Domestic Resource Mobilization in Tanzania

FINAL REPORT

MINISTRY OF FINANCE AND ECONOMIC AFFAIRS

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List of Abbreviations

AGOAAfrican Growth Opportunity Act
ASDPAgricultural Sector Development Programme
BESTBusiness Environment Strengthening in Tanzania
BOTBuild-Operate-Transfer
BoTBank of Tanzania
D-by-DDecentralization by Devolution
DOEDepartment of Environment
EACEast African Community
EIAEnvironmental Impact Assessment
GDPGross Domestic Product
ICTInformation and Communications Technology
IPOInitial Public Offering
LGLocal Government Authority
M&EMonitoring and Evaluation
MDGsMillennium Development Goals
MKUKUTAMakakati wa Kukuza Uchumi na Kupunguza Umasikini Tanzania (NSGRP)
MKURABITAMpango wa Kuramishina Rasilimali na Biashara za Wanyonge Tanzania (PBFP)
MKUZAMakakati wa Kukuza Uchumi na Kupunguza Umaskini Zanzibar (ZSGRP)
MOFEAProvince of Finance and Economic Affairs
MSMEMicro, Small and Medium Enterprises
MTEFMedium Term Expenditure Framework
NBSNational Bureau of Statistics
NGONon-governmental organization
NSGRPNational Strategy for Growth and Reduction of Poverty
PBFPProperty and Business Formalization Programme
PERPublic Expenditure Review
PPPPublic-Private-Partnership
PRSPPoverty Reduction Strategy Paper
RGOZRevolutionary Government of Zanzibar
SADCSouthern African Development Community
SELFSmall Entrepreneurs Loan Facility
SMESmall and Medium Enterprises
TICTanzania Investment Centre
TRA Tanzania Revenue Authority
UDSMMUniversity of Dar es Salaam
UNUnited Nations
URTUnited Republic of Tanzania
VATValue Added Tax
ZRBBank of Tanzania
ZSGRPNational Strategy for Growth and Reduction of Poverty
Executive Summary

Why a focus on domestic resources mobilisation?

Following the ongoing improvement of quantity and quality of social services, and the productive sectors in general, spending needs of Tanzania are growing rapidly and more than the foreign resources can actually meet. Therefore, it is important that the country seeks the ways to mobilizing more domestic financial resources.

Although revenue collection as a percentage of GDP has recently increased, from 11.8% in 2004/05 to 17.9% in 2008/09, it is still not enough and ought to grow much faster. Domestic revenue is expected to contribute 56% to the total revenue in 2009/10, while 33% will be coming as foreign grants and loans. To increase the relative share of domestic revenue in the total spending and also as a percentage of GDP, boosting domestic revenue has to be a part and parcel of the MKUKUTA II’s strategic objective for the next 5 years. This is a matter of concern as we know that the major sources of revenue have remained the same for quite a number of years.

Objectives

The tripartite objectives of this study are: to identify the potential space for improvement of domestic resources mobilization; to draw the guidelines for domestic resources mobilization; and to analyze various possible effects of internal and external shocks on the government revenue.

Methodology

This study is done through assessment and analysis of the outputs of PER, TRA and ZRB as the main sources of relevant information. Different tools, including simple quantitative and qualitative techniques are employed in the data analysis. Much of the work is done as a desk review of the secondary data collected from the above-mentioned sources, the government ministries/organizations and libraries/publications.

Revenue sources from domestic taxes

The outline of the possible internal and external shocks, those likely to affect the government’s revenue in the next few years is provided. Such shocks include: changes in weather; changes in the consumers’ tastes; and electricity shortages as the main internal shocks, while the relevant external shocks include: changes in the oil and food prices; changes in export prices; and the current global economic crisis.

Sectoral contribution to GDP

Services constitute the largest sector, and its share in the total GDP stood at around 47% in 2007. Within this sector, trade and repairs together with real estate and business services are the major contributors. The second largest contributor to the GDP is agriculture, hunting and forestry as one comprehensive sector, which produced 25% of GDP during 2007. Crops accounted for 18.6% of GDP, while livestock, and forestry and hunting contributed 4% and 2%, respectively.
Industry and construction follow, with manufacturing as the major contributor in the sector, accounting for around 9% of GDP in the same year.

**Contribution to tax revenue by sector**

Manufacturing sector contributes about 9% of the GDP, and it is the largest contributor to the government domestic resources with more than a quarter of the total tax revenue. Transport, storage and communications, which contribute over 7% of GDP ranks second to manufacturing, accounting for over 19% of the total tax revenues. Wholesale and retail trade sector follows the preceding two sectors by recording 15% of the total tax revenue. Financial intermediation which has minimal contribution (of only 1.8%) to GDP ranks fourth in the revenue contribution, raising 9% of the total tax revenue. In contrast, agricultural sector which is large in terms of its proportion in GDP, contributes only 0.2% of the total tax revenue. The other big surprise is in mining and quarrying sector, which despite its share of about 10% in GDP; it counts roughly for only 4% of the total tax revenue.

**Estimates of revenue losses attributable to tax relief schemes**

Among the major factors eroding the tax base is the low compliance resulting from tax evasion. Tax evasion is caused by high tax rates, inefficient tax administration, multiplicity of taxes, ambiguous tax legislation, too frequent contacts of tax collectors and taxpayers, misuse of public funds, corruption, and dishonesty. The other main source of erosion of tax base is fiscal incentive in the form of tax relief and generous exemptions. Many developing countries have put in place fiscal incentives to attract foreign investors; however, there is no evidence to date, which shows that fiscal incentives have explicitly succeeded in attracting foreign investments in these countries.

Exemptions as percentage of GDP grew from 2.2% in 1996/97 to 3.4% in 2007/08, and the trend has been a fluctuating one. Likewise, exemption as a percentage of tax revenues has indicated an increasing trend. Both exemption as a ratio of GDP and tax revenue almost doubled between 1996/97 and 1997/98, and thereafter assumed a gradual but significant decline until 2003/04. From 2003/04 to 2005/06 it hit a peak of 4.5% and 38.6% of GDP and tax revenue, respectively, after which the ratios started to decline fast to 3.3% and about 24% in 2007/08.

**Financing by non-traditional (non-tax) domestic resources**

Non-tax government revenue is defined here as a total of the proceeds collected from all other sources than taxes; which traditionally include fees, loyalties and fines. Although there is a large potential for non-tax revenue in Tanzania, so far the government earns less than 2% of GDP from these sources, and account for less than 10% of the total revenue collection per annum. On average, during 1998–2008 non-tax revenue to total government revenue ratio was 9.1% while non-tax revenue to GDP ratio was 1.3%.

Normally, tax and traditional non-tax revenue sources like fees and fines are the means the government has been using to raise its revenue. However, to venture to the other potential domestic non-traditional financing sources is necessary. Some new sources that can be harnessed to finance government projects, including the Public-Private-Partnership (PPP); Initial Public Offering (IPO); Loans Syndications; and Build-Operate-Transfer (BOT) should be considered.
Potential resources for mobilization by the new non-traditional options

Being that non-traditional financing options imply the use of new instruments, we have estimated their potential capacity to raise domestic resources for public companies via the market’s desire for investment in securities of the government. On this ground, we used the Treasury bonds market to indicate from the tendered amount (as a proxy) the private sector demand for government long-term investment instruments. We find a difference between tendered and offered amounts to help project resources the market is willing to investment in the government bonds but, nevertheless, that avenue is not at the market’s disposal. In 2005/2006, the over-subscription in the bonds market was TZS 235.0 billion and by 2007/2008 it had increased to TZS 268.7 billion. Over-subscription approximates domestic resources that are chasing the long-term investments in the government but unsuccessfully. If the government entities decided to make a PPP arrangement, for example, these financial resources would most likely move there without any private investment crowding out. This is the saved money which the government has to consider a way to invest it for acceleration of output growth.

Where the government can use non-traditional financing options?

New financing approaches can be used to enhance financing of the growth sectors. Growth sectors are the ones that either directly or indirectly have high growth potential for the economy given the resources available. In the view of this, if we want to enhance growth sectors of the economy at large, we should invest in the propellers of the identified sectors; the propellers that are referred to as growth drivers (i.e. the catalysts or stimuli of growth sectors). The implication we get is – the government has to prioritize a few sectors (of course with the rest not neglected) and it has to finance growth drivers, particularly those which cut across (or are favourable to) many sectors. Growth stimuli are several, however, infrastructures (notably that of transport and communication) are an important growth catalyst cutting across the key sectors of the economy. Infrastructure can be the first priority area where the government can focus the use of the non-traditional financing options. Also the use of these approaches to finance energy and water resources as its second area of priority would be a right option.

Tax revenue from the informal sector

The informal component of the economy is large in Tanzania, and it has to contribute adequately to the government domestic resources. The spirit is to facilitate the more equitable widening of the tax base. With regards to some country experiences, the way forward to raising more revenue from this sector as one of the means for improving domestic resources mobilization is that importance has to be given to the formalization process currently underway.

Estimation of unexploited potential revenue from the informal sector

By our definition, the informal sector is not paying taxes since it is underground and evading taxes. One can only infer on the potential loss or otherwise unexploited tax revenue from the informal sector. The potential tax revenue from the informal sector is usually equated to the tax evaded by the informal sector operators. It is estimated as a product of the informal sector GDP (size) and the average income tax rate in the official economy, assuming that the informal sector would be taxed at the same average income tax rate. In the case of Tanzania, tax trends show that
evaded taxes as a percentage of tax revenue swayed upwards from 8% in the mid-1970s to 12.5% in 1999 and then fell to 9.6% in the 2006. The fall in tax evasion is associated with improved tax administration and the government effort to curb illegal activities.

**Useful strategies for tax collections from the informal Sector**

Strategies for taxes collection from the informal sector have necessitated some degrees of recognition of the informal sector activities. Informal sector operators may voluntarily get organized, usually for the purpose of obtaining some public service or facilitation, especially if the government is credible. Taxation of the informal sector then becomes possible through their association(s) since authorities can reach many enterprises at reasonable costs. After all, not all informal operators are anti-tax, and it is even so for the majority. With a long-run objective, strategic formalization is the good way forward to sustainably taxing the informal sector.

**Recommendations**

Based on the assessment of this study, the following are the main recommendations for increasing tax revenue and using the new financing approaches as a drive to mobilizing more domestic resources. These recommendations can be prioritized in the order of this presentation.

(i) **Enhance tax revenue collection**

   (a) Exploit property tax potential
   (b) Enforce tax payment compliance
   (c) Review tax relief policy
   (d) Enhance revenue collection trough provision of proper tax information and education
   (e) Expand the tax base instead of raising tax rates.

(ii) **Enhance collection of user fees of public utilities and services**

(iii) **Use non-traditional financing approaches**

   - Organize local loans syndications
   - Engage in Public-Private-Partnership
   - Assign Build-Operate-Transfer rights to the projects
   - Use Initial Public Offerings

(iv) **Formalize and raise more revenue from informal sector**
I. Introduction

1.1 Why Focus on Domestic Resources Mobilisation?

Expanding Spending Needs Relative to Foreign Financing

The resources gap in Tanzania continues to attract attention about the ways and means it is covered. To supplement domestic resources, increases in inflows in the form of aid and foreign direct investments have since the mid-1990s been associated with scaled up spending on social services like education and health, particularly, from the on-set of the Poverty Reduction Strategy Paper (PRSP I) in 1999/2000 and subsequently, the National Strategy for Growth and Reduction of Poverty (NSGRP) or MKUKUTA I. In the course of implementation of MKUKUTA I, infrastructure has also attracted increasing attention in support of productive sectors. Table 1.1 shows trends in the fiscal deficit and its financing in the past 8 years, while Figure 1.1 based on Table 1.1 data shows the trend in fiscal deficit before and after grants.

Table 1.1: Fiscal Deficit and its Financing (as % of GDP)

<table>
<thead>
<tr>
<th>Year</th>
<th>1999/00</th>
<th>2000/01</th>
<th>2001/02</th>
<th>2002/03</th>
<th>2003/04</th>
<th>2004/05</th>
<th>2005/06</th>
<th>2006/07 Est.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total revenue</td>
<td>11.3</td>
<td>12.0</td>
<td>12.1</td>
<td>12.1</td>
<td>13.0</td>
<td>13.6</td>
<td>14.1</td>
<td>14.5</td>
</tr>
<tr>
<td>Total expenditure</td>
<td>18.6</td>
<td>17.0</td>
<td>17.6</td>
<td>19.8</td>
<td>22.0</td>
<td>25.0</td>
<td>26.3</td>
<td>28.3</td>
</tr>
<tr>
<td>Overall balance before grants</td>
<td>-7.8</td>
<td>-5.3</td>
<td>-5.6</td>
<td>-7.7</td>
<td>-9.3</td>
<td>-11.3</td>
<td>-12.6</td>
<td>-13.8</td>
</tr>
<tr>
<td>Grants</td>
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<td>3.7</td>
<td>4.5</td>
<td>6.2</td>
<td>6.1</td>
<td>7.6</td>
<td>6.7</td>
<td>8.5</td>
</tr>
<tr>
<td>Overall balance after grants</td>
<td>-3.3</td>
<td>-1.6</td>
<td>-1.1</td>
<td>-1.5</td>
<td>-3.2</td>
<td>-3.7</td>
<td>-5.6</td>
<td>-5.3</td>
</tr>
</tbody>
</table>

Source: Tanzania Authorities (CGO) & IMF

Figure 1.1: Fiscal Deficit Before and After Grants as % of GDP 1999/00-2005/06

The proportion of foreign financing of recurrent and development expenditures has been significant and is still going to be appreciated. Grants as percentage of GDP have steadily increased from 4.5% at the beginning of the first PRSP (1999/00) to 7.6% of GDP in 2004/05.
and were expected to reach 8.5% in 2006/07. Overall fiscal balance before grant during the same period shows a steady rise to 12.6% in 2005/06, and was expected to rise further to 13.8% of GDP in the 2006/07. Fiscal deficit after grants jumped from 3.7% of GDP (2004/05) to 5.6% of GDP in 2005/06 and is estimated to remain at just above 5% in the current fiscal year (2006/07).

Over the same period, the breakdown of performance of different tax components shows that tax revenue provides the bulk of revenue (Table 1.2). The contribution of non-tax revenue has been low, ranging between 1% and 1.2% of GDP (Figure 1.2).

Table 1.2: Summary of central government revenue FY99-FY06 (% of GDP)

<table>
<thead>
<tr>
<th></th>
<th>1999/00</th>
<th>2000/01</th>
<th>2001/02</th>
<th>2002/03</th>
<th>2003/04</th>
<th>2004/05</th>
<th>2005/06</th>
<th>2006/07 Est</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total revenue</strong></td>
<td>11.3</td>
<td>12.0</td>
<td>12.1</td>
<td>12.1</td>
<td>13.0</td>
<td>13.6</td>
<td>14.1</td>
<td>14.5</td>
</tr>
<tr>
<td><strong>Tax revenue</strong></td>
<td>10.1</td>
<td>10.7</td>
<td>10.9</td>
<td>11.0</td>
<td>11.9</td>
<td>12.4</td>
<td>12.9</td>
<td>13.4</td>
</tr>
<tr>
<td>Import duties</td>
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<td>1.0</td>
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<td>1.2</td>
<td>0.9</td>
<td>1.3</td>
<td>1.1</td>
</tr>
<tr>
<td>VAT</td>
<td>3.3</td>
<td>3.9</td>
<td>4.1</td>
<td>4.2</td>
<td>4.5</td>
<td>5.6</td>
<td>5.6</td>
<td>4.9</td>
</tr>
<tr>
<td>VAT on domestic G&amp;S</td>
<td>1.6</td>
<td>1.6</td>
<td>1.7</td>
<td>1.7</td>
<td>2.1</td>
<td>2.2</td>
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<td>VAT on imports</td>
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<td>2.8</td>
<td>3.4</td>
<td>3.3</td>
<td>2.5</td>
</tr>
<tr>
<td>Excises</td>
<td>1.3</td>
<td>2.0</td>
<td>2.1</td>
<td>1.9</td>
<td>1.9</td>
<td>1.8</td>
<td>1.7</td>
<td>3.1</td>
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<tr>
<td>Excise on domestic G&amp;S</td>
<td>1.0</td>
<td>0.9</td>
<td>0.8</td>
<td>0.8</td>
<td>0.8</td>
<td>0.9</td>
<td>1.0</td>
<td></td>
</tr>
<tr>
<td>Excise on imports</td>
<td>0.3</td>
<td>1.1</td>
<td>1.2</td>
<td>1.0</td>
<td>1.1</td>
<td>1.0</td>
<td>0.8</td>
<td>2.2</td>
</tr>
<tr>
<td>Income taxes</td>
<td>3.0</td>
<td>2.5</td>
<td>2.6</td>
<td>2.7</td>
<td>3.2</td>
<td>3.6</td>
<td>3.9</td>
<td>3.9</td>
</tr>
<tr>
<td>PAYE</td>
<td>1.1</td>
<td>1.2</td>
<td>1.4</td>
<td>1.3</td>
<td>1.6</td>
<td>1.8</td>
<td>1.9</td>
<td>1.9</td>
</tr>
<tr>
<td>Corporate</td>
<td>0.7</td>
<td>0.6</td>
<td>0.7</td>
<td>0.8</td>
<td>1.0</td>
<td>1.2</td>
<td>1.3</td>
<td>1.3</td>
</tr>
<tr>
<td>Other taxes net (including Refunds)</td>
<td>1.3</td>
<td>1.1</td>
<td>1.1</td>
<td>1.1</td>
<td>1.1</td>
<td>1.0</td>
<td>0.4</td>
<td>0.4</td>
</tr>
<tr>
<td>o/w Transfer to Refunds Account</td>
<td>-0.5</td>
<td>-0.8</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Non-tax revenue</strong></td>
<td>1.2</td>
<td>1.3</td>
<td>1.2</td>
<td>1.1</td>
<td>1.0</td>
<td>1.2</td>
<td>1.2</td>
<td>1.1</td>
</tr>
</tbody>
</table>

Source: TRA

Figure 1.2: Trends in total revenue, tax and non-tax revenue as percentage of GDP

Source: Tanzania Authorities (CGO) & IMF
Not only is non-tax revenue low as percentage of GDP and in absolute terms compared to tax revenue, but also its annual percentage increase has been erratic (Figure 1.3)

**Figure 1.3: Annual Percentage Change in Tax and Non-Tax Revenue (%)**

![Chart showing annual percentage change in tax and non-tax revenue](chart.png)

Source: MOFEA files. Percentages based on nominal fiscal year values.

