TOWARDS THE ACHIEVEMENT OF A SOUND FISCAL POLICY IN TANZANIA (MICRO AND MACRO PERSPECTIVE)

Evans Eusebius Mlelwa

By

THESIS

Submitted to
KDI School of Public Policy and Management
in partial fulfillment of requirement
for the degree of

MASTER OF PUBLIC POLICY

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ABSTRACT

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This study undertakes an empirical investigation to explore how effective the fiscal policy in Tanzania had been over time. Various methods were applied to achieve this objective namely collection of data from various organizations, institutions and ministries, the use of interviews, literature review and econometric methods were also applied.

The tax system since 1960s underwent a number of restructuring but since then very little change had occurred. A number of problems are still prominent in achieving a stable Fiscal Policy such as the mismatching between revenue and expediture, lack of coordination among institutions dealing with Fiscal and Monetary Policy and the overlapping between the Central and Local Government taxes. The purpose of this study is to identify ways to correct this situation in order to create more revenue opportunities.

The analysis found that for the achievement of a stable Fiscal Policy, the inclusion of other Macroeconomic variables like inflation, exchange rates and real GDP growth rate is of paramount importance. This view necessitates the need for Policy coordination amongst institutions of Fiscal and Monetary Policy and hence calling for Policy mix argument

CERTIFICATION

The undersigned certification has read and hereby recommend for acceptance by the Korea Development Institute (KDI), School of Public Policy and Management, the Thesis titled: Towards the Achievement of a Sound Fiscal Policy in Tanzania (Micro and Macro Perspective)

Professor Yoo, Ilho,
(Supervisor)
Date:

DECLARATION AND COPYRIGHT

I Evans Eusebius Mlelwa, hereby declare that this dissertation is my own original work and that it has not been presented and will not be presented at any other university for a similar or any other degree award.

Evans Eusebius Mlelwa

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DEDICATION

To God who is the almighty, To my father Eusebius Mgawila Mlelwa for his devotion and encouragement since the inception of my academic career.

AND

To my wife Ukundi and my daughter Osmunda for their tolerance and sincerity whenever they needed me.

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ABBREVIATIONS

ASYCUDA	-Automated System for Customs Data
AU	= African Union
BOT	-Bank of Tanzania
COMESA	-Common Market for Eastern and Southern Africa
DANIDA	-Danish International Development Agency
DSE	-Dar-es-Salaam Stock Exchange
EAC	-East African Community
ECC	- The Economic Committee of Cabinet
EPZ	-Export Processing Zone
ERP	-Economic Recovery Programme
FDI	-Foreign Direct Investment
FECP	-The Finance Economic Committee of Parliament
FINIDA	-Finnish International Development Agency
GTZ	-German Tanzania Cooperation
HIPC	-Highly Indebted Poor Countries
IPC	-Investment Promotion Center
NCEPC	-The National Consultative Economic and Planning Council
NESP	-National Economic Survival Programme
NIPPA	-National Investment Promotion and Protection Act
OECD	-Organization of Economic Cooperation and Development
PAYE	-Pay As You Earn
PC	- The Planning Commission
SADC	-South African Development Cooperation
SAL	-Structural Adjustments Loans
SAP	-Structural Adjustment Programme
SIDA	-Sweden International Development Agency
TANESCO	-Tanzania Electric Supply Corporation
TIC	-Tanzania Investment Center
TRA	-Tanzania Revenue Authority
TRC	-Tanzania Railway Corporation
UNDP	-United Nation Development Programme
URT	-United Republic of Tanzania
VAT	-Value Added Tax
ZIPPA	-Zanzibar Investment Promotion and Protection Act

Chapter 1.Introduction

1.0. Background

Since its independence in 1961,Tanzania fiscal stance had not been stable. This can be explained by the existence of the colonial relations and externally dependent economy, which had not fully utilized its abundant available resources. The existence of externally oriented economic development programmes had a negative effect on the achievement of a stable macroeconomic policy. Since then Tanzania is amongst the poorest countries in the world and now in the HIPC list.

From the 1960s-1970s the prescription provided by the IMF and World Bank were not accepted wholly as the country had its own internally oriented development programmes. Henceforth from the 1980s,the grip of these institutions was vivid during the introduction of the structural adjustment programmes which were planned and financed by these institutions. The experience on the liberalization policy from the mid 1980s decelerated Tanzania’s autonomy to decide her own economic destiny. Examples of the encroachment of these institutions is the implementation of the privatization policy which has the divergence effect where ownership goes to private hands. This policy came from outside as the cure for inefficiency and loss making firms.

The developed world is now asking countries like Tanzania to globalize. Does the country have anything to offer in these economic relations? Globalization was here since the slave trade and colonial era and in all cases the developing nations have not gained but always counted as losers. It is now "cosmeted" as the sole solution towards solving the economic illness of the country like Tanzania.

Tax revenue finances the budget by more than 60 percent. The narrowness of the existing tax base made things more difficult. Whenever government expenditure exceeds revenue, other ways to finance the budget should be taken like asking for bilateral and multilateral loans and grants. Reducing government expenditure is not a solution as it may result in slow economic growth. Expansion of the domestic market, protection of infant domestic industries, zero rating export and import control are measures towards a stable macroeconomic policy. I perceived that this country is not only open to the outside world but also "naked". Domestic industries are dying, as they cannot compete with the imported products. For the achievement of a stable fiscal policy, I still presume on the quest to re-introduce the protectionism policy as it was in the 1970s.

Every country protects her industries against harmful competition as it is in Korea, German, USA, U.K etc. A vivid example had been shown in march, 2002 when USA put import tariff on steel coming from Korea, Europe, Japan and Brazil and exempt those coming from developing countries which are not a threat to the USA steel industry.

1.0.1.Statement of the problem

The economic development of Tanzania had been mostly externally dependent type of economy since independence. Little progress had been made in sectors like transportation, agriculture, fishing, mining, communication and manufacturing. The need to look for an alternative policy is inevitable both at micro and macro level. Fiscal imbalances should be thought at all dimensions possible. From 1960s, we experienced government control in all ventures like price control, exchange control, monopolies and centralization. In the 1980s, we saw the beginning of a free market economy, where the market rules the economy. The lagging behind of revenue to expenditure is the central issue of this study.

How can it be solved to achieve a sound Fiscal Policy (revenue and expenditure assignment). Various policies need to be designed to achieve this objective.

1.0.2. Objectives and significance of the study

1.0.2.0.Objectives

This study has four objectives:

a) To seek for an appropriate tax administration and structure which will enhance tax compliance
b) To suggest strategies for the achievement of a sound fiscal policy.
c) To look for an alternative policy approach
d) To identify sources of raising government revenue to match an increasing government expenditure

1.0.2.1.Significance of the study

It is important to look at ways to achieve a sound fiscal policy in Tanzania after more than 40 years of independence. This study looks at the economic trend over time and what should be done in the future.

It focuses on the importance of coordination and linkages between sectors as most of the sectors of the economy are fragmented and disorganized. International institutions such as IMF and World Bank dictate on the economic fate by suggesting programmes such as liberalization, cost sharing, privatization and now globalization.

1.0.3.Organization of the study (Format)

This study approaches the whole context in seven chapters. In the first chapter, there is an introduction part which provides the background of the Tanzania economy since independence and its fiscal stance. This part also includes the statement of the problem, objectives and

significance of the study. It also looks at the methodology which will be used and the hypothesis to be tested. Chapter two highlights on the Tanzania macroeconomic development which covers the adjustment programmes and their main objectives. It also provides details on the budget, debts and investment in Tanzania. Chapter three covers the literature review on tax policy.

Chapter four looks at the Fiscal centralization and decentralization. The institutions in charge of both the Central and Local Government taxation.

In Chapter five, the study focuses on the Fiscal Policy reform and the relevant approaches. In chapter six, this study looks at the hypothesis testing, methodology and empirical results. The last chapter is the conclusion

1.0.4.Hypothesis and methodology

1.0.4.0.Hypothesis to be tested

The macroeconomic variables that are hypothesized to be the determinants for achieving a sound fiscal policy include: The real GDP growth rate, tax revenue, exchange rate policy, external debt management, the rate of inflation, Balance of Payment and FDI inflow.

Thus it is hypothesized that: -

i) The slow growth rate of GDP has an adverse effect on the maintenance of a stable fiscal policy.

ii) High tax rates have a negative effect on the amount of revenue to be collected.

iii) Exchange rate policy lowers the value of domestic currency (through devaluation), which may cause revenue loss.

iv) An increase in external debt decreases government capacity to accelerate economic growth. .

v) Inflation has an adverse effect on the losses of real tax revenue and cause problems in debtor country.

vi) The Balance of Payment deficit indicates that a country living beyond its means. This has a negative effect on resource allocation.

vii) Foreign Direct Investment (FDI) has a positive stimulus towards economic growth especially of a developing country like Tanzania.

1.0.4.1.Methodology

Both qualitative and quantitative techniques are applied to accomplish the objectives of this study. Qualitatively, the study employs tables, statistical (percentage, ratios) and other documentary evidences, while quantitatively; an analysis employing econometric techniques of estimation is undertaken. The use of Ordinary Least Square (OLS) techniques is applied to time series data on Tanzania.

Chapter 2.Tanzania Macroeconomic Development

1.0. Stability of the Economy and trend

During the Arusha Declaration in 1967,the major means of production were nationalized. This had a fiscal implication to development and changes in the macroeconomic variables. Inflation rate was 2.62%, Exchange rate to a dollar stood at Tshs 7.14,real GDP growth was at 4.13%, external debt was at 14.8% of GDP, tax revenue was at 11.4% and the FDI inflow displays a negative trend (-9.24%) refer table 6.0.Fiscal stability entails that these variables should exert a growth pattern or stable trend. The achievement of a sound Fiscal Policy is inevitable without a display in the GDP growth, a decline in inflation, revenue growth, decline in unemployment and decrease in economic dependence which may accelerate the growth of external debt and balance of payment deficit.

Tax revenue to GDP grew well from 1967 –1975 from 11.4% to 19.84% respectively. However real GDP showed the lowest growth rate in 1993 (0.4%) and started increasing from 1998 (4.0%).

It is possible for tax revenue growth to match with an increasing expenditure, if inflation rate goes down, exchange rate is stable and real GDP growth is increasing. The Tanzanian shilling has been falling against foreign currencies, for instance US dollar in the late 1970s –1980s.When the domestic currency (Tshs) is devalued for other macroeconomic objectives like boosting exports, this measure may cause revenue loss. However, overvalued exchange rate discourages exports and, furthermore, the overvaluation of foreign exchange rate can be the chief reason for economic stagnation (Lewis, 1967,55)

On the hand if the real GDP growth rate for various economic sectors like agriculture, manufacturing, fishing, tourism etc goes down then the achievement of a sound Fiscal Policy is not possible. There is no period in the last two decades where macroeconomic variables have been stable or exhibiting continuous growth. The agriculture sector being the backbone of the economy, employing 80% of the population has not shown substantial contribution to GDP.

The contribution of the sector to GDP, declined to 48.2% in 2000 from 48.9% in 1999.While growth of value added in the sector declined to 3.4% in 2000 from 4.1% in 1999.FDI displayed a negative growth (-9.24 in millions USD) in 1967 and positive growth (12 in millions USD) in 1992 as shown in table 6.0.

The analysis of economic growth by Harrod (1939,14-33) and Domar (1946,137-47) is heavily dependent on the central role that investment plays an important role in the growth process. Investment is the key determinant of economic growth in the Neo-Keynesian framework as opposed to the relative price variable which is the focal point of the Neo-Classical analysis.

The Policy environment in Tanzania during 1970 –1985,the public owned firms operated as if the budget constraint did not matter. The state acts as a universal insurance company which compensates loss-making firms. In this way the paternalistic state guarantees automatically the survival of publicly owned firms (see Kornai, 1979,806-08). The monopoly positions of the public firms create sellers’ markets in which there was no incentive for improving quality of goods produced or innovation.

The role of the market was zero, price control was in full swing but by 1988,the controlled items were 8 down from 400 before the Economic Recovery Programme (1986-1989). During the 1970s,priority was given to the Import Substitution Industrialization (ISI) and the capital-intensive state owned farms.

By 1985,the Liberalization policy took over causing another trend for the macroeconomic variables. The instability (not sound) may be duly caused by the unrelated changing macroeconomic policies from 1970s,the externally oriented economic development plans, domination of the politico-economic agendas and lack of coordination amongst institutions of fiscal and monetary policy.

The Macroeconomic framework for Tanzania Vision 2025 focuses mainly on:

i) Achieving the macroeconomic stability, minimize price control distortion, ensure price stability and manage macroeconomic balances.

ii) Attaining high levels of domestic savings and investment, broad based human resources development and sustainable economic growth.

Real GDP is expected to increase from the current average of 4% to

an annual average of 8-9% up to 2025.Fiscal policy is expected to achieve the objective of Fiscal balance and price stability, promote savings, productive investment and economic justice.

2.0.Review of the Adjustments Programmes 1980s –1990s

By the 1980s,the Structural Adjustment Loans (SALs) had already taken pace in Tanzania. This was initiated so as to improve the economic performance that was deteriorating. This included improvements which necessitated tax and expenditure side reforms.

By 1970s,the severity of the Tanzania economy was reaching at a climax hence the urge for an external financial support adopted " a go it alone strategy". Negotiations with IMF were reached and a standby agreement was signed in September, 1980.A number of Economic programs followed then.

