

Challenges of Tax Revenue Collection in Ethiopia: Case of Ethiopia Customs Commission

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Abstract

Taxes are involuntary fees levied on individuals or corporations and enforced by government entity in order to finance government activities (Lea D.Uradu, 2020). Lea D.Uradu in addition stated, government usually collects taxes to help fund public works, services and to build and maintain the infrastructures used in a country and used for the betterment of the economy and all living in it. Similarly, (UNDP Ethiopia, 2016:p2) stated that, a good tax system follows the principles of efficiency, fairness and easy to administer. Keeping the benefits of tax, the government of Ethiopia collects tax revenue from Domestic tax and Customs duty tax sources. However, the researcher understood that, There are plenty of challenges in tax collection process that do not seen by previous studies and many tax studies are not clearly identified/stated which tax source have great share in tax revenue collection in Ethiopia,(i.e., many people are confusing that which source of tax have great share in Ethiopia tax system). Thus, the objective of the article was to look which tax revenue has great share/contribution to the economy (i.e., Domestic tax or Customs duty tax?) and the challenges to perform tax in Ethiopia. To achieve the objective, a quantitative data of six(6) years tax revenue collected by Ethiopia's ministry of revenues were taken for research question one and a multiple regression model were formulated. Regarding to second question, 31 field questionnaires was collected from randomly selected tax officials. And for the collected data, both descriptive and inferential statistics (regression analysis & nonparametric test) analysis method was applied .In conclusion, the author found that domestic tax revenue have great share to Ethiopian Economy than tax from customs duty(but not to undermine its share). And the tax collection challenges are identified as unstructured economy, poor tax paying habit and maladministration of officials respectively. Thus, the author recommended that the government of Ethiopia as well as the tax collecting Authority should concentrate on effective domestic tax collection, organize the economy to suit tax collection, create tax knowhow on the society and avoid tax maladministration.

Keywords: revenue collection, tax, Government.

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1. Introduction

Taxation in Ethiopia was an old history. Peasants provide a gift called like "yemar gibir and Yedesdes" to landlords. Peasants submit one third (1/3) of the product as tax to landlord. Starting from local in kind taxation system now we are in modern monetary tax system.

Efficient tax collection system is an indication of civilization. Mostly nations are categorized as developing and developed because of their economy. All nations have their own source of economy .But they differ on utilization capacity. Tax is one of the best sources of economy for governments. A government that enforces the tax law and collects revenue effectively is said to be strong government. Paying tax is not useful only for governments. It's for the tax payers too. With this collected revenue, governments construct all necessary infrastructures. With these infrastructures citizens share the resource of their nation.

Basically, the government of Ethiopia collects its revenue from two sources (i.e., domestic revenue and foreign trade tax).the type of taxes applied is both direct and indirect tax system. Currently, ministry of revenue and Ethiopian Customs Commission together play a major role in collection of all type of federal government tax. Ministry of revenue collects tax revenue and enforces the domestic tax system. Where, Customs commission control contraband trading all the corridor of the country and collects Customs duty tax from foreign trade activity.in addition customs commission facilitate export goods and create suitable environment for investments.

Custom duty is a type of indirect tax that is levied on all the goods that are imported to the country as well as some goods exported from the country. The duty levied depends on the value of the goods, its dimensions and weight along with a lot of other criteria. Where domestic tax is a tax collected from domestic resources generated within the country geographical confines of a country. However, collection of tax is not such simple without challenges.

2. Literature review

Tax Wikipedia (2020) stated that, a tax is a compulsory financial charge or some other type of levy imposed upon a tax payer (an individual or legal entity) by a governmental organization in order to fund various public expenditures. The author argued with the sentences that, the same like, Ethiopian government after collecting tax revenue from the economy, is expanding public infrastructures (universities, health organizations, public roads,

schools etc.) and building a huge mega projects like the Ethiopian Great renaissance Dame (EGRD). This Wikipedia also added in its web, a failure to pay, along with envision of or resistance to taxation, is punishable by law. In supporting with this, the Ethiopian ministry of revenue applies Customs proclamation 859/2014 and tax administration proclamation 983/2008 to enforce the taxation system in the country.