Although overall total revenue shows an upward trend, performance of different components has been variable. Tax revenue is dominated by VAT (value added tax). Even though lower, VAT on domestic goods shows a slow but steady increase, rising from 1.6% in 1999/2000 to 2.3% of GDP in 2005/06 and was projected to rise in 2006/07.

Revenue effort as a percentage of GDP has recently increased, from 11.8% in 2004/05 to 17.9% in 2008/09; but this cannot be sufficient even with resources from debt situation from MDRI.\(^1\) Domestic revenue is expected to contribute 56% to the total revenue in 2009/10, while 33% will be coming as foreign grants and loans (Budget Digest 2009). Since the required improvements in quantity and quality of social services and infrastructure sub-sectors (energy, transportation) are growing rapidly, overall spending needs are bound to grow more steeply than the foreign resources can guarantee. For this reason, in order to increase the relative share of domestic revenue in the total spending and also as a percentage of GDP, domestic revenue effort has to be one of MKUKUTA II’s strategic objectives. For a donor-dependent economy, the importance of steady domestic financial resources base is further ingrained by the recent global economic and financial crisis which tampered with inflows of aid and foreign direct investments and to a great deal remittances in the past two years.

\(^1\) Multilateral Debt Relief Initiative
Non-Tax Revenues Potential

The tax-base remains narrow, relying mainly on indirect taxes rather than on direct taxes (income and corporate taxes). In Tanzania non-tax revenues at slightly over 1% of GDP should be improved by especially targeting plugging of loopholes and improving budgeting, accounting and remittance of revenue in ministries. Potentials for expending revenue effort require changes in policy, legal and regulatory frameworks, especially in the area of natural resource/extractive sectors. Rationalisation of tax exemptions and promoting compliance without turning the measures into a disincentive for growth is also a policy challenge.

Potential to Expand Tax Base from Informal Sector

The current financial crisis has further hammered home the significance of tapping the potential taxable capacity of the informal sector as domestic source. Medium to long-term policies and a more flexible and adaptive tax system, specifically designed to foster the integration of informal sector into the mainstream development process and a better supply of public goods could encourage the informal sector to come out in the open and pay taxes (Drine, 2009). The informal sector in Tanzania is large. Promoting its growth or “formalizing” it elevates its prospect of growing into medium and large businesses category and brings it into the tax net, which is a more effective way of expanding domestic revenue with an additional advantage of improving the perceived equity of the tax system (Gupta and Tareq, 2008).

Increased Spending Autonomy

While continuing to recognize the role of foreign aid in the country with pressing spending needs for human development and infrastructure (broadly defined), increased attention to expanded and more efficient domestic mobilization of resources merits support. This is because aid-financed projects give rise to additional spending, largely in the form of operations and maintenance and recurrent spending through wage bill and other operating charges. Therefore, strengthened domestic revenue enables the country to more freely decide on high-priority spending (fiscal space) and ability to handle adverse shocks to budgetary operations owing to volatility and uncertainty in aid flows.

Trade Liberalisation and Regional Integration Effects

Other reasons for increased domestic resource mobilization stem from on-going international economic policy processes to which Tanzania is party an which would likely involve loss of sovereignty in fiscal policy, which is why a robust domestic tax capacity would set the country on a stronger footing in face of these effects:

(i) Pressure to further liberalize trade regimes and regional integration by lowering average tariff rate on external trade (which naturally forces these countries to reduce their reliance on international trade taxes) implies a need to turn to domestic sources of revenue (Mitra 1992, Lyakurwa et al., 2002). Tariff rates are expected to fall as
countries form free trade areas and customs unions within the region and with other regional blocks such as the European Union. Tanzania’s reliance on trade taxes means potential loss of trade-based tax revenue; strengthening domestic revenue effort becomes a long-term strategic option for recovering some of the lost revenue and policy space.

(ii) The rise in corporate income tax (CIT) competition in African countries, by which, is meant aggressive competition of the countries in attracting FDI tends to lower the tax rate (Gupta and Tareq, 2008). Since the trend is towards lower tax rates, it is fair to consider broadening of domestic tax base would be beneficial by way of minimizing the dent likely to be caused by the fall in revenue in case the CIT rates are actually forced fall.

(iii) As the EAC move closer to the Common Market, policy space (flexibility) for each country in varying tax rates and types will be affected so that any projections in the medium term would be affected by any agreed tax harmonisation system, covering tax policies and laws on domestic taxes in order to avoid tax distortions and so allow movement of goods, services and investments within the Community. This would consider the extent and form of tax coordination (indirect taxes, tax incentives, administration, double taxation provisions, common approach to transfer pricing, common methodology for computation of taxes, income tax treatment of contributions to pension schemes etc.) (Tarimo, 2009).

What is required is to improve the efficiency and effectiveness of the tax systems, and to widen options of broadening the tax base. But the push for more domestic resource mobilization seeks to build on recent record in tax administration improvements, including the implementation of TRA’s corporate plan. There have been efficiency gains from use of IT (e-filing of returns, especially for large tax payers) and payment of taxes through banks. Customs administration has been improved, with measures to further tighten leakage of fuel levy and customs personnel are at work 24 hours. Challenges remain due to the fact that multiple institutions are involved – including the port authority, food and drugs authority etc. all of whom need to work in a coordinated way. Other areas where improvements can be made include administration of tax exemptions, non-tax revenues. Domestic resources mobilization needs to be improved for the government to succeed in avoiding domestic deficit financing and to ease the pressure on monetary policy and interest rates.

2 Currently, for instance, the EAC is under “pressure” to sign a free trade deal with the EU. Among other reasons for trepidation is a fear by EAC of reduced policy space, declining tariff revenue and possible damage of local industry due to EU imports. Either of the last two fears has revenue effort implications. EAC would have to liberalise 86.2% of EU goods imports by 2033 while EU liberalises all tariffs on EU good imports.

3 Ideally, as much as possible, this would entail developing agreed same tax rates, similar but simplified tax structure and harmonized tax polices and procedures.

4 Effectiveness of tax administration is measured by, among key indicators, total operating costs of the tax administration as a percentage of total revenue collections both voluntary and enforced; total tax revenue (adjusted for inflation) compared to prior years tax revenue; voluntary tax payments as a percentage of total collections (voluntary and enforced collections); total numbers of registered taxpayer by taxpayer class (type of taxpayer, type of tax and size of taxpayer) compared to prior years; public opinion of taxpayers concerning the image of the tax administration; total revenue collected through enforcement actions or by type of enforcement actions.
1.2 Objectives

To complement foreign assistance or even reduce the degree of aid dependence, continued improvement in domestic resources mobilization presents itself as an imperative way for Tanzania to raise public investment for accelerated growth and poverty reduction. In order to reduce reliance on external financing of budgetary operations, the United Republic of Tanzania (URT) and the Revolutionary Government of Zanzibar (RGOZ) need to expand domestic sources of financing. The revenue effort has to increase from the current levels. In pursuit of growth acceleration, the sources of revenue should be expanded beyond the traditional formal sources, which are taxes and a few non-tax sources. Even for the tax sources, opportunities for diversifying and increasing the efficiency of different taxes need to be explored.\(^5\) Broadening the tax base entails promoting economic activity of the formal private sector and increasing the rate of formalization of the informal sector, checking loopholes for leakages (due to incompetence or corruption), and rectifying the tax exemptions and incentives regimes.

The primary challenge is one of raising economic growth through the use of domestic resources. Understanding of the buoyancy and elasticity of the revenue sources is therefore important in improving revenue. Recent challenges to government effort in revenue collection include (i) how to raise tax revenue from informal sector; (ii) how to increase the level of non-tax revenue; and (iii) how to address the concern about a widespread tax relief to the high potential revenue sources like the mining sector.

Given the above, three major objectives of this study are identified as: (i) to identify the potential space for improvement of domestic resources mobilization; (ii) to draw the guidelines for domestic resources mobilization; and (iii) to analyze various scenarios of revenue sources in relation to internal and external shocks.

1.3 Methodology

The task requires an assessment of the relevant frameworks in guiding domestic resources mobilization, including explaining various scenarios of revenue yield of important sources of financing, while taking into account the likely domestic and external shocks. This study is done through assessment and analysis of the outputs of PER, TRA and ZRB as the main sources of relevant information. Reports from these sources were accessed as a part of documentation review for information/data. The analyses are generally in line with the established macro models of Tanzania, and also in tandem with the existing literature on the theories of taxation.

\(^5\) Tax administration reforms towards increasing the coverage of taxpayers by the LTD, (ii) possible merger of the LTD and Domestic Revenue Department, (iii) extending and strengthening the taxpayer segmentation approach for medium taxpayers, and (iv) further strengthening of customs post-clearance audit, risk management, and intelligence and rolling out of the Automated System for Customs Data (ASYCUDA++) to all major customs stations. The authorities indicated that the measures proposed by the recent Fund Tax Policy Review mission would be considered for inclusion in the 2006/07 budget (IMF2006, IMF Country Report No. 06/138.)
Different tools, including simple quantitative and qualitative techniques are employed in the data analysis. Much of the work is done as a desk review of the secondary data collected from the above-mentioned sources, the government ministries/organizations and libraries/publications.

1.4 Outline of the Report

The report is organised as follows. Section II examines prospects of raising revenue from domestic taxes. Section III explores the possibility of expanding revenue realisation from non-traditional (non-tax) domestic sources other than the usual fees and fines, while Section IV examines the prospects of raising tax revenue from the informal sector. Section V makes some projections over MKUKUTA2 period and suggests measures that should be adopted to enhance revenue collection. Section VI makes concluding remarks.

II. Revenue Sources from Domestic Taxes

This section seeks to analyze various scenarios of revenue sources in relation to internal and external shocks. In pursuit of this objective, the approach entails: identifying the possible internal and external shocks that can affect the government revenue in the next few years; modelling and constructing respective scenario of expected revenue under shock and no-shock situations, both in the contexts of internal and external shocks; investigating and recommending appropriate hedging mechanisms that can alleviate revenue drift in the case of a shock. This section focuses on the review of the ways to alleviate tax revenue loss especially, that which may be emanating from asymmetrical tax relief schemes given to the high potential sources.

In short, the way forward to doing this is: a) to analyze sectoral contribution to GDP and their respective proportions of tax revenue collection; b) to estimate revenue losses attributed to tax relief scheme and provide the amalgam of alternative investment incentives that can minimize the revenue loss while at the same time encouraging investments; and c) to recommend some necessary amendments as regards arrangements and processes of tax relief (or incentives).

2.1 Impacts of Internal and External Shocks on Government Revenue

Economic shock is an event that produces a significant change within an economy, whether it occurs from within or from outside the economy. Economic shocks are unpredictable and typically impact supply or demand throughout the markets. An economic shock may come in a variety of forms. A shock in the supply of an essential commodity, such as oil, can cause prices to skyrocket, making it expensive to use for business purposes. The rapid devaluation of a domestic currency would produce a shock on the import/export industry because a nation would have difficulty importing intermediate input and capital goods.

Economic shocks cause unpredictable changes in aggregate demand and short run aggregate supply which lie outside the normal macroeconomic models. The unpredictable natures of these shocks create a fluctuating rate of economic growth and may require some sort of macroeconomic policy response. However, it is difficult to predict a priori whether these shocks
can have any significant long-lasting impact on the economy, which raises questions about how much government can and should do in order to mitigate the impact of a shock.

In light of the above considerations, there are possible internal and external shocks that are likely to affect the government’s revenue in the next few years. These are briefly outlined (discussed) here under.

2.1.1 Internal Shocks

(i) Changes in Weather

The changes in weather undoubtedly affect productivity of agricultural sector in a country. Since the Tanzania’s economy still depends significantly on agriculture, unexpected changes in weather may affect productivity and consequently the government revenue collection through a reduced tax base.

(ii) Changes in Taste of a Consumer

If in the near future the consumer behaviour changes towards a certain product then the government’s revenue from that product will also change. Currently for example in Tanzania the taste of the society towards cars is changing. So in the near future if they prefer to drive cars that are fuel efficient then it is our expectation that even the revenue collected from those cars will also change.

(iii) Electricity Shortage

If an erratic supply of electricity continues, the government may lose part of revenue due to this. Electricity affects productivity and if it is not available industries especially will not effectively engaged in productive activities since the cost of using alternative source of energy are too high. Power cut-offs and power rationing affect revenue collection by reducing the tax base. As a result the revenue to the government may decline.

2.1.2 External Shocks

(i) Changes in oil and food prices

In the recent years the oil price has once again reached record levels. Such a dramatic rise in the price of this vital commodity is something that firms and governments have little control over. Accordingly, they are referred to as 'external shocks'. Any external shock will have some impact on firms and the overall performance of an economy – but to a greater or lesser extent depending on the severity of a shock. The rise in oil prices will eventually feed through to higher inflation rates and this will trigger tighter monetary policies across the globe. The rise in the oil prices will
lead to a global economic slowdown as a result. As a result, it will also affect the revenue of the government but this will depend on the type of tax system adopted by the government.

Moreover, changes in food prices may also affect government’s revenue. A rise in food prices will cause higher inflation because the economy will start to redistribute incomes and profits between all industries and food industry. Therefore there will be an impact on price-levels; and corrections for other product prices will follow continuously over some few years. Due to higher profitability some producers could switch to food-producing industries/technologies – so different sorts of imbalances are expected.

**(ii) Changes in export prices**

The rise in export prices may affect government revenue. The degree of competition in markets can affect how much costs increase. Changes in commodity and material prices can also reflect movements in exchange rates. The timing and extent of any fall in import and export prices might affect the economy and revenue collected by the government.

**(iii) Global economic and financial crisis**

Tanzania as any other developing country depends so much on international trade. The current global economic crisis is likely to affect the economy, and consequently the revenue collection will also be affected. The financial crisis can lead to the following economic impacts on a country like Tanzania: weaker export revenues; further pressures on current account and balance of payments; lower investment and growth rates; and loss of employment. The expected impacts of global financial crisis include the fall in the flows of FDI, the fall in prices of some commodities and the drop in earnings from tourism. These in turn affect the revenue collected by the government.

**2.2 Sectoral Contribution to GDP and Revenue Collection**

Services constitute the largest sector in the economy, and the sector’s share in total GDP stood at 47.3% in 2007. Within this sector, trade and repairs together with real estate and business services are the major contributors. In 2007 they contributed about 14% and 10.2% of GDP, respectively. The other major contributors in this sector are public administration, and transport, which contributed 8%, and 5.1%, respectively (Table 2.1 and Figure 2.1).
Table 2.1: Sectoral Contribution to Gross Domestic Product

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Source: National Bureau of Statistics

Figure 2.1: Contribution to GDP (by Sector)
Agriculture, Hunting and Forestry sector is second in importance in terms of contribution to GDP. The sector contributed 25% of GDP in 2007. Crops accounted for 18.6% of GDP, while livestock, and forestry and hunting contributed 4% and 2%, respectively. Thus crops sub-sector is the most important sub-sector in the Agriculture, Hunting and Forestry sector. Fishing contributed 1.6%.

