Local government taxation and tax administration in Tanzania

Odd-Helge Fjeldstad and
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Summary

Local taxes represent less than 5 per cent of total tax revenues in Tanzania. However, the large number of these taxes, together with their unsatisfactory nature, means that their economic, political and social impacts are considerably more significant than their figure implies. This report reviews the main characteristics and impacts of the existing local tax system. It discusses how the present tax system emerged, and why it has been maintained for such a long period in spite of all its weaknesses. Furthermore, it considers options for reform. An important component of the ongoing decentralisation reform in Tanzania is to increase the fiscal autonomy of local authorities. This policy is encouraged and partly initiated by the donor community. The above findings suggest that care must be taken in implementing this policy. It is unrealistic to expect that the present administration in many local authorities has adequate capacity and the required integrity to manage increased fiscal autonomy. In fact, there is a real danger that in the absence of substantial restructuring of the current tax system combined with capacity building and improved integrity, increased autonomy will raise mismanagement and corruption.

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Bergen, July 1999

Odd-Helge Fjeldstad
Chr. Michelsen Institute

Joseph Semboja
Research on Poverty Alleviation

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Executive summary

1 Introduction

1.1 This report is aimed at contributing to the ongoing debate on fiscal decentralisation – the devolution of taxing and spending powers to lower levels of government - in Tanzania. It explores the main characteristics and performance of the existing local revenue system, and presents options for reform.

1.2 Improved understanding of the reasons and mechanisms that lead to deteriorating fiscal situations of local governments is important for the ongoing reform exercise. This knowledge is also relevant to aid policy, especially in the areas of institutional support for strengthening public administration, including tax administration.

1.3 The report draws on the findings of research carried out through 1996 to 1998. The fieldstudies were conducted in Kibaha District Council, Coastal Region, and Kilosa DC, Morogoro Region. These studies aimed at providing primary data and analyses of the capacities and constraints of the local tax administrations, especially in relation to tax design, revenue collection, incentive problems and service delivery. In addition, data on tax revenues for about 50 councils were collected from the Ministry of Local Government in Dodoma. Data on central government taxes were acquired from the Ministry of Finance and Tanzania Revenue Authority.

1.4 In the following sections we briefly summarise the findings of the study and their implications for the ongoing local government reforms.

2 The current local government revenue system

2.1 Local authorities levy a large number of taxes, licences, fees and charges. For instance, in one council studied more than 60 different revenue bases were applied, not including the various sub-groups of individual taxes and the various tax rates in use. Moreover, large variations exist among councils with respect to the number of revenue sources.

2.2 The distinction between taxes, licences, charges and fees is often unclear. A number of levies are referred to as charges although they are really more like taxes, since no service is rendered directly and exclusively to the payer. In addition, a wide variety of fees for forms and permits exist. The primary purpose of such permits is for regulation, although in many councils they have become mainly a source of local revenue rather than a control mechanism.

2.3 In spite of the large number of revenue sources, four main sources are crosscutting almost all district councils. These are *development levy*, *crop and livestock cess* (agricultural cess), *business licences* and *market fees*. In 1997 these sources accounted for, on average, about two-thirds (66 percent) of the tax revenues in 42 district councils studied. Development levy dominated by contributing 30 percent of total own revenues, followed by agricultural cess (22 percent), business licences (about 9 percent) and market fees (5 percent).

2.4 In a sample of 10 urban councils, the major own revenue bases in 1997 were licences (33 percent), property tax (21 percent) and development levy (19 percent).

2.5 Large annual fluctuations in the revenue generation of councils are observed. For rural councils, these variations may partly be explained by fluctuating weather conditions since produce cesses are important revenue sources. In addition, we found indications of revenue shortfall in some councils in election years, particularly with respect to development levy. This may be due to the influence of politicians (both of the local and central governments) who advise (or order) the local tax administrators "to relax on tax collection" and "not to harass taxpayers" during election years.

2.6 The trend describing fluctuations in local government own revenues does not follow a linear path, but is better described by a polynomial function (i.e., wave-like or undulating). However, in contrast to other studies which argue that there is a general declining trend in the real value of local government own revenues, we find no general trend. From a sample of about 50 councils the trend during the period 1992-95 was declining for some councils, while it was increasing in real terms for others.

2.7 The offices of the council treasury (revenue section in particular), the ward executive officer (WEO) and the village executive officer (VEO) are the official tax collection centres. In principle, revenues are recorded at all three collection points, and the books are subject to auditing. In practice, records are often inaccurate and poorly organised. Data on specific revenue-generating activities at particular collection sites are rarely kept. Inconsistencies were found between the revenues recorded by the village executive officers and the records at the ward level. There were also inconsistencies between the records of the ward and district levels. In general, budgeting, reporting and auditing practices are weak in the councils studied.

3 Qualitative characteristics of the local government revenue system

3.1 Many local taxes perform poorly with respect to the basic principles of taxation. However, these issues do not appear to be recognised by most local governments, whose main concern simply seems to be to increase local tax revenues - at almost any cost. This concern has been encouraged by calls from the central government to local authorities to try harder to collect enough revenues to cover the council's wage bill.

3.2 Some councils have imposed high local taxes on export crops, in conflict with the national government's development policy to stimulate export production. In Kibaha DC, for instance, the cess rate on cashew nuts in 1997 represented 20 percent of the price paid to producers, creating disincentives for producers.

3.3 The effective rates for the same tax item (for instance crops) may differ significantly among councils. Therefore, producers living in councils with high taxes, transport and sell their products in "low tax councils" where they can obtain higher after tax prices. In border areas, smuggling has become extensive due to relatively high cess rates on some crops, for instance on tea and coffee. Thus, peasants dodge and manoeuvre to avoid the deprivation inflicted upon them by public policy.

4 How the current revenue system emerged

4.1 The by-law system gives local authorities quite a wide discretion to introduce new local taxes and to set tax rates, subject to ministerial approval. Due to lack of capacity and poor co-ordination between the central and local government only limited restrictions are in practice imposed by the central level on local governments' tax design. Therefore, the local revenue systems have developed without much interference from above. This has led to large variations in the revenue structures of local authorities, and to duplication of local and central government taxes.