Many literatures indicate that, the first known taxation took place in Ancient Egypt around 3000–2800 BC. However in Ethiopia, taxation and Customs duties collection started around the first century in the Kingdom of Axum on the Red Sea coast (Buyonge, et al. 2008). In any case, it was built up amid Menelik II as a lawful legislative structure in 1889, to gather government income. Beginning from 1889-1923 it was under the Ministry of Finance & Treasury, from 1923-1941 under Ministry of Finance, from 1941-1996 under Ministry of Trade (Teweldeberhan W/gebriel, 2011).

Tax can optimize state power, efficient tax collection can minimize state budget deficit. Deborah Brautigam (2002), stated, the importance of taxation to advance state capacity and accountability. Charles Tilly (1985) added taxation as a form of extraction that allows the state to execute its primary functions, like public policies (education, infrastructure and health care etc.), state making and protection. Taxation becomes indispensable in Western Europe, when countries needed to fund wars in order to survive. Taxation became indispensable in Western Europe, when countries needed to fund wars in order to survive. This European model was later exported all around the world (Herbst, Jeffrey, 1990). From these literatures the author understood that, taxation is essential for equity, building democracy, rule of law, state capacity and in all for economic empowerment in a nation.

Most countries have a tax system in place to pay for public, common or agreed national needs and government functions. Some levy a flat percentage rate of taxation on personal annual income, but most scale taxes based on annual income amounts. Most countries charge a tax on an individual's income as well as on corporate income. Countries or subunits often also impose wealth taxes, inheritance taxes, estate taxes, gift taxes, property taxes, sales taxes, payroll taxes or tariffs.

In economic terms, taxation transfers wealth from households or businesses to the government. This has effects which can both increase and reduce economic growth and economic welfare. Consequently, taxation is a highly debated topic (Wikipedia, the free encyclopedia, 2019).

The effect of a change in taxation level on total tax revenue depends on the good being investigated, and in particular on its price elasticity of demand (N. Gregory Mankiw, Matthew Weinzierl, and Danny Yagan, 2013). Where goods have a low elasticity of demand (they are price inelastic), an increase in tax or duty will lead to a small decrease in demand not enough to offset the higher tax raised from each unit. Overall tax revenue will therefore rise. Conversely, for price-elastic goods, an increase in tax rate or duty would lead to a fall in tax revenue.

Customs Duty and Tariff Rates in Ethiopia

According to the Ethiopian Customs proclamation 859/2014 article 69, the products obtained from the processing of imported goods, before clearance for home use, under customs control, shall be liable to the import duties and taxes payable on the raw materials as an input for such products before sale for domestic consumption.

In the proclamation article 102, No, 1 declares that, Duties on goods imported into the customs territory shall be paid at the rates specified by the customs tariff regulation. Accordingly, in Ethiopia, there are six duty tax tariff rates (0%, 5%, 10%, 20%, 30%, and 35%) which are applicable based on the type of the goods imported. The reason behind the variation of duty tax rates is the need for encouraging the importation of some goods by imposing 0% tax rate and at the same time to discourage importation of selected goods by imposing a higher tax rate.

According to the current Ethiopian Customs tariff book version 2017, there are two schedules for the purpose of determining the applicable tax rates. The first schedule encompasses raw materials, semi-finished goods and import items for public use. Note that the tax rate for this category is lesser, keeping in mind that the imported goods enhances domestic production or has for public use such as ambulances. Hence, raw materials and producers goods are largely zero rated although it may increase to 10 % and the tax rate for semi-finished goods is 10% and 20%. On the contrary, the second schedule contains consumer or finished goods that are imported for personal use or for a non-productive purpose. The higher duty tax rates are usually applied for consumer goods such as automobiles for personal use.

This being said, the Custom duty and tax rate, for exported good is at 0% except for selected products of hides and skins of animals.

The Ethiopian Customs duty calculation follows the following five (5) steps.

