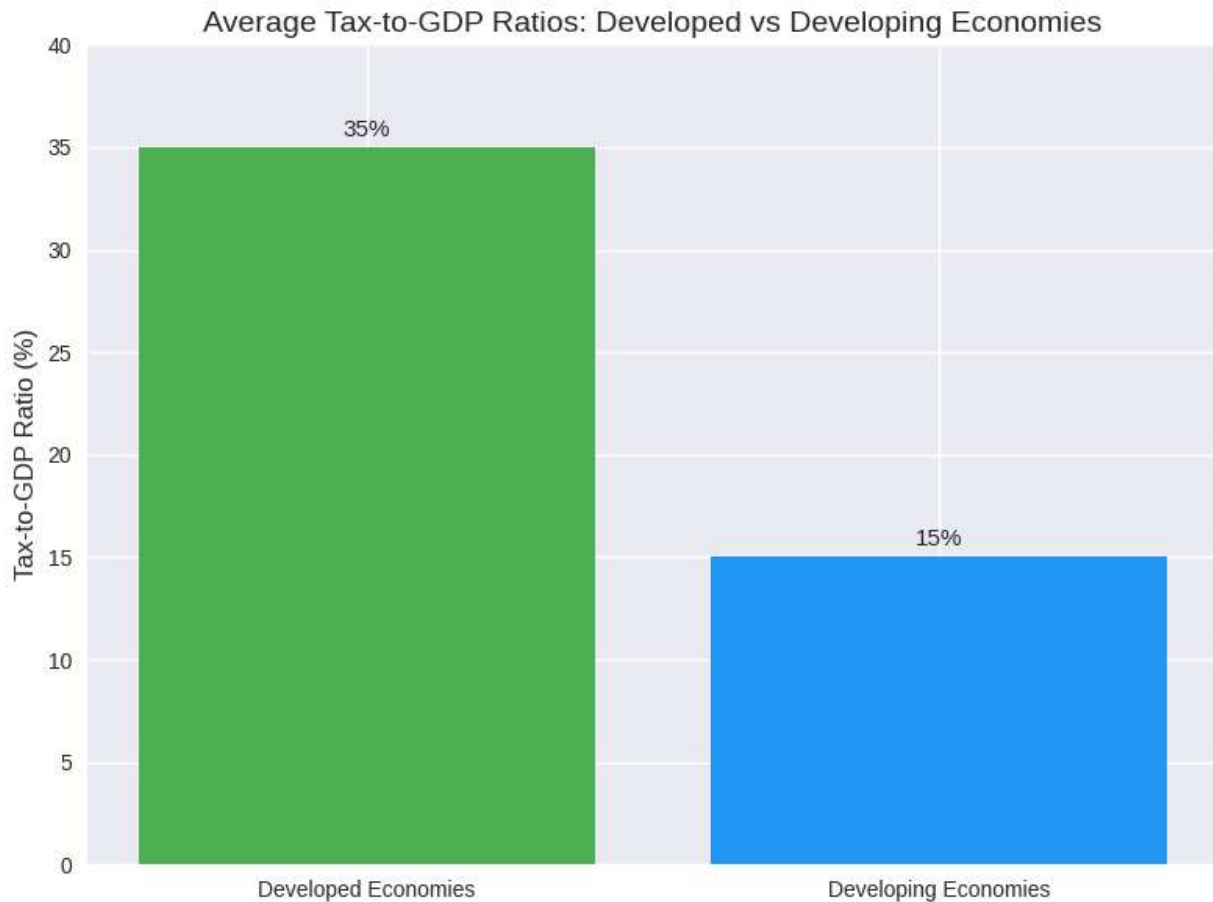
RESEARCH METHODOLOGY:

The present study has adopted a descriptive and analytical research design in order to examine the



complexity of taxation in developing economies. The appropriateness of the design is premised on the fact that it allows for both the systematic description of the prevailing tax structures and the critical analysis of how such systems are performing relative to their developmental goals. By combining descriptive elements with analytical inquiry, the study is able to capture not only the current state of taxation but also the underlying dynamics that shape fiscal performance, compliance, and reform outcomes. Purposive case selections from Asia, Africa, and Latin America are used in the study to provide depth and contextual richness. The three regions have been selected because of the presence of different economic structures, wide varieties in governance capacities, and many reform trajectories. The GST reform in India constitutes a major attempt to unify the highly fragmented indirect tax systems; African economies are keen on innovative use of digital tax initiatives to address the problems of informality; while the Latin American countries lean heavily on VAT systems, their efforts at incorporating progressive taxation also stand out. This purposive sampling strategy has therefore allowed the research study to highlight both common challenges, such as informality and evasion, and context-specific innovations that may offer transferable lessons. This methodology integrates quantitative and qualitative techniques to ensure balance in the approach. Quantitative methods involve trend analysis and the statistical comparison of tax-to-GDP ratios, composition of revenues, and compliance rates across countries. These approaches offer measurable insights into fiscal performance and make it possible to identify long-term patterns. Qualitative methods include thematic and content analysis applied to policy documents, reform strategies, and governance frameworks. These techniques provide an opportunity to explore the underlying themes of equity, fairness, and political economy considerations that cannot be captured using quantitative data alone. A framework of comparative analysis is used, pointing to both common challenges and innovations specific to particular contexts. Such a framework allows for the identification of recurring issues, such as limited administrative capacity and reliance on indirect taxation, while also acknowledging unique reform strategies, such as the use of digital tax tools in Africa or experiments in progressive taxation in Latin America. Ultimately, this methodological framework allows the study to move beyond the narrow focus on taxation as a revenue tool, positioning it as a driver of equity, governance, and sustainable development. The combination of descriptive, analytical, quantitative, and qualitative approaches serves to provide an all-rounded understanding of taxation within developing economies and contributes to the greater discussion on fiscal capacity and state-building.

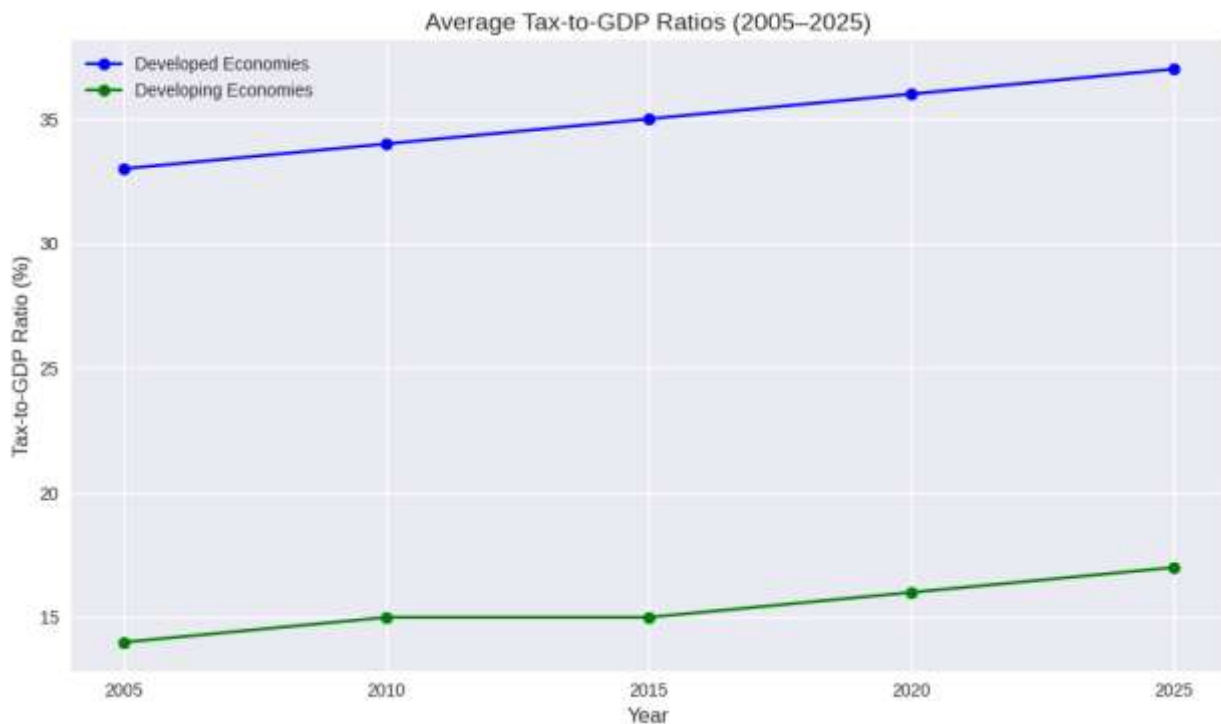
DATA ANALYSIS:



Explanation of the Diagram

Developed Economies: Average tax-to-GDP ratio of 35%, reflecting stronger institutions, broader tax bases, and higher compliance.