4.2 Presently all the relevant decision making levels lack the required tax expertise for designing an appropriate tax system. At the local level the serious shortage of qualified staff at the treasury and planning departments has been noted across almost all councils. Even the available staff lacks expertise on tax issues. At the ministerial level, experience shows that the main concerns with respect to local tax design are raised by the Legal Department; the ministry has no tax experts. However, even if it contained any they would easily be over-flooded by influx of proposals from more than 110 councils.

4.3 The stakeholders involved in local tax design reinforce the variations observed between councils. In particular, the emphasis by local politicians on equity considerations has led to a fine-tuning of the tax structure in councils where politicians have the power to influence tax design. Thus, the present local revenue structure are partly a result of the different interests of the stakeholders involved in tax design, and partly a consequence of the councils' and the ministry's inability to understand the financial, economic and social implications of the local tax system.

5 The gap between the statutory and the effective revenue system

5.1 Large gaps exist between the revenue potential and what actually is reported to the council treasury. Thus, the ratio between reported and projected revenues differs significantly both between councils and between areas within councils. From a sample of 27 councils, the effective development levy rate in 1995 varied from TSh 40 (Kilwa DC) to TSh 967 (Makete DC), indicating large variations in effective tax enforcement. The ratio between actual reported levy and projected revenue in wards in Kibaha DC in 1996, varied from 8.9 percent to 38.7 percent. The corresponding figures for Kilosa DC were 13 percent and 97 percent.

5.2 The costs of administering the complicated tax structures are high. In some wards in Kilosa DC the administrative costs of tax collection are far higher than the tax revenues remitted to the council.

5.3 The costs of tax enforcement vary between the different revenue sources. Some revenues are relatively easy to collect because there are clear ways to deal with defaulters. If, for instance, businesspeople fail to pay a licence fee they can be refused services or closed down. Some revenues are not even collected directly by the council. For instance, civil servants pay the development levy through a withholding system, where the employer acts as the collector. Many taxes are, however, relatively difficult to collect. Tax collectors at the ward and village levels in Kibaha DC and Kilosa DC considered development levy to be the most problematic tax to collect, followed by crop cess and livestock cess. Tax officials at the district headquarters also ranked development levy as the most problematic tax to collect, followed by property and land taxes.

5.4 Taxes are widely perceived to be unfair. Taxpayers see few tangible benefits in return for the taxes they pay. Virtually no development activities are undertaken through councils' financial sponsorship and, even the existing capacities are not producing the expected services due to lack of operation and maintenance funds. The deterioration and in some cases non-existence of public services raises taxpayers perceptions of exploitation from an unequal contract with government.

5.5 Taxpayers' resistance to pay adds to the enforcement costs. Collectors often have to use harsh methods and violence. Roadblocks and the local militia are frequently used as instruments of tax enforcement. For instance, manned barriers are used to control buyers of certain crops like cashew nuts in the Coastal Region. The buyer has to produce the cess receipt before he is allowed to take any cashew nuts from the district.

5.6 Severe sanctions (including strict enforcement and harassment of taxpayers), and discontent with what people feel they get in return from the government promote tax resistance, and contribute to explain the widespread tax evasion observed. Thus, tax authorities' unresponsive, disrespectful and unfair treatment of taxpayers may foster disrespect for and resistance against tax authorities and tax laws. Accordingly, harsh enforcement and harassment by collectors may induce tax evasion, especially if no expected services are provided in return. This also contributes to undermine the legitimacy of the government both at the local and national levels.

5.7 Fiscal corruption is extensive in the councils studied, facilitated by the complicated and non-transparent tax system. Corruption takes many forms and varies by types of taxes, methods of tax collection and location. It cuts across all levels of the local government, from the village to the district council headquarters. Magnitude in terms of the amounts of money involved seems to rise by the level of the council.

5.8 Our findings show that the most common type of corruption (also involving large amounts of money) is embezzlement of revenues by tax collectors. Embezzlement is the form of tax revenues that does not accrue to the accounts of local governments, but is siphoned off by tax collectors and administrators.

5.9 In one council studied, evidence was found that large numbers of tax receipt counterfoils were not returned to the council headquarters as required by the financial regulations It is reasonable to assume that the counterfoils not returned are used to embezzle tax revenues. A note from the district chief executive supported this hypothesis. For development levy, we found that the amount embezzled in this way in 1995 corresponded to more than 35 percent of the council's actual revenues from development levy. The corresponding figure for 1996 was about 15 percent. In another case, which we followed over a period of three months, we found evidence that less than 5 percent of maize cess collected was reported to the council, or to put it differently, more than 95 percent of the revenues were embezzled.

5.10 Embezzlement also take place through collusion between staff of the council's treasury department and bank officials, leading to the non-banking of tax revenues: Bank officials issue a receipt on the correct amount to the treasury official. The receipt is brought back to the council's revenue office for control, and is consistent with the money remitted. However, only a part of the tax revenues is actually deposited into the council's account. The rest is shared between the bank officials and the collectors involved. This method may be sustained over time since what actually is deposited in the council's bank account is rarely controlled. In early 1998, the Controller and Auditor General uncovered cases from 31 councils where cashbook-receipts were not reflected in the bank statements.

5.11 Prolonged embezzlement of large amounts of tax revenues requires the involvement of relevant senior officials from the councils' headquarters. In one council we found evidence of a corruption network involving the head of district treasury, the district revenue inspector, the district accountant and ward executive officers. Furthermore, the prolonged existence and performance of such corruption networks requires that:

(i) the tax collectors and tax inspectors are stationed relatively permanently in their positions, i.e., they are rarely transferred;
(ii) the network is limited to a relatively small number of people in the tax administration; and
(iii) taxpayers are not directly involved.

5.12 The exclusion of taxpayers from the embezzlement corruption network is possible because the tax collectors may indeed provide genuine receipts to taxpayers on taxes paid. In some cases two sets of similar receipt books are used.

6 Options for fiscal reforms

6.1 Although local taxes represent less than 5 percent of total tax revenues in Tanzania, the large number of these taxes, together with their unsatisfactory nature means that their economic, political and social impacts are considerably more significant than their figure implies.

6.2 There is undoubtedly room for improved fiscal and financial management in local authorities, and improved co-ordination between the different levels of government. Measures may include capacity building, including training programmes for all actors involved in revenue mobilisation and collection. Building local administrative capacity may contribute to reduce revenue losses caused by inefficiencies and corruption. However, attempts to squeeze additional revenues from poorly designed taxes may have negative effects on the economy and the society in general. In general, improved tax administration cannot compensate for bad tax design. Thus, reforming the tax structure should precede the reform of tax administration since there is not much merit in making a bad tax system work somewhat better.