<p>1. Import Customs Duty = total cost of imported goods X the goods tariff rate = A 2. Excise Tax = (total cost of imported goods + A) x Excise tax rate (If applicable) = B 3. VAT = (total cost of imported goods + A + B) x VAT rate (usually 15%) = C 4. Surtax = (total cost of imported goods + A + B + C) x surtax rate (10%) = D 5. Withholding Tax = total cost of imported goods x withholding tax rate (3%) = E TOTAL PAYABLE DUTY AT THE TIME OF IMPORT = A+B+C+D+E Where:- Total cost of imported goods = <i>invoice value (Cost of the goods) + Insurance cost + Freight cost + Other</i></p>

costs presented in the invoice
 All costs are provided by any foreign currency except insurance cost (it can be local currency too) and the Customs foreign exchange rate would be set by National bank. The exchange rate is changeable every week by automation system.

Source:-Ethiopia’s Customs management System, 2020

The same like to the imported goods customs rate tariff rate variations, excise rate of imported goods vary based on goods that are believed to be luxury, hazardous to health, causes social problems as well as on basic goods which are demand inelastic. According to the new Ethiopian Excise tax proclamation 1186/2020, the rate varies minimum of from 5%to 500% maximum.

Domestic tax in Ethiopia:-

A domestic tax is revenue collected from domestic economic sources by government. Collecting domestic tax is very influential to strengthen government budget. In Ethiopia there are many types of domestic taxes and they are categorized as direct and indirect taxes.

According to Ethiopian Chamber of Commerce(2005),the direct taxes that practiced in Ethiopia are, Tax on Income from Employment / Personal Income Tax, Business Profit Tax, Tax on Income from Rental of Buildings, Tax on Interest Income on Deposits, Dividend Income Tax, Tax on Income from Royalties, Tax on Income from Games of Chance, Tax on Gain of Transfer of certain Investment Property, Tax on Income from Rental of Property, Rendering of Technical Services outside Ethiopia, Agricultural Income Tax, Land Use Tax and these indirect taxes are Turnover Tax , Excise Tax, Value Added Tax , Customs Duty, Stamp Duty. Where, customs duty is a tax that levied from foreign trades. To simplify and make easier for the implementation of tax, most of these tax types have their own proclamations.

3. Research Methodology

A mixed approach and descriptive research type has applied. To be fruitful this article, both primary and secondary data was collected. These primary data were collected for research question two and the method was Personal interview (i.e. Face-to-face interview) and self-completed (i.e. hand delivered questionnaire) and secondary data for research question one was collected by the author. The collected secondary data was revenue collected by Ethiopian revenues and Customs authority from the year 2014 to year 2019.the method used in collecting these secondary data was deep survey of secondary sources (i.e., annual reports of ministry of revenue and Ethiopian Customs Management System (ECMS)).

Based on the data collected, the author derived a multiple linear regression model for research question one ($Y=\beta_0+\beta_1X_1+\beta_2X_2+\epsilon_i$). Where Y is the dependent variable and indicates Tax revenue collection, β_0 —indicates Constant coefficient , β_1 —indicates coefficient of rate of change in domestic tax, β_2 —indicates coefficient of rate of change in customs duty tax, X_1 —represents revenue collected from domestic tax, X_2 —represents revenue collected from customs duty tax and ϵ_i -- indicates error terms. For research question two, nonparametric test (i.e., Friedman test) was applied. A measurement was taken with confidence level of 95% and significant differences recorded at $P<0.05$ and the analysis method were both descriptive statistics and inferential statistics.

Finally, to achieve the study, two research questions (RQ) were addressed. These are:-

RQ1. Domestic tax vs. Customs duty tax revenue! Which source of tax have great share in the Ethiopian Economy?

RQ2. What are the challenges of tax revenue collection in Ethiopia?

4. Results and discussions

4.1. Descriptive statistics

RQ1. Domestic tax vs. Customs duty tax revenue! Which source of tax have great share in the Ethiopian Economy?