Industry and construction sector ranks third in terms of revenue contribution. In 2007 the sector contributed about 21% of GDP. The major contributor in this sector was manufacturing, which accounted for 9.2% of GDP in 2007, followed by construction, 6.5%, and mining and quarrying 2.7%, while electricity and gas contributed 2.1%.

**Growth in Sectoral Contribution to GDP**

In order for a country to develop, economic theories suggest that the share of agriculture to GDP should contract so as to leave space for the expansion of industrial and services sectors. Analysis of sectoral contribution to GDP since 2001 indicates modest structural change (Poverty and Human Development Report 2009 (not for quotation). While the agricultural sector remains central to Tanzania’s economy, its contribution to GDP (excluding fishing) has dropped by 4 percentage points from around 29% in 2001 to approximately 25% in 2007. The contribution of its components such as crops, livestock and forestry and hunting have exhibited similar declining trend.

Unlike agricultural sector, the contribution of industry and construction has moderately increased from 18% in 2001 to about 21%. In this sector the fastest growing component has been mining and quarrying, which grew from 1.8% of GDP in 2001 to 2.7% in 2007. This is an increase by one-third over a period of six years. Mining has been the most dynamic sector, expanding rapidly at an average growth rate of around 15% annually from 2000 to 2007. However, in 2008 growth in this sector fell sharply to 2.5% as a result of a fall in production of gold and diamonds. Among the reasons for this fall in production include the transfer of ownership of Williamson Diamond Mine. Both construction and manufacturing have registered a modest growth compared to mining and quarrying. In contrast, the contribution of electricity and gas as well as water supply to GDP has remained more or less constant.

Services like industry and construction sector has registered a modest growth in contribution to GDP, growing from 45.5% in 2001 to 47.3% in 2007. In this sector information and communications technology (ICT) has recorded a significant growth. While trade repairs, financial intermediation, public administration have registered a modest growth over the period under consideration, the contribution of hotels and restaurants (tourism inclusive), transport, and education have shown a declining trend. However, real estate and business and health have exhibited stagnation in terms of contribution to GDP (Table 2.2).
Table 2.2: Gross Domestic Product Growth (by Sector)

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<td>10.2</td>
<td></td>
</tr>
<tr>
<td>Real estate and business services</td>
<td>4.2</td>
<td>7.1</td>
<td>6.5</td>
<td>6.8</td>
<td>7.5</td>
<td>7.3</td>
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<td></td>
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<tr>
<td>Public administration</td>
<td>10.5</td>
<td>9.2</td>
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<td>13.6</td>
<td>11.4</td>
<td>6.5</td>
<td>6.7</td>
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</tr>
<tr>
<td>Education</td>
<td>11.4</td>
<td>7.0</td>
<td>2.8</td>
<td>4.0</td>
<td>4.0</td>
<td>5.0</td>
<td>5.5</td>
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<tr>
<td>Health</td>
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<td>8.6</td>
<td>8.7</td>
<td>7.8</td>
<td>8.1</td>
<td>8.5</td>
<td>8.8</td>
<td></td>
</tr>
<tr>
<td>Other social and personal services</td>
<td>3.1</td>
<td>2.1</td>
<td>2.0</td>
<td>3.0</td>
<td>2.6</td>
<td>3.7</td>
<td>3.2</td>
<td></td>
</tr>
<tr>
<td>GDP Growth</td>
<td>6.0</td>
<td>7.2</td>
<td>6.9</td>
<td>7.8</td>
<td>7.4</td>
<td>6.7</td>
<td>7.1</td>
<td>7.4</td>
</tr>
</tbody>
</table>

Source: National Bureau of Statistics

2.3 Contribution of Tax Revenue by sector

The analysis of contribution of each sector to tax revenue is important for policy since it can be useful in identifying the sectors which are significant contributors to government revenue. Table 2.3 shows sectoral contribution to tax revenue. Manufacturing sector, which contributes 9.2% of the GDP, is the major contributor to tax revenue. It contributes over one quarter of the total tax revenue, and accounts for 30.3% of the total VAT collections, 72.7% of the total excise duty collection, 24.5% of corporation income tax collection and 7.3% of the total PAYE.

Transport, storage and communications, which contribute over 7% of GDP, ranks second to manufacturing in terms of revenue contribution, contributing over 19% of the total tax revenues. The sector contributes 29.2% of the VAT revenue, 26.3% of the excise duty revenue, 10.4% of the PAYE, and about 25% of corporation income tax. Thus this sector’s contribution to tax revenue is much higher than its contribution to GDP.

Wholesale and retail trade sector ranks third in contribution to revenue. It accounts for 15% of the tax revenue. The sector accounts for about 14% of the VAT revenue, 0.4% of the excise duty revenue, 16.4% of corporation income tax, and 15.7% of the PAYE, but contributes about 39% of the individual income tax.
Financial intermediation which has minimal contribution (only 1.8%) to GDP ranks fourth in revenue contribution. It accounts for 9% of the tax revenue. It contributes 26% of the corporate income tax, which is slightly higher than that of transport, storage and communications (25%) and that of manufacturing (24.5%), but much higher than that of the wholesale and retail trade (16.4%). Thus, like manufacturing its contribution to tax revenue is considerably high relative to its contribution to GDP.

In contrast, Agricultural sector which is the back bone of the economy contributes only 0.2% of the tax revenue. It has negligible contribution to the major tax categories such as VAT, excise duty, corporation income tax and PAYE.

Another big surprise is in mining and quarrying sector. Although the sector contributes about 10% of GDP, it counts for only 3.7% of tax revenue. Its contribution to VAT, corporation income tax and PAYE are minimal, 1.2%, 2.2%, and 8.2%, respectively.

The remaining sectors such as electricity, gas and water, construction, hotels and restaurants (which include tourism) account for less than % of the total tax revenue, and fishing contributes only about 0.1%.

### Table 2.3: Contribution to Tax Revenue (by Sector)

<table>
<thead>
<tr>
<th>ECONOMIC SECTOR</th>
<th>VAT</th>
<th>CORP. TAX</th>
<th>EXCISE DUTY</th>
<th>PAYE</th>
<th>SDL</th>
<th>W/H TAX</th>
<th>RENTAL</th>
<th>STAMP DUTY</th>
<th>INDIVIDUAL TAX</th>
<th>OTHERS</th>
<th>DEP. CHARGE</th>
<th>TOTAL TSH</th>
<th>% of total taxes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture, Livestock &amp; Forestry</td>
<td>1,131.3</td>
<td>688.1</td>
<td>16.2</td>
<td>1,361.6</td>
<td>225.9</td>
<td>226.9</td>
<td>262.6</td>
<td>93.5</td>
<td>19.9</td>
<td>403.7</td>
<td>103.2</td>
<td>4,533.2</td>
<td>0.19</td>
</tr>
<tr>
<td>Fishing</td>
<td>507.8</td>
<td>308.9</td>
<td>7.8</td>
<td>611.2</td>
<td>101.4</td>
<td>101.4</td>
<td>118.0</td>
<td>42.0</td>
<td>8.9</td>
<td>181.2</td>
<td>46.3</td>
<td>2,035.0</td>
<td>0.08</td>
</tr>
<tr>
<td>Mining &amp;Quarrying</td>
<td>8,572.2</td>
<td>9,195.9</td>
<td>95.9</td>
<td>54,445.1</td>
<td>9,324.9</td>
<td>7,149.3</td>
<td>251.9</td>
<td>97.5</td>
<td>13.7</td>
<td>301.6</td>
<td>83.3</td>
<td>89,529.3</td>
<td>3.71</td>
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<tr>
<td>Manufacturing</td>
<td>210,102.1</td>
<td>101,835.4</td>
<td>207,450.0</td>
<td>48,236.8</td>
<td>13,059.9</td>
<td>17,672.4</td>
<td>4,097.5</td>
<td>1,281.2</td>
<td>257.2</td>
<td>5,369.9</td>
<td>1,313.9</td>
<td>610,591.0</td>
<td>25.31</td>
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<tr>
<td>Electricity, Gas &amp; Water</td>
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<td>378.0</td>
<td>74.2</td>
<td>15,983.4</td>
<td>4,019.2</td>
<td>8,365.9</td>
<td>17.8</td>
<td>6.3</td>
<td>1.3</td>
<td>32.8</td>
<td>6.9</td>
<td>63,659.6</td>
<td>2.64</td>
</tr>
<tr>
<td>Construction</td>
<td>22,838.7</td>
<td>15,574.0</td>
<td>46.7</td>
<td>10,318.7</td>
<td>2,446.3</td>
<td>3,137.9</td>
<td>850.7</td>
<td>228.5</td>
<td>46.6</td>
<td>991.8</td>
<td>241.6</td>
<td>54,721.4</td>
<td>2.27</td>
</tr>
<tr>
<td>Wholesale &amp; Retail Trade</td>
<td>96,079.2</td>
<td>67,953.1</td>
<td>1,044.2</td>
<td>104,251.6</td>
<td>18,297.8</td>
<td>16,613.4</td>
<td>17,696.3</td>
<td>6,065.0</td>
<td>1,280.3</td>
<td>26,063.9</td>
<td>6,632.6</td>
<td>361,956.4</td>
<td>15.00</td>
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<tr>
<td>Hotels &amp; Restaurants</td>
<td>20,216.2</td>
<td>6,874.0</td>
<td>148.5</td>
<td>22,424.6</td>
<td>2,838.9</td>
<td>2,780.2</td>
<td>2,154.8</td>
<td>745.5</td>
<td>158.3</td>
<td>3,232.0</td>
<td>819.9</td>
<td>62,392.9</td>
<td>2.59</td>
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<tr>
<td>Transport, Storage &amp; Commns.</td>
<td>203,099.7</td>
<td>62,019.4</td>
<td>75,041.1</td>
<td>69,085.1</td>
<td>14,110.4</td>
<td>18,525.8</td>
<td>8,339.8</td>
<td>1,982.7</td>
<td>404.5</td>
<td>8,819.1</td>
<td>2,295.5</td>
<td>463,723.3</td>
<td>19.22</td>
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<tr>
<td>Financial Intermediation</td>
<td>11,590.4</td>
<td>197,457.3</td>
<td>26.5</td>
<td>60,177.2</td>
<td>10,579.8</td>
<td>23,249.4</td>
<td>2,940.5</td>
<td>556.7</td>
<td>10.4</td>
<td>408.4</td>
<td>53.9</td>
<td>217,450.5</td>
<td>9.01</td>
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<td>Real Estate, Renting &amp; Business Activities</td>
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<td>19,792.0</td>
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<td>36,170.7</td>
<td>8,457.4</td>
<td>5,026.5</td>
<td>5,276.5</td>
<td>1,579.6</td>
<td>428.1</td>
<td>6,830.9</td>
<td>1,731.0</td>
<td>128,509.5</td>
<td>5.33</td>
</tr>
<tr>
<td>Public Administration &amp; Defence</td>
<td>559.9</td>
<td>226.6</td>
<td>5.1</td>
<td>179,508.5</td>
<td>638.5</td>
<td>183.1</td>
<td>103.4</td>
<td>146.3</td>
<td>6.3</td>
<td>138.4</td>
<td>32.5</td>
<td>182,286.1</td>
<td>7.56</td>
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<td>7.2</td>
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<td>128.0</td>
<td>100.6</td>
<td>141.6</td>
<td>43.9</td>
<td>8.8</td>
<td>186.5</td>
<td>45.7</td>
<td>12,624.6</td>
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<td>Health &amp; social Work</td>
<td>784.9</td>
<td>477.4</td>
<td>11.3</td>
<td>944.7</td>
<td>156.8</td>
<td>157.4</td>
<td>182.3</td>
<td>64.9</td>
<td>13.0</td>
<td>280.1</td>
<td>71.6</td>
<td>3,145.1</td>
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<td>Other Community, Social &amp; Personal Service Activities</td>
<td>37,890.5</td>
<td>22,814.1</td>
<td>1,185.0</td>
<td>46,217.2</td>
<td>7,381.5</td>
<td>7,448.3</td>
<td>8,225.3</td>
<td>2,861.9</td>
<td>607.4</td>
<td>12,382.1</td>
<td>3,146.4</td>
<td>150,156.2</td>
<td>6.22</td>
</tr>
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<td>Private H/hold with Employed Persons</td>
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<td>736.2</td>
<td>17.4</td>
<td>1,456.8</td>
<td>241.7</td>
<td>242.8</td>
<td>281.2</td>
<td>100.0</td>
<td>21.3</td>
<td>432.0</td>
<td>110.4</td>
<td>4,850.1</td>
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<tr>
<td>Extraterritorial Organizations &amp; Bodies</td>
<td>150.5</td>
<td>91.5</td>
<td>2.2</td>
<td>181.1</td>
<td>30.1</td>
<td>30.2</td>
<td>35.0</td>
<td>12.4</td>
<td>2.6</td>
<td>53.7</td>
<td>13.7</td>
<td>603.0</td>
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<tr>
<td><strong>Total</strong></td>
<td>693,451.2</td>
<td>414,818.3</td>
<td>285,462.8</td>
<td>662,327.3</td>
<td>92,038.9</td>
<td>50,882.4</td>
<td>15,907.8</td>
<td>3,289.6</td>
<td>66,107.2</td>
<td>16,748.7</td>
<td>2,412,767.</td>
<td>100.00</td>
<td></td>
</tr>
</tbody>
</table>

Source: Tanzania Revenue Authority
2.4 Estimates of Revenue Losses Attributable to Tax Relief Scheme

One of the major impediments to domestic resources mobilization is a narrow tax base. Among the major factors that erode the tax base is low compliance resulting from tax evasion. Tax evasion is caused by high tax rates, inefficient tax administration, multiplicity of taxes, ambiguous tax legislation, too many contact of tax collectors with taxpayers, misuse of public funds, corruption, dishonesty, etc. Another source of erosion of tax base are fiscal incentives in the form of tax relief and generous exemptions. Tax incentives are one of the major sources of erosion of tax base in Tanzania. The fiscal incentives are granted particularly to investors with a view to attract foreign investment. Many developing countries have put in place fiscal incentives to attract foreign investors. However, there is no hard evidence to date, which shows that fiscal incentives have explicitly succeeded in attracting foreign investments in these countries. At most fiscal incentives have eroded the tax bases in most of these countries.

The more important factors than fiscal incentives, which are good indicators of attraction of foreign investments include good infrastructure (good roads and communication networks), reliable power and water supply, less bureaucracy, low corruption level, and peace. Undoubtedly, there factors are more important to an investor in making a decision to invest in a country than fiscal incentives.

In Tanzania there are two types of tax exemptions, statutory and discretionary exemptions. Statutory are exemptions which are provided for in tax legislation. Exemptions in this category do not pose any serious problems in tax administration. The only problem is that if they are too many they erode the tax base. However, if they are minimized they would have minimal effect on tax the base or tax collection. The most problematic type of exemption is discretionary exemption. These are the exemptions which are not embedded in tax legislation. Instead they are granted by the minister of finance. The minister has been entrusted with the legal power to exempt anybody from paying tax or exempt any item from tax. Such discretionary powers are subject to abuse, and of course, the abuse of powers has happened in Tanzania in several occasions. There have been attempts by the government to reduce the powers of the minister by requiring that the Tanzania Revenue Authority (TRA) advice the minister on discretionary exemption before making decision. Nevertheless, the final decision on discretionary exemption still rests on the minister mandate. The minister can take or leave TRA advice on discretionary exemptions.

Table 2.4 and Figure 2.2 show the magnitude of exemptions by category of beneficiaries and trend of exemptions as a share of GDP and tax revenue, respectively. The major beneficiaries of tax exemptions are government institutions, parastatal organizations, religious and charitable institutions, NGOs, donor funded projects, Regional Trade Agreements, private companies and individuals, and IPC/TIC. In the form of type of taxes, exemptions include VAT exemption, excise duty exemptions, and sales tax rebates. Table 4 shows those exemptions as percentage of GDP grew from 2.2% in 1996/97 to 3.4% in 2007/08, nonetheless; the trend has been a fluctuating one. Likewise, exemption as a percentage of tax revenues has indicated an increasing trend. Figure 2 shows that both exemptions as a ratio of GDP and tax revenue almost doubled between 1996/97 and 1997/98, and thereafter assumed a gradual but significant decline until
2003/04. From 2003/04 to 2005/06 it hit a peak of 4.5% and 38.6% of GDP and tax revenue, respectively, after which the ratios started to decline fast to 3.3% and about 24% in 2007/08.