6.3 The capacity of local governments is very weak in tax design, and the resource requirements for building this capacity at the local level are high. Therefore, in the short run, very clear guidelines and limits should be given by the central government regarding tax design. Furthermore, the current system of approving tax by-laws should be strengthened. In particular, there is an urgent need to improve co-ordination with the national tax system. Thus, one may consider establishing an expert committee (a "Finance Commission") to advise both the Ministers of Finance and Local Government on the local government tax system. This committee should advise the two ministers before the by-law is approved.

6.4 Given the poor performance of many local taxes, any reform programme should include the abolition of a large number of these taxes. In particular development levy should be abolished. This is a tax that we have found to be costly to enforce. The levy is extremely unpopular among taxpayers and tax resistance is widespread. Furthermore, the levy represents an extra income tax on formal sector employees.

6.5 A reform should also include the abolition of nuisance taxes like bicycle tax, livestock levy, entertainment levy, etc.. Many of the licences should also be abolished since they rarely have a regulatory function. This should also be the fate of many fees that simply have a high nuisance value and that costs more to enforce than what they yield in terms of revenues, including push cart fees, cattle trekking fee, bicycle registration fee, etc..

6.6 In particular, there is a need to simplify the licence and fee structures by reducing the number of rates and coverage. Charges should in principle only be levied when services are provided. For instance, advertisement board fee, sand fee and business licences may be retained since they have a certain regulatory function. To avoid double taxation, fees and licences should be harmonised with central government revenue sources.

6.7 The establishment of uniform rates on some major crop cesses at the national level should be considered. In this context one may consider the appointment of revenue collection agencies, including the possibility to centralise the collection of certain taxes. For instance, cess on export crops could be collected at their points of export by Tanzania Revenue Authority.

6.8 Export taxes should, in general, be discouraged. However, at present many local cess rates are very high, and thereby discouraging export production. Thus, by abolishing all local cesses and imposing a lower (flat) national cess rate on export crops across all councils, the effective tax rate on these products can, in general, be reduced. For instance, a 10 percent tax on the border value of export crops would levy TSh 21 billion, equivalent to 3.7 percent of total central government tax revenues in 1997/98. This amount is slightly less than the total own revenues currently reported by local governments.

6.9 The distribution of these revenues among local governments can be made on a derivation basis, with each council getting the same share of the cess originating from its district. In this way revenue sharing avoids the problems associated with local government tax administration and policy harmonisation.

6.10 Land and property taxes have some attractions as local bases since they are imposed on immobile resources, and therefore are difficult to avoid - at least in principle. However, they also have some weaknesses that need to be taken into consideration before too heavy reliance is placed on them as major local government revenue sources. These weaknesses are partly of political and partly administrative character, manifested in problems of valuation and tax enforcement. In particular, it is important to seriously consider the administrative capacity to maintain assessments of property value. Furthermore, the enforcement mechanisms must be carefully designed to avoid a mushrooming number of court cases from angry property and land owners.

6.11 In general, a fundamental requirement when redesigning the local tax system is a greater concern with the cost-effectiveness of revenue collection, taking into account not only the direct costs of tax administration, but also the overall excess burden to the economy, including the compliance costs to the taxpayers. To these aims increased staff productivity and reduced losses through corruption are needed. Such improvements may take a long time to achieve, although a simplification of the local revenue system should be a positive contribution towards these aims.

6.12 Tax resistance is likely to increase without improvements in service delivery, necessitating costly and coercive methods of tax enforcement that will further undermine the legitimacy of the government. Improvement in service delivery - a major objective of public sector reforms in Tanzania - is therefore a necessary condition to improve tax compliance. Thus, the challenges facing the government are to improve public service delivery, and to secure funding to provide basic services. However, whatever is done to improve the local government revenue system, the reality is that local authorities in Tanzania will continue to be heavily dependent for their sustenance on fiscal transfers from above. Transfers should therefore be considered an important component of the decentralisation programme.

6.13 A key element in the ongoing decentralisation reform in Tanzania is the provision of conditional block grants from the centre to local authorities. These are planned to be introduced as a pilot project in 35 local authorities in January 2000. Conditional block grants are earmarked to finance major nationally defined services, such as primary education, primary health, water supply, agricultural extension and roads, rather than specific programmes. The conditionality refers to earmarking to certain broad-based services (education, water, etc.), but not to particular budget lines (personal emoluments, etc.).

6.14 The grants will be based on minimum standards of service to be defined by the sector ministries in negotiation with representatives of local governments. These grants relate only to recurrent costs. Such earmarking of grants will of course limit the autonomy of local governments, and thereby partly negating the arguments for decentralisation. However, imposing conditions may be justified by distributional considerations, such as the need to ensure minimum nation-wide standards for the provision of services of national concern.

6.15 Stability and transparency considerations call for formula-based revenue-sharing and other general-purpose transfer systems. However, in this process of fiscal decentralisation it is important to be aware of the risks for macroeconomic management and fiscal discipline. Mechanisms of fiscal transfers may impose considerably rigidity to the central government budget. Therefore, substantial devolution of revenues and spending responsibilities to local authorities can affect the central government's ability to carry out stabilisation and macroeconomic adjustment through the budget.

6.16 The destabilising potential of local governments' is greatest when they face no *hard budget constraint.* Expectations of bail-out in case of financial trouble weaken the incentives to economise on costs, and thus generate resource waste and rigidity within local authorities. These inefficiencies, in turn, may spill over into macro-economic imbalances. Thus, short-run macro-economic management considerations call for effective limits on local governments' deficits, consistent with national objectives for growth, inflation and balance of payments.

7 Concluding remarks

7.1 An important component of the ongoing decentralisation reforms in Tanzania is to increase the fiscal autonomy of local authorities. This policy is encouraged and partly initiated by the donor community. The above findings suggest that care must be taken in implementing this policy. It is unrealistic to expect that the present administration in many councils has adequate capacity and the required integrity to manage increased fiscal autonomy. In fact, there is a real danger that, in the absence of substantial simplification and restructuring of the current revenue system combined with capacity building and improved integrity, increased autonomy may raise mismanagement and corruption in many councils.