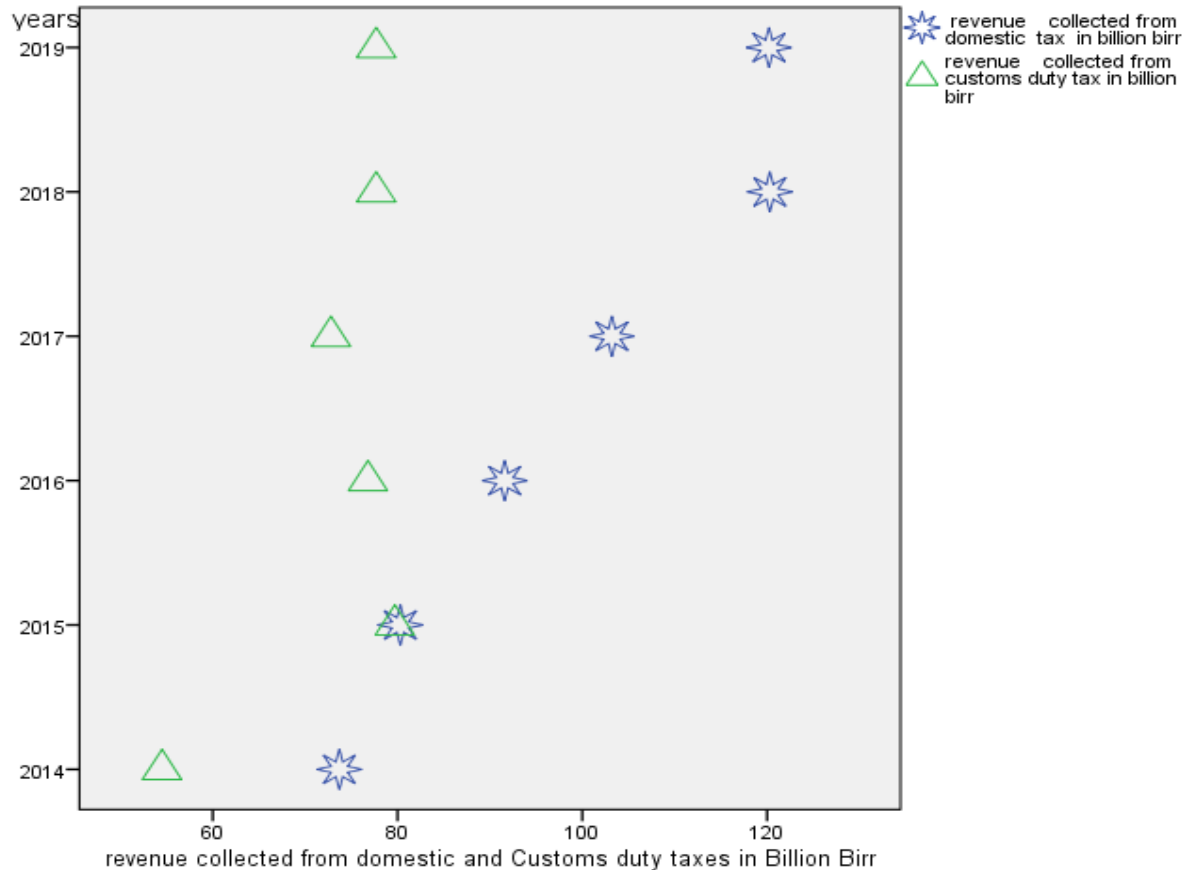
Table4.1:Correlation statistics

Tax revenue Collection		Revenue collected from domestic tax	revenue collected from customs duty tax
Revenue collected from domestic tax	Pearson Correlation	1	.70
	Sig. (2-tailed)		.003
	N	6	6
revenue collected from customs duty tax	Pearson Correlation	.70	1
	Sig. (2-tailed)	.003	

Table4.1 above indicates a descriptive statistics of the causal relationship of domestic tax and Customs duty tax with government revenue collection. The above association shows these tax types have direct effect on government revenue share. Accordingly, While the tax collection system of the tax authority is strong and effective, government revenue become enough to cover its public expenditures.