1
"The shortage of foreign exchange merely reflects failure to maintain a proper balance between the growth of manufacturing industry and agriculture" (Lewis, 1956,388)

The National Economic Survival Programme (NESP): 1981-1982.It was a short term, crisis alleviation and based on the mobilization and utilization of the available resources. To enhance this initiative export taxes were abolished in the 1981 budget but any potential loss of revenue was offset by an increase in the rates of sales tax and import duty. This objectives did not succeed due to a fall in the world prices in the 1980s.A severe decline in imports in 1982-83 allowed a reduction in the current account deficit which had risen to over 10% of GDP in the 1970s. Structural Adjustment Programme (SAP):

1982/83-1984/85;

It was intended to restore external and fiscal balance, contain inflation and stimulating a recovery output growth .The outcome of SAP was not as good as expected in the first instance. Real GDP was actually negative in 1983.During the 1982-84,investment and savings fell, the balance of payment current account deficit failed to improve though the agricultural output and the supply of food grains to the local market did increase while manufacturing fell. Economic Recovery Programme (ERP): June 1986-1989:It was responding to donor ideas regarding market oriented economic reforms, trade liberalization, privatization and the reduction of government intervention.

The government wanted to achieve the positive per capita economic growth, lowering inflation and raising real interest rates to positive levels, reducing the balance of payment deficit largely by increasing agricultural exports and reducing the budget deficit to permit net repayment of domestic bank credit. Real per capita growth rates were sustained after 1986 and agriculture also expanded. Studies on the tax reforms were undertaken between 1985-87.The focuses were on tariffs and the need to generate revenue while recognizing the internal demands for protection. Later studies thought of reforms on the domestic sales tax. Major reductions and rationalization of both import duties and domestic sales tax were announced in 1988 and 1989.

The range and levels of tariffs were reduced and most specific sales taxes were converted to ad- valorem taxes while marginal tax rates on personal income were reduced. A tax institute was established in 1987 to train tax administrators with technical assistance from UNDP.Economic Recovery

Programme (ERP II)- Economic and Social Action Programme-ESAP: 1989-92;Launched in 1989 focusing on reducing dependence on external support.

In 1990,the government announced its intention to undertake privatization, to limit government intervention to social and physical infrastructure, and to implement further reductions and rationalizations of both import duties and domestic sales taxes. Excise duty was reintroduced in 1989.The overriding aim of strengthening the tax system and mobilizing domestic revenue, given the failure of the ERP to achieve these objectives, led to the establishment of tax commission in late 1989.Success was only in areas of exchange rates, trade and tax conditions.

3.0.Budget, Debts and Investment

The budgeting process in Tanzania is an annual exercise and dynamic as referred in table 2.0.It determines the sources of revenue and its use in running various public activities according to set priorities and ground rules. The government budget consists of revenue and expenditure budgets. Both components must be considered in discussing the budgeting process.

Table 2.0.Summary of the key phases of the budget cycle

Date	Institution	Activity
Aug-Nov	1. Technical institutions 2. Central ministries	1. Review of previous financial year's activities to assess budget implementation. 2. Preparation of the annual performance review 3. Formulation of preliminary guidelines and distribution to technical institutions 4. First quarter reports preparation and review
Dec-Jan	1. Technical institutions 2. Central ministries 3. ECC	1. Mid-year reports-preparation and review 2. Finalization of guidelines and submission to ECC for approval 3. Distribution of final guidelines to technical 4. Preparation of budget estimates
Feb-April	1. Technical institutions 2. NCEPC 3. central ministries	1. Submission of estimates proposals from tech.institutions to central ministries 2. Scrutiny of estimates proposals by central committees 3. Discussion of budget estimates 4. Consolidation of overall budget estimates 5. Submission of development expenditure estimates by PC to NCEPC for review and recommendation
May	1. ECC 2. FECP 3. Technical institutions	1. Presentation of budget proposals for review and approval 2. Printing of budget documents 3. presentation of budget 4. proposals to FECP for scrutiny examination and approval
June-July	1. National Assembly 2. Technical institutions 3. Central ministries 4. Parliament	1. Budget speech 2. Public debate on budget estimates proposals 3. Authorization of budget

Source: URT (1984), Table1, p.86.Submitted draft estimates are scrutinized by the officers of the Budget Division of the Treasury and the Planning and Control Division of the Prime Minister's Office to ensure that the estimates are consistent with Treasury guidelines and that necessary approvals have been obtained.

Collection of government revenue improved since the establishment of the TRA and the launching of VAT. Revenue was projected to increase from 12.6% in 1997/98 to 13% in 1998/99 and to rise gradually to 13.8% by the end of the Medium Term Expenditure Framework (MTEF) period. Fiscal balance before grants improved from –2.3% of GDP in 1997/98 to –1.4% of GDP in 1999/00 as the government strives to increase development expenditure. Real growth of the economy averaged 3.4% and population growth stood at 2.8% growth. Inflation was still at 9% by February 1999 the government pursued tight money supply and cash budgeting. External trade expanded and Tanzania indebtedness remained at an unsustainable level of 130% of GDP.The target is to reduce it to 80% of GDP by 2001/02 through debt reduction initiatives.

The sound economic management policy is fundamental in the budget. Looking at the macro /aggregate level of stability, resource allocation and utilization and accountability are of paramount importance.

In most cases most of the sectors are under funded hence the need to mobilize resources, expand tax base, reduce leakage like tax exemptions, initiate policy reform and set strategy to alleviate poverty and unemployment which have impacts on the fiscal policy -Fiscal austerity.

For the deficit financing, there is an urge to increase donor support like MDF(Multilateral Debt Financing) meanwhile to avoid problems of off and extra budgetary funds, integration of donor funds in the government budget is important as the government budget depends mainly on the tax revenue at more than 50%, others being foreign funds. The unpredictability of these funds hinders a lot of government efforts to revamp the economy. Allocation of funds should be directed mainly to the priority sectors.

As at the end of December 2000 both the domestic and external debt reached $8.8 billion where $1.2 billion were domestic and $7.6 billion were external debt. By the end of 1999, total debt was $ 8.1 billion. There are a number of reasons why the country reached that state of debts.

This was mainly contributed by: Government efforts to restructure the economy hence donor advanced loans, low export capacity, depreciation of national currency, high interest rates and accumulated arrears of national debt. More than 20% of domestic revenue directly went to repay external debt. The domestic debt of $1.2billion in 2000 was comprised of the following: 95% were government securities (Treasury bills of 91,182 and 364 days), bills servicing as liquidity paper, Treasury bonds, long term special bonds

(2-20years) and government bonds (5-20years).

The other 5% is mainly debts by privatized parastatals, compensations on required building by government and dues under duty drawback scheme. It is obvious that government borrowing from domestic banks and financial institutions increased the debt from $1.1billion (1999) to $1.2 billion (2000). By the end of December, 2001 total domestic debt owned by the URT including government securities (stocks, bonds, treasury bills and tax reserves certificates) and other government liabilities stood at Tshs 811.5 billion (increase of Tshs 0.3 billion compared to Tshs 811.2 billion recorded at the end of September, 2001.This was mainly attributed to unclaimed interest on tax reserve certificates.

Before the HIPC in 2000/2001,about 20% of the government revenue was spent in paying the external debts, after HIPC, only 7.7% of revenue will be spent on debt service during the period 2001/2002,and it will be down to 4.4% of revenue during the final ten years 2011/2012 to 2020/2021.Revenue resources saved from debt service are being allocated to key anti-poverty programmes like education, health and rural roads. These anti-poverty programmes are outlined in the Tanzania’s poverty programmes.

The sectors for investing have been divided into priority and lead sectors as shown in table 2.2. The priority sectors (those contributing significantly to GDP) and lead sectors (those showing substantial growth potentials. Most of the investments (projects) in Tanzania are concentrated in few cities and towns. By December 2000,the TIC had approved 1,624 projects (refer table 2.1) worth Tshs 4,957.288 million with the capacity of employing 241,250 people on completion.

There is no “an investment menu” whenever someone either domestic or foreign investor wants to invest. There should be a clearly distinction between sectors for foreign and local investors. Tax concessions, incentives and exemptions are leakages to the government revenue.

This is true to most developing countries where government expenditure is planned first and the means to raise revenue follow (Osoro, 1993). In addition, tax incentives are also associated with inequity and could result in rent seeking activities and therefore causing further tax administrative difficulties.

Tax incentives have had positive bearing on the flows of investment, be it foreign or local (Alworth, 1985:Dunning, 1985: and Shiraz and Shah, 1991). FDIs should assist in bridging the gap between government expenditure and revenue, otherwise the country's objectives to have an independent budget will not be achieved hence continue to experience budget deficit.

Table 2.1.Registered Projects, September 1990-December, 2000.

	Sector	Total Projects Approved	New Projects	Expanded/ Rehabilitated Projects	Local Projects	Foreign Projects	Joint Venture	Total employment	Total Investment
1	Agr&Livestock	126	71	55	34	36	56	41,935	273,446
2	Natural resources	97	76	21	43	21	33	24,073	339,517
3	Tourism	229	173	56	105	44	80	21,612	282,619
4	Manufacturing	763	574	189	396	152	215	112.181	1,238,953
5	Petroleum & Mining	76	65	11	27	14	35	9,076	417,600
6	Construction	97	81	16	48	22	27	9,040	1,161,529
7	Transportation	87	59	28	39	13	35	7,057	140,203
8	Services	87	68	19	36	22	29	12,970	129,368
9	Computer	5	4	1	1	2	2	81	1,397
10	Financial Institutions	31	28	3	6	12	13	1,315	349,436
11	Telecommunication	16	14	2	4	3	9	1,410	483,532
12	Energy	1	1	-	-	-	1	90	97,800
13	Human resources	9	5	4	6	2	1	410	41,888
	Total	**1,624**	**1,219**	**405**	**745**	**343**	**536**	**214,250**	**4,957,288**

Source: Tanzania Investment Center

Table 2.2The list of Lead and Priority sectors

1.0. Lead Sectors

Particulars	Corporation tax	Customs duty on capital goods	VAT on capital goods	Capital allowances deductions	Withholding tax on dividends
Mining	30	0	0	100	10
Infrastructures	30	0	0	100	
EPZ	0	0	0	100	10

Note: Infrastructure includes: Road construction bridges, railways, airports, generation of electricity, telecommunication, water services, backup services to mining sectors and the like

2.0.Priority sectors

Particulars	Corporation tax	Customs duty on capital goods	VAT on allowances deductions	Capital allowances deductions	Withholding tax on dividends
Agriculture	30	0	0	100	10
Aviation	30	0	0	100	10
Commercial buildings	30	0	0	100	10
Commercial development and micro finance banks	30	0	0	100	10
Export oriented project	30	0	0	100	10
Geographical special development areas	30	0	0	100	10
Human resources development	30	0	0	100	10
Manufacturing	30	0	0	100	10
Natural resources including fisheries	30	0	0	100	10
Rehabilitation and expansion	30	0	0	100	10
Tourism and tour operators	30	0	0	100	10
Transport	30	0	0	100	10
Radio and television expansion	30	0	0	100	10

Source: Tanzania Revenue Authority

Chapter 3.The literature review

Fiscal policy-interpreted broadly to encompass tax, expenditure and debt policy has multiple objectives including micro as well as macro concerns. The role of fiscal policy and indeed the consequences of fiscal behavior thus depend on the macro as well as the micro functioning of the economy. Prior to the Keynesian revolution (classical view) of the 1930s,the use of fiscal instruments including expenditure, tax and debt policy were thought out in the micro context of efficient resources use and distributional equity. Fiscal operations were needed to provide for public goods, the invisible hand could not resolve the task as Adam Smith well recognized. Also, if more reluctantly fiscal operations would be needed to render distributional adjustments.

The Keynesian economics (Keynesian model) in the 1930s,the macro model shifted from a presumption of market clearance to one of market jamming. Main concern of the fiscal policy had been on redirecting demand from private to public goods or between households, now shifted to their macro effect on aggregate demand.

Unemployment became the dominating policy concern and the Keynesian view of market failure-the system's inability to balance saving and investment at full employment, along with the impotence of monetary policy to overcome an infinitely elastic liquidity preference, assigned fiscal policy a unique position in overcoming these ills. Deficit finance by way of expenditure increase offered the solution, followed later by tax reduction as an alternative instrument of demand creation. Economies emerged from World War II in strengthened position, leaving behind the earlier stagnation hypothesis and rekindling inflation concerns. Compensatory finance thereby becomes a two-dimension weapon, adding its potential for demand restriction to that for demand creation. Deficit finance in its position role as a cure for unemployment gave way to its negative role as a source of inflation. Based on the Hicksian IS-LM design, the mechanics of income determination were restated so as to accommodate a variety of saving, investment and employment outcomes. Monetary policy was reinstated as an effective device, to be combined with fiscal policy so as to secure the correct Policy mix.

On the other hand, increasing Pre-occupation with the effects on the price level and on the external balance has given prominence to the monetary approach. Posted in this double tradition, contemporary analysis of the effects of fiscal policy, especially on the balance of payments rests on the most part on the well-known Mundell-Flemming model. Fiscal Policy considerations play an equally pivotal role in taking decisions on economic policy in industrial and transitional countries. As the matter of fact in developing countries it comes when reducing unemployment, excessive budget deficits, public debts burdens, national savings rates are too low and on pension and public health systems.

Fiscal policy activities to influence the economic stability of the transition and growth process are likely the structural taxation reforms, reform of public spending, debt management, extra budgetary operations and changes in the less visible quasi-fiscal activities of the state owned enterprises or financial institutions.