7.2 It is particularly important for the time being to impose hard budget constraints on the local authorities, through a design of intergovernmental fiscal relations that ensures for the local governments an adequate balance between expenditure responsibilities and their own revenues, in addition to clearly defined transfers from the centre.

7.3 It is beyond doubt that large and dramatic changes are necessary to improve performance and to re-establish legitimacy of the local government system. However, the present speed with which the decentralisation programme seems to impose reforms may prove counter-productive. Furthermore, substantial decentralisation is likely to make it more complicated for the central government to carry out macroeconomic stabilisation through budgetary policies. Therefore, due to Tanzania's acute fiscal imbalances and its aid dependency, decentralisation should probably progress more slowly and cautiously.

1 Introduction

Fiscal decentralisation – the devolution of taxing and spending powers to lower levels of government - has become an important theme of governance in many developing countries in recent years (Fukasaku et al., 1999; Manor, 1999; World Bank, 1999; Shah, 1998; Devas, 1997). As a consequence of much dissatisfaction with the results of centralised economic planning, reformers have turned to the idea of decentralisation as a reform that would break the grip of central government and induce broader participation in democratic governance (Oates, 1998; Smoke, 1994).[1] Being closer to the people, it is argued local authorities can more easily identify people's needs, and thus supply the appropriate form and level of public services (Semboja and Therkildsen, 1991; Rondinelli et al., 1989; Oates, 1972). In turn, it is argued, communities are more likely to be willing to pay taxes locally where the amounts they contribute can be related more directly in their eyes to services received (Livingstone and Charlton, 1998; Westergaard and Alam, 1995). As a result, it is expected, the level of tax revenue raised without excessive public dissatisfaction may be increased.

Yet, both the approach and the results of decentralisation have varied widely between countries. According to Smoke and Lewis (1996:1281), the limited success is attributed to two factors. First, the decentralisation process has been resisted or undermined by central government institutions fearful of losing power and rationale. Second, many initiatives have been donor driven, over-ambitious, and not taking into consideration the complex institutional realities that govern the extent to which, and the pace at which, decentralisation can occur in a particular country. Oates (1998) argues that the case for decentralisation has often been made in a very general and uncritical way with little systematic empirical support. Predictably, the argument for decentralisation has provoked response from some observers who assert that the case for fiscal decentralisation is much-overstated (Prud'homme, 1995).

Despite the mounting concern, Tanzania is now implementing a local government reform, within the framework of the reform of the Civil Service.[2] Both share a common goal: to improve services delivery (URT, 1996). The first phase of decentralising responsibilities and resources from the centre to local institutions begins in January 2000 when 35 local authorities will be given additional responsibilities and decision making powers for public service delivery (Price Waterhouse, 1998). A key element in this process is the provision of conditional block grants from the centre to local authorities. Additional reforms include measures to strengthen local governments' revenue raising, and measures of revenue sharing between local and central government.

This report is aimed at contributing to the ongoing debate on fiscal decentralisation in Tanzania. It explores the main characteristics and performance of the existing revenue system, and presents options for reform. The paper draws on the findings of studies carried out through 1996, 1997 and 1998. The fieldstudies were conducted in Kibaha District Council, Coastal Region, and

[1] *As a* 'Financial Times" *commentator has observed, 'If "rolling back the frontiers of the state" was the policy mantra of the 1980s, then the creed of the 1990s is to roll them downwards" (Flanders, 1995, quoted in Devas, 1997:351).*

[2] *The new Local Government Act was approved by the Parliament in February 1999.*

Kilosa DC, Morogoro Region. These studies aimed at providing primary data and analyses of the capacities and constraints of the local tax administrations, especially in relation to tax design, revenue collection, incentive problems and service delivery. The studies covered all three council levels, namely the district headquarter, the wards and the village levels. Information was collected from a variety of sources and through different methods, and covered staff members of the tax administration, local politicians and taxpayers.[3] In addition, data on tax revenues for about 50 councils were collected from the Ministry of Local Government in Dodoma.[4] Data on central government taxes were acquired from the Ministry of Finance and Tanzania Revenue Authority, where we also interviewed officials on the relationship between local and central government taxation. Furthermore, representatives from the donor community were interviewed.

The paper is organised as follows: Chapter 2 reviews the general characteristics of the local government tax system. The importance of various revenue sources is discussed and the institutional set-up for revenue collection examined. In chapter 3 the performance of the main local taxes is reviewed according to the standard public finance criteria. Chapter 4 explores how the present revenue system emerged. It examines the role of the by-law system, and discusses the criteria used for tax design. Chapter 5 attempts to explain the gap between revenue potential and what actually is reported to the local government treasury. Both administrative and political factors are examined, including the administrative capacity to enforce taxes, tax evasion, fiscal corruption and political pressure. In chapter 6 the outline for a new local government revenue system is presented. Finally, chapter 7 concludes.

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[3] *See appendix 1, and Fjeldstad and Semboja (1998) for details.*

[4] *Until 1998, the Ministry of Local Government was incorporated in the Prime Minister's Office. In September 1998 a new, independent "Ministry of Regional Administration and Local Government" was established.*

2 The current local government revenue system

2.1 Introduction

This chapter reviews the existing local government tax system in Tanzania, and uses data for about 50 councils. Details, however, refer mainly to Kibaha DC and Kilosa DC, and partly to Dar es Salaam City Commission. We start by discussing the importance of various revenue sources, and make a comparison between councils with respect to tax bases and rates. Thereafter, the institutional set-up for revenue collection is presented. To give a more comprehensive picture of the local government revenue system that cannot be captured by purely statistical summaries, a description of methods of payment, reporting and budgeting procedures follows. We compare the statutory system as described in the laws with how these functions are carried out in practice.

2.2 The revenue structure

2.2.1 Revenue bases

Local authorities levy a large number of taxes, licences, fees and charges, some of which are listed in table 2.1. The table lists 10 major categories of taxes; 18 major categories of licences; 41 groups of charges and fees; and 16 items listed as "other" revenue sources. The distinction between taxes, licences, charges and fees is, however, often unclear. A number of levies are referred to as charges although they are really more like taxes, since no service is rendered directly and exclusively to the payer. An example of this is market fees that are also levied on people selling goods outside market places. In addition, a wide variety of fees for forms and permits exist. The primary purpose of such permits is for regulation, although in many councils they have become mainly a source of local revenue rather than a control mechanism.[5] Thus, in this paper the concept "taxes" comprises both taxes, licences, charges and fees, if not otherwise is stated.