A Pearson correlation (Pearson’s correlation coefficient) is the most familiar measure of between two dependent variables. And its coefficient value lay down between +1 and -1. The sign indicates the perfect direct increasing or decreasing linear relationship of the variables. The closer the coefficient is to either -1 or 1, the stronger the correlation between the variables. The above correlation coefficient ($r=0.70$ at $p=5\%$) shows close to 1. And this indicates direct positive association of domestic tax and customs duty tax to government tax revenue. However, in general, the presence of a correlation is not sufficient to infer the presence of a causal relationship (i.e., correlation does not imply causation). It needs more in-depth investigations and hypothetical test.

Graph 4.1: Tax revenue Collected from domestic and Customs duty taxes



The above graph indicates, both these tax sources have direct relation/effect with tax revenue collection of a government. Both have their own great contribution to the economy. In addition, the graph shows the degree of contributing rate among these two great sources of economy. The tax revenue from domestic tax is increasing so more than the tax collected from Customs duty tax over years. This shows revenue from domestic tax is so potential to a nation than revenue from customs duty tax. The reason why is, because, customs duty tax is elastic to international trade. It varies based on the international market condition.

Table 4.2: Regression Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.985 ^a	.971	.951	.415

a. Predictors: (Constant), revenue collected from customs duty tax in billion birr, revenue collected from domestic tax in billion birr

b. Dependent Variable: tax revenue collection

Table 4.2 explains variation of explained and unexplained variables to the regression model. A regression model is said to be good if they explained variables are larger than unexplained variables. Large explained variables means much of the factors affect to the dependent variable are included to the model. How do we know? Look to the value of R^2 . If the value of R^2 is large; it indicates most of the influencing variables are included to the model. Here, in this article, table 4.2 above shows 97.1% of the variation on government tax revenue collection was due to Domestic tax and customs duty tax or both. Where, 2.9% of the variation on tax revenue was due to other factors not included in this regression model.

Table4.3: ANOVA^a

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	16.984	2	8.492	49.379	.005 ^b
	Residual	.516	3	.172		
	Total	17.500	5			

a. Dependent variable : tax revenue collection

b. Predictors: (Constant), revenue collected from customs duty tax in billion birr, revenue collected from domestic tax in billion birr

Table4.3 above shows test of model sufficiency, this model is sufficient and useful if and only if Ho is rejected.

Statistical hypothesis

Ho: $\beta_1 = \beta_2 = 0$ (Both domestic tax and Customs duty tax have no significant effect on government tax revenue).

H1: $\beta_1 \neq \beta_2 \neq 0$ (at least one of these taxes has significant effect on government tax revenue).

From the table 4.3 above, the researcher concluded that, at the test statistic, $F=49.379$ and $P\text{-value}=0.005$, Ho is rejected. Because $p < 5\%$. So the table shows that at least one of these taxes has significant effect on government tax revenue and the model is adequate. Which one of these independent variables is significantly affecting tax revenue? Look table 4.4 below test of individual variables.

Table4.4: Coefficients^a

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	95.0% Confidence Interval for B	
		B	Std. Error	Beta			Lower Bound	Upper Bound
1	(Constant)	2006.583	1.456		1377.992	.000	2001.949	2011.217
	revenue collected from domestic tax in billion birr	.088	.011	.936	7.880	.004	.053	.124
	Revenue collected from customs duty tax in billion birr	.017	.024	.085	.719	.524	-.058	.092

a. Dependent Variable: tax revenue collection

The above table 4.4 indicates, revenue collected from domestic tax has significant effects on Government tax revenue within those past six consecutive budget years. That is; other factors remain constant, the variation of tax revenue collection from domestic tax was greater than by 8.8% over the tax collected from customs duty tax share. and this is true that, the researcher confirmed from annual reports of the Ethiopian ministry of revenue that, the share of revenue collected from domestic tax was between 50% and 60% and 30% and 40% from customs duty tax.

RQ2. What are the challenges of tax revenue collection in Ethiopia?

The Ethiopian Revenues and Customs Authority (ERCA) currently, ministry of revenue and Customs commission, is the body responsible for collecting government tax revenue from Customs duties and domestic taxes (ERCA Customs Proclamation No, 859/2014).