Table 2.4: Value of Exemptions by Category of Beneficiaries (In Percentage) Mainland Tanzania

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<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Government Institutions</td>
<td>0.4%</td>
<td>0.5%</td>
<td>0.4%</td>
<td>0.4%</td>
<td>0.1%</td>
<td>0.1%</td>
<td>0.1%</td>
<td>0.0%</td>
<td>0.1%</td>
<td>0.1%</td>
<td>0.1%</td>
</tr>
<tr>
<td>Parastatals Organizations</td>
<td>0.3%</td>
<td>0.6%</td>
<td>0.1%</td>
<td>0.0%</td>
<td>0.1%</td>
<td>0.1%</td>
<td>0.2%</td>
<td>0.1%</td>
<td>0.0%</td>
<td>0.1%</td>
<td>0.0%</td>
</tr>
<tr>
<td>Religious &amp; Charitable Institutions</td>
<td>0.1%</td>
<td>0.2%</td>
<td>0.1%</td>
<td>0.2%</td>
<td>0.2%</td>
<td>0.1%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
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<tr>
<td>NGOs</td>
<td>0.2%</td>
<td>0.4%</td>
<td>0.5%</td>
<td>0.3%</td>
<td>0.6%</td>
<td>0.4%</td>
<td>0.4%</td>
<td>0.2%</td>
<td>0.2%</td>
<td>0.1%</td>
<td>0.1%</td>
</tr>
<tr>
<td>Donor Funded Projects</td>
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<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
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<td>0.0%</td>
<td>0.1%</td>
<td>0.4%</td>
<td>0.1%</td>
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</tr>
<tr>
<td>Regional Trade Agreements</td>
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<td>0.0%</td>
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<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.1%</td>
<td>0.0%</td>
<td>0.0%</td>
</tr>
<tr>
<td>Private Companies &amp; Individuals</td>
<td>0.4%</td>
<td>1.3%</td>
<td>1.0%</td>
<td>0.6%</td>
<td>0.4%</td>
<td>0.2%</td>
<td>0.3%</td>
<td>0.3%</td>
<td>0.5%</td>
<td>0.6%</td>
<td>0.4%</td>
</tr>
<tr>
<td>IPC/TIC</td>
<td>0.2%</td>
<td>0.4%</td>
<td>0.4%</td>
<td>0.4%</td>
<td>0.5%</td>
<td>0.5%</td>
<td>0.4%</td>
<td>0.8%</td>
<td>1.2%</td>
<td>0.8%</td>
<td>1.3%</td>
</tr>
<tr>
<td>VAT Exemption</td>
<td>0.4%</td>
<td>0.3%</td>
<td>0.4%</td>
<td>0.4%</td>
<td>0.7%</td>
<td>0.6%</td>
<td>1.0%</td>
<td>1.6%</td>
<td>2.2%</td>
<td>2.4%</td>
<td>1.5%</td>
</tr>
<tr>
<td>Excise Duty Exemption</td>
<td>0.2%</td>
<td>0.1%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
</tr>
<tr>
<td>Sales Tax Rebates</td>
<td>0.0%</td>
<td>0.2%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>2.2%</td>
<td>0.0%</td>
<td>0.0%</td>
</tr>
<tr>
<td>Exemptions % of GDP</td>
<td>2.2%</td>
<td>4.0%</td>
<td>2.8%</td>
<td>2.3%</td>
<td>2.5%</td>
<td>2.0%</td>
<td>2.4%</td>
<td>3.0%</td>
<td>4.5%</td>
<td>4.2%</td>
<td>3.4%</td>
</tr>
<tr>
<td>Exemptions % of Tax Revenue</td>
<td>18.2%</td>
<td>36.9%</td>
<td>30.9%</td>
<td>23.6%</td>
<td>26.2%</td>
<td>20.4%</td>
<td>23.5%</td>
<td>27.6%</td>
<td>38.6%</td>
<td>31.8%</td>
<td>23.9%</td>
</tr>
</tbody>
</table>

Source: Tanzania Revenue Authority

Figure 2.2: Trend on the Exemptions as Share of GDP and Tax Revenue in Tanzania for 1996-2008
2.5 Remaining Tax Revenue Improvement Space

Tax revenue in Tanzania depends so much on income tax, VAT and import duties. These sources are important but insufficient in terms of the resources need of the country. There are other taxable opportunities like that in the property tax area, which have not been sufficiently harnessed. This section presents available space for improving tax revenue in the country. We outline the areas of actions that the government can take to boost revenue collection from the base expansion and some restructuring of the tax collection modalities.

2.5.1 Exploit Property Tax Potential

It is important to note that most of properties especially in towns and cities, and notably buildings both commercial and residential, are not contributing adequately to tax revenue. Although the law spells it clearly that property tax has to be collected and that the TRA is mandated to collect, collection effort in this category of taxes has been too low. It may be due to difficulties involved in making a follow up of the tax payers, which means it is likely that collection cost is high. But the payers can be easily motivated to pay property tax by making sure that while they are forced to pay, there is also provision of noticeable social services, which in a way, reflects the use of the collected proceeds. For instance, in the residential areas of urban centres, compliance can be enforced strictly while in the same time; roads cleanliness and the removal of garbage are provided. This kind of two-way demands can become an effective incentive for the payers to comply.

On condition that a house (i.e. the property) is located in a place where it is accessible, whether within a surveyed plot or not, by the fact that it shares in a way or another in using facilities and/or services provided by the government including public goods overall, the tax for this property should be paid. The question of the rates differentiation depending on the location, benefit principle, and so forth is quite imperative and it has to be brought into the picture when assessing for the property tax to be paid. Effective payment of property tax will add a significant amount of revenue to the government. One means of ensuring compliance will be to set affordable rates but with effective enforcement to benefit from the economies of scale in collection.

2.5.2 Enhance Revenue Collection Trough Tax Information and Education

In order for the government to manage collecting tax with some relative ease, it has to provide enough information to the tax payers on the rate, base and tax computation procedures. This may be at cost, but it is important because a tax payer may not know on what basis he has to pay a given tax and so assessing the amount due wrongly, at times perceiving it too high to pay. An example can be where a contractor could have information that the tax rate is 25% of the total earnings of the business. If at the same time he does not know that the receipts on which tax will be based is net of the costs of his construction work (i.e. wages, overheads, etc.) may evade the tax as it is deemed unbearable. But if this tax information is well available to the payer, that is – the proportion of the received money the tax exactly has to fall on, he will understand that the tax is only on his non-cost receipts and would be convinced to pay since the amount would not be
unnecessarily too huge. We emphasize that there is a good space for tax revenue improvement through better tax education. The government has to be aware that many potential small and medium size tax payers do not have the capacity to pay tax consultants and so they have a great deal of information gap that limits effective payment.

2.5.3 Review of Tax Relief Policy

Tax relief policy should be reviewed to make sure there are no loopholes for the loss of the government revenue. Investment tax incentives may not be the best option to choose especially where investors have an opportunity to harness the grace period of the relief and then change the business or quit. There are many other ways investment incentives can be granted instead of tax holidays. For instance, improvement in the aspects of investment climate like the time one takes to open or close the business, the extent of licence bureaucracy, promptness of legal processes in resolving commercial disputes, and so forth. Tax incentives have the potential for abuses and also become disincentive to the other good tax payers. The country cannot completely go without tax incentives, however, but these must be minimised to the lowest possible level. It is not a matter of mentioning outright which relief must be cancelled, but the government has got a room to evaluate all its relief grants to see which ones can be reversed. If a large foreign investor is welcomed to the country to use domestic non-renewable natural resource, for example, it makes no sense to grant him a tax exemption. The advantages to this investor would be the opportunity to use such scarce resources with relative ease, nonetheless, while paying a tribute (tax in this case) to the locals (owners).

2.5.4 Compliance Enforcement

Many issues are around this point including: corruption and less collection efforts. In some cases tax payers bribe tax officers for under-payment or default. In some others, there is no enough effort to revenue collection. The government must be able to close corruption loopholes at all levels (small and big rent seeking opportunities) to create essential high integrity for genuine tax collection. There is no convincing reason why some potential tax payers do not pay tax, and more so those of the property and business taxes. It is important to ensure maximum enforcement of tax payment in accordance with the law. Closing revenue leakages (i.e. controlling corruption) and setting reasonably affordable tax rates, can be a good incentive to the tax payers to remit their due amounts to the government. The use of effective punishments is necessary for tax payment compliance. Evasion benefit must necessarily be less than the punishment cost in case of this misconduct detection.

2.5.5 Expansion of Tax Base versus Raising Tax Rates

It is normally easy to raise extra revenue from the simple-to-catch sources like PAYE and taxes on oil. If the government wants to raise more revenue it can be tempted to just impose higher rates on such sources, but this is not an appropriate way of raising tax revenue unless if? It is advisable that each year, there must be some part of unexploited potential base that is reached by the revenue authority to contribute to the government revenue. Some issues on this are discussed under inclusion of the informal sector in paying some tax. The major point is that, while
expanding tax base, a kind of phase by phase formalization of some activities currently under informal sector will be part and parcel.

III. Financing by Non-traditional (Non-tax) Domestic Resources

In this section we discuss non-traditional (non-tax) financing approaches, simply referred to in this document as non-traditional financing options. We start with a brief overview of the overall non-tax revenue in Tanzania, and then a discussion on available space for the non-tax financing options follows. The section also provides the approaches used in those financing options and areas where the government can adopt them. A few examples of other countries are also highlighted concisely.

3.1 Overview of Non-tax Revenue Collection

Non-tax government revenue is defined as a total of the proceeds collected from all other sources than taxes; which traditionally include fees, loyalties and fines. Although there is a large potential for non-tax revenue in Tanzania, so far the government earns less than 2% of GDP from this source, and this accounts for less than 10% of the total revenue collection per annum. On average, during 1998–2008 non-tax revenue to total government revenue ratio was 9.1% while non-tax revenue to GDP ratio was 1.3%. While non-tax revenue to GDP ratio was rising from 0.8% in 1998 to 1.9% in 2008, the ratio of non-tax revenue to the total government revenue was falling from 9.2% to 6.5% during the same period, this indicating that emphasis over the last decade was generally on raising tax revenue (Figure 3.1).

Figure 3.1: Developments of Non-tax Revenue Collection

Normally, tax and traditional non-tax revenue sources like fees and fines are the means the government has been using to raise its revenue. As the trend of developments in collection of
non-tax revenue shows, it may be that the ratio of non-tax revenue to the total government revenue is declining because the scope for expansion of the traditional non-tax revenue base is limited. It is time, however, to explore the possibility to venture to other potential domestic non-traditional sources of revenue. In this section we consider some sources that can be harnessed to finance government projects, including the Public-Private-Partnership (PPP); Initial Public Offering (IPO); Loans Syndications; and Build-Operate-Transfer (BOT). As may be noted from the outset, some of these approaches render government companies going public.

It is important to notice that in finance theory there is contention that “financing government by using domestic resources especially from financial markets has a crowding-out effect on the private investments”. Nonetheless, Tanzania is one of the countries where banks and other financial institutions experience accumulation of excess liquidity craving for (bankable) investments avenues. All together the government is in need of financial resources and the options at its disposal are either to borrow from abroad or domestically to bridge the financing gap after realization of the achievable revenue collections. Rationally, mobilization of resources from either inside or outside the economy is influenced by the attached costs including interest obligations, various risks involved, sacrifice of sovereign integrity, and so forth. During this time when the world economy is suffering from the global financial crisis, opportunities for government financing by foreign resources are limited, and the need for increasing domestic resources mobilization is more important than ever before. The objective here is to get different ways by which expensive government projects can be financed domestically, not as substitutes to the conventional tax financing method but as additional means.

3.2 Available Non-tax Financing Space

As indicated earlier, not-tax revenue comes mainly from fees, fines and loyalties. These are the leading non-tax revenue sources that should be improved to enhance their productivity. The important areas of action for enhancement of non-tax revenue from traditional sources are as follows:

(i) User fees of public utilities and services should be adequately collected. The government has to make sure public utility companies – notably the energy and water supply providers – can standalone in financing their capital and operational expenses. This is possible if the following issues are fulfilled:

(a) Every user has to pay the fees according to the required rates. Metres must be installed to avoid estimations of the charges with likely under/over-pricing.

(b) Rationalization of the charges must be done to minimize rent seeking. Too high fees of services, bureaucratic processes and inefficiencies are the main causes of customers’ search for unlawful shortcuts to getting such services.

(c) Improvement of collection and financial management at the revenue collection centres. In all public offices where collections are made (especially in the form of
fees and cost sharing) managements should make sure there are professional collectors, those at least with basic accounts and financial management qualifications.

(d) Formalization of the potential sources of revenue including businesses and natural resources extractions will enhance revenue collection.

With these initiatives, revenue from traditional non-tax sources can increase noticeably. Nonetheless, there is a wide space for non-tax collections from non-traditional non-tax avenues that which Tanzania has not utilized adequately. Those avenues encompass:

(ii) Initial Public Offerings (IPOs): It is known that the main financial constraint to public utilities in Tanzania is inadequate capital. IPOs are among the methods of financing business organizations, and the public utilities in particular, through the stock market. The government has a space for its organizations/authorities especially those of energy and water supply to go public for their financing. This has the major double advantages: (i) raising funds from within the economy at low costs; and (ii) enhancing development of the stock market. It is not a quite new financing approach since other countries like Australia have listed a number of their public infrastructures and utilities. Using IPOs will have the following merits:

- Raising funds directly to the organization that is going public.
- Reducing dependence on taxes and external loans for corporate projects financing.
- Increasing control through the market.
- Reducing government obligation to directly funding productive organizations.
- Incentive to performance as the value of the firm will necessarily be determined by the market price of its shares, which is normally attached to performance results.

Issuance costs will include:

- Fees paid to the underwriting syndicate.
- Direct costs such as filing and legal fees.
- Under-pricing as IPOs stocks are mostly sold at lower prices than their true market values.

(iii) Local Loans Syndications: Some government development projects like infrastructures are expensive and they need a large sum of money in a short period. It is difficult to borrow those large amounts from one individual domestic bank. For this reason, a loan syndication (which means organizing some banks to jointly lend to a public project in need of such large amount of funds) is an alternative non-tax financing opportunity. In construction of infrastructures, power plants, water supply projects, and other development public projects the government can first use the potential credit available in the domestic market before it goes for the foreign market sources.
It is imperative to note that commercial banks in Tanzania have excess liquidity (IMF, 2009) and they are willing to lend to the government. This is evident from the fact that there are over-subscriptions in the government securities market though interest rates are relatively low compared to the private sector lending rates. The main reason for the high lending rates has been attributed to risks involved, *inter alia*. Virtually, banks are like they have mobilized more resources than they can profitably release to domestic private investment. If the government is in need of domestic resources, the failure to allocate such resources to productive projects *through the market* can be reckoned as a problem of inefficient resources management. This means the government has to organize for domestic loans to finance some *development* projects instead of rushing to external credits. Using loans syndication will have the following advantages:

- Banks will bear reasonable credit risk.
- The government will make use of financial resources available from within the economy, which reduces unproductive accumulation of excess liquidity in banks.
- Reduction of external dependency of the government budget.

The use of this method of financing needs a reasonable care because the government has to target banks’ resources in line with the amount of excess liquidity available. Over-use of this opportunity has a risk of crowding out private investments following public sector induced resources constraint.

(iv) *Public-Private-Partnership (PPP)*: The government can decide to combine its investment in public infrastructure assets with operational efficiency of the private management in the form of PPP. Financing infrastructural projects is expensive and returns are contingent on management efficiency. Private management of projects is often more effective than public management since the private management experiences less moral hazards, and therefore the predetermined performance measure/criteria becomes a central yardstick of the achievement.

The other way PPP could function is through collection process. There are difficult areas of collection (for example, collecting revenue from the informal sector) where the government can get only some little revenue. Using private agents to collect revenue for the government in such areas can be rather effective. Government can facilitate compliance while the private sector facilitates collection process. Merits of PPP approach include:

- Increasing non-tax revenue productivity, i.e. lowering collection costs of the government.
- Makes it possible to transfer risks between the two partners (public and private sectors).
• Optimization of the synergy available for resources mobilization in the country. Private sector management efficiency can combine with the available public resources to produce adequate service.

Problems with PPP may arise where there are contractual incompleteness. It must be noted that this approach has been attempted in Tanzania but with failures in most companies owing to poor management. Nevertheless, the central idea is we have to be cautious when appointing private managements so that performance merit becomes a selection and assessment criteria for the managers.