In spite of the large number of revenue sources, four main sources are crosscutting almost all district councils. These are *development levy (head tax)*, *crop and livestock cess* (agricultural cess), *business licences* and *market fees* (see section 3.3 for details). In 1997 these sources accounted for, on average, about two-thirds (66 percent) of the tax revenues in 42 district councils studied (see table 2.2). Development levy dominated by contributing 30 percent of total own revenues, followed by agricultural cess (22 percent), business licences (about 9 percent) and market fees (5 percent).

The four main sources of revenue have dominated district councils' revenue generation since local government was re-introduced in 1983 (URT, 1991). In 1987/88, from a sample of ten rural councils, development levy, cess and business licences contributed with 77 percent of the revenues (Semboja and Therkildsen, 1991:19). Thus, although there is a tendency that their contribution is declining, they still account for the major share of the revenues from councils. In a sample of 10 urban councils, the major own revenue bases in 1997 were licences (33 percent), property tax (21 percent) and development levy (19 percent).

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[5] *This system has many similarities to the local revenue system in Indonesia in the 1980s as described by Devas (1988).*

Table 2.1 Current local government revenue sources

TAXES	*NON TAX SOURCES*		
	Licences	**Fees and Charges**	**Other Revenue**
1. Development levy	1. Business licence	1. Market fees	1. Road toll
2. Crop cess	2. Street vending and hawking licence	2. Tax registration fees	2. Land rent and service charge
3. Livestock cess	3. Intoxicating liquor licence	3. Tax registration fees	3. Rent from council's houses/buildings
4. Industrial cess	4. Foreign liquor licence	4. Street vending fee	4. By-law fines
5. Property taxes	5. Local liquor licence	5. Sand fee	5. Stray animals fine
6. City service levy	6. Livestock licence	6. Entertainment fees	6. Permit to move animals in urban areas
7. Hotel levy	7. Dog keeping licence	7. Advertising board fee (billboards)	7. Tourist hunting fee
8. Guest house levy	8. Fisheries licence	8. Cattle market charge	8. Sale of fish commission
9. Entertainment levy	9. Hunting licence	9. Abattoir (slaughter) fee	9. Bank interest
10. Bicycle tax	10. Gun holding licence	10. Bicycle registration fee	10. Sale of assets
	11. Blood drying activity licence	11. Business licence application fee	11. Hire of plants and vehicles
	12. Forestry product	12. Licence transfer fee (for business people changing area or type of business)	12. Sale of plants and seeds
	13. Road licence	13. Tender application fee	13. Sale of identity cards
	14. Taxi, pick-up and lorry licence	14. Refuse collection charge	14. Investment dividends
	15. Bus stand licence	15. By-law permit charge	15. Other transfers
	16. Scaffolding licence	16. Burial charge	16. Other income
	17. Plying licence	17. Business premises inspection charge	
	18. Human resource licence	18. Playing ground charge	
		19. Cesspit emptying fee	
		20. Planning scrutiny fee	
		21. School fee	
		22. UPE contributions fee	
		23. Weights and measures fee	
		24. Motor vehicle parking fee	
		25. Water pipe installation fee	
		26. Storm water drainage fee	
		27. Inoculation/vaccination fee/clinic fee	
		28. Medical examination fee	
		29. Fire service fee	
		30. Market stall renting fee	
		31. Hire of plant fee	
		32. Valuation fee	
		33. Cultural games/recreation fee	
		34. Ambulance hire fee	
		35. Public convenience fee	
		36. Recovering charge of lost dev. levy receipt	
		37. Contract approval fee	
		38. Skin treating fee	
		39. Push cart fee	
		40. Cattle trekking fee	
		41. Pupil transfer fee (paid by parents)	

Source: By-laws and revenue schedules from various councils

Table 2.2 Local government own revenue sources, 1995-1998 (Mill. TSh)

A: District Councils (N=42)	*1995*		*1996*		*1997*		*1998*	
Revenue sources	*Actual*	*%*	*Actual*	*%*	*Actual*	*%*	*Budget*	*%*
Development levy	913,40	24,4	1482,60	27,2	1882,50	30,7	4017,70	30,8
Agricultural cess (crop & livestock)	944,20	25,2	1377,60	25,2	1352,70	22,1	3369,00	25,9
Business licences	362,00	9,7	557,50	10,2	522,80	8,5	690,40	5,3
Market fees	204,30	5,5	328,30	6,0	305,50	5,0	480,20	3,7
Other taxes	108,60	2,9	163,50	3,0	285,80	4,7	826,60	6,3
Liquor licences	82,50	2,2	94,00	1,7	118,10	1,9	171,90	1,3
Other fees & fines	457,40	12,2	648,60	11,9	758,20	12,4	1657,00	12,7
Miscellaneous	668,60	17,9	804,40	14,7	899,20	14,7	1817,90	14,0
Total	*3741,00*	*100,0*	*5456,50*	*100,0*	*6124,80*	*100,0*	*13030,70*	*100,0*

B: Urban Councils (N=10)	*1995*		*1996*		*1997*		*1998*	
Revenue sources	*Actual*	*%*	*Actual*	*%*	*Actual*	*%*	*Budget*	*%*
Development levy	292,9	10,9	890,8	17,4	1659,6	18,9	2368,8	17,3
Property tax	423,2	15,7	965,4	18,9	1869,6	21,3	3184,2	23,3
Licences	712,0	26,4	1359,0	26,6	2918,3	33,3	3825,9	28,0
Industrial cess	124,0	4,6	223,3	4,4	262,3	3,0	387,1	2,8
Other cess	120,9	4,5	145,7	2,8	191,6	2,2	327,0	2,4
Fees	275,6	10,2	417,4	8,2	493,6	5,6	952,6	7,0
Levies	272,6	10,1	335,3	6,6	345,7	3,9	724,4	5,3
Miscellaneous	474,7	17,6	776,0	15,2	1027,8	11,7	1910,9	14,0
Total	*2695,9*	*100,0*	*5112,9*	*100,0*	*8768,5*	*100,0*	*13680,9*	*100,0*

Source: Computed from Price Waterhouse (1998)

As noted above, the number of different taxes, licences, charges and fees is high and varies between the councils. In 1997, for instance, there were at least 25 types of revenue sources being levied in Kibaha DC, compared to more than 60 for Kilosa DC and about 50 in Dar es Salaam City Commission. These figures do, however, not take into account the various sub-groups of particular revenue bases. For instance, in Kilosa DC *trade licence* and *weight and measure fee* had 9 components each. In Kibaha, *hunting licence* had 10 components (varying with the type of animal), *business licence* had 8 components and *building inspection fees* had 5 main components and 12 sub-groups (including inspection fees for the different components of a building such as foundation, roofing, walls, finishing and occupation). The by-law on *hawking and street trading* in Kibaha DC from 1991, specifies in detail 38 different components (including licences for bicycle repairs, tyre puncture repairs, shoe shiner, car wash, carpenter, firewood, potato chips seller licenses, etc.).