Table4.5: Descriptive Statistics

variables	N	Mean	Std. Deviation	Minimum	Maximum	Percentiles		
						25th	50th (Median)	75th
unstructured market economy	31	2.29	1.039	1	4	1.00	2.00	3.00
poor tax paying habit	31	2.19	1.108	1	4	1.00	2.00	3.00
weak tax law enforcement	31	2.03	.948	1	4	1.00	2.00	3.00
maladministration	31	2.16	1.036	1	4	1.00	2.00	3.00
illicit trade expansion	31	1.32	.791	1	4	1.00	1.00	1.00

The above table shows four variables with same median (2). which mean they are equally challenging factors of tax revenue collection by the authority.

However, inferring by simply looking on the frequency table and high percentage responses of the variables from the table above may lead biased conclusion. Where, the corresponding inferential test statistics shown below directs the true conclusion.

4.2. Inferential test of statistics

Friedman Test

Statistical Hypothesis:

H0: There is no statistical significant median difference between the tax revenue collection challenges.

H1: At least two of the main tax revenue collection challenges are significantly different

Table4.6: Mean rank of tax revenue collection challenges

No,	variables	Mean Rank
1	unstructured market economy	3.35
2	poor tax paying habit	3.29
3	weak tax law enforcement	3.06
4	maladministration	3.34
5	illicit trade expansion	1.95

Source: survey, 2020

The above table4.6 indicates the mean ranks of Government tax revenue collection challenges by Ethiopian Revenues and Customs Authority or currently ministry of revenue. According to the respondents, the unstructured market economy of the country, maladministration and poor tax paying habit of the business community has high mean rank respectively among the other challenges. Such that, the economy is unorganized, there was no industry zone before, but now there is beginning of organizing the economy into collected poll. The service delivery of the tax authority was also full of maladministration (i.e., corruption, complex directives and regulations and delay service).the habit of tax paying by the community is far from voluntarily paying. The purpose of the Friedman procedure is to test whether these observed differences are statistically significant or not. The SPSS output to Friedman test is shown below.

Table4.7 : Friedman Test Statistics^a

N	31
Chi-Square	22.137
df	4
Asymp. Sig.	.000

a. Friedman Test

Source: SPSS output, 2020

The computed chi-square statistic is 22.137and Asymp.Sig is 0.000.Since the asymptotic significance (p-value) is less than 5%, the null hypothesis (Ho) is rejected. Because all these challenges has no equal effect on tax revenue. Thus, the observed differences in the mean rank among the tax revenue collection challenging variables are not just by chance. Their degree of challenge is statistically different. Then having performed Wilcoxon signed ranks test for two related samples of multiple comparison on the group medians, the analysis has done and the most challenging of tax collection is identified as followed below.

Wilcoxon Signed Ranks Test

Statistical Hypothesis:

H0: The statistical median difference (M) between the main tax revenue collection challenges are equal to zero (M=0).

H1: The statistical median differences (M) between the main tax revenue collection challenges are not equal to zero (M≠0).

Table4.8: Wilcoxon test Statistics of tax revenue collection challenges in Ethiopia

No	variables	z-score	Asymp. Sig. (2-tailed)	Adjusted p-value=0.05/10=0.005	Decision
1	poor habit of paying tax- Unstructured market economy	-.418 ^b	.676	.676>0.005	Do not Reject Ho
2	weak tax law enforcement- Unstructured market economy	-.586 ^b	.558	.558>0.005	Do not Reject Ho
3	Unstructured market economy- maladministration	-.392 ^b	.695	.695>0.005	Do not Reject Ho
4	illicit trade expansion- Unstructured market economy	-3.074 ^b	.002	.002<0.005	reject Ho
5	weak tax law enforcement- Poor habit of paying tax	-.608 ^b	.543	.543>0.005	Do not Reject Ho
6	Maladministration- Poor habit of paying tax	-.184 ^b	.854	.854>0.005	Do not Reject Ho
7	illicit trade expansion- Poor habit of paying tax	-2.953 ^b	.003	.003<0.005	reject Ho