Developing Economies: Average tax-to-GDP ratio of 15%, showing reliance on narrower bases, weaker enforcement, and higher informality.



Interpretation of the Chart

Developed Economies: Ratios steadily increased from 33% in 2005 to 37% in 2025, reflecting stronger institutions, broader tax bases, and improved compliance.

Developing Economies: Ratios rose modestly from 14% in 2005 to 17% in 2025, highlighting persistent challenges such as informality, weak enforcement, and reliance on indirect taxes.

CONCLUSION:

Taxation remains a cornerstone of economic development and state-building, yet in developing economies it faces persistent structural and institutional challenges. Low tax-to-GDP ratios, widespread informality, weak administrative capacity, and high levels of evasion restrict governments from being able to raise enough domestic resources to finance public goods and reduce their dependence on external aid. Heavy reliance on indirect taxes, such as VAT and excise duties, although administratively convenient, too often exacerbates inequality by burdening low-income households disproportionately. Meanwhile, globalization further complicates the fiscal landscape, with multinational corporations exploiting loopholes in the tax system to shift profits and erode domestic tax bases. But despite these challenges, there are also great opportunities for taxation in developing economies. Reforms that broaden the base, integrate large informal sectors, and make use of digital technologies have the potential to significantly improve efficiency and compliance. International cooperation, under frameworks such as the OECD's BEPS initiative, also provides avenues to address



cross-border tax avoidance, while progressive tax policies can help reduce inequality and build the social contract between citizens and the state. The experience of case studies from India, Africa, and Latin America suggests that outcomes from reforms differ, yet innovations such as GST unification, digitalization of tax administration, and progressive VAT structures do lead to measurable improvements, provided strong institutions and political will back them up. Ultimately, taxation in developing economies needs to be conceptualized not just as a source of revenue but as a transformative tool for equity, governance, and sustainable development. For the creation of effective tax systems, efficiency needs to be combined with equity, administrative capacity enhanced, and trust built between governments and their citizens. Responding to these priorities will help the developing economies mobilize domestic resources more effectively and reduce reliance on external financing, thus laying the foundation for inclusive and resilient growth.

SUGGESTIONS:

Strengthening taxation in developing economies requires a multi-dimensional approach that addresses both technical and institutional challenges. A top priority is a broadening of the base through formalization of the informal sector, extending taxpayer registration, and lowering exemptions that artificially narrow the effective coverage. At the same time, improving administrative capacity through better training of tax officials, stronger audit mechanisms, and enhanced coordination among fiscal institutions is necessary for effective enforcement. Digitalization offers significant opportunities, with tools such as e-filing, e-invoicing, mobile payments, and data analytics helping to make compliance easier and evasion harder, though all these need adaptations into resource-constrained settings. Equity considerations also demand attention, with a gradual shift from regressive indirect taxes toward more progressive direct taxes, complemented by wealth or property taxation and social safety nets for protecting vulnerable groups. On the global front, developing countries should strengthen transfer pricing regulations, participate actively in international tax cooperation frameworks such as the OECD's BEPS initiative, and negotiate fair treaties to safeguard domestic revenues. Equally important is the political economy dimension: building trust through transparency in revenue use, public awareness campaigns, and grievance redressal mechanisms can enhance compliance and legitimacy. Finally, comparative learning from successful reforms such as India's GST, Rwanda's digital tax systems, and Latin America's VAT models provides valuable insights, while regional collaboration can foster innovation and shared solutions. Together, these measures can transform taxation from a narrow revenue tool into a driver of equity, governance, and sustainable development in developing economies.

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