2.2.2 Tax rates

Some rates are levied on a daily basis, others yearly or taxpayers may choose between the two options. For instance, market fees are in general levied on a daily basis: However, some councils offer the option of paying an annual fee. The number of tax rates applied on individual revenue components may be high. Examples include land tax rate in Kilosa DC where the rate rises with the number of acres owned. In 1997 seven land tax rates were specified varying from TSh 3,000 for 1-50 acres, to TSh 9,000 for 501-600 acres. In addition, TSh 1,000 was to be paid for every 100 acres in excess of 600.

Rates on similar revenue bases may also differ very much between councils. This is the case for development levy, which is levied on an annual basis. Rural councils, in general, apply flat rates. For instance, in 1997 the development levy rate in Kibaha DC was TSh 1,000 compared to TSh 2,000 in Kilosa DC. In Bunda DC, however, a graduated system applies with annual levy rates in 1996 ranging from TSh 2,000 to TSh 4,000 depending on income. Urban councils, in general, apply graduated rates or a combination of flat and graduated rates. In Dar es Salaam, in 1997, a flat rate of TSh 2,000 was imposed on peasants and low income earners, while the rate for other persons was 1 percent of annual their income.

Also for other revenue bases there are large variations in rates between councils. For instance, in 1997 the annual bicycle tax rate in Kibaha DC was TSh 500 compared to TSh 1,000 in Kilosa; and the daily street-vending fee in Kibaha was TSh 50 compared to TSh 100 in Kilosa. Similarly, the entertainment levy varies between councils. In Kibaha in 1997 this levy was TSh 3,000 per show, compared to TSh 20 per person watching the show in Kilosa DC (see table 2.3). Furthermore, some rates are flexible. In Kilosa, for instance, the open weekend market fee varies by the type of goods from TSh 10 to TSh 400. Furthermore, the market fee for identical goods may vary by the size of the container that the good is kept. Thus, the fish fee in Kilosa varied from TSh 300 to TSh 500 in 1997.

Table2.3 Examples of rates in Kilosa DC and Kibaha DC

		Rates (in TSh, 1997)	
Revenue sources	***Specification***	***Kilosa DC***	***Kibaha DC***
1. Development levy	Per man above the age of 18	2,000	1,000
2. Hotel levy	Percent of turnover	20	
3. Crop and livestock cess			
Maize	Per 100 kg	200	200
Paddy (rice)	Per 100 kg	200	
Sweet potatoes	Per 100 kg	200	
Cashew nuts	Per 100 kg		4,000
Cattle	Per animal	200	100
Other livestock (goat, sheep, donkey, pig)	Per animal	100	50
4. Business licences			
Guest house licence		24,000	25,000 (a) + TSh 1,000 per room if no liquor licence; or (b) + TSh 2,000 per room if liquor licence
Application fee for business licence	(a) Liquor licence (b) Others	(a) 1,500 (b) 1,000	(a) 3,000 (b) 1,500
5. Market fees			
	Per day	100	100
6. Others			
Bicycle tax	Annual fee	1,000	500
Fishing licence	Annual	960	1,500
Entertainment levy		20 per person	3,000 per show
Advertising board fee		(a) 2,000 (above 1 square metre) (b) 1,000 (below 1 sq.m.)	(a) 2,000 (for common ones), and (b) 4,000 for advanced ones (with lights etc.)
Sand fee	Per lorry á 7 tons	500	1,000

Source: Information provided by the District Revenue Offices, Kibaha DC and Kilosa DC

Most rates on crops and livestock are specific, based on physical units. As such, comparison between councils can only be made for similar items, e.g., cess on maize or cattle (table 2.3). Since crop cess is levied on quantity sold (per bag, per container, etc.), and the market price varies throughout the season, the effective tax rate as a percentage of the market price also differs for the same tax base throughout the agricultural season. For example, using the July 1997 local market prices the following cess rates were applied (table 2.4):

Table 2.4. Local market prices and cess rates in Kilosa DC and Kibaha DC (July 1997)

	Market price/100 kg (in TSh)	*Cess rate (in TSh)*	*Effective tax rate (in percent of market price)*
Kilosa DC:			
Maize	7,000	200	2.9
Paddy (rice)	27,500	200	0.7
Sweet potatoes	8,000	200	2.5
Kibaha DC:			
Maize	9,000	200	2.2
Cashew-nuts	20,000	4,000	20.0

Source: Information collected during fieldstudies in 1997

2.2.3 Tax revenues per capita

Total tax revenues per capita reveal substantial differences between councils (table 2.5). In 1995, reported revenues per person above the age of 18 ranged from TSh 344 in Lindi DC, to TSh 1,541 in Mbinga DC. Furthermore, we observe large variations between areas within councils (table 2.6). For instance, in Kibaha DC reported revenues per capita in 1996 in Visiga ward were TSh 199, compared to TSh 439 in Magindu ward (table 2.6). We also observe variations between villages within individual wards (see table 2.7). In 1996 tax revenues per capita in Tumbi ward (Kibaha DC), varied from TSh 29 in Mkuza/Kibondeni villages, to TSh 376 in Vikawe village.