The problems in the Government revenue sector are:

-Dependence of taxation on international trade

-Low incomes (subsistence economy, internal sector)

-Opaque taxation systems (exemptions rules, small tax base, high tax rates)

-Lack of economic incentives

-Unequal taxation (unequal treatment of ordinary and judicial people)

-Inefficient administration procedures

-Hierarchical administrative action

-Low taxpayer honest

-Political resistance by influential interest groups; and

-Corruption

A low revenue productivity of the tax system is argued to have been attributable to mainly generous tax exemption, low compliance and tax evasion coming both from a weak tax administration and high tax rate (Osoro, 1991). High tax rates have acted as an incentive to evasion, resulting in a shift in production towards informal sector activities that difficult to tax (Maliyamkono and Bagachwa, 1990).

Thus the existence of the under ground economy may be considered as a result of high tax rates. Over the last two decades the efficiency of fiscal policy as an instrument for economic stabilization has been the subject of heated debate.

Earlier work has been undertaken to investigate if government spending, whether debt or tax financed has a permanent effect on real output, or if it merely crowds out private spending (Kye-Sik Lee, 1988). Fromm and Klein (1973) and Batten and Hafer (1983) in particular, presented empirical evidence for countries such as United States, Japan, Canada and West Germany which supports crowding over effects and thus ineffectiveness of fiscal policy. Over the past few years several studies in the area of public economics have examined the casual relationship between various pairs of economic variables. One such pair of variables is government spending – tax revenue. All the studies have one thing in common; they have used different variants of the classical Granger causality test (Provopolous and Zambaras, 1991)

In the literature, the high growth of and the persistence of government deficits have been observed in a number of countries. This has aroused the interest in determining causality between government spending and revenue. Singh and Sahni (1984), Manage and Marlow (1986), Anderson et al. (1986), Von Furstenburg et al. (1986), Marlow and Manage (1987), and Provopolous and Zambaras (1991), Osoro,1995 have investigated the relationships in questions.

The economic effects of fiscal deficits are an important item on the macroeconomics agenda (Khan, 1988). Khan argues that high deficits and the rapid growth in spending have been an issue of persistence debate among US economists and politicians.

Buchanan and Wagner (1977) postulate that the rapid increase in federal spending is caused by large federal deficits. They argue that federal deficit increases federal spending because it reduces the perceived price of publicly provided goods and services. In this view, citizen taxpayers, in response, increase their demand for such goods and services. This results in an increase in public spending as long as the elasticity of demand for federal services with respect to the perceived tax price is negative (Niskanen, 1978).

Government expenditure can be financed in three ways: by levying taxes, selling interest bearing government debt-bonds and issuing non-interest bearing high powered money (HPM). The fact that the government has to finance any difference between its expenditure and its tax revenues by changing the stock of high powered money and/or bonds is known as the government budget constraint. If the government runs a budget deficit then it must be financed by additional government bonds or by extra money balances.

Hence:

$$\underbrace{G_t - T_t}_{\text{Budget Deficit}} = \underbrace{\frac{B_t - B_{t-1}}{I}}_{\text{Increase in stock bonds}} + \underbrace{H_t - H_{t-1}}_{\text{Increase in stock of high-powered money}}$$

Where: G= Government expenditure= Tax revenue, H= High powered money, B=The number of government bonds outstanding; each bond pays its owner $1 per year in interest payments as perpetuity, a total interest payments by government are $B,I = Current rate of interest on bonds,B/I=Total market value of outstanding government bonds

This problem did not suffice until the mid 1960s when it was raised by Ott and Ott and Christ. Since then the literature on the subject has grown apace .As bonds are assumed to be perpetuities, their present value can be obtained by applying this simple discounting formula. If tax revenue exceeds government expenditure, then there is budget surplus, which must be financed either by withdrawing bonds and/or high-powered money.

It is further explained that in Neo-classical ISLM model, fiscal policy cannot alter the level of real national output. It only affects the price level and interest rate. Fiscal policy needs to be addressed both in its flow dimension-what should be the size of the deficit and what are the consequences and in its stock dimension-what are the long run consequences of the debt accumulation necessary to finance it? For many economies the domestic and external mix of this financing is of secondary importance to the overall level. For others, the issues of level and composition must be treated in an integrated way.

There is a good case for arguing that Tanzania is in a different position altogether not only that the levels of domestic and external debt should be analyzed separately, but that the overall deficit should also be split into its domestic and external components and considered separately. The case of reducing concentration on the overall deficit and separating it into the component that is domestically financed and the component that is externally financed can arise in a variety of ways.

A stylized fact of development is the non-linear relation between tax revenue and income: the tax to GDP ratio tends to rise with per capita GDP levels (Burgess and Stern, 1993).A second often quoted empirical regularity is the negative influence of inflation on tax revenue. It is also stated that adverse terms of trade shocks erode tax revenue by reducing taxation on exports or income from exportable production.

Henceforth $Tax = \Upsilon o + \Upsilon 1 Lgdp + \Upsilon 2 infl + \Upsilon 3 totsh$

Where; -

Lgdp =log of percapita GDP

Infl =Inflation

totsh = Terms of trade shocks

Taxation is considered essential for state formation (Tilly, 1992), economic growth (Gemmel, 1987); for shaping state citizens relations (Levi, 1988;Moore, 1998); for developing state capacity to deliver services (Semboja and Therkildsen, 1995).

Comparative studies of taxation in industrialized countries indicate that existing tax systems tend to reflect the politics of taxation (Brennan and Buchanan, 1980;Lane 1995) and tax administration (Slemrod, 1990;Slemrod and Yitzhaki, 1996; Myles, 1995).

The present tax system in African countries reflect, we assume the impact of and changes in seven (7) key features; -

-Colonial heritage

-Socio- Economic structures

-Post-Independent warfare and democratization

-Rural –urban tensions

-Political and administrative institutions

-Development aid; and

-Global and economic integration

Fiscal decisions are political, and if there is any economic influence it must be analyzed within an explicit framework of politico-economic interdependence………otherwise one may end up with the "optimal tax" proposals being completely distorted in the democratic process (Frey, 1976:32)

Chapter 4.Fiscal Centralization and Decentralization

4.0. Why Fiscal centralization or decentralization?

Decentralization of government seems to be one of the intellectual darlings of public finance in the 1960s just as direct tax consumption-based taxation in its various guises (e.g. the expenditure tax, the tax on consumed income, the flat tax, the x-tax and the simplifying alternative tax was the darlings of the 1980s as decentralization is generally favored as it brings the government closer to the people.

The government structure of the United Republic of Tanzania do consists of both the Central government and 114 Local government authorities. In 1960 – 1972,Tanzania had a central government and 47 local governments. In 1972,the local governments were dissolved and their institution merged into the Central government. Local governments were then re-introduced in 1984.These two institutions are complementary and independent from each other having its own level of obligations, powers and accountability. The Local Government Finance Act, 1982 (section 5 to 9) identify sources of revenue for various levels of the local authorities.

4.1. Taxation under the Central Government

Fiscal implementation and collection of the central government taxes is under the jurisdiction of the TRA, which is a semi-autonomous organization and government agent in tax collection. It was established by the TRA Act, 1995 and came in operation by July 1996 taking over the tax administration assignment which was formerly under the Ministry of Finance.

The TRA's fiscal assignment lies in its underlying functions, which are to assess, collect and account for all central government revenue. Administer effectively and efficiently all the revenue laws of the central government, advise the government on all matters related to fiscal policy, promote voluntary tax compliance, improve the quality of services to the taxpayers, counteract fraud and other form of tax evasion, produce trade statistics and publications.

4.1.0.Tax administration, structure and challenges

The TRA administers the central government taxes both the indirect and direct ones. The supporting departments of the TRA include: The Research and Policy, Taxpayer Education, Legal, Audit, Investigation, Information System, Finance, Human Resources and Administration.

The revenue department includes: the Income Tax which administers all the income and property taxes (direct taxes), the Customs and Excise Department which administers all the trade taxes, the VAT department which administers the VAT and other inland taxes, duties and fees and the newly established Large Taxpayer Department not in the TRA organization structure shown in Appendix 1.

The simpler the tax administration the less bureaucratic the organization will be and more efficient in its service delivery. Tax administration is very fragile overtime depending on the prime objective set by the government. As the TRA computerizes most of its activities and reducing paper work, this may contribute towards minimizing corruption and fund embezzlement. Table 4.0. Indicates the portion tax revenue takes in financing government expenditure. The set up tax administration should support this objective.

The recruitment of more diligent staff, qualified and motivated should be given priority. The TRA must be equipped with the necessary facilities to fulfill this objective.

Tax revenue as a percentage of total expenditure was 53.3% (1993/94) and 63.4% (2000/01). Non-tax revenue does not constitute a large portion of government revenue as shown in table 4.0, the non –tax

revenue contribution to the total expenditure was 10% (1993/94) and 12.3% (2000/01).

Categorization of Non-tax revenue according to Ministries is here below:

-Ministry of Home Affairs –Hiring of police services, immigration fees visa and passport

-Ministry of works-Ferries, vehicle maintenance

-Ministry of Lands-Land rent and service charges

-Ministry of Communication and transport-Aircraft landing and parking charges, navigation, transport licensing authority, rentals (airdromes), hire of plant, vehicles and craft.

-Ministry of Natural resources and tourism-forest royalties, hunting licenses, tour operation services, miscellaneous receipts on fisheries

-Ministry of Education-Training and examination fees and;

-Ministry of Energy and minerals-Mining royalties, mineral rents, geological fees

Table 4.0 Analysis of Central government finance, 1993/94 –2000/01. (Mill.Tshs)

Item	1993/94	1994/95	1995/96	1996/97	1997/98	1998/99	1999/00	2000/01
Total revenue-A+B	349,233.8	389,744.0	495,254.5	653,445.3	738,440.9`	859,270.9	1,057,951.4	1,215,930.1
Recurrent revenue-A	242,443.8	331,239.0	448,372.9	572,029.7	619,082.6	689,325.3	777,644.7	929,624.0
Tax revenue	220,357.6	299,899.0	383,743.5	505,354.7	566,122.1	616,284.1	685,107.4	827,788.4
Non tax revenue	22,086.2	31,340.0	64,629.4	66,675.0	52,960.5	73,041.2	92,537.3	101,835.6
Grants-B	106,790.0	58,505.0	46,881.6	81,415.6	119,358.3	169,945.6	280,306.7	286.306.1
Total expenditure	413,053.0	439,550.0	475,395.9	608,384.0	856,177.4	927,732.2	1,168,778.8	1,305,035.3
Recurrent expenditure	338,364.0	407,858.0	470.013.6	579,488.4	669,592.4	791,208.3	808,865.4	1,018,782.1
Current expenditure	-	316,168.0	355,534.0	372,846.2	442,569.7	589,354.5	680,687.0	890.632.4
Debt service includes. redemption	-	91,690.0	114,479.6	206,642.2	227.022.7	201,853.8	128,178.4	128,149.7
Development expenditure	74,689.0	31,692.0	5,382.3	28,895.6	186,585.0	136,523.9	359,913.4	286,253.2
Memorandum item expenditure float	72,163.0	30,110.0	22,885.0	14,864.0	10,554.4	14,208.0	23,211.8	-23,411.9
Surplus/deficit	-63,819.2	-49,806.0	19,858.6	45,061.3	-117,736.6	-68,561.4	-110,827.4	-89,105.2
Other items	-40,695.8	-14,753.0	-41,128.1	32,078.0	49,599.3	92,885.0	-2,444.2	-25,447.5
Total financing	104,515.0	64,559.0	21,269.5	-77,139.3	68,137.2	-24,423.6	113,271.6	114,552.7
Foreign (net)	63,958.0	2,956.0	-34,899.5	-49,065.3	64,468.1	-18,683.6	105,417.2	90,354.2
Loans	100,610.0	42,365.0	15,509.0	19,233.1	136,890.0	53,842.8	187,786.2	172,880.4
Program	77,678.0	19,862.0	7,703.4	16,543.4	80,069.0	36,626.2	54,821.0	45,326.1
Development project	22,932.0	22,503.0	7,805.6	2,689.7	56,821.0	17,216.6	132,965.2	127,554.3
Amortization	-36,652.0	-39,409.0	-50,408.5	-68,298.4	-72,421.9	-72,526.5	-82,369.0	-82,526.2
Domestic (net)	40,557.0	61,603.0	56,169.0	-28,074.0	3,669.2	-5,740.0	7,854.4	-2,494.4
Domestic non bank borrowing	26,557.0	5,803.0	62,753.0	-26.072.3	-23,605.1	-6,970.0	163.8	16,160.4
Domestic bank borrowing	14,000.0	55,800.0	-6,584.0	-15,854.3	27,274.3	1,230.0	7,690.6	-18,654.8
Amortization	-1,439.0	-2,117.0	-4,465.3	-24,696.3	-53,419.5	-38,499.1	-234,029.1	-256,372.3
Privatization fund			0.0	13,852.6	0.0	7,000.0	0.0	26,692.9

Source: Bank of Tanzania

The challenges ahead of the tax administration in order to reduce the gap between revenue and expenditure are such as;

i) Tax evasion and avoidance.

The challenges ahead of the tax system had been tax avoidance and evasion whereby tax avoidance means changing ones behavior in such a way as to reduce legal liability and as such tax avoidance is not illegal. Estimating tax evasion requires knowledge of the size of the underground economy.

ii) The growth of Informal sector

Not all sectors grow at the same pace hence leaving others behind. The left behind sectors are therefore termed as the informal sectors. Taxation of the informal sector had been difficult due to the absence of permanence (no permanent establishment), no record keeping and not easy to trace the business information (file) to the revenue authorities. In Tanzania this sector is growing at a tremendous speed and employs a great number of people. Otherwise a big firm may split into smaller business units to evade tax as tax rates rise above the real business earnings.

iii) Transfer Pricing.