(v) Assigning Build-Operate-Transfer (BOT) projects: BOT is a form of project financing, wherein a private entity receives a concession from the public sector to design, construct, finance, and operate a facility stated in the concession contract. This enables the project proponent (private sector) to recover its investment, operating and maintenance expenses before the project/infrastructure is transferred to the government at the end of the concession period. Due to the long-term nature of the arrangement, the fees are usually raised during the concession period. The rate of increase is often tied to a combination of internal and external variables, allowing the proponent to reach a satisfactory internal rate of return for this investment. Examples of countries using BOT are Taiwan, India, Canada, Croatia, Australia, Japan, China, Malaysia, New Zealand and Philippines. The advantages of this approach include among others:

• The private sector (partner) can initiate operations, and reach operating stability much faster than it can be with the government effort in the beginning of the project, i.e. there is a benefit of assured successful start.

• This approach is suitable for many types of infrastructures.

3.3 Status of Non-traditional Financing Options in Tanzania

The new non-traditional financing options, especially IPOs, PPP, and BOT are not yet widely used in Tanzania. Local loans syndications for public companies are as well not popular in the country, but in September 2007 Tanzania Electric Supply Company (TANESCO) managed to secure a big sum of TZS 300 billion under the government guarantee through domestic loan syndication from various local banks for capital investment. Therefore, these approaches are generally not among the major financing options for public projects in Tanzania so far.

3.3.1 Potential Resources for Mobilization by the New Non-traditional Options

Because non-traditional financing options imply the use of new instruments, we want to estimate their potential capacity to raise domestic resources for public companies via exploration of the market’s desire for investment in securities of the government. Private investors make a portfolio arrangement that allocates resources between risky and riskless assets. It is believed that investments made in securities of the government (or its entities) are safer than those made in
private securities. This belief underlies the high likelihood of the government to be able to raise domestic resources at lesser cost than the private sector could do.

On this ground, we use the government bond market to indicate from the tendered amount (as a proxy) the private sector demand for overall government long-term investment instruments. We find a difference between tendered and offered amounts to get approximated resources that the market is willing to invest in the government bonds but, nevertheless, that avenue is not at the market’s disposal.

Table 3.1 Treasury bonds market over-subscriptions, 2005 – 2008 (Million of TZS)

<table>
<thead>
<tr>
<th></th>
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</tr>
</thead>
<tbody>
<tr>
<td>Offered</td>
<td>188.0</td>
<td>208.0</td>
<td>244.0</td>
<td>213.3</td>
</tr>
<tr>
<td>Tendered</td>
<td>423.0</td>
<td>485.0</td>
<td>512.7</td>
<td>473.6</td>
</tr>
<tr>
<td>Over-subscription</td>
<td>235.0</td>
<td>277.0</td>
<td>268.7</td>
<td>260.2</td>
</tr>
<tr>
<td>Interest cost</td>
<td>101.3</td>
<td>52.4</td>
<td>55.5</td>
<td>69.7</td>
</tr>
</tbody>
</table>

Source: Bank of Tanzania

In 2005/2006, the over-subscription was TZS 235.0 billion and by 2007/2008 it had increased to TZS 268.7 billion. Over-subscription in the bonds market approximates domestic resources that are chasing the long-term investments in the government but unsuccessfully. If the government entity decided to make a PPP arrangement, for example, these financial resources would most likely move there. That is therefore the saved money which the government has to consider a way to invest it for acceleration of output growth.

As indicated in the table, the cost of government bonds declined from TZS 101.3 billion in 2005/06 to TZS 55.5 billion in 2007/08, and that has been the trend due to, among other reasons, the high demand for government securities. This is one of the indications that the economy is awash with liquidity. Normally, it is never healthy for the government to heavily borrow to finance its budget deficit, but in the market environment where there is excess liquidity, it is viable for the government through its entities to mobilize such resources; basically, for investment in development projects. A good thing with development public projects is that – if well done – they have a high repayment potential in the form of economic growth.

3.4 Non-traditional Financing Approaches

Looking at the long-term maturities of government securities overall, it is evident that the public is interested in placing its long-term investments in government assets. Bonds that are listed in the Dar es Salaam stock exchange so far include the 10-year, among other maturities. Reflecting on this therefore, the maturity structure of a new non-tax financing option can be designed such that it goes up to 10 years and above as may indicatively be learned from the market preference.

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6 Treasury bonds are chosen to reflect investment that private sector is willing to place in the public instruments particularly in the long-run.
3.4.1 Initial Public Offerings Underwriting

Because large initial public offerings (IPOs) are usually underwritten by a syndicate of banks led by a major investment bank (the lead underwriter), large public entities, especially the suppliers of amenities (electricity, water, etc.) can liaise with the Tanzania investment bank as well as other commercial banks to plan for IPOs arrangement. This is not a new financing approach in the world since there are many good examples of government utility companies that have gone public in other countries; to mention a few:

- National Hydroelectric Power Corporation (NHPC) Ltd – India
- The Abu Dhabi Water and Electricity Authority – UAE
- Mumbai Reliance Power – India
- Public Authority for Electricity and water – Oman

The underwriting process begins with a decision on what type of the offering the company needs. The business usually consults with an investment banker to determine how best to structure the offering and how it should be distributed. Securities are usually offered in either the new issue, or the additional issue market. Initial Public Offerings are issues from companies that are first going public, while additional issues are from companies that are already publicly traded.

The next step in the underwriting process is to form the syndicate (and selling group if needed). Because most new issues are too large for one underwriter to effectively manage, the investment banker (also known as the underwriting manager) invites other investment bankers to participate in a joint distribution of the offering. Under the most common type of underwriting, the managing underwriter makes a firm commitment to the issuing corporation to purchase all shares being offered. If part of the new issue goes unsold, any losses are distributed among the members of the syndicate.

3.4.2 Public-Private-Partnership Engagement

In the identified area of infrastructures the government can opt for one of the pressing needs; for example, can choose PPP for roads construction specifically. In this context, an agreement can be reached between the public and interested private organization(s) to accordingly toll the roads for compensation of those involved in their construction and maintenance. The private organizations will have to enjoy part of the revenue collected by the tolls imposed on roads under concession. Public Private Partnerships have a spectrum of models that progressively engage the expertise and/or capital of the private sector.

(i) At one end, there is a straight contracting out, and that is as an alternative to the traditionally delivered public services based on the direct execution of duties without government involvement.
(ii) At the other end, there are arrangements that are publicly administered but within a framework that allows for private finance, design, building, operating and possibly the temporary ownership of an asset.

In Tanzania the first approach has been attempted for the TANESCO and TTCL among others, but unsuccessfully. This may be because of adverse selection of those bidding for the management assignment, and/or due to the intrinsic less public control over these kind concessions. The second approach which is better in terms of control has not been practised in Tanzania.

3.4.2.1 A Case of India’s PPP Development Strategy

We select only a few important items from the case of PPP in India to illustrate how this approach can be strategized to succeed. In the group of developing countries India is one of leading economies in terms of the private investments. In pursuit of effective institutionalization of the PPP, the Department of Economic Affairs (DEA) of India facilitates mainstreaming of Public Private Partnerships through technical assistance from various institutions including Asian Development Bank. Important aspects of consideration in this study are:

(a) Eligibility of the State participation

The States wishing to benefit from a technical assistance are required to enter into a memorandum of understanding (MOU) with DEA, which details the steps that would be taken to promote PPPs in the State. The MOU requires the State Government to:

- Set up a PPP Cell as an agency for processing all PPP projects in the State with a designated PPP officer and a defined scope of work.

- Develop a robust shelf of projects amenable for PPPs and adhere to the following set of targets on the level of PPPs in the State:
  - Projects for bidding out annually in the recent years, and their values.
  - Commitment to establishment of policies, regulatory and governance frameworks in the identified infrastructure sectors to enable transparent and effective private sector participation.
  - Prepared Plan of PPP projects in conjunction with its Annual Plan.

- Commit to: (i) adopt standard concession agreements for PPP projects in defined infrastructure sectors; (ii) adopt competitive bidding procedures for bidding and awarding of infrastructure projects under defined rules and procedures according to the best international commercial practices and the government of India guidelines; (iii) designate
a State-level dispute resolution mechanism for the speedy resolution of disputes relating to PPP projects; and (iv) adopt formal State policies on environment, resettlement and social safeguards with respect to the implementation of infrastructure projects, according to best international commercial practices.

(b) Usefulness of technical assistance in PPP

Government at all levels cannot have enough technical human resources readily employed. The technical assistance aims to:

- Help the participating State to implement PPP schemes effectively and efficiently.
- Enhance capacity of PPP cells in participating entities to prepare, evaluate, and appraise PPPs in infrastructure.
- Significantly improve the monitoring of overall progress in PPPs in infrastructure at both central and state levels through well-knit databases.
- Increase awareness among potential private sector partners about the project cycle of PPP in infrastructure, and the expectations of the government with respect to value for money.
- Over the long-term, there is an increase of the private sector participation in infrastructure development and management throughout the country.

Lessons from the India’s PPP development strategy

- There must be a national PPP policy for this approach to succeed in investment development.
- The bank of public projects targeted for PPP arrangement and the targets of implementation are necessary in ensuring performance and enabling assessment of investment promotion.
- Adoption of standard concessional agreements is important to avoid unscrupulous contracts. In this view, the government negotiation skills must be enhanced, and contracts drafting must involve the respective well informed experts with the national stakeholding.

3.4.2.2 The World Bank Study on PPP for Urban Water Utilities

In 2009 the World Bank studied 65 developing and emerging economies that entered PPP in the urban water sector during the past two decades (Marin, 2009). Four dimensions of performance were analyzed: (i) access, (ii) quality of service, (iii) operational efficiency, and (iv) tariff levels were studied. The main finding is that water PPPs are a viable option in developing countries.
Despite limitations related to the data accessibility and reliability, and the ambiguity of indicators, the analysis of the four dimensions of performance suggests that the overall performance of water PPP projects has been generally quite satisfactory. Several PPP projects performed well on coverage (access), service quality, and efficiency together. More performed well in one or two key aspects. Some brought sizable improvements to the populations they served even though they proved unsustainable and were terminated early. A few others failed to achieve any meaningful results by most accounts. Note that out of 65 developing countries that embarked on water PPPs during the past two decades:

- At least 41 still had private water operators.
- 84% of all awarded contracts were still active by the end of 2007.
- 24 countries had reverted to public management, and some contracts had been terminated early following conflicts between the parties.

The argument made is that these numbers are not unreasonable considering what has in practice been a market test of a wide variety of contractual designs in many different (and often challenging) environments/countries.

The study also attempted to be broader by drawing a general picture of PPP in developing world from a total of 205 million people in developing and emerging countries that have been served by water PPP projects at some point during the past 15 years. Of these:

- 160 million people were still being served at the end of 2007, while about 45 million people had been served by PPPs that were either terminated early or not renewed at expiration.
- Among the 160 million people served by private operators in 2007, about 50 million are served by PPP projects that can be classified as broadly successful.

It worth noting that the main factors that matter for the success of these PPP from the view point of the study are: (i) contractual designs; and (ii) the willingness of the public and private partners to make it work during implementation.

Successful PPP projects exist in all regions of the developing world, including Latin America, notably in Colombia, Chile, and Guayaquil in Ecuador, Brazil and Argentina. In sub-Saharan Africa noted cases were Côte d’Ivoire, Gabon, and Senegal, while in Asia one of the success stories was the Eastern Manila (Philippines). Eastern Europe and Central Asia had good examples of Yerevan in Armenia, and the Middle East and North Africa (Morocco).
Active PPP projects whose performance was mixed or disappointing are estimated to represent a population of about 20 million. The remainder (90 million) receive services under PPP projects that were not reviewed in this study, most of these projects being recent (awarded since 2003).

3.4.3 Build-Operate-Transfer (BOT) Assignment

This is a form of public-private-partnership, but with unique characteristic of mandating the private sector a full role of undertaking a public project/service, especially during the concession period. Government involvement and control is not exercised as long as both parties adhere to the contract. Although the term BOT is the most famous one, there are several models of this approach and so BOT can take place in different ways, however, with some similar objectives. This financing option has an advantage in that it can be used where there are many customers and also where the government could become the firm’s only customer and promises to purchase at least a predetermined amount of the project's output as a way to ensure that the firm recoups its initial investment in a reasonable span of time.

3.4.3.1 South Africa’s Case Study

This case study was done in 2006 for presentation in the Economic Ministers Forum of Pacific Islands on PPP and BOT arrangements. South Africa like many other countries is faced with the problem of infrastructure backlogs and budget constraints. The case study focused on learning from the initiatives that have been implemented for the provision of public services by the private sector through Asset Procurement and Operating Partnership Systems (APOPS) in South Africa. The Department of Public Works (DPW) was engaging in APOPS since 1996. The department assigned private sector consortium the responsibility for the design, build, finance, and operate. At the end of the concession period of 25 years the projects will be transferred to the state.

The government pays the private sector periodically, money referred to as concessionaire for the compensation of services rendered. Three objectives under APOPS programme have been to secure: (i) value for money; (ii) optimal risk allocation; and (iii) affordability of service/project. These objectives have important implications on the projects financing.

Lessons from the South Africa’s case

- Based on efficiency, the service is supposed to be provided at a lower cost than the cost at which the public sector would have delivered the same level of service.

- There must be regular assessments of whether the value for money has been attained. Private sector comparator should be used to establish whether the value for money was achieved.

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7 From Pacific Islands Forum Secretariat, 2006
There is a need for the public sector comparator of the cost that private sector should incur as opposed to the cost which the public sector would otherwise incur for the same service/project. This exercise can be done at the time of request for the proposal.

Respective degrees of risk allocated to the public and private sectors have to be ascertained. Transfer of too much risk to the private sector will make the project too expensive. There has to be a model for optimum risk sharing between the parties (private and public sector).

The BOT approach is bound to succeed if there is a proper assignment of the service/project, which is not affected by a problem of adverse selection of the private partners before the contract is signed. Adherence to the governing laws and assurance of quality at affordable prices are fundamental to these kinds of projects/services.

3.5 Where the Government Can Use Non-Traditional Financing Options

The government can use the presented new approaches to enhance financing of its growth sectors. Growth sectors are the ones that either directly or indirectly have high growth potential for the economy given resources available. Krugman (1994) views the popular Asian growth miracle and says, “but there is nothing miraculous about the successes of Asia's tigers." The rise was fuelled by mobilization of resources – increasing inputs of machinery, infrastructure, and education”. This means that the sources of growth were from increasing the factors of production (i.e. physical accumulation) in the first place, and the total factor productivity as its second part.

In the view of this, if we want to enhance growth sectors of the economy we should invest in the propellers of specifically identified sectors; the propellers that are referred to as growth drivers (i.e. the catalysts or stimuli of growth sectors). The implication we get is – the government has to prioritize a few sectors (of course with the rest not neglected) and it has to finance growth drivers, particularly those which cut across (or are favourable to) many sectors. Even for the growth drivers, the government needs to narrow down to some few that it can start with especially during the time it attempts to use the new public investments financing approaches.

Growth stimuli are several, however, infrastructures (notably that of transport and communication) are an important growth catalyst cutting across the key three sectors of the economy as categorized by the United Nations and World Bank (Bosworth and Collins, 2008) comprising: (i) agriculture, the “primary sector,” with forestry and fishing too; (ii) industry, the “secondary sector,” composed of manufacturing, construction, and utilities; and (iii) the service or “tertiary sector” that covers the remainder of the economy.

We regard infrastructure as the first priority area where the government can focus the use of the non-traditional financing options. Also the government can use these approaches to finance energy and water resources as its second area of priority. These sectors are faced with shortage of capital/investment resources; however, utilities are necessary for stimulation of growth across all sectors of the economy. The selection of these two areas of concentration for the highlighted options is based on three facts: (i) the government cannot do all at one time; (ii) resources are
always scarce; and (iii) these selected areas are crossing cutting in terms of sectoral importance and also in terms of growth potential.

**IV. Tax Revenue from the Informal Sector**

This section aims to contribute to a discussion of how to raise additional tax revenue from the informal sector. The informal component of the economy is large in Tanzania, and it has to contribute adequately to the government domestic resources. The spirit here is to facilitate the more equitable widening of the tax base. With reference to some country experiences, the section suggests the way forward to raising more revenue from this sector as one of the means for improvement in domestic resources mobilization citing the importance of the formalization process currently underway.