Table 2.5 Tax revenues per person above the age of 18 in district councils, 1992-1995 (in TSh)

DISTRICT	*1992*	*1993*	*1994*	*1995*
Lushoto	264	253	400	544
Mwanga	432	495	518	925
Moshi DC	441	498	600	848
Meatu		874	1 030	1 220
Maswa	554	380	716	838
Bariadi	385	715	880	1 476
Kigoma DC	353	483	526	608
Kasulu	445	614	557	684
Kyela	385	894	589	694
Kwimba	272	341	617	1 007
Mbinga	537	560	1 266	1 541
Songea DC	651	816	973	1 026
Mbeya DC	535	694	873	706
Chunya	492	608	944	708
Makete	790	1 153	688	703
Njombe	687	714	689	1 527
Nachingwea	337	385	639	1 128
Lindi DC	136	194	289	344
Igunga	599	490	470	1 142
Nzega	437	545	479	720
Average	460	585	687	920
Number of DCs	*19*	*20*	*20*	*20*

Source: Computed from data collected from the Ministry of Local Government in 1997, and the National Population Census (URT, 1988)

Table 2.6 Tax revenues in wards in Kibaha DC, 1996 (in TSh)			
Ward	*Total tax rev.*	*Population*	*Tax revenues per capita*
Tumbi	6083562	29269	208
Visiga	2359781	11839	199
Kibaha	4415832	17674	250
Mlandizi	5923870	17763	333
Ruvu and Kwala	3909019	19333	202
Soga	1424545	7064	202
Magindu	3579212	8144	439

Source: District Revenue Office, Kibaha DC

Table 2.7 Tax revenues in villages in Kibaha DC, 1996 (in TSh)			
Ward	*Village*	*Tax revenues per household*	*Tax revenues per capita*
Mlandizi ward			
	Mlandizi A	437	
	Mlandizi B	7235	
	Disunyara	311	
	Vikurotu	373	
Tumbi ward			
	Mailimoja +Mwanalugali	3648	237
	Pizha ya ndege + Sofu	733	82
	Pangani	332	39
	Mkuza + Kibondeni	212	29
	Bokotimiza	588	97
	Vikawe	2431	376

Source: Ward offices, Kibaha DC

2.2.4 Revenue fluctuations

Large annual fluctuations in the revenue generation of councils are observed. The trend describing fluctuations in local government own revenues does not follow a linear path, but is better described by a polynomial function (i.e., wave-like or undulating). However, in contrast to other studies, which argue that there is a general declining trend in the real value of local government own revenues (e.g., Semboja and Therkildsen, 1991 and 1992), we find no general trend. From a sample of about 50 councils the trend during the period 1992-95 was declining for some councils, while it was increasing in real terms for others (Fjeldstad and Semboja, 1999).

There are of course some *a priori* reasons for expecting real tax revenues to be fluctuating. First, many of the local tax bases are partially based on agricultural output, and thus are very sensitive to unpredictable weather conditions. For example, although many agriculture-related taxes are specific rather than *ad valorem* something which limit their responsiveness to economic upswings, their yield falls dramatically when there is a crop failure due to drought or floods. This asymmetric elasticity may even extend to those local taxes presumed to be relatively stable. Therefore, if income is significantly reduced either directly or indirectly because of a drop in agricultural production, people may be unable to pay development levy, business licences, hotel levies, and other local taxes. Furthermore, we find indications of revenue shortfalls in some councils in election years, particularly with respect to development levy (see section 5.3.4).

2.3 Tax administration

2.3.1 The institutional set-up for tax collection

Local government tax collection is basically a council's staff affair.[6] In district councils it is organised around three levels, namely the council headquarters, the wards and the village levels (see figure 2.1). At the sub-village level, the kitongoji leader is responsible for mobilising taxpayers.

At the council headquarters the responsibility rests with the council treasury, headed by the District Treasurer (DT). Here, two major groups of staff exist, namely revenue collectors (DRC) under the revenue accountant (DRA), and revenue inspectors (DRI). The first is responsible for the revenues collected at the council headquarters and the sub-district levels, i.e., the ward and village levels. The second group forms the inspectorate that is the audit and investigation wing of revenue collection. In principle, the inspectorate staff do not assess and collect taxes. They are responsible for identifying tax evasion and frauds, they shall facilitate enforcement and compliance of taxpayers, and enhance work discipline and accountability of tax collectors. Partly due to the incentive structure produced by the above institutional arrangement, lack of adequate staff and transport facilities (especially for distant and not easily accessible areas) revenue inspectors may actively participate in revenue collection. The example of Kilosa DC, to be further elaborated in section 5.3.3, provides an illustrative case.

At the ward levels, the responsibility for tax collection rests with the office of the Ward Executive Officer (WEO). The WEO also handles developmental and law and order functions at that level. For this purpose the local militia are to their disposal. In larger wards which may possess greater revenue potential there will also be a ward revenue collector (WRC) to spearhead revenue collection in the ward.