The existence of tax havens like Monaco and other places where corporate tax rates are very low which then change the direction of investment from other countries. Transfer pricing by multinational corporations involves reduction in their worldwide tax payments by shifting income from highly taxed jurisdiction to more lightly tax locations.

iv) Globalization.

It has shaken revenues of many countries as the result of reduced corporate taxes, VAT rates and other taxes to match with the global fiscal environment. It is true that globalization will affect government ability to continue providing social protection at the level of recent decades. Globalization creates many challenges in the field of tax policy and one of the most heatedly discussed issues is "harmful" tax competition. Globalization provides new opportunities for minimizing and avoiding taxes, through the relocation of mobile capital.

While reduction in the tax burden on enterprises per se might not necessarily be “harmful”, the difficulty to tax capital of multinational enterprises might result in distortions in the patterns of trade and investment.

It may also result in a redistribution of the tax burden from mobile capital onto less mobile factors, in particular labour. Similarly, it might result in a shift of the burden of taxation from large multinational enterprises to small national ones. Thus the ability of large multinational enterprises to reduce their tax burden significantly or evade altogether might entail more regressive tax systems, and large budget deficits and/or reduction in the provision of public services.

In 1990s the impact of globalization began to be felt more intensely as capital markets were liberalized and economies became more integrated

v) E-Commerce

The emerging of E-Commerce will make taxation of inter-net shopping more difficult and hence loss of revenue in both developed and developing countries.

A shift from traditional shopping (buying and selling) which may be easier to assess and get the tax liability becomes a challenge to tax authorities. Training of taxmen is essential to go with changes in the business world and consumers' behavior.

vi) FDI inflow

FDI inflows may affect corporate income tax revenues through increasing the domestic capital stock. Moreover, this revenue effect may be confounded through transfer pricing or other strategies to minimize taxes.

Developments in FDI have been accompanied by a reduction and convergence in statutory as well as effective corporate tax rates. The OECD average statutory corporate tax rates declined from 44% in 1988 to 36% in 1997,and its standard deviation was reduced from 8% to 5%. However, it might very well be that the effective tax burden on corporation has not changed, as the effective burden also depends on the tax base.

4.1.1.Self financing, revenue transfer and financial authority

The TRA like any other government ministry before the commencement of a fiscal year (July) submits its estimated budget to the government (Ministry of finance) for approval. The budget preparation starts from all the departments compiled together to get the authority's budget. The TRA does not get commission out of the total revenue collected. Any expenditure and cost to be covered must appear on the authority overall budget. There is no retention of the amount collected. There is no self-financing by the authority.

The authority prepares its accounts on accrual basis and on the historical cost convention basis of accounting modified to include revaluation of fixed assets. The revenue is accounted for on cash basis. Following the computerization of expenditure accounting, fixed assets have been classified where necessary to match with the platinum asset manager module, adjustment have been made to exclude items wrongly reported as assets at takeover period

2
Similarly deficit financing is not considered to be a permanent feature of public recurrent spending

It is the policy of the authority not to depreciate fixed assets in the year of acquisition, if the assets are acquired within the last six (6) months of that financial year. It is the policy of the TRA to price closing stocks at 30th June, using weighted average method. As at 30th June 2000,the closing stocks for stationery and supplies was Tshs 662,998,633.55(1$-Tshs 799.45).

Outstanding liabilities inherited from the former tax departments amounting to Tshs 48,391,602.95 were outstanding, as at 30th June, 2000.These have been transferred to the treasury for settlement. Gross revenue collections for the year 2000 was Tshs 755,428,596,538.

3

Tanzi (1996) points out that, the net effect of transfer pricing can result in a reallocation of total tax liability among countries.

4

Tanzi (1996) argues that globalization will affect governments' ability to continue providing social protection at the level of the recent decades.

The three revenue departments collected the amount as follows:

a) Income tax department Tshs 226,527,358,222 (29.9%)

b) VAT department Tshs 252,887,528,271(33.4%)

c) Customs and Excise Dept. Tshs 278,859,909,298(36.8%)

Tshs 758,274,795,791

Tax refunds affected by customs, income tax and VAT departments for the year amounted to Tshs 2,993,006,823 and Tshs 6,839,941,679 and 15,392,993,384 respectively.

4.1.2.Tax structure decision and revenue projections

The TRA suggests to the government the tax rate, tax base and revenue targets for the revenue department at each fiscal year. The governing factors being the manpower available, TRA capacity in terms of equipments, taxpayer complaints, enhancement of compliance, reduce tax avoidance and evasion and hence generate more government revenue. This is amongst the TRA functions to advise the government on fiscal matters.

There is still more potentials for the TRA to collect more government revenue as shown in table 4.1. The GDP growth rate determines how much of revenue is going to be collected also as various sectors of the economy produce and earn more, and then more revenue will be generated refer table 4.1.

Table 4.1 Summary of the revenue collection opportunities for the TRA on the mainland 1998/99 – 2004/05

	1998/99	1999/00	2000/01	2001/02	2002/03	2003/04	2004/05
Revenue Based on GDP growth (Tshs Billions)							
VAT	246	268	294	323	355	389	427
Customs	212	231	254	278	306	335	368
Income tax	178	195	213	234	257	282	309
Total	636	694	762	836	917	1,006	1,104
Impact of Administrative improvements and efficiency gains (Tshs Billions)							
VAT	7	26	48	76	108	145	190
Customs	14	31	51	75	103	137	177
Income tax	4	7	18	31	46	64	104
Total	25	64	117	182	257	346	471
Impact of Economic and policy changes and administrative improvements (Tshs billions)							
VAT	7	26	12	32	56	84	118
Customs	10	29	51	77	108	145	189
Income tax	(9)	(44)	(40)	(35)	(27)	(17)	13
Total	8	10	22	74	137	212	320
Adjusted revenue projections (Tshs billions)							
VAT	253	294	306	355	410	473	545
Customs	222	260	305	355	414	481	557
Income tax	169	150	173	199	230	265	322
Total	644	705	784	910	1054	1219	1425
Adjusted revenue projections as percentage of GDP							
Total as percentage of GDP	12.4	12.4	12.6	13.3	14.0	14.8	15.8

Source: Tanzania Revenue Authority

4.2.Taxation under the local Government.

In the 1970s,Tanzania underwent the programme of regional decentralization. This was mainly on the administrative part not financial decentralization where the local authorities could determine their own developmental plans as per the resources available. This had a big impact on the programmes implementation.

The vast areas of Tanzania require deliberate policy to give the local authorities more administrative and financial power. More power to the local authorities means fast development to the local areas.

The local government act of 1982 and the urban authority act of 1983 empowers any local authority to pass by-laws, which allow the authority to charge local taxes and collect levies and fees within its jurisdiction. The type and number of taxes, levies and fees differ from one local administration to another because of differences in the economic base of the area and hence the tax base. Important taxes and fees which are charged by most of the local authorities are:- Development levy ,property tax ,service levy ,agricultural produce and livestock cess ,business licenses. In addition to the above taxes and levies there are other minor taxes and demand driven user-charges, which also contribute revenue to the local authorities.

Local government revenue represents less than 6% of the total national tax revenue in Tanzania. However, the large number of these taxes, together with their unsatisfactory nature, means that their economic, political and social impacts are considerably more significant than their revenue figure indicates.

4.2.0 Self financing, revenue transfer and financial authority

There are many tax bases for the local governments but their revenue yield does suffice the revenue –expenditure gap that sometimes needed to be filled by subventions from the central government. Development levy accounts for 20% -25% of the local government own revenue sources but paid mostly by employees income and businesses as a percentage of license fees. Property tax is under exploited by about 50% basing on individual councils estimates

5
Significant institution changes in support of centralization were initiated starting with the introduction of a one party state in 1966,followed by gradual but deliberate efforts to weaken and eventually replacing the peoples' institution with Central and party institutions (Semboja and Therkildsen, 1994). The Arusha declaration (1967) laid further ground in support of centralization. Local government was abolished and replaced by a system of decentralization in 1972.Under the new centralization system, local initiatives were placed under the guidance and supervision of the party and (to a lesser extent) the central government completed self help projects were transferred to the central government. The majority of the basic service facilities were nationalized between 1967 and 1972 and placed under the central government

The level of valuation, coverage and rates applicable for this tax remains a major problem. The money collected by most local authorities is used to finance the existing infrastructures in the municipals or districts but the work done is less vivid as the resources collected is still below the demands.

The local authorities have full authority over the revenue collected. It is the responsibility of the authority to allocate the money properly. Though this is not always the case due to misappropriation of funds by the local officials. Poor coordination between Central and Local government authorities as well as individual councils' lack of expertise in collection had led to poor performance of hotel and guest levy.

Business license has become more of a revenue earner than a regulatory tool. Weaknesses in the revenue collection manifested in non-performance of hotel levy, which partly was contributed by the introduction of VAT- a tax on turn over. Some councils charged service levy and industrial levy simultaneously and the former having the same base as that of VAT. Politicization of revenue collection by councilors was found to dominate at local government level, which has been an impediment to performance.

Operationalization of by-laws was limited by the provision in the 1982 Local government Act, which requires the minister to endorse the laws before they can be operational.

The taxation of the informal sector could result in substantial revenue gain in the local authorities if properly managed as the collection efficiency has declined in most municipalities. Local government authorities are heavily dependent on central government grants and subventions. The central government is obliged under the law to provide grants to finance costs of running delegated responsibilities to the local authorities.

4.2.1. Extra and off budgetary funds

Most of local government authorities cannot raise revenue above the expected or targeted amount hence less extra funds beside what was budgeted. The existence of other sources of funds may come if donor organizations start certain projects, which may supplement local government efforts in the area. The collection efficiency (Actual collection divided by estimates of revenue from all sources for a specified period) in many municipalities remained very poor.

For a region like Dodoma municipality, collection efficiency felled from 79%(1996) to 29.6% (1999), Morogoro felled from 81% to 30.5% in 1995 and Geita district declined from 91% (1996) to 37%(1999). Therefore extra and off budgetary funds is not a serious problem in most of the municipals and districts unless individuals councils and districts start to mobilize funds from others sources which could be difficult to account for.

4.3.Harmonization of the Central and Local Government taxes

The problems mainly emanates from the conflicting laws and administration of both the Central and Local government taxes. The overlapping of both taxes poses a big problem to the taxpayers.

Charging taxes from the same base by both the Central and Local government authorities prevent voluntary tax compliance and call for tax evasion. The Income Tax Act, 1973 and regulations empower local authorities to charge and administer taxes on income from businesses taking place in non-major trading centers. The TRA hence collects taxes in some districts while councils collect in others. In some centers it is a question of who gets first to the taxpayer.

This leads to overlap of collection responsibility and duplication of efforts and accounting of the revenues. Rationalizing of duties between the TRA and Local authorities staff is of paramount importance. The rates used by most council have been overtaken by time and therefore appear to be too low. Since the introduction of VAT in 1998,it is suggested that the Central government should leave other taxes to be collected solely by the local authority. The local authority believes that hotel levy could potentially be an important source of revenue to the local authority and recommend revenue sharing as necessary step in that direction.

It is true that information on the hotel levy is useful for income tax purposes and the central government (TRA) stands to benefit from efficient administration of the tax.

Chapter 5;Fiscal Policy Reform

There is no doubt that the fiscal and investment legislation together with the regulatory initiatives of 1997 do go a long way towards the national goal of creating a friendly, facilitative and hassle free environment for private business. Already in place is a regulatory framework that has enabled privatization, establishment of a stock exchange, an open market, removal of exchange controls, free repatriation of earned income, profits and dividends and reliance on market forces in allocating resources.

5.0.Fiscal trend and development for the year 1998-2000 entailed;

a) Reducing inflation: The 12-month inflation rate declined to less than 9 percent in the first quarter of 1999, the lowest rate in two decades, despite the impact of the introduction of the (VAT) in July 1998 and pressures on food prices from the partial failure of seasonal rains at the end of 1998.

b) Achieving a strong fiscal stance and credit to private sector: It was able to grow by 58 percent in the year ending march 1999, continuing the recovery of credit from the stagnation occasioned by the restructuring of

the state-owned banks in 1995-97. Treasury bill rates declined in line with the improved inflation outlook.

c) Continuing with prudent fiscal and monetary stance and the real growth of the economy: these include a further decline in the annual inflation rate to 5 percent by June 2000 and an increase in gross official international reserves to the equivalent of four months of imports of goods and non factor services by the same date. Real growth of the economy is thus projected to increase to 4.9 percent in 1999/2000 due to an increase in investment in the mining sector. The monetary program is formulated in line with these targets.

d) Tax reforms will be more revenue neutral: Reforms of the tax system has been a major element of the government's structural adjustment programme in recent years, and further reforms in import duties, excise duties, and income taxes were implemented in the 1999/2000 budget.

e) Strengthening measures to control exemptions: The introduction of VAT in July 1998 has been largely successful, but the VAT base has been somewhat eroded by statutory exemptions, and further exemptions with respect to certain medical products, aircraft engines and parts, and air charter services have recently been granted for humanitarian reasons or because of the need to take account of favorable VAT treatment offered in neighboring countries.

5.1.Tax approach Reform

Tax reforms in Tanzania dates back to the late 1960s. However, major tax reforms started in the 1970s. Motivations for tax reform have been due to apparent failure of the tax system to generate adequate revenue required to meet growing expenditure needs.

Rapid growth of expenditure has been caused by social economic and political developments since the Arusha Declaration in 1967.