**4.1 Scope of Informal Section of the Economy**

During the era of socialism the informal sector was, like the formal private sector, frowned upon on ideological grounds and was not openly encouraged. The “second economy”, as the sector is also known was prompted by the need to run away from extreme regulation and clampdown during the economic crisis of the end of the 1970s and the first half of the 1980s shortages of goods and foreign exchange (Malyamkono and Bagachwa, 1990). Following the gradual adoption of market-oriented policies beginning in the mid-1980s, the informal sector started growing rapidly encouraged now by the “warming up” of policy towards private sector development. Swantz and Tripp (1996) show the problems of the struggling informal sector during the era of trade liberalization in Tanzania, that is the time when bureaucratic attitudes towards private enterprise were slowly improving following the proclaimed policy commitment to the market economy was tested (Bagachwa and Ndulu, 1996).

Alluding to the difficulties of disentangling the meaning of the informal economy, Tripp (1996) distinguishes between licit and illicit informal businesses; the latter as generally scams associated with abuse of formal institutions for fraudulent purposes (e.g. drug trafficking, prostitution) even of they may be highly lucrative and spinning off jobs even. In this study the focus is on production and service activities that are hidden away from the regulatory authorities even if the commodities are not harmful to the consumers or society at large. To-date, entry into the informal sector is prompted by both “distress” and opportunity, as well as tax policy and enforcement of regulations.

*Structure of the informal economy*

Seven key characteristics of informal sector activity include:

(i) low entry costs, and general ease of entry;
(ii) unregulated and competitive markets;
(iii) reliance on indigenous resources;
(iv) family ownership of enterprises; small scale operation;
(v) labour intensive and simple technology;
(vi) skills acquired outside formal schooling system.

The easy with which an activity can move from informal to formal status or the reverse makes estimation of the precise size of the informal sector extremely difficult. Operators performing within the law today could easily "de-formalise" their operations on the next day, by hiding in the informal sector following a tightening of the regulation or a rise in the tax rate. Thus, a change in policy regime and variability in the severity of enforcement make the precise measure of the size of the informal sector difficult (UNCTAD, 2000).

In rural or peri-urban areas informal economic activities include rudimentary manufacturing, using traditional blacksmith methods in producing hand-hoes, spears, machetes, etc. Other activities take on various forms such as vending, hawking, petty trading, small and micro-scale enterprises, food manufacturing, carpentry, hairdressing, shoe repair, construction, but also selling agricultural crops outside the formal market systems and even informal networks of exchange such as bureaucratic favours, clietelism and various forms of corruption.

These products are simple and affordable for the poor. However, because of the low levels of education and technological skills, the products are of low quality. It is true that some works of art such as handicraft wares like basketry and pottery are usually more accomplished and capture the niche of export markets; but because of the weak urban-rural linkages the products do not get wide publicity. Also, of interest are commercial activities from small retail shops and local private entrepreneurs who own milling machines and small agro-processing equipment (e.g. for de-husking), transporters, repair and fabrication workshops, restaurants and small food-stalls, furniture workshops, construction, trade, that are associated with gradual development of small rural towns as growth nodes (URT, 1991; URT, 2007)

Like in other developing countries the precise definition and size of the informal sector for purposes of determining its size remains difficult. Tanzania has relied upon national surveys to approximate the size and characteristics of the informal sector, although different independent studies carry out their own designed surveys in rural and urban councils focusing on specific activities of their choice. Often the difficulty lies in capturing the “border cases”, that is, between the informal and formal, small enterprises that can easily–on the next day–slip back into informality to avoid “regulatory net”.

In Tanzania, the national Informal Sector Survey (URT, 1991) upon which a later Integrated Labour Force Survey (URT, 2007) built defined the informal sector to include the following categories of activities and size of an informal enterprise (Box 1).
Box 4.1: Defining the Informal Sector in Tanzania

For the National Informal Sector Survey the following features defined the informal sector:

(i) restricted to private sector, excluding all government and parasitical concerns and registered cooperatives
(ii) agricultural activities included in urban areas only, provided the activity was a business enterprise; fishing was included for urban and urban areas also provided the activity was undertaken as business enterprises with the objective of raining income;
(iii) enterprises with 5 or less paid employees – minimum number raised to 10 in the ILFS (2000/01) in construction, manufacturing and mining sectors;
(iv) enterprises at a market place, in a temporary structure and on a footpath, street or open space;
(v) The definition excluded certain professional type enterprises (e.g. doctors, lawyers), and enterprises using high technology or having other “formal” characteristics


The 2006 Integrated Labour Force Survey ILFS (URT, 2007) reports that the majority of workforce is employed in the agricultural sector, 77.0% in 2005/06, and that employment growth was shifting towards private non-farm activities, including informal sector employment, with 9.3% of the total workforce employed in informal sector.

Other independent survey-based studies use or cite different estimation methods to approximate the size of the sector. Recently, policy has turned on Hernando de Soto’s idea of tapping the “dead capital” through legal framework that recognises the assets of the informal economy including security of land (Becker, 2004), but most studies highlight concrete problems and solutions, including the costs of doing business and obstructionist attitudes of public officials and bribery, and lack of access to credit and managerial skills (Nelson and De Bruijn, 2004; Müller, 2005; World Bank, 2005a; World Bank 2005b, Fjeldstad, Kolstad and Nygaard, 2006). Varying degrees of constraints include infrastructural issues (transport, storage, water, electricity), institutional (low level of training, limited access to land and property rights, physical place to locate business, limited access to formal financial services, cumbersome and time-costly registration procedures, not-easy-to-understand regulations leading to high transactions costs, job insecurity and poor working environment are highlighted.

The informal sector has often been viewed as marginal and backward part of the national economy. However, by considering the motives for certain actors to enter the sector it becomes evident that it is in fact lucrative sector able to supply a sufficient outcome. Furthermore, the informal economy is in fact a largely important component of the national economy. The size of the informal sector depends on the size of the formal sector and changes with changing policy regimes as noted above. If the formal sector cannot supply jobs to absorb surplus labour and if real wages are too low, people will, seek employment within the informal sector. Thus the product of the failed economy and people seek entry into the sector due to poverty. Maliyamkono and Bagachwa (1990) estimated the informal economy to be more than half of the official GDP (25% of real official GDP in 1969 to 51% in 1985); Osoro’s estimates lie between 31% of GDP in 1990 and 48% for 2006 (Oroso 2009). It is with this basic indication of the

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8 There are direct and indirect techniques for estimating the size of the informal sector (e.g. the direct techniques use fiscal and national accounts approaches while indirect techniques use comparative estimates of labour markets, physical inputs or currency in circulation (Chipeta, 2002; Osoro, 2009; Joshi, Hasan and Amoranto, 2009).
relative size of the sector that estimations of the potential tax revenue from the sector can be made. The next problem is on how to recoup part of this “lost” revenue.

4.2 Estimating Unexploited Potential Revenue from the Informal Sector.

By our definition, the informal sector is not paying taxes. It is underground, evading taxes. One can only infer on the potential loss or otherwise unexploited tax revenue from the informal sector. The potential tax revenue from the informal sector is usually equated to the tax evaded by the informal sector operators. *It is estimated as a product of the informal sector GDP (size) and the average income tax rate in the official economy, assuming that the informal sector would be taxed at the same average income tax rate* (Chipeta, 2002; Osoro, 2009).

Curiously, an expanding non-tax paying informal economy undermines domestic revenue collection. Failure to tax growing informal sector would mean government over-taxing the formal sector. This may then lead to resentment by otherwise obedient formal enterprises and so a rise in tax avoidance. For argument’s sake, an unfair advantage is seen to be enjoyed by the informal sector which is seen to free-ride indivisible public goods financed by taxes on formal activities. As result, disgruntled formal tax payers might turn into the informal sector.

In the case of Tanzania, Osoro adopts the currency in circulation indirect method to infer on extra cash held for hidden transactions. The results, the most recent by far, show trends in evaded taxes as a percentage of tax revenue trended upwards from 8% in the mid-1970s to 12.5% in 1999 but had fallen to 9.6% in the 2006 (Table ).
### Table 4.1 Estimates of Tax Evasion

<table>
<thead>
<tr>
<th>Year</th>
<th>Evaded Tax Revenue</th>
<th>Tax Revenue</th>
<th>Potential Tax Revenue</th>
<th>Evaded tax as % of tax revenue</th>
</tr>
</thead>
<tbody>
<tr>
<td>1975</td>
<td>257.7</td>
<td>3129.0</td>
<td>3386.7</td>
<td>8.2</td>
</tr>
<tr>
<td>1976</td>
<td>335.9</td>
<td>3439.7</td>
<td>3775.6</td>
<td>9.8</td>
</tr>
<tr>
<td>1977</td>
<td>398.6</td>
<td>5333.7</td>
<td>5732.3</td>
<td>7.5</td>
</tr>
<tr>
<td>1978</td>
<td>446.7</td>
<td>5377.3</td>
<td>5824.0</td>
<td>8.3</td>
</tr>
<tr>
<td>1979</td>
<td>508.6</td>
<td>6147.9</td>
<td>6656.5</td>
<td>8.3</td>
</tr>
<tr>
<td>1980</td>
<td>593.7</td>
<td>7908.4</td>
<td>8502.1</td>
<td>7.5</td>
</tr>
<tr>
<td>1981</td>
<td>689.6</td>
<td>8502.0</td>
<td>9191.6</td>
<td>8.1</td>
</tr>
<tr>
<td>1982</td>
<td>816.1</td>
<td>12529.1</td>
<td>13345.2</td>
<td>6.5</td>
</tr>
<tr>
<td>1983</td>
<td>979.0</td>
<td>13397.9</td>
<td>14376.9</td>
<td>7.3</td>
</tr>
<tr>
<td>1984</td>
<td>1220.3</td>
<td>18482.5</td>
<td>19702.8</td>
<td>6.6</td>
</tr>
<tr>
<td>1985</td>
<td>1643.3</td>
<td>21781.8</td>
<td>23425.1</td>
<td>7.5</td>
</tr>
<tr>
<td>1986</td>
<td>2162.5</td>
<td>27406.6</td>
<td>29569.1</td>
<td>7.9</td>
</tr>
<tr>
<td>1987</td>
<td>3062.4</td>
<td>42556.7</td>
<td>45619.1</td>
<td>7.2</td>
</tr>
<tr>
<td>1988</td>
<td>4478.0</td>
<td>63083.1</td>
<td>67561.1</td>
<td>7.1</td>
</tr>
<tr>
<td>1989</td>
<td>5506.9</td>
<td>81470.7</td>
<td>86977.6</td>
<td>6.8</td>
</tr>
<tr>
<td>1990</td>
<td>6615.5</td>
<td>118257.2</td>
<td>124872.7</td>
<td>5.6</td>
</tr>
<tr>
<td>1991</td>
<td>9180.7</td>
<td>153355.6</td>
<td>162536.3</td>
<td>6.0</td>
</tr>
<tr>
<td>1992</td>
<td>18054.1</td>
<td>146200.0</td>
<td>164254.1</td>
<td>12.4</td>
</tr>
<tr>
<td>1993</td>
<td>22775.9</td>
<td>220358.0</td>
<td>243133.9</td>
<td>10.3</td>
</tr>
<tr>
<td>1994</td>
<td>30604.7</td>
<td>299898.0</td>
<td>330502.7</td>
<td>10.2</td>
</tr>
<tr>
<td>1995</td>
<td>40152.1</td>
<td>383743.5</td>
<td>423895.6</td>
<td>10.5</td>
</tr>
<tr>
<td>1996</td>
<td>49959.9</td>
<td>505354.7</td>
<td>555314.6</td>
<td>9.9</td>
</tr>
<tr>
<td>1997</td>
<td>58116.2</td>
<td>566122.6</td>
<td>624238.8</td>
<td>10.3</td>
</tr>
<tr>
<td>1998</td>
<td>73081.0</td>
<td>616284.1</td>
<td>689365.1</td>
<td>11.9</td>
</tr>
<tr>
<td>1999</td>
<td>85131.8</td>
<td>685107.4</td>
<td>770239.2</td>
<td>12.4</td>
</tr>
<tr>
<td>2000</td>
<td>95117.8</td>
<td>827788.4</td>
<td>922906.2</td>
<td>11.5</td>
</tr>
<tr>
<td>2001</td>
<td>108611.9</td>
<td>936266.8</td>
<td>1044878.7</td>
<td>11.6</td>
</tr>
<tr>
<td>2002</td>
<td>123490.5</td>
<td>1116555.5</td>
<td>1240046.0</td>
<td>11.1</td>
</tr>
<tr>
<td>2003</td>
<td>141997.9</td>
<td>1340139.0</td>
<td>1482136.9</td>
<td>10.6</td>
</tr>
<tr>
<td>2004</td>
<td>161935.0</td>
<td>1615247.0</td>
<td>1777182.0</td>
<td>10.0</td>
</tr>
<tr>
<td>2005</td>
<td>187309.5</td>
<td>1946432.6</td>
<td>2133742.1</td>
<td>9.6</td>
</tr>
<tr>
<td>2006</td>
<td>2174430.2</td>
<td>2269578.8</td>
<td>2487009.0</td>
<td>9.6</td>
</tr>
</tbody>
</table>

Source: Osoro (2009: Table 3, p.83)

The fall in tax evasion in recent years is associated with improved tax administration and government effort to curb illegal activities (Osoro, 2009). This, however, does not mean that these measures are likely to result in a complete realization of the evaded taxes. Rather, it is only possible to anticipate that a good part of the estimated evaded tax can be realized through both enticement (incentives to formalization) and enforcement. Neither is it all to be loaded upon the informal sector that it is responsible for the largely criminal evasion by knowledgeable actors who engage in rent-seeking, cheating customs etc. Rather, there is apparent “evasion” due to inability of institutional weakness or capacity of the tax authority at some point(s) in time, poor infrastructure and rudimentary business practices which make it difficult for the tax authorities to
track all activities of even formal enterprises. A part of course would be due to the resistance or inability of the informal sector to come forward, declare and pay the taxes.

Direct taxation of the informal sector, it may be argued, is extremely difficult unless there is minimum degree of formality (and operator confidence in government policy), making it possible for a number of informal enterprises to come forth for registration (perhaps in order to gain access to specific government service such as credit guarantee, business extension services etc.). As and when informal operators get enticed to a credit programme, for instance, so begins the process of “getting them listed, their addresses taken, referees noted, type of business recorded, etc.” This would be a low-key starting point, whether carried out by a non-state organization (e.g. a micro-finance government and non-governmental facilities or commercial banks and social funds such as the Tanzania Social Action Fund (TASAF) which supports community-based activities.

4.3 Strategies to Collect Taxes from the Informal Sector

Strategies to collect taxes from the informal sector have necessitated some degree of recognition of the informal sector activities. Informal sector operators may also voluntarily begin to organize, usually for the purpose of obtaining some public service or facilitation. Taxation of the informal sector then becomes possible through their association(s), since authorities can reach many enterprises or individuals at reasonable costs of tax collection. After all, not all informal operators are anti-tax even though; for many others, the reason for going informal is not to avoid taxes but to avoid the hassle of excessively complex tax and unnecessarily harsh enforcement.

Thus Everest-Phillips (2008) supports some level of formalization in order to create ‘quasi-voluntary compliance’ of MSEs (micro- and small-sized enterprises) making them contribute to state-building objectives by broadening the tax base and increasing the scope of institutionalizing state engagement with the sector in the political process.

Perceived fairness is relative but important in inducing formalisation and inducing informal operators to see ‘taxation as state-building’ (Everest-Phillips, 2008). Tax administrator attitudes, incentives and discretion can result in unequal treatment among tax payer groups. Unequal access to exceptions and prevalence of bribes make the tax system unpredictable. Stern and Loeprick (2007) propose improvements in the quality of tax administration, introducing simplified options to improve SMEs compliance, and a simple and fair tax regime (e.g. a single presumptive tax based on turnover or on specific indicators like floor space, number of employees, and electricity consumption); but also the regime would have to include safeguards against abuses. Direct taxation of the informal sector is difficult; the strategy to tax it should be phased simplification of the taxation system for micro-and SMEs so that the informal operators may see the benefits of formalising and of paying taxes. Thus the ‘presumptive assessment’ becomes a transitory method, mainly because its imposition may also help better accounting practices being adopted (Drine, 2009).

A reflection on Tanzania ought also to recognize the simple tax payer analysis to appreciate the yield for an effort directed at the informal sector. Figure 1, which is based on Kimungu and
Kileva (2007) shows that majority (in numbers) of the tax papers are small formal enterprises, but what they pay is maximum of 10% of the total revenue. On the contrary, only a few large taxpayers account for 70% of the total tax revenue. The large tax payer department (LTD) which was established in October 2001 with 100 taxpayers grew to 370 taxpayers in July 2006, contributing about 70% of domestic revenue and 38% of overall TRA collections. The aim has been to ensure that the department collects about 80% of domestic revenue with additional taxpayers in line with strengthening the operational capacity of the department.