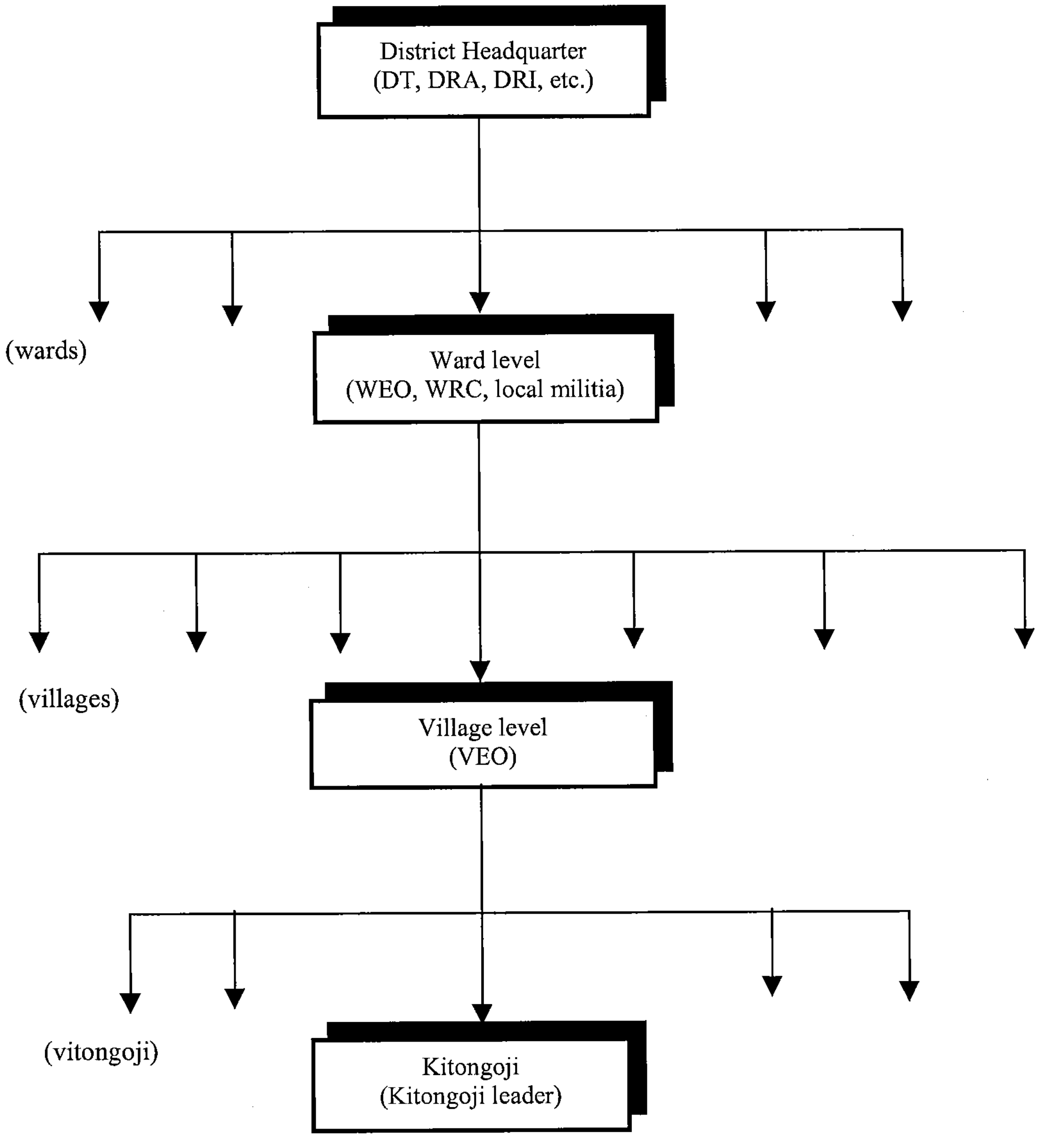
At the village level, the responsibility rests with the office of the village executive officer (VEO). The VEO is also responsible for village developmental issues. The village executive officers are nominated to their position by the village governments, but appointed and employed by the council. The system of nomination ensures that the VEOs have to come from the villages. Many of the present VEOs are the previous village CCM party-secretaries. At the sub-village level the kitongoji leader assists in mobilising taxpayers.

The way tax collection is organised in practice may, however, vary between councils. In Kilosa DC, for instance, the village level has been excluded from collection, and collection has been taken over by the ward level. According to the district treasury staff, this was due to incentive problems connected with tax collection at the village level. One problem arises from the presence of two principals for the VEOs, i.e., the village government as the nominating authority and the council as the appointing and employing authority, leading to divided loyalty. Another problem arises from VEOs operating within their areas of domicile. Lack of arm's-length-relationship between tax collectors and taxpayers introduces economics of affection into village tax collection. In many villages the kitongoji leaders also resist in mobilising people to pay taxes due to the unpopularity of taxation. In yet other

[6] Local government tax administration is completely separated from the central government revenue authority (Tanzania Revenue Authority). Appendix 4 provides a brief presentation of the central government tax administration and tax structure.

councils, Village Executive Officers work as free agents or as agents of the village council, to collect development levy and other minor revenue sources (Price Waterhouse, 1998a). In Lindi DC, for instance, the council gives a commission of 20 percent of the total revenue collected to the VEOs. This is meant as an incentive to the revenue collectors, as the more revenue they collect the higher the commission.[7]

Figure 2.1 The institutional set-up for tax collection in district councils



[7] *This incentive scheme has some parallels to "tax farming": Businessmen (either individual or syndicates) who wish to become state fiscal agents submit competitive bids to the government (council) specifying how much they are willing to pay for the privilege of collecting taxes. In principle, the highest bidder is to win the council's choice. Tax farming was widespread during the Athenian and Roman Republics and in medieval Europe. Historical evidence indicates that tax farming often led to extortion of taxpayers' initiating tax riots (Webber and Wildavsky, 1986). Proponents of the system today argue that it minimises administrative costs and results in more efficient collection (Azabou and Nugent, 1989). Others argue that the supposed gains are largely illusionary because the system leads to extortion through overzealous collection. Thus, the government would have to spend considerable resources on monitoring tax collectors (Stella, 1993). Pre-shipment inspection companies inspecting and assessing the value of imports to some countries, including Tanzania, may be considered a modern version of "tax farming". In yet other countries, collection of customs duties has been fully privatised. For instance in Mozambique since 1997, collection of customs has been commissioned to the British company* Crown Agents. *In recent years, some councils in Uganda have privatised the collection of market dues.*

2.3.2 Collection procedures

Most taxes are paid in cash. One exception is for civil servants whose development levy is withheld from their salaries. Taxpayers should receive an authentic council receipt for the amount of tax they pay. Voluntary payment can be made during office hours at any of the revenue collecting centres mentioned above. For development levy, this period starts on January 1 up to September 30. All tax payments made after the deadline are subject to a penalty equivalent to 50 percent of the tax rate (Fjeldstad and Semboja, 1998). As from October 1 to December 31 development levy payment "campaigns" are conducted, organised by the ward office and using state organs, i.e., the local militia and judiciary, to ensure compliance. Defaulters may be visited in their homes, or people may be required to show their tax receipts at roadblocks. Non-compliers who are caught are brought to court at the primary court or ward level. Due to widespread resistance, tax campaigns for development levy in Kilosa DC (involving the militia) start as early as in July, i.e., three months before the voluntary (and statutory) payment period expired. The treasury staff argued that by waiting to the end of September, taxpayers' would have spent their money and no money would be left for taxation.

Many people are brought to court every year for not paying development levy. According to the WEO in Kibaha ward (Kibaha DC), more than 700 people (out of a total number of taxpayers of 3080) were called to court after a tax campaign in 1994.[8] In 1996, 200 people in Mlandizi ward (Kibaha DC) were brought to court after a similar campaign. The District Treasurer confirmed that hundreds of people were brought to court every year for not having paid the levy. However, only few people are jailed because of non-compliance, since family members generally pay them out before they are imprisoned.

Market fees and crop cesses are, in general, collected at the selling points and markets. However, "big buyers" of cessable goods (often co-operatives) are expected to pay directly to the council treasury. The buyer then pays the council in advance based on the strength of the figures estimated by the co-operative officer from Ministry of