Tax system in Tanzania had undergone major reform for the last three decades (0soro, 1991). Nevertheless, Osoro (1991) demonstrated that the reforms have not achieved the objective of raising revenue productivity. The low buoyancies and the elasticities that the tax system has exhibited over the last decade as indicated in table 5.0.

The objectives of tax reform in the 1970s remained revenue and equity, but protection become increasingly an important objective. The major tax reform in this decade was the introduction of a progressive income tax in 1973 (see the Income Tax Act, 1973), the repealing of the 1969 Sales Tax Act, replacing it with a new Sales Tax Act of 1976, and raising import duty rates and abolition of excise duty in the late 1970s.

Table 5.0.Bouyancy and elasticity of major taxes in Tanzania

Mtatifikoro and Katabaruki (1992)			Osoro (1993)			
Income tax	Buoyancy	Elasticity	1969-90	Buoyancy	Elasticity	Difference
1969-79	1.44	1.48	Income tax	1.0397	0.9159	12.39
1980-90	0.92	0.62	Company tax	1.1349	1.1349	0
1974-84	1.17	0.97	PAYE	0.6601	0.6601	0
Sales tax	Buoyancy	Elasticity	Sales tax	0.8961	0.7943	10.18
1969-79	1.84	0.97	Import duty	1.0843	0.5518	53.25
1980-90	0.9	0.67	Total tax	1.0602	0.7588	30.14
1974-84	1.16	0.94	1979-89	Tax to Income Elasticity	Base to income elasticity	Tax to base elasticity
Import duty	Buoyancy	Elasticity	Income tax	0.9158	0.8698	1.0743
1969-79	0.6	0.2	Company tax	1.1349	1.117	0.9006
1980-90	1.37	1.18	PAYE	0.6601	0.4231	1.5062
1974-84	1.16	0.59	Sales tax	0.7943	0.7083	1.0171
Total tax	Buoyancy	Elasticity	Import duty	0.5518	1.5923	0.4367
1969-79	1.12	0.71				
1980-90	1.04	0.78				
1974-84	0.998	0.86				

Source: Mtatifikoro and Katabaruki (1992) and Osoro (1993).

The objective of the first two reforms was to broaden the tax base with a view of raising revenue, and achieving equity. The abolition of excise tax resulted in a substantial rise in sales tax rates to compensate for the resulting revenue loss, and complicated sales tax structure.

Tax reform in the 1980s was a result of economic crises of that decade. Prior to 1985, most tax changes were made on indirect taxation. The rates of import duty and sales tax were raised virtually annually, the result of which was an extremely high tax rates and a very complicated indirect tax system. Following 1985, the countries policies assumed a new dimension. The tax reforms in the 1990s comprised by further reduction of individual income tax rates from 10-50% to 7.5-35% in 1992. Further, in 1992 the investment Promotion Act was passed by Parliament to establish the Investment Promotion Center (IPC). The Act provided for tax incentives with a view to attracting foreign investments The tax incentives included among other things, a tax holiday, exemption of taxes on imported inputs.

If anything, the Act has eroded the tax base rather than achieving significant attraction of foreign investment. Despite all the reforms described above, Tanzania is still experiencing massive revenue shortage leading to large fiscal deficit. Thus tax reforms have not yet succeeded in raising revenue productivity of the tax system.

Four factors have been accounted for the failure of tax reform to generate adequate revenue:

1). Complicated tax structure that has prevailed since the 1970s;The tax paying community to a greater extent does not understand the procedures, rates, type of taxes they have to pay and when. This demands the tax administration to educate the taxpayers on tax matters. The number of taxes and rates should be reduced to assist small businesses and corporations comply.

2). The granting of generous tax exemptions: statutory and discretionary (by the Minister of Finance and through IPC/TIC). This has been increasing from 1997 and noted that exemptions in 1997 and 2001 amounted to 1.97% and 4.03% of the total tax revenue collected respectively.

3). High tax rates encourage tax evasion and reduce compliance; they lower corporations profits and growth. For income earners the demand for goods and services is reduced. This may encourage large firms to split into small units and become informal and on the other side the growth of underground economy is accelerated.

4). Lack of failure to undertake reform in tax administration. Before 1996,the tax collection function was performed by the revenue department under the Ministry of Finance. When TRA took this function in 1996,the amount of revenue collected increased though not in real terms. In 1978 and 1999,the tax revenue as percentage of GDP was 19.16% and 10.3% respectively. Reforms in the tax administration should be a continuous process to ensure that the revenue objective of the government to meet its expenditure is achieved.

In the late 1990s,tax reforms have been receiving external support through the Tax Administration Project (TAP). The project seeks to assist the government of Tanzania in raising its tax revenue without increasing tax rates by improving the legal framework, facilitate voluntary taxpayer compliance, improve controls over tax evasion, broadening the tax base, strengthening the TRA to increase the efficiency and effectiveness of tax administration and improve the administrative infrastructure.

The donors for this project are: DANIDA, DFID, EU, GTZ, FINIDA, SIDA, UNDP and World Bank.

The presence of donors in a local authority may be crucial by changing the “ balance of power’’ with implications for accountability and democratic development. These results may explain why we observe widespread differences in revenue performance between local authorities. If donor funded projects are in the municipals or districts, it may give rise to off and extra budgetary funds, which are not part of the budget, and the municipals and districts account for their expenditures not to the government but to the donors. The government is looking at ways to rectify this situation by coordinating with the donor organizations to include the amount granted in the main budget.

5.2.Debt Approach Reform

On the debt crisis which is a major fiscal problem in this country and given the demand for debts in the debt market. A number of variables should be considered in order to solve this problem.

The demand for debt will be related to:

R =Interest rate, P=Price of commodities, GDP=Gross Domestic Product, Q =Price of imports, V= Exchange rates, W =Wealth of creditor country

Hence D (t) =d (R, P, GDP, Q, V, W)

This informs us of what determines the ability to service debt. Firstly, is the term under which the external debt is contracted. A number of things should be considered namely: interest charged on foreign borrowing, maturity and cash flow profiles, currencies in which liabilities are denominated, risk showing between debt and equity and the level of composition of country's reserves.

Secondly, the absorptive capacity of debtor countries that mainly depends on the following: level of technological development, institutional capacities, legal framework, domestic resources availability and the level of political maturity.

Thirdly, the state of the domestic economic environment, which the borrowing country has to face during the repayment period. If the environment were not conducive, the ability to repay will be weakened.

Solutions to the debt crisis may be one of the following options: Firstly, payback continues approach where negotiation between debtor and creditor continues, debtor honoring the obligations and transfer resources to the creditor. Meanwhile creditor evaluates the present creditworthiness of debtor. Secondly, not payback continues approach. In this case debtor transfer very little to creditor and there is economic relations impasse.

Thirdly, payback stop approach, debtor honor its obligations/outstanding, creditor stops new outflows of capital to the debtor and erosion of confidence on the creditor nation. Lastly, not pay stop approach, in this aspect debtor transfer minimum resources to meet their most basic consumption, debtor and creditor-loosing site of the objective of long run economic development and the need to sustain international economic relations. In this case debt crisis deepens, complete stop lending and there is global economic crisis.

5.3.Policy Mix Approach

Monetary policy was reinstated as an affective device, to be combined with fiscal policy so as to secure the correct policy mix; An easy money-tight budget mix would be more favorable to growth. An easy budget-tight money mix would favor consumption. It is essential to achieve a close degree of coordination amongst decision makers in the areas of monetary and fiscal policy. Without efficient policy coordination, financial instability could ensue, leading to high interest rates, exchange rate pressures, rapid inflation, and an adverse impact on economic growth.

At the same time, however, monetary and fiscal policies are designed and implemented by different official bodies, each with its own objectives, resources, constraints, and incentives. The effective implementation of monetary and fiscal policies thus requires extensive coordination between the respective authorities. Lack of coordination between the monetary and fiscal authorities will result in inferior overall economic performance. A weak policy stance in one policy area burdens the other area and is unsustainable in the long term.

For example, lax fiscal policy will put pressure to tighten monetary policy, even if the latter cannot fully compensate for fiscal imbalances. Moreover, the lack of credibility of the overall policy mix will diminish the effectiveness of monetary policy.

The coordination process also needs to take into account that monetary and fiscal policy adjustments operate in different time frames. Normally, it takes a long time to alter the monetary conditions on a daily basis. This inevitably requires monetary policy to bear most of the burden of any “fine tuning” of stabilization policies. More focus should be put on monetary policy and public debt management. In the long term, the policy coordination problem rests on how to design a balanced monetary and fiscal policy mix that is conducive to maintaining the economy on its equilibrium growth path – controlling inflation and promoting financial conditions for sustainable growth.

This implies limiting the fiscal deficit to a level that can be financed through the operation of the capital market without creating distortions in the allocation of resources in the economy, without having recourse to direct monetary financing from the central bank, and without relying on an excessive level of external borrowing.

Caution should be taken when setting a very restricting monetary policy to offset a lax fiscal policy may crowd out private investment and significantly increase the borrowing costs for the government. The need for policy coordination also arises in the case of structural reform and liberalization of the financial sector. Such reform can only proceed within the framework of a supportive fiscal policy that provides macroeconomic stability, fiscal discipline and avoidance of taxes that discriminate against financial activity. Developing countries rely much more than industrialized countries on the central bank to finance the fiscal deficit. During the period 1979-93, the median OECD country government was repaying debt to the central bank, while at the same time the median developing country government obtained 30 percent of its borrowing requirements from the central bank.

Also, in the median OECD country, central bank net credit to the government amounted to only 12 percent of the overall banking system's net credit to the government, compared to 66 percent in the median developing country.

To better understand the relationship between monetary policy and fiscal policy, the links between the government deficit, including both the treasury and the central bank, and the sources for its financing can be expressed as follows:

$D(t) = [B(t) - B(t-1)] + [M(t) - M(t-1)]$

Where D (t) is the government's budget deficit on a cash basis, [B(t) – B(t-1)] is the net placement of government bonds (foreign and domestic), and [M (t) – M (t-1)] is the change in the monetary base arising from central bank credit to the government. It is obvious that only two of the three elements in the above equation can be determined exogenously.

In case of Tanzania this item has not got enough attention. I perceive that the coordination between the different institutions like TRA, BOT and capital market is of significant importance. Recently the BOT has decided that the selling of treasury bills and other government securities to take place at the Dar-es-salaam stock exchange (DSE). This is a step forward towards institutional coordination and interdependence which may lead to the macroeconomic stability.

Chapter 6.Hypothesis, Methodology and Empirical results

6.0.Introduction

After analyzing the fiscal aspects such as debts, taxes and looking at the fiscal stance and trends in Tanzania, it is possible now to test hypotheses using empirical tools. In this case, this chapter specifies the hypothesis, the model to test them and the empirical outcome of their actual testing.

6.1.Hypotheses

6.1.0.Hypothesis to be tested

The macroeconomic variables that are hypothesized to be the determinants for achieving a Sound Fiscal Policy include: The real GDP growth rate, tax revenue, exchange rate policy, external debt management, the rate of inflation, Balance of Payment and FDI inflow. Thus it is hypothesized that: -

i) The slow growth rate of GDP has an adverse effect on the maintenance of a stable fiscal policy.

ii) High tax rates have a negative effect on the amount of revenue to be collected.

iii) Exchange rate policy lowers the value of domestic currency (through devaluation), which may cause revenue loss.

iv) An increase in external debt decreases government capacity to accelerate economic growth.

v) Inflation has an adverse effect on the losses of real tax revenue and cause problems in debtor country.

vi) The Balance of Payment deficit indicates that a country is living beyond its means. This has a negative effect on resource allocation.

vii) Foreign Direct Investment (FDI) has a positive stimulus to the economic growth especially of a developing country.

6.2.Methodology

Both qualitative and quantitative techniques are applied to accomplish the objectives of this study. Qualitatively, the study employs tables, statistical (percentage, ratios) and other documentary evidences, while quantitatively; an analysis employing econometric techniques of estimation is undertaken. The use of Ordinary Least Square (OLS) technique is applied to time series data on Tanzania.

6.3.Data Sources

The data sources include the Tanzania Revenue Authority, Bank of Tanzania, Ministry of Finance, Bureau of Statistics, planning commission and Economic and Social Research Foundation (ESRF), Economic and operation report (various), World Bank, World debt tables (various), Financial statements and revenue estimates. Annual series for the Net FDI inflow were obtained from different sources: FDI inflow for 1967 – 1979 proxied by net long-term foreign private loans. Net inflow of FDI data from 1980 – 1997 was obtained from the World Investment Directory, Volume V (Africa), published by UNCTAD in 1998.The other FDI data from Economic and Operations report of BOT.

6.4. Model Specification

Tax revenue –TAXREV is defined to be the function of the following variables Real GDP growth, Exchange rate, External debt, Inflation, Balance of Payment and FDI inflow.

Then let the function be denoted as:

TAXREV = ϕ (RGDP, EXCHRA, EXTEDE, INFL, BOP FDI, μ)

TAXREV = βo + $\beta 1$RGDP+$\beta 2$EXCHRA + $\beta 3$EXTEDE + $\beta 4$INFL + $\beta 5$BOP +

$\beta 6$FDI + μ…………………………………………(1a)

The log linear model will therefore be:

LnTAXREV =ϕ (LnRGDP, LnEXCHRA, LnEXTEDE, LnINFL, LnBOP, LnFDI, μ)
LnTAXREV =$\beta 0$ + $\beta 1$LnRGDP + $\beta 2$LnEXCHRA + $\beta 3$LnEXTEDE + $\beta 4$LnINFL + $\beta 5$LnBOP + $\beta 6$LnFDI + μ

Where:
Ln =Logarithm,
μ = Error term,
βi=0,1,2………6 (parameters to be estimated)
TAXREV = Tax revenue as % of GDP

RGDP = Real GDP growth

EXCHRA = Nominal exchange rate

EXTEDE = External debt as % of GDP,

INFL =Nominal Inflation rate

BOP = Balance of Payment (Current Account)

FDI = Net Foreign Direct Investment inflow in Millions of USD

6.4.0.Variables explanation

-A Positive relationship is expected between the Real GDP growth and tax revenue as a result of output growth in various economic sectors.