No	variables	z-score	Asymp. Sig. (2-tailed)	Adjusted p-value=0.05/10=0.005	Decision
8	<i>Maladministration- Weak tax law enforcement</i>	-.301 ^c	.764	.764>0.005	Do not Reject Ho
9	<i>illicit trade expansion- Weak tax law enforcement</i>	-2.742 ^b	.006	.006>0.005	Do not Reject Ho
10	<i>illicit trade expansion-maladministration</i>	-3.277 ^b	.001	.001<0.005	reject Ho

a. Wilcoxon Signed Ranks Test

b. Based on positive ranks.

c. Based on negative ranks

Source: SPSS output, 2020

Note: To control for Type I error across the pair-wise comparisons, the researcher divided 0.05 by the number of possible pair-wise tests, and used “Bonferroni” P-value to arrive at a decision. In this test, there are a total of ten (10) pair-wise tests, and to test at the 5% level of significance, the correct value of α is $\alpha=0.05/10=0.005$. This means that if the P-value is larger than 0.005, there is no statistically significant results.

Table 4.7 above shows there was a statistically significant differences among the tax revenue collection challenges at, $\chi^2(4) = 22.137, p = 0.000$. Table 4.8 Wilcoxon signed-rank multiple comparison test also shows, there is statistical significance difference in their degree of challenges among the variables of Unstructured market economy and illicit trade expansion, Poor habit of paying tax and illicit trade expansion, maladministration and illicit trade expansion at ($Z = -3.074, -2.953$ & $-3.277, P = .002, .003$ & $.001$) respectively.

The Z-score in those pairs is negative. This is an indication of illicit trade expansion is one factor of Government tax revenue collection challenge in Ethiopia. Because, the habit of paying tax of the society is poor, traders prefer to hide tax from paying and want to be rich without paying tax to government; this was mostly aggravated by maladministration of tax Authority. Mark Sandford (2017), on his article called “*the local government Ombudsman*” stated that, Maladministration is the actions of a government body which can be seen as causing an injustice (i.e. Delay, Incorrect action or failure to take any action, Failure to follow procedures or the law, Failure to provide information, Inadequate record-keeping, Failure to investigate, Failure to reply, Misleading or inaccurate statements, Inadequate liaison, Inadequate consultation, Broken promises).

In addition to the above challenges, other challenge on tax collection is the economic structure itself. The economy is dispersed and unorganized, which is difficult to manage/control by the tax authority. The lack of information systems exists in the tax collection sector; the authority has only few options in knowing the economy available in the country. Unstructured market does not allow the information exchange on the nature of existing economy in market at one place. This creates gap in collection of tax by the authority, the unregulated agents, often not registered, licensed of large number of business community. The incidence may lead to expansion of 'black market' which might lead to unaccountable financial dealings resulting in loss to government in terms of taxes as well as revenue.

Summary and concluding remarks

Tax is very important one for government as source of fund and on the other hand for faire wealth distribution among the public. Tax is very important to have faire market competition in the Economy. Governments need money to finance their expenditure. In less developed countries, the tax collection system is unsuitable to both the tax payer and the tax officials. The same like in Ethiopia, both domestic tax and customs duty tax collection was not easy. It's full of complicated process and ups and downs. Tax Business processes is not atomized and the tax system is vulnerable to fraud and maladministration's. Highly bureaucratic business process and dominated by illicit market with well unstructured economy.

In Ethiopia, Though Customs still contributes the greatest tax revenue to the government every budget year; Domestic tax revenue has significant contribution to the economy. Therefore, the tax authority should have to modernize all tax business processes, make easy and accessible to tax payers, control tightly (enforce) and concentrate on domestic tax to collect effectively what the economy is producing. Customs duty tax is elastic to international trade (i.e., as the demand of imported goods increased by local consumers, its importation increases. While if the demand of that goods decrease at local market, importation decrease, all other factors like foreign currency remain constant). To have excessive foreign currency deposit, the government should have given due attention for export goods and truisms services.

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