Table 4.2: Analysis of Tax Payers – formal and informal

<table>
<thead>
<tr>
<th>Tax payer group</th>
<th>Number of tax payer groups as percentage of total</th>
<th>collected by taxpayer</th>
</tr>
</thead>
<tbody>
<tr>
<td>Formal</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Large</td>
<td>10</td>
<td>70</td>
</tr>
<tr>
<td>Medium</td>
<td>5.25</td>
<td>10 to 25</td>
</tr>
<tr>
<td>Small (SMEs)</td>
<td>70.93</td>
<td>0-10</td>
</tr>
<tr>
<td>Informal</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Formalization</td>
<td>???</td>
<td></td>
</tr>
</tbody>
</table>

Source: Kimungu and Kileva (2007)

While, for maximization of revenue effort it is important to design systems appropriate for each category of tax payers (large, medium and small), it is in this particular case important to focus on the formalization effort to get the micro-enterprises, most of which, as per the SMEs policy are informal, to move or graduate into tax-paying formal SMEs category.

Important initiatives aimed at reforming policies and institutions to integrate the informal economy into the formal economic mainstream include: the Property and Business Formalization programme ((PBFP) (popularly known as MKURABITA) which seeks to address the main obstacles that prevent property and business owners in the informal sector from joining the formal sector. The programme was formally adopted in 2004 to facilitate the transformation of property and business entities in the informal sector into legally held and formally operated entities in the formal sector. The programme mainly targets property owners in the informal sector and allows them opportunities to use their assets to access capital and other advisory services. The PBFP is being implemented in four phases: diagnosis, reform design, implementation and, capital formation and good governance.

Other high level institutional arrangements include the Tanzania National Business Council (TNBC), established by a Presidential Circular of September 2001 to provide for a forum for public/private sector dialogue and the Business Environment Strengthening for Tanzania (BEST) programme under the Better Regulation Unit (BRU). The aim is to reduce the burden of businesses by eliminating as many procedural and administrative barriers as possible and to improve the quality of services provided by the government in the private sector including
commercial disputes resolution (Sitta, 2005). This initiative is supplemented by export development and competitiveness initiatives under the National Trade Policy, fair competition law and SMEs Development Policy and national empowerment council. In 2007, Tanzania Revenue Authority (TRA) and the Zanzibar Revenue Board (ZRB) jointly compiled a booklet on the basic principles of running small business, “The Ethics of Doing Business” in tandem with the provisions of the National Economic Empowerment Policy.

4.3.1 Constraints to Effective Assessment and Collection of Tax from the Informal Sector

The constraints to effective assessment and collection of tax from the informal sector much more related to the costs of gathering and analyzing information about the informal sector activities and collection is mainly constrained again by the costs related to tracking down tax payers who by definition do not have a permanent physical address, records and are in most cases less well educated.

The costs associated with collection of data/information on informal activities of which there are currently few in Tanzania is usually borne by government and sometimes supported by development partners. Existing national surveys mentioned above (e.g. the Informal Sector Surveys and Integrated Labour Force Surveys provide information about specific activities, location and output as well as operator attributes such as level of education. This may not be regarded as a constraint to assessment of tax capacity of the informal sector; rather an appreciation is made of the fact that the information elicited of the informal operators’ incomes, output or sales would usually be taken with caution as to its exactness (for two possible reasons – (a) unwillingness to reveal the entire operations/sales/output if the operator suspects a tax would follow (b) out of lack of systematic records the operator would have a tendency to under-report, having in mind (a) also). The assessment of taxable capacity based on this information (apparently the best starting point) would need fine-tuning thereafter.

The actual constraint lies in tracking the informal operators, once identified, when it comes to revenue collection, for a number of reasons:

(i) Unwilling payers or when not able to pay, the informal operators may shift from one physical address to another – the cost of tracking them becomes high.

(ii) The informal operators are themselves dispersed and not necessarily located in one geographical area. It is expected, however, that since majority of the informal operators are located in urban areas, the costs of tracking them would be relatively cheaper in urban than in rural areas (excepted regions are few cases such as parts of Kilimanjaro Region, Kagera and Mbeya). Logistic would otherwise be costly for the tax authority who weighs the returns (collections) against manpower input and logistic costs of tracking a shilling (productivity).

(iii) Verifying the size or scale and assessing the appropriate tax liability firm by firm, especially for the informal operators who do not keep books of accounts.
Collection may be hampered (or facilitated) by the mode of payment, frequency of collection/filing. Not many informal operators would have an account with the bank. However, even when they have to pay in cash at the counter, the paper work and procedures have to be reasonably short; otherwise, the tax payers finds the costs of compliance too high to bear and opts out of this level of formality.

The relationship between a taxpayer (both formal and informal operators) and the tax authority (central and local government) is important for inducing tax compliance (from willingness to be assessed and readiness to pay). Both sides take this as contractual, with individuals paying taxes in exchange for a commensurate quantity and quality of goods and services. Where there is mistrust or where the tax payer, considers that enforcement is too harsh or unfair, cooperation and morale of the tax payer wanes, with the latter resorting to tax evasion schemes. Voluntary compliance is prompted by the citizen’s assessment that the (local) government is providing the required service. Coercion is built-in with both sides’ knowledge, to detect non-payment of taxes due. What is important is that the sanctions against defaulters should be fair and not so oppressive as to create mistrust (which might lead to evasion and costly collection measures on the part of government) or tainted with unfairness as to prompt feelings that bribes are involved (cost to government and obedient tax payers).

Fjeldstad (2006), for instance, in a survey of citizens’ views of ordinary people of local government taxation in Tanzania finds that the reasons for non-compliance include:

(i) The feeling by the citizens that they receive little in return for taxes paid in terms of services from (local) government (primary schools, water supply and road maintenance, law and order and the market place, garbage collection, agricultural extension services), and with the attitude that “all civil servants are corrupt and they protect each other”.

(ii) Oppressive, uncompromising and non-transparent approaches to collecting taxes, fees and charges affect citizens’ attitudes towards taxation and actually foster tax resistance and disrespect for the laws.

(iii) Citizens’ lack of access to information on taxes collected and how revenues are spent inhibits accountability, transparency and participatory governance. Very few of the respondents had seen any information about local government finances. This turned off taxpayer interest.

These three reasons matter to all tax payers but much more strongly amongst the SMEs and informal sector operators who are usually targeted by authorities as most likely offenders. The informal operators find themselves in constant fear and hence ready to exploit any loophole to evade or avoid the taxes. Otherwise, it is easier for the informal sector firm to drop from attempts to grow into a formal SME or even for formal SME to slide back into the informal economy shadow.
When confronted with such regimes, informal sector operators seek to exploit tax loopholes or otherwise stay away from the mainstream tax system altogether. Tax loopholes relate to laws that can be exploited to evade a tax liability (violating the law) or otherwise tax avoidance (if law is not being violated). Such situations arise due to differential tax treatment across activities and groups of tax payers and time. The loopholes, as discussed by Mugoya (2009) are important for the development of nascent firms in the informal sector, firms which aim to grow. Authorities would thus have to keep an eye on the incentives provided for business start up (e.g. treatment of incorporated and unincorporated business with the latter attracting a further 10% tax on dividend upon making profit which the unincorporated business does not have to pay).

In addition, formalization interventions would be welfare-blind or anti-welfare if authorities eyed on the tax revenue and left out the “working conditions” of employees in the informal sector as elsewhere in the formal sector (both private and public sector). Why workers in the informal sector are underpaid is not only because they are most likely less productive or less educated/trained than their counterparts in the formal sector, it is often that the operator wants to avoid taxes or contributions that are related to hiring labour.

The government has to incur cost of enforcing existing regulations that protect labour considering especially the minimum wage legislation and employer contribution to workers’ social security.

On the macro-level, authorities would also need to weigh the cost of the “formalization incentive packages” in terms of what it takes to design and deliver the business support programmes to informal (if these are not provided by volunteer organizations) and establishing if the targeted informal operators use these services at all.

4.4 Enhancing the Taxability of the Informal Sector

4.4.1 Reduce the Burden on SME Taxpayers to Make Formalising Attractive

Rather than speak to the informal sector as such, our focus is on the SMEs (as argued earlier), with the view that this is the next stage which the formalization process will see the informal sector operator move into next. Inching close to the SME stage for the informal sector operators is the ideal situation where several operators come together into an association or organization so that individual operators can access a service under “group security”. Otherwise, individual informal operators will increasingly embrace formalization of their activities into a formal SMEs and access services of government and other non-state actors.

Thus the proposed tax system (which is by no means new), has an express aim of fostering the growth of small and medium enterprises and/or reduce bureaucracy that faced these firms (or aspiring informal sector operators at the bottom).

The elusive nature of the informal sector makes it less easily traceable and, as argued above, best practices in quality tax administration of the formal SMEs followed by the micro-enterprises,
will complement institutional efforts to attract the informal operators to come into the open. The tax system must be simple although, as noted above, authorities will always be watchful of the costs of delivering the best formalisation incentive package. It does mean use standard measures for overall effectiveness of a tax administration need to be brought into the picture with a purposive intention to get them simplified and applied on “zonal basis” (urban versus rural, city/town centre versus peri-urban areas, and by sector/activity).

4.4.2 Institutional Requirements for Effectiveness

To be effective the authority must prove, to the general public and in particular to the informal sector operators, its image as a responsive and not repressive organization (image of government) and to be fair and as anti-corruption. This is where the informal sector confidence would start. Overall, also, the tax procedures should be simple and regulations and procedure clearly defined, with few tax rates easy to manage, leaving no fraudulent manipulation. The tax policy measures and administration should contain key attributes.

4.4.2.1 Tax Policy Measures

Accordingly a special tax regime would be appropriate with rate structures, incentives and accounting rules. The tax regime should have the following features:

- special provisions on (exemption from VAT) registration; operators with turnover under specified threshold amount given further consideration; informal sector operator for special exemption for a given (grace) period
- Simplified recordkeeping and/or accounting rules (softer for informal sector operators – supported by massive education on the matter in a “business support package”; could be assisted by tax department officials extending support)
- Single tax for small taxpayers combing all types of taxes (income, VAT, etc.)(informal sector to benefit in terms of planning)
- Presumptive tax based on the size, location, and type of business activity for small enterprises
- Tax incentives, or relief from taxation based on new business investments.

4.4.2.2 Tax Administration Measures

- Simplified Registration and a Taxpayer Identification Number (TIN). TIN became operational in July 2002 and was by the end of December 2008 had been rolled out to all Mainland regions and Zanzibar, with a total of 433,959 taxpayers (excluding employees) registered.
- Transparency of tax administration policies and procedures - with limited exemptions, uniform procedures, regulations, and certainty or stabilized routines
- Skilled, ethical staff
Increased taxpayer assistance and educational programmes (with advanced users electronic filing)

Tax Return Simplification - use of “plain language” tax returns and instructions, with instructions provided free of charge.

Frequency of return filings: period to be set according to the ability of payers, assessed best when the category of informal operators is consulted through their association; depending on the type of activity (e.g. cottage manufacturers, vendors, food stalls) – following an analysis of the seasonality of the activity.

Simplified record-keeping: Small business taxpayers should not be subjected to the same recordkeeping as large corporations. Small business taxpayers should be permitted to use cash accounting methods

Single Return for Employment Taxes. A single return can be used by employers to report all employee wages; all employer withholding for income tax and social taxes (pension, health, unemployment, etc.), and employer contributions for social taxes.

Special assistance to new Business Taxpayers. Provide all the necessary information, tax returns and instructions – some “Small Businessman’s Kit” for image building.

Creation of Business Advisory Panels – or some forum for business taxpayers to voice their concerns over tax administration procedures or practices and to suggest practical alternatives, and as sources of input into new procedures the administration is planning

Liaison with Chambers of Commerce and Business Associations. Informal operators in a locality or those dealing with a certain type of business may organize into an association as mentioned earlier.

Penalty waivers e.g. late filing penalties caused by natural disasters and other circumstances over which the taxpayer has no control

Tax amnesties to move taxpayers from the shadow economy onto the tax roles or to bring registered but non-compliant taxpayers current in their tax obligations a tax amnesty programme can be considered (Bauer 2005).

TRA collections from the presumptive tax from the small businesses though small (Mutakyahwa 2009) stand a chance of being improved. Prior to July 2004, both the VAT and Income Tax Departments dealt with small taxpayers respectively through the stamp duty on receipts and the presumptive income tax regime (Shekidele 2008). In the same year (2004) the presumptive scheme was rationalized by introducing a new simplified tax schedule for small business taxpayers to make it easier for informal sector operators (including start-up businesses) to register, formalize and start paying taxes (under paragraph 2 of the First Schedule to the Income Tax Act, 2004 (Cap 332 RE 2006). The specific objectives are described as:

- To rationalize turnover tax regime.
- To increase an administrative efficiency by minimizing real resources needed by TRA to administer income tax and stamp duty payable by small businesses separately.
- To enhance compliance by minimizing time and trouble expended to fill in the relevant forms and up and down movements to TRA offices every month.
To eliminate avenue for evading taxes through submission of false sales declarations by taking advantage of sections 9 and 10 of the Stamp Duty Act, 1972.

To solve the problem of evading paying Stamp Duty by taxpayers once they pay income tax.

The simplified tax regime is applicable to small business taxpayers (SBTs).

In Tanzanian context SBTs refer to all resident sole proprietors with business gross turnover not exceeding TShs 20,000,000 (USD 14,981.27) per annum.

The system has had a very good impact on the number of registration albeit with the small income tax contribution. As of December, 2008 a total of 300,530 small taxpayers were registered, accounting for 69.3% of all taxpayers.

During the period from July to December, 2008 tax contribution of SBTs to total tax accounted for only 0.68%, whereas their contribution to total tax revenue collected by TRA was only 0.28%.

Administrative difficulties of pursuing micro and small and medium enterprises and the fact that very few of these enterprises keep records improve over time as efforts continue to inculcate the culture of compliance.

V. Basic Projections and Recommended Actions for the Medium-Term

5.1 TRA-based Projections

The projections of revenue in TRA’s Third Corporate Plan 2008/09-2012/13 cover the first three years of MKUKUTA2 (2010/11-2014/15). The terminal data of MKUKUTA2 coincide with that of the Millennium Development Goals (MDGs) and attainment of both sets of goals is predicated on rising public spending. According to the corporate plan, attainment of TRA’s projections demands cost efficiency in collection, along with broadening the tax base by improving the Block Management System (BMS), further modernisation of TRA operations, quality customer service, promoting voluntary tax compliance and enhancing staff management system as well as supporting Local Government Authority in terms of capacity to collect taxes efficiently. The plan envisages strengthened Domestic Revenue Department for more efficient collection of taxes from Medium and Small Tax Payers and improved service to large tax payers, more simplified tax structure and reduction of the loopholes for tax evasion. The projections take into account the baseline forecast and the impact of tax reforms that are expected to be implemented during the period as well as the revenue gap recovery over the period. With 2007/08 target collection of TShs 3,333.1 billion, the first corporate plan (2008/09) was assumed to net TShs 4,375.1, or growth of 33.3% (TRA 2008). Table 5.1 shows the projections of revenue collection for the corporate plan period mainland Tanzania.

With respect of regional and global integration, TRA projections take note of the on-going issues that may affect revenue performance – such as loopholes for tax evasion and avoidance for which the authority improves compliance surveillance. However, in terms of regional groupings (Such as EAC, SADC) the authority acknowledges that revenue losses would be declining over
time; but in the case of AGOA and ACP-EU EPA the tax losses would be minimal (TRA 2008:19-20). Any new rates in an East African Common Market (if and when it starts) may not dislocate the projections since the new negotiated rates (so far not agreed) are not likely to deviate from those applied by TRA for domestic revenue.