-A positive relationship is expected between exchange rate and tax revenue. When the domestic currency appreciates against foreign currencies, there is a revenue gain. If the currency depreciates then there is a revenue loss.

-External debt diverts revenue to finance it hence less resources to economic activities which may result into revenue loss. Therefore a negative relationship exists between external debt and tax revenue.

-There is a negative relationship between inflation and tax revenue as prices are inflated hence a loss in real tax revenue needed to meet government expenditure.

- A negative relationship is expected between Balance of Payment deficit and tax revenue (TAXREV) as a country is living beyond its means.

-A positive relationship is expected between FDI and TAXREV as investment does act as an engine and stimulus to economic growth.

The expected signs of the parameters are therefore:

$\beta1 > 0, \beta2 > 0, \beta3 < 0, \beta4 < 0, \beta5 < 0$ and; -

$\beta6 > 0$

Table 6.0.DATA USED FOR QUANTITATIVE ANALYSIS

Year	RGDP	EXCHRA	INFL	BOP	EXTEDE	TAXREV	FDI
1967	4.13	7.14	2.62	37.10	14.8	11.04	-9.24
1968	5.21	7.14	2.81	-18.10	16.9	11.52	10.64
1969	2.30	7.14	1.99	226.40	21.6	13.56	2.37
1970	3.95	7.14	3.41	-104.80	23.03	14.67	-0.08
1971	3.52	7.14	3.77	-486.60	26.36	15.64	1.90
1972	6.40	7.14	8.64	-252.10	28.61	14.22	-0.98
1973	2.70	2.70	10.46	-646.00	30.63	16.40	1.50
1974	1.27	7.37	19.51	-1899.50	37.81	18.77	2.03
1975	5.13	7.37	26.15	-1620.40	45.95	19.84	-0.28
1976	6.10	8.38	6.91	-533.10	52.03	15.94	-0.07
1977	0.40	8.29	11.63	-996.20	55.23	18.81	4.55
1978	2.13	7.71	12.21	-3630.40	51.31	19.16	-7.46
1979	2.91	8.22	12.95	-2836.30	55.14	18.54	0.41
1980	2.49	8.20	30.15	-4929.80	56.17	18.32	4.6
1981	-0.50	8.28	25.65	-3359.50	51.05	18.56	18.9
1982	0.59	9.28	28.95	-4857.30	54.36	17.57	17.3
1983	-2.38	11.14	27.06	-3394.30	67.27	17.48	1.5
1984	3.38	15.29	36.14	-5491.90	79.54	17.53	-8.4
1985	2.63	16.50	33.29	6499.60	57.25	18.7	14.5
1986	3.26	51.72	32.42	-10632.70	157.78	16.7	-7.5
1987	5.09	83.72	29.95	-28654.70	214.92	11.5	-0.5
1988	4.23	125.00	31.19	-37222.80	237.29	10.2	3.8
1989	4.0	192.30	25.85	-52662.03	306.26	11.1	5.8
1990	4.77	196.60	19.7	-97885.20	292.75	11.1	-3.3
1991	3.89	233.90	22.3	-118682.10	259.91	12.3	2.9
1992	1.8	335.00	21.9	-121018.50	204.97	12.5	12
1993	0.4	479.87	25.2	-181385.50	237.59	9.5	20
1994	1.4	523.45	33.1	-196915.00	208.40	11.0	50
1995	3.6	550.36	28.4	-440925.00	174.66	11.3	119.9
1996	4.2	595.64	21.0	-294394.60	139.22	11.3	150.1
1997	3.3	624.57	16.1	-333297.30	119.38	11.9	157
1998	4.0	681.00	12.8	-561007.8	104.69	11.0	172.22
1999	4.7	797.33	8.1	-588907.9	105.92	10.3	183.4
2000	4.9	799.45	5.1	-310506.4	90.5	10.1	192.8

The results of the estimation are summarized in Table 6.1 below

Table 6.1.Results of Modelling TAXREV by OLS (General Model). Sample Period: 1967 -2000.

Dependent Variable	Independent Variable	Expected (Hypothesized) Sign	Coefficient	Std Error	t-Stat	P-Value
TAXREV	Constant	+ve/-ve	16.38	1.0085	16.25	1.839
	RGDP	+ve	-0.30	0.1946	-1.56	0.129
	EXCHRA	+ve	-0.009	0.0056	-1.72	0.097
	EXTEDE	-ve	-0.02	0.0076	-2.52	0.018
	INFL	-ve	0.12	0.0408	2.90	0.007
	BOP	-ve	-1.07	6.1252	-0.17	0.863
	FDI	+ve	0.01	0.0211	0.69	0.493

$R^2 = 0.760773$, $F(6,27) = 14.3106$ [2.792]. $DW = 2.36$

It is therefore depicted that goodness of fit of the model is satisfactory ($R^2 = 0.76$) and all the variables except inflation (INFL), Real GDP growth (RGDP) and Exchange rate (EXCHRA) had the expected signs. However, these variables were significant at one percent significance level. The variables which were insignificant were denoted to be Balance of Payment (BOP) and Foreign Direct Investment (FDI). They were obtained when the model was regressed and obtain the Unrestricted Model (General Model) where all the independent variables were regressed against the dependent variable

TAXREV.

From the Model:

$$TAXREV = \beta o + \beta 1RGDP + \beta 2EXCHRA + \beta 3EXTEDE + \beta 4INFL + \beta 5BOP + \beta 6FDI + \mu \quad \text{...(1a)}$$

Putting the coefficients in the regression equation

$$TAXREV = 16.38 - 0.30RGDP - 0.009EXCHRA - 0.002EXTEDE + 0.124INFL - 1.07BOP + 0.01FDI \quad \text{..............................(1b)}$$

In order to remain with a Parsimonius model, the insignificant variables (BOP and FDI) were gradually removed and obtained the results indicated in table 6.2.

Table 6.2.Results of Modelling TAXREV by OLS (Parsimonius Model). Sample Period: 1967 -2000.

Dependent Variable	Independent Variable	Expected (Hypothesized) Sign	Coefficient	Std Error	t-Stat	P-Value
TAXREV	Constant	+ve/-ve	16.32	0.9803	16.64	2.218
	RGDP	+ve	-0.26	0.1809	-1.41	0.168
	EXCHRA	+ve	-0.005	0.0013	-3.88	0.000
	EXTEDE	-ve	-0.02	0.0049	-4.86	3.721
	INFL	-ve	0.13	0.0383	-3.33	0.002

$R^2 = 0.75488$, $F(4,29) = 22.3273$ [1.67]. DW = 2.38

The goodness of fit was also satisfactory ($R^2 = 0.75$) though the External debt (EXTEDE) was insignificant at one percent significance level and the sign displayed was the one hypothesized. The significant variables were RGDP, EXCHRA and INFL and they displayed different signs from the hypothesized ones.

From the Model:

TAXREV = βo + β1RGDP+β2EXCHRA + β3EXTEDE + β4INFL +

μ…………………………………………………………….(2a)

Putting the coefficients in the regression equation then

TAXREV = 16.32 - 0.26RGD - 0.005EXCHRA – 0.02EXTEDE + 0.13INFL

………………………………………………………(2b)

The Model was further regressed by removing the insignificant variables until we obtain the most plausible Model for TAXREV as shown in table 6.3.

Table 6.3. The summary results of the models regressed using OLS method for the time series datas. Then the OLS estimation results were obtained.

Dependent variable	Independent variable	Model I	Model II	Model III	Model IV	Model V	Model VI
TAXREV	Constant	16.38	16.37	16.31	17.10	16.29	16.49
	RGDP	-0.30	-0.30	-0.26	-0.48	-0.67	-0.69
	EXCHRA	-0.009	-0.009	-0.005	-0.008		
	EXTEDE	-0.02	-0.02	-0.02			
	INFL	0.12	0.12	0.13	0.02	0.008	
	BOP	-1.07					
	FDI	0.01	0.02				
	R^2	0.76	0.76	0.75	0.56	0.15	0.15
	F-statistics	F(6,27) =14.31 [2.79]	F(5,28) =17.78 [6.26]	F(4,29) =22.33 [1.67]	F(3,30) =12.47 [1.81]	F(2,31) =2.75 [0.08]	F(1,32) =5.65 [0.02]

The goodness of fit was observed to be satisfactory (R^2=O.56) at Model IV.Further regressing the Model to Model V and Model VI, the goodness of fit is not satisfactory (R^2=O.15). Hence the Model represented by the equation 3a and 3b below was found to be the most plausible Model –Model IV.

From the Model:

TAXREV = βo + β1RGDP+β2EXCHRA + β3INFL + μ…….(3a)

TAXREV = 17.10 - 0.48RGDP - 0.008EXCHRA + 0.02INFL…(3b)

Regressing the Model stopped at Model VI and the results were then summarized in table 6.4 below.

Table 6.4.Results of Modelling TAXREV by OLS (Parsimonious) were obtained.

Dependent Variable	Independent Variable	Expected (Hypothesized) Sign	Coefficient	Std Error	t-stat	P-Value
TAXREV	Constant	+ve/-ve	17.10	1.2808	13.35	3.695
	RGDP	+ve	-0.48	0.2317	-2.08	0.046
	EXCHRA	+ve	-0.008	0.0016	-5.22	1.245
	INFL	-ve	0.02	0.0408	0.41	0.682

$R^2=0.56$, F (3,30)=12.47[1.81]

It is mostly obvious that Tax revenue as a percentage of GDP (TAXREV) is strongly explained by Real GDP growth rate (RGDP), Exchange rate (EXCHRA) and Inflation rate (INFL). The RGDP, EXCHRA and INFL still displayed different signs from the hypothesized ones.

6.4.1.Summary findings

These results indicate that the macroeconomic variables exert a strong effect on TAXREV and to the Fiscal Policy which its main focus is revenue and expenditure.

The Balance of Payment (BOP), Foreign Direct Investment (FDI) and External Debt (EXTEDE) have not shown a greater effect on the TAXREV. BOP comprises mainly of exports and imports. From early 1980s export taxes were abolished and imports by investors with certificate of incentive are zero rated or lower than the global rates. VAT on imports is deferred and there are a number of statutory exemptions on imports which have impact on revenue loss. Investment plays a bigger role in economic development but for the case of Tanzania it is insignificant despite of the tax incentives provided to investors. The need to monitor the newly registered investments, putting an investment menu, reduce the number of tax incentives and concentrate on non-tax incentives like better infrastructure; all seasoned roads, constant water supply, electricity supply and less bureaucracy in getting permits is of paramount importance. FDI if properly managed should accelerate economic growth especially to a country like Tanzania.

When a country gets loans whether bilateral or multilateral, proper use of it is very important. If directed towards investment activities more output will be generated and more tax revenue will collected as a result. It does not matter how much external debt a country owes donors or international institutions. If production grows then repayment of the loan is not going to be a problem. The positive approach of an increase in the size of EXTEDE signifies that more funds are injected towards productive activities. As noted in Chapter 2,EXTEDE increased because the government wanted to restructure the economy, due to low export capacity and depreciation of the national currency then donors advanced loans. These measures have not been successful to revamp the economy due to misallocation of funds, funds embezzlement, lack of accountability and an existence of a dependent budget where a greater portion goes to recurrent not to development expenditure.

6.4.2.Policy Implications and suggestions

As it was done by other studies by Sachs, 1989,Easterly, Rodrignez and Schimidt-Hebbel, 1994), fiscal adjustment is a necessary but not sufficient condition to achieve the macroeconomic stability. It is obvious that for the achievement of a sound fiscal policy the fiscal variables alone will not lead to this objective. The inclusion of other macroeconomic variables is of paramount importance. Coordination amongst institutions dealing with these variables is important- calling for policy mix (Monetary and Fiscal Policy) approach to ensure macroeconomic stability. The fiscal variables alone do not tell us fully why there is a gap between revenue and expenditure .If the value of currency depreciates, inflation is high and growth is stagnant then Fiscal stability is not easily achievable and may lead to macroeconomic instability.

Taking the variable external debt (EXTEDE) though under HIPC debts are cancelled and rescheduled, if there is no growth in sectoral domestic production (RGDP), this initiative will not assist a developing nation like Tanzania.

The sole institutions of monetary policy (BOT) and fiscal policy (TRA) should all be effectively coordinated by the Ministry of Finance to bring about the intended economic results. For more FDI inflow, the TIC should also put more emphasis on non-tax incentives though traditionally tax incentives are used widely for the attraction of FDIs.

Figure 6.0

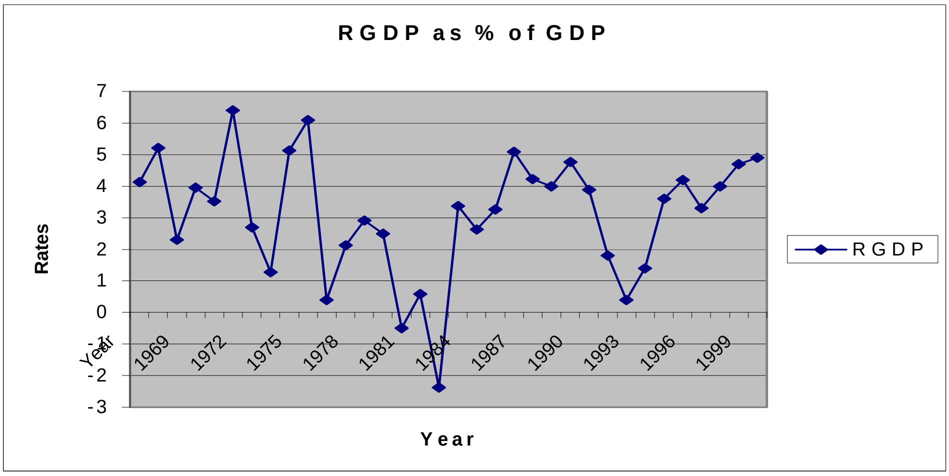


Figure 6.1

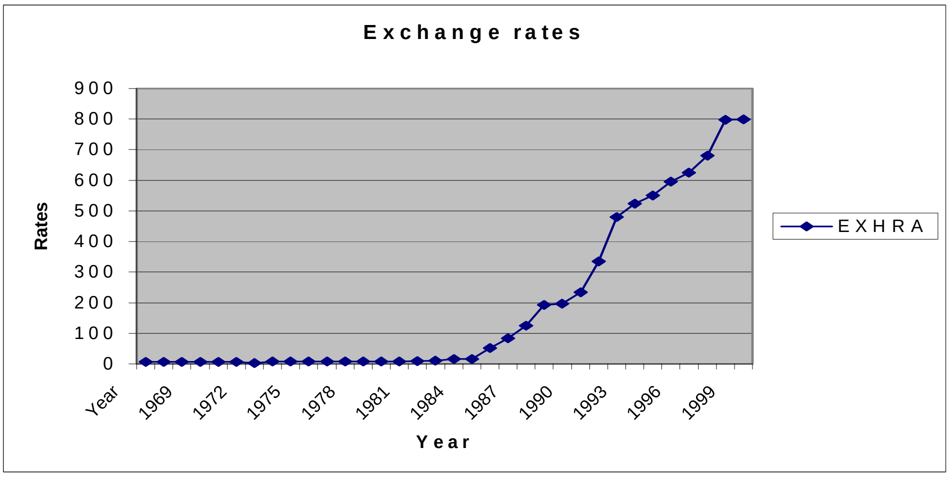


Figure 6.2

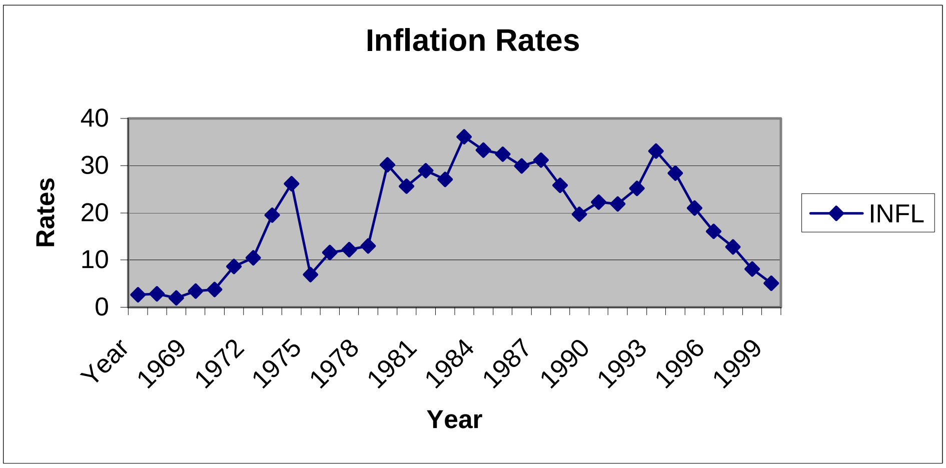


Figure 6.3

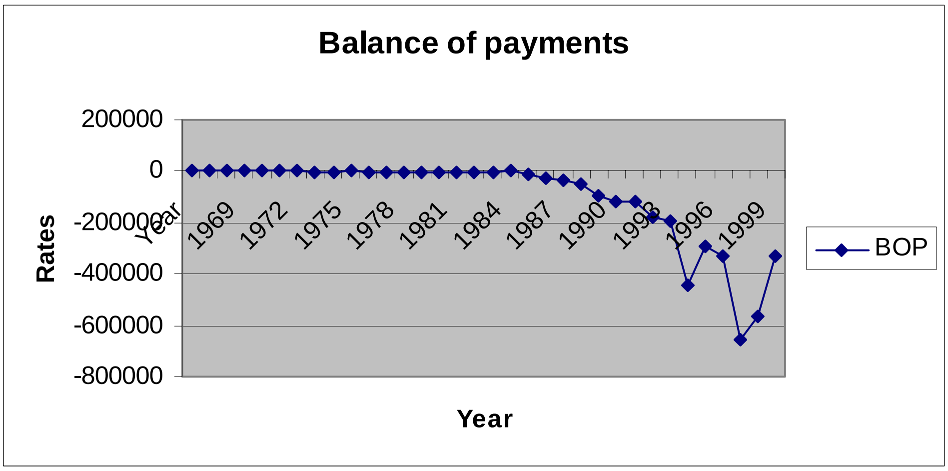


Figure 6.4

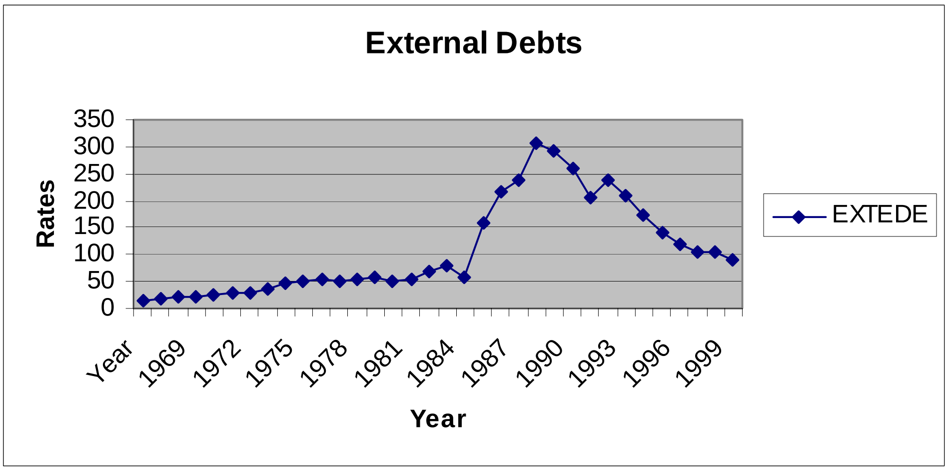


Figure 6.5

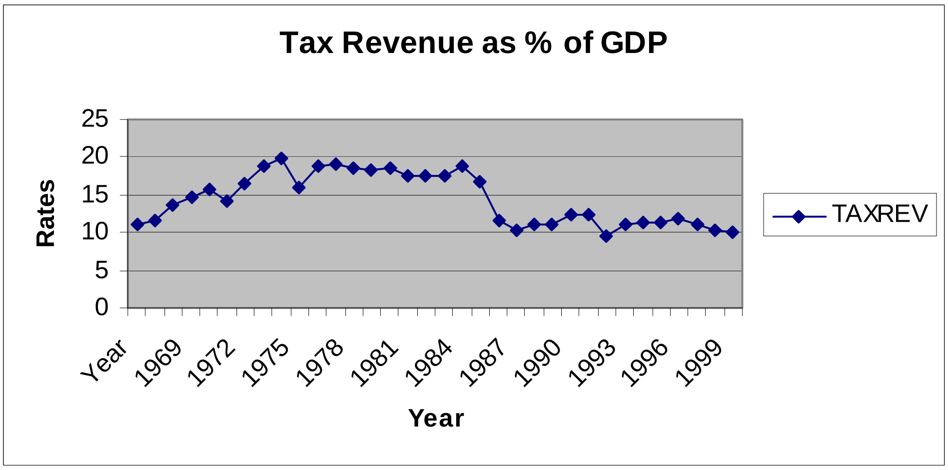
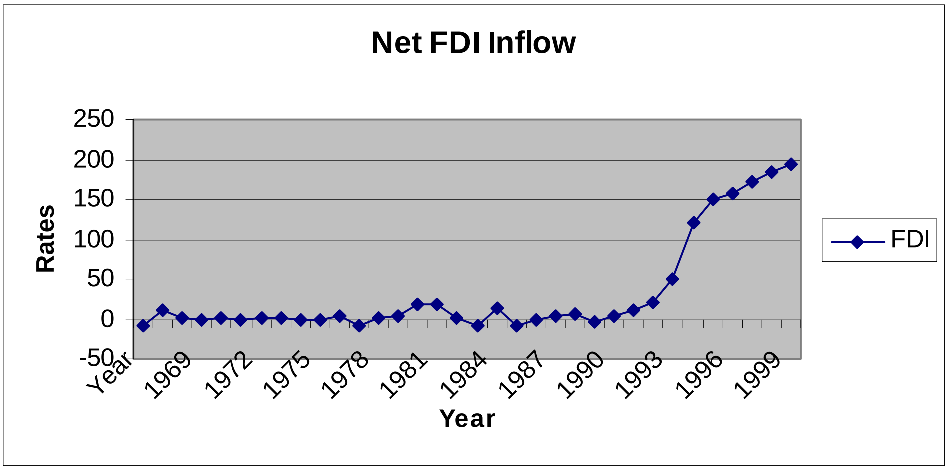


Figure 6.6.



6

Fiscal adjustment is a necessary but from sufficient condition to achieve macroeconomic stability and growth as shown by a growing body of empirical evidence (Sachs, 1989:Easterly, Rodrignez and Schimidt-Hebbel, 1994). Fiscal adjustment and macroeconomic performance are closely related. As is widely recognized, fiscal indicators like the deficit and the level of taxation and macroeconomic performance indicators like inflation, the current account and growth influence each other in both directions

Chapter 7.Conclusion

Operationalization of the investment policy since its inception in 1990s had not done substantial contribution to the economy as far as the tax revenue contribution and the growth of various economic sectors are concerned. Tax incentive has been the major incentive for attracting investment in this country. The TIC should establish regional and district centers for monitoring and control, change the one stop center tactic by going outside the boarders to look for investors and introduce an investment menu.

The number of new projects increased but little is seen in terms of tax revenue contribution to GDP, from more than 15% in early 1980s to less than 12% in late 1990s.There is less monitoring of the existing investments in this country. There are no clear statistics to explain out of the 1,624 approved projects between 1990 – 2000,how many are still in operation and how many are not. There is no preferential treatment between the local and foreign investors hence unfair competition for the locals.

The only difference is on the capital amount required to be given certificate of incentive where local investors are supposed to have a capital amount of $ 100,000 and foreign investors is $300,000 .The local investors should be provided and allowed to invest in certain sectors without foreign interference-“Investment Menu”.

Tanzania should go back to the era of developmental plans (1960s –1970s) before the structural adjustment programmes of 1980s which were mostly externally oriented and financed. The development plans had a domestic focus where external influences were secondary. It is important to reduce donor dependence because it is not a way towards a stable economy.

Tax revenue makes a greater contribution to the total government budget therefore there is a need to have payable tax rates reflecting the real business earnings, efficient tax administration and broadening the tax base will assist tax authority to meet this fiscal assignment.

In fulfilling this fiscal obligation a number of problems are still prominent in the tax system like tax evasion, corruption among employees in the tax authorities, bureaucracy to get exemptions, clearing goods at the port or airport, over assessment, lack of customer care, lack of tax education to the taxpayers, no enforcing mechanisms and the increasing growth of the informal sector which is not easy to tax.

There is also too much dependence on the international trade as a source of revenue which is threatened by an increasing wave of regionalization (SADC, COMESA, EAC, AU) and globalization. The Customs department should be directed mainly towards protection and control. More tax should be collected through income and consumption taxation.

The recent privatization policy of the government owned enterprises like TANESCO and TRC is not a solution to the economic illness of this country. Better infrastructures, good micro and macro economic policies, absence of political agendas on issues pertaining to national interest and absence of fund embezzlement are the main issues towards solving problems like poverty and dependence on bilateral and multilateral funding.

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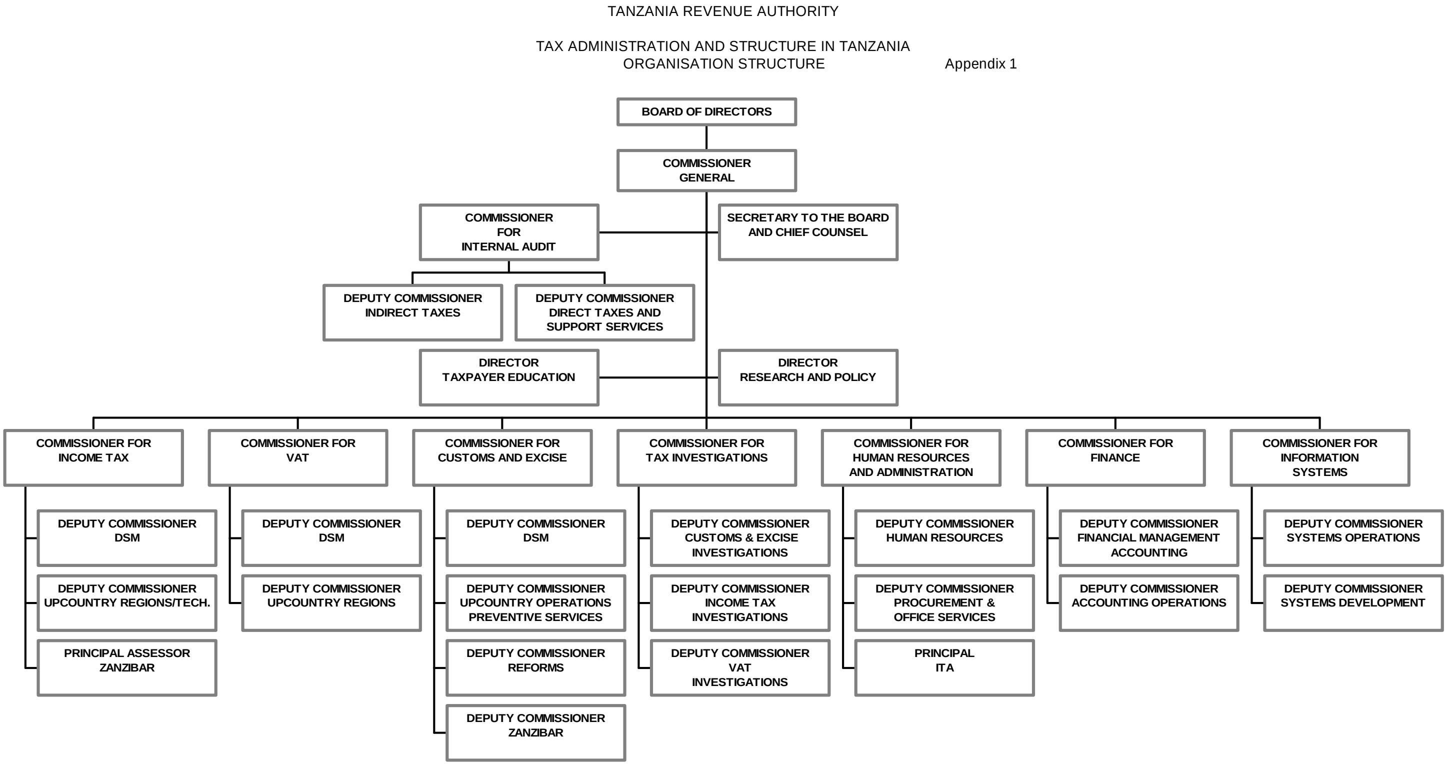
APPENDIX 1.


TANZANIA REVENUE AUTHORITY
TAX ADMINISTRATION AND STRUCTURE IN TANZANIA
ORGANISATION STRUCTURE
Appendix 1
BOARD OF DIRECTORS
COMMISSIONER GENERAL
COMMISSIONER FOR INTERNAL AUDIT
SECRETARY TO THE BOARD AND CHIEF COUNSEL
DEPUTY COMMISSIONER INDIRECT TAXES
DEPUTY COMMISSIONER DIRECT TAXES AND SUPPORT SERVICES
DIRECTOR TAXPAYER EDUCATION
DIRECTOR RESEARCH AND POLICY
COMMISSIONER FOR INCOME TAX
COMMISSIONER FOR VAT
COMMISSIONER FOR CUSTOMS AND EXCISE
COMMISSIONER FOR TAX INVESTIGATIONS
COMMISSIONER FOR HUMAN RESOURCES AND ADMINISTRATION
COMMISSIONER FOR FINANCE
COMMISSIONER FOR INFORMATION SYSTEMS
DEPUTY COMMISSIONER DSM
DEPUTY COMMISSIONER UPCOUNTRY REGIONS/TECH.
PRINCIPAL ASSESSOR ZANZIBAR
DEPUTY COMMISSIONER DSM
DEPUTY COMMISSIONER UPCOUNTRY REGIONS
DEPUTY COMMISSIONER DSM
DEPUTY COMMISSIONER UPCOUNTRY OPERATIONS PREVENTIVE SERVICES
DEPUTY COMMISSIONER REFORMS
DEPUTY COMMISSIONER ZANZIBAR
DEPUTY COMMISSIONER CUSTOMS & EXCISE INVESTIGATIONS
DEPUTY COMMISSIONER INCOME TAX INVESTIGATIONS
DEPUTY COMMISSIONER VAT INVESTIGATIONS
DEPUTY COMMISSIONER HUMAN RESOURCES
DEPUTY COMMISSIONER PROCUREMENT & OFFICE SERVICES
PRINCIPAL ITA
DEPUTY COMMISSIONER FINANCIAL MANAGEMENT ACCOUNTING
DEPUTY COMMISSIONER ACCOUNTING OPERATIONS
DEPUTY COMMISSIONER SYSTEMS OPERATIONS
DEPUTY COMMISSIONER SYSTEMS DEVELOPMENT

APPENDIX 2. TRA Balance sheet as at 30th June 2000(Mill.Tshs)

	1999/2000	1998/99
FIXED ASSETS	12,764,412,259	13,678,323,364
CURRENT ASSETS		
Stationery stock	662,998,634	615,475,786
Debtors &prepayments	880,647,953	578,982,083
Bank &cash balances	14,242,149,609	17,885,270,723
Inter transfers	6,097,075,540	
Tax revenue cash float	44,196,380,557	61,084,020,680
Pay Master General account	692,072,351,290	574,618,695,086
PSI operations A/C	6,104,412,591	4,664,727,692
Total Current assets	764,256,016,173	659,447,172,050
CURRENT LIABILITIES		
Creditors & accruals	8,159,751,908	13,710,455,313
Inter transfers	5,207,748,264	51,964,290
Revenue collection	736,274,349,923	635,705,872,615
PSI Agency fees	7,931,802,831	7,780,368,392
TOTAL CURRENT LIABILITIES	757,573,652,927	657,248,660,610
Net current assets	6,682,363,246	2,198,511,440
TOTAL ASSETS	19,446,775,505	15,876,834,804
REPRESENTED BY:		
Capital reserve	13,389,838,039	13,356,256,215
Accumulated surplus	6,056,937,466	2,520,578,589
TOTAL	19,446,775,505	15,876,834,804

Source: Tanzania Revenue Authority

APPENDIX 3.TRA Income and Expenditure statement for the year ended 30th June 2000(Mill.Tshs)

	1999/2000	1998/99
Grants from government	20,948,067,297	18,996,000,001
Grants from donors	3,149,595,564	18,566,563
Other income	606,394,510	442,653,861
TOTAL INCOME	24,704,057,272	19,457,220,426
Recurrent expenditure:		
Personnel emoluments	10,844,603,561	10,817,522,877
Staff recruitment and training	1,050,088,887	798,890,007
Staff traveling and M/V expenses	2,193,323,413	1,839,098,632
Repairs and maintenance	1,473,361,989	1,452,126,283
Administrative expenses	4,776,278,403	3,883,104.049
Taxpayer education	229,062,529	240,293,284
TOTAL RECCURENT EXPENDITURE	20,566,718,782	19,031,035,132
Surplus before depreciation	4,137,338,491	426,185,294
Less depreciation	696,722,560	1,447,614,372
Surplus after depreciation	3,440,615,930	-1,021,429,079
Add surplus brought forward	2,520,578,589	3,571,573,135
Prior year expenses	95,742,946	-29,565,467
TOTAL SURPLUS CARRIED FOWARD	6,056,937,466	2,520,578,589

Source: Tanzania Revenue Authority

APPENDIX 4.TRA Cash flow statement for the year ended 30th June 2000(Mill.Tshs)

	1999/200	1998/99
Surplus before taxation	3,440,615,931	-1,021,429,078.81
Adjustment for: Depreciation	1,675,073,322	1,447,614,372.00
Prior year expenses	95,742,946	-29,565,467.00
Fixed assets adjustment	-126,568,657	-
	5,084,863,541	396,619,826.19
Changes in working capital		
Increase/Decrease in stationery	-47,522,847	23,623,797.00
Increase/Decrease in debtors &prepayments	301,665,870	-175,336,260.50
Increase/Decrease in PSI operation/AC	-1,439,684,899	-3,364,122,205.00
Increase/decrease in creditors &accruals	-5,550,703,405	11,007,011,809.00
Increase/decrease in internal transfers	-941,291,565	33,847,378.00
Increase/decrease in PSI agency fees	151,434438	5,530,444,989.00
Increase/decrease in revenue collection	2,461,227	3,156,849.00
Increase/decrease in capital reserve	33,581,824	1,439,705,368.81
Net cash from operating activities (A)	-3,008,527,556	14,894,951,551.50
Cash flow from investing activities		
Acquisition of fixed assets	-634,593,560	-2,459,134,739.50
Net cash from investing activities (B)	-634,593,560	-2,459,134,739.50
Net increase/decrease in cash and cash equivalent (A+B)	-3,643,121,116	12,435,816,812.00
Cash and cash equivalent at the beginning of the year	17,885,270,725	5,449,453,913.00
Cash and cash equivalent at the end of the year	14,242,149,609	17,885,270,725.00

Source: Tanzania Revenue Authority

APPENDIX 5.Requests versus Central government subvention to selected local governments from 1995 to 1999(Tshs Mill)

	1995		1996		1997		1998		1999	
Council	Request	Actual	Request	Actual	Request	Actual	Request	Actual	Request	Actual
Mwanza (M)	1087.2	672.8	1391.4	953.7	1833.2	1805.5	1429.6	1292.7	1694.6	1452.3
Mbeya (M)	800.7	788.2	1,038.1	1,005.7	1,264.2	1,218.4	993.6	943.5	1,337.7	662.6
Tarime (D)	1,095.7	897.1	1,494.9	887.7	2,138.6	1,485.7	2,256.7	1,545.5	2,490.9	2,200.2
Mpwapwa (D)	1,143.0	895.4	1,234.7	963.6	1,193.0	1,091.4	1,038.5	1,202.0	955.2	904.8
Kilosa (D)	0.0	25.5	33.4	43.4	77.8	80.1	54.9	70.9	66.3	78.1
Geita (D)	1,081.4	845.0	1,482.1	1.024.1	1.681.6	1.224.9	1,695.4	1,405.2	2,329.8	1,407
Musoma (D)	404.0	398.5	566.4	426.4	574.8	535.6	771.3	716.2	290.2	290.2
Morogoro (M)	689.5	661.5	619.5	644.5	967.4	697.0	1,162.2	1,010.3	1,870.4	1,303.3
Moshi (D)	1,503.5	1,331.6	1,860.9	1,574.8	2,626.4	2,077.9	2,538.9	1,828.5	2,489.1	2,845.4
Mbinga (D)	845.9	277.8	1,322.5	849.1	1,681.6	1,080.4	1,681.6	1,080.4	1,813.2	1,575.8

Source: Respective Councils

APPENDIX 6.Withholding taxes and their rates as at 2000/2001

	APPLICABLE TAX RATES	
	RESIDENTS	**NON-RESIDENTS**
Interest (other than foreign loans)	15%	15%
Dividend income from DSE listed companies	5%	N/A
Dividend income from unlisted companies	10%	10%
Insurance commission	7.5%	N/A
Rental income(on excess of Tshs 500,000 p.a)	15%	N/A
Management and Professional fees	N/A	20%
Royalties fees	N/A	20%
Pension and retirement annuity	N/A	15%
Technical services (mining)	N/A	3%
Overland transport	4%	4%
Business insurance claim	30%	N/A
Rent premium or the like consideration for use of property	N/A	20%
Goods and services (not applicable to traders registered with TIN)	2%	2%
Management fees (mining)	N/A	3%

Source: Tanzania Revenue Authority

APPENDIX 7.Sector composition of public expenditure as percentage of Total public expenditure for 1982/83-1990/91

Year	1982/83	1983/84	1984/85	1985/86	1986/87	1987/88	19888/89	1989/90	1990/91
General public expenditure	17.1	2.2	29.9	28.9	25.5	27.6	26.7	31.3	23.4
Defence	13.3	12.8	13.9	10.4	14.6	10.3	9l.1	8.6	6.2
Education	13.2	11.7	7.3	7.3	6.4	5.9	5.5	6.6	6.9
Health	5.1	5.5	5	4.3	3.7	4.4	4.5	4.9	4.9
Economic services	27	26	24.2	22.8	16.5	16.8	16.9	15.9	22.1
Public debt	20.2	18.1	15.4	24.2	31.4	31	30.6	25.6	26.3

Source: Tanzania economic trends, economic survey, Bank of Tanzania and Tanzania twenty years of independence.

APPENDIX 8.External debt developments, 1994/95 –1999/2000

Item	1995/95	1995/96	1996/97	1997/98	1998/99	1999/2000
Overall Total Debt Committed	8,440.7	7,933.0	8,100.8	7,901.7	7,972.9	7,595.7
Disbursed outstanding debt	6,917.5	6,623.3	6,600.3	6,435.8	6,580.3	6,538.3
Undisbursed debt	1,523.2	1,309.7	1,500.5	1,465.9	1,392.6	1,057.4

Source: CS-DRMS, Debt Management Department -Bank of Tanzania

APPENDIX 9.Tax exemption trend and tax contribution to GDP, 1997 – 2001

Year	Tax Exemption by IPC/TIC as a % of total tax collected	Tax revenue as% of GDP
1997	1.97	11.9
1998	3.26	11.0
1999	3.17	10.3
2000	4.25	10.1
2001	4.03	-

Source: Bank of Tanzania (BOT), Tanzania Revenue Authority (TRA), own computation.

APPENDIX 10.Tax revenue contribution to the total expenditure, 1994-2000

Year	Tax revenue as a % of total expenditure
1994	53.0
1995	68.8
1996	80.7
1997	83.1
1998	66.1
1999	66.4
2000	58.6
2001	63.4

Source: Bank of Tanzania, Own computation