Table 5.1: Tax Revenue Projections for Corporate Plan Period 2008/09 -2012/13 Mainland (billion TShs)

<table>
<thead>
<tr>
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</tr>
</thead>
<tbody>
<tr>
<td>GDP at Mkt prices</td>
<td>25,616.0</td>
<td>29,234.3</td>
<td>33,485.9</td>
<td>38,374.9</td>
<td>43,977.6</td>
</tr>
<tr>
<td>Revenue Yield</td>
<td>17.1%</td>
<td>17.5%</td>
<td>18.4%</td>
<td>19.3%</td>
<td>20.3%</td>
</tr>
<tr>
<td>Total Revenue (1+2+3)</td>
<td>4,375.1</td>
<td>5,112.5</td>
<td>6,160.1</td>
<td>7,406.4</td>
<td>8,936.8</td>
</tr>
<tr>
<td>3. Reforms</td>
<td>202.3</td>
<td>219.7</td>
<td>238.5</td>
<td>258.4</td>
<td>285.0</td>
</tr>
<tr>
<td>% of Reforms to GDP</td>
<td>0.79%</td>
<td>0.75%</td>
<td>0.71%</td>
<td>0.67%</td>
<td>0.65%</td>
</tr>
<tr>
<td>2. Gap Recovery</td>
<td>24.8</td>
<td>29.8</td>
<td>35.8</td>
<td>42.9</td>
<td>51.5</td>
</tr>
<tr>
<td>% of Gap Recovery to GDP</td>
<td>0.10%</td>
<td>0.10%</td>
<td>0.11%</td>
<td>0.11%</td>
<td>0.12%</td>
</tr>
<tr>
<td>1. Total Net Baseline Revenue &amp; TVCs)</td>
<td>4,147.9</td>
<td>4,863.0</td>
<td>5,885.9</td>
<td>7,105.0</td>
<td>8,600.3</td>
</tr>
<tr>
<td>% of Net Baseline Revenue Forecast to GDP</td>
<td>16.2%</td>
<td>16.6%</td>
<td>17.6%</td>
<td>18.5%</td>
<td>19.6%</td>
</tr>
<tr>
<td>Treasury Vouchers (TVCs)</td>
<td>43.7</td>
<td>43.7</td>
<td>43.7</td>
<td>43.7</td>
<td>43.7</td>
</tr>
<tr>
<td>Total Net Baseline Revenue</td>
<td>4,104.3</td>
<td>4,819.3</td>
<td>5,842.2</td>
<td>7,061.4</td>
<td>8,556.6</td>
</tr>
<tr>
<td>Total Refunds</td>
<td>147.3</td>
<td>192.9</td>
<td>238.2</td>
<td>294.5</td>
<td>367.4</td>
</tr>
<tr>
<td>Baseline Revenue Forecast</td>
<td>4,251.6</td>
<td>5,012.2</td>
<td>6,080.4</td>
<td>7,355.9</td>
<td>8,924.0</td>
</tr>
<tr>
<td>DIRECT TAXES</td>
<td>1,365.3</td>
<td>1,645.8</td>
<td>2,001.7</td>
<td>2,447.2</td>
<td>2,996.9</td>
</tr>
<tr>
<td>Employment Taxes</td>
<td>695.6</td>
<td>835.7</td>
<td>1,014.2</td>
<td>1,236.1</td>
<td>1,509.6</td>
</tr>
<tr>
<td>Corporate</td>
<td>481.5</td>
<td>585.2</td>
<td>715.3</td>
<td>879.1</td>
<td>1,081.6</td>
</tr>
<tr>
<td>Other Taxes</td>
<td>188.3</td>
<td>225.0</td>
<td>272.2</td>
<td>332.0</td>
<td>405.7</td>
</tr>
<tr>
<td>INDIRECT TAXES</td>
<td>2,886.2</td>
<td>3,366.4</td>
<td>4,078.7</td>
<td>4,908.8</td>
<td>5,927.1</td>
</tr>
<tr>
<td>Consumption taxes</td>
<td>1,048.6</td>
<td>1,207.9</td>
<td>1,502.2</td>
<td>1,825.7</td>
<td>2,234.8</td>
</tr>
<tr>
<td>Excise Duty - Domestic</td>
<td>280.9</td>
<td>337.5</td>
<td>405.9</td>
<td>487.1</td>
<td>591.4</td>
</tr>
<tr>
<td>Beer</td>
<td>115.0</td>
<td>139.4</td>
<td>167.9</td>
<td>202.4</td>
<td>244.3</td>
</tr>
<tr>
<td>Cigarettes</td>
<td>67.5</td>
<td>78.3</td>
<td>93.5</td>
<td>110.1</td>
<td>135.1</td>
</tr>
<tr>
<td>Soft Drinks</td>
<td>23.8</td>
<td>28.8</td>
<td>34.5</td>
<td>41.4</td>
<td>49.9</td>
</tr>
<tr>
<td>Mobile Phones</td>
<td>55.1</td>
<td>66.3</td>
<td>80.4</td>
<td>97.6</td>
<td>118.6</td>
</tr>
<tr>
<td>Other</td>
<td>19.5</td>
<td>24.7</td>
<td>29.7</td>
<td>35.8</td>
<td>43.5</td>
</tr>
<tr>
<td>VAT Domestic</td>
<td>686.2</td>
<td>773.3</td>
<td>938.5</td>
<td>1,147.3</td>
<td>1,410.4</td>
</tr>
<tr>
<td>Beer</td>
<td>73.2</td>
<td>87.2</td>
<td>104.9</td>
<td>127.3</td>
<td>155.5</td>
</tr>
<tr>
<td>Cigarettes</td>
<td>28.0</td>
<td>33.7</td>
<td>40.5</td>
<td>49.3</td>
<td>60.2</td>
</tr>
<tr>
<td>Soft Drinks</td>
<td>19.9</td>
<td>23.7</td>
<td>28.5</td>
<td>34.6</td>
<td>42.3</td>
</tr>
<tr>
<td>Others</td>
<td>565.1</td>
<td>628.7</td>
<td>764.6</td>
<td>936.1</td>
<td>1,152.5</td>
</tr>
<tr>
<td>Other Domestic Taxes</td>
<td>81.4</td>
<td>97.1</td>
<td>157.8</td>
<td>191.2</td>
<td>233.1</td>
</tr>
</tbody>
</table>

A further two years were extended on the TRA projections to complete MKUKUTA2 (end of the MDGs). The same base 2007/08 and information on revenue collection since 2003/04 are plotted together. The estimates for the two last years of MKUKUTA2 have been derived on the assumption that GDP at market prices will grow at 15% compared to 14% at the end of TRA
projection period and that the revenue yield will peak and flatten out at around 20% (for the 2013/14 and 2014/15 years). Figure 5.1 plots the projections to 2014/15.

The current financial and economic crisis has since 2008/09 begun to feature in slowed down growth in real GDP; but this is expected to change for the better in the next three years provided the judicious investments are directed towards critical sectors, as is the intention of MKUKUTA2 and MKUZA, which identify focus on “growth drivers” (for key sectors (infrastructure, agriculture, mining, manufacturing, trade), growth promoting tax reforms, expansion of the tax base as well as increased efficiency of tax collection as in the third corporate plan.

**Figure 5.1 Figure Projections of Total Revenue up to 2014/15 (Tshs billion)**

The long-term objective remains to reduce the relative significance of external aid in total resource envelop (external grants assumed to decline from 6% of GDP in 2009/10 to 4.5% by 2014/15, and assuming that aid is used effectively.

### 5.2 Econometric Forecasts to the Next Six-Years

The present study approached the projections from yet another perspective. The forecasts are derived from econometric estimations of the data for a 20 years period 1990–2009. It is assumed

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9 This may sound too optimistic or too early for the revenue yield to have peaked that high by 2014/15. From Kim and Saito (2009:12), about 20% would have been attained by 2017/18.
that non-tax revenue will continue to grow on average at 17% \((the\ past\ two\ decades’\ average)\). With the current global financial crisis, Tanzania’s economic growth is expected to decline by not more than 2%, and will recover in the next two to three years if policy measures already taken continue to be implemented. The average growth rate of tax revenue for the period will come closer to the recent past average of 19%. Note that between 2008 and 2009 Tanzania’s tax revenue growth rate decelerated by 15.5%, registering growth of 10.9% in 2009 down from 26.4% in 2008. Table 5.2 indicates expected government revenue collection up to 2015. Projections show that tax revenue will rise from TZS 4,179,812 million in 2009 to TZS 9,671,454 million in 2015.

### Table 5.2: Recent Government Revenue Collections and Forecasts (Million TZS)

<table>
<thead>
<tr>
<th></th>
<th>Actual</th>
<th>Projections</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax revenue</td>
<td>1,756,211</td>
<td>2,212,869</td>
</tr>
<tr>
<td>Non-tax revenue</td>
<td>158,334</td>
<td>176,838</td>
</tr>
<tr>
<td>Total</td>
<td>1,914,545</td>
<td>2,389,707</td>
</tr>
<tr>
<td>Growth TR</td>
<td>26.0</td>
<td>34.7</td>
</tr>
<tr>
<td>Growth NTR</td>
<td>11.7</td>
<td>27.5</td>
</tr>
</tbody>
</table>

\(TR = \) Tax revenue  
\(NTR = \) Non-tax revenue  
Source: Based on annual calendar year financial data for the period 1990-2009.

The two sets of projections are not too far apart considering the differences in the methods: TRA projections are based on financial year data over the recent years and concrete analysis of the anticipated policy reform and institutional improvements that can more realistically be expected to hold over the medium term. The second set is based on annual data for the past 20 years (run on an econometric estimation) and drawing therefore on underlying long-term trends. These differences in the projections may thus be explained but it is worthy noting that the two provide the “best-case scenario” (TRA) and the “worst-case scenario”, with a suggestion that performance may lie between the two – for instance – that by 2014/15 (TRA) or 2015 (authors’ estimation), revenue collection would lie between TShs 9 and TShs 11 trillion.

Both cases thus suggest a need for a big push in revenue generation; but TRA’s projection (with two additional years up to 2014/15 is recommended as a performance reference, however high exacting they look; this is in order given the enormity of effort needed to embark on MKUKUTA2 with its focus on infrastructure and “growth drivers” and come closer to the MDGs as much as possible.

### 5.3 Measures and Issues for MKUKUTA2

This sub-section consolidates from the discussion above of tax, non-tax and informal sector taxable capacity sections) measures that should be taken in the course of the next five years (medium-term) as the country embarks on MKUKUTA2, some of which measures would be useful even in the subsequent years for the long-term goal of reducing aid dependency.
5.3.1 Widening tax base and collections

(i) **Addressing low compliance which erodes the tax base:** One of the major impediments to domestic resources mobilization is a narrow tax base. Among the outstanding factors that erode the tax base is low compliance resulting from tax evasion caused by high tax rates, inefficient tax administration, multiplicity of taxes, ambiguous tax legislation, too many contact of tax collectors with taxpayers, misuse of public funds, corruption, and dishonesty, among others. The other main source of erosion of tax base is fiscal incentives in the form of tax relief and generous exemptions. These need to be reviewed periodically to detect and rectify problems in collection. The emphasis should be to minimize the loopholes of both evasion and avoidance; and also closing all the rent seeking opportunities available to the tax collectors.

(ii) **Enhance collection of user fees of public utilities and services:** – notably that of energy and water supply providers – should be adequately collected. This is possible if: enforcement ensures that every user pays effectively according to stipulated rates; charges are rationalized; financial management is improved at the collection points; and formalization of the potential sources of revenue (including businesses and natural resources extraction) is done.

(iii) **Natural resources-based activities:** Efforts of including all sectors of the economy in the tax-net and their resultant outcome in terms of revenue collection should be made together with the correction of distortions due to lapses in governance in the management of these resources through corrupt practices) as well as revenue-sharing between central and local governments. The extractive activities concerned are mainly mining, fishery, forestry, land use etc. The retention formula for sector MDAs may be revisited (at least as matters stand, the formula is not uniform. These are sources of concern for sustainable domestic revenue collection and an area for consideration in the MKUKUTA2.

(iv) **Exploit property tax potential:** This is one of the areas with a lot of uncollected revenue and the government can exert effort to mobilize the remaining potential. Of course it may imply more collection cost but it is profitable if effectively done. Ministry of Lands and Human Settlements and local government authorities would be helpful in the designing of an appropriate approach.

(v) **Review tax relief policy:** The way forward is to target minimization of some unnecessary generous exemptions. Non-tax incentives to investments should be more preferred to tax incentives.

(vi) **Enhance revenue collection through provision of proper tax information and education:** The role of information in increasing revenue is emphasized. Proper information about the tax base, rates, exemptions, tax assessment computational methods, etc. is among the good incentives for the payers to comply.
(vii) **Desist from a tendency to raising tax rates:** It is imperative to target bringing into the taxpaying group the more new payers as time goes rather than targeting to raise revenue from increasing the rates, which is obviously a disincentive to taxpayers’ compliance.

### 5.3.2 Use non-traditional financing options

(i) **Organize Local Loans Syndications:** Some government development projects like infrastructures are expensive and they need large sums of money in a short period. Loan syndications are an alternative non-tax financing opportunity as some banks join together to finance a large public project under a certain arrangement.

(ii) **Engage in Public-Private-Partnership (PPP):** The government can combine its investment in public infrastructure assets with operational efficiency of the private management in the form of PPP. Financing infrastructural projects is expensive and returns are contingent on management efficiency. Private management of projects is often more effective than public management and in this context of PPP, the government can work to reduce resources misuse especially after collection if PPP is adopted judiciously.

(iii) **Assign Build-Operate-Transfer (BOT) projects:** Provide private entities with concessions to design, construct, finance, and operate public facilities. The advantages of this approach include, among others: the private sector (*partner*) can initiate operations, and reach operating stability much faster than it can be with the government, i.e. there is a benefit of assured successful start; and this approach is suitable for many types of infrastructures.

(iv) **Use Initial Public Offerings (IPOs):** The government has a space for its organizations/authorities especially those of energy and water supply to go public for their financing. This is a method adopted in many countries and Tanzania can have a number of success cases from which it can learn.

### 5.3.3 Formalize and raise more revenue from informal sector

**Attracting the Informal Sector:** This study widely discusses how to raise additional tax revenue from the economy’s informal sector, emphasizing the importance of the formalization process currently underway. Apart from the delivery of incentive packages to encourage informal sector operators to come forward, register and pay taxes, specific tax policy measures along the presumptive tax scheme should be intensified.

(i) Improve the business environment for the SMEs to attract informal operators, particularly upcoming micro-enterprises.

(ii) Continued efforts to administer the presumptive tax system with clearly articulated incentives for compliance. In focus is the Block Management Scheme that should be improved upon.
5.3.4 Response to Ongoing financial crisis

To mitigate the likely effects, Tanzania should ensure: macroeconomic stability; judicious banks regulation; establishment of credit rating institution; investment in social protection; improvement of domestic sources of revenue; and encouraging the private sector to invest in the areas of the country’s comparative advantage, *inter alia*. The following measures need to be done:

(i) Ensure continued investment by reducing cost of investing and doing business. This can be achieved by: (a) eliminating red tape and bureaucracy in investment promotion together with improvement in facilitation services to local and foreign investors; (b) bring down cost of utilities (including power, water, communications) and cost of credit; (c) Ensuring protection of assets and income arising from investment

(ii) The government continuing to invest in infrastructure development while ensuring adverse impact on macroeconomic stability is mitigated: This can be achieved: (a) by identifying new alternative sources of financing the huge infrastructure development cost – local bonds issuance; (b) Leverage private sector resources in PPP infrastructure ventures.

VI. Concluding Remarks

The objectives of this study were: to identify the potential space for improvement of domestic resources mobilization; to draw the guidelines for domestic resources mobilization; and to analyze various possible effects of internal and external shocks on the government revenue. The study outlines briefly the possible internal and external shocks that are likely to affect the government’s revenue in the next few years. Such shocks include: changes in weather; changes in the consumers’ tastes; and electricity shortage as the main internal shocks, while the relevant external shocks include: changes in the oil and food prices; changes in export prices; and global economic and financial crisis.

Importance of sectors to contribution of the government revenue is studied. It is observed that contribution to the government revenue is not necessarily determined by the size of the sectors as indicated by their shares in the GDP. Analysis of sectoral contributions shows that services constitute the largest sector in the economy, which produced around 47% of GDP in 2007, while the second is agriculture, hunting and forestry as one sector, which produced 25% during the same year. Industry and construction follows, with the major contributor in this sector being manufacturing, which accounted for 9.2% of GDP in 2007.

Although there is a large potential for non-tax revenue in Tanzania, so far the government earns less than 2% of GDP from this sources, and it accounts for less than 10% of the total revenue collection per annum. It is time, however, to venture to other potential domestic non-traditional sources of revenue. In this study we consider some new sources that can be harnessed to finance government projects, including the Public-Private-Partnership (PPP); Initial Public Offerings
(IPO); Loans Syndications; and Build-Operate-Transfer (BOT). Most of these are not yet widely used in Tanzania. However, attention is drawn to the limited capacity of the human resources and institutions for the country to master and manage often intricate contractual arrangements/obligations involved.

The government can use recommendations presented in Section 5 to enhance financing of its growth sectors and their catalysts/drivers; the sectors which have either direct or indirect potential for high growth of the economy, given the resources available. The objective was to assess the ways the government could improve tax and tax revenues as well as bringing to the government’s attention some new no-traditional methods of domestic financing. Our recommendation is that the government will need to only rationally differentiate tax rates but to undertake more redistribution function from the expenditure side. This will have a direct impact on poverty as collected revenue will be channelled to helping the poor through financing of poverty alleviating activities/projects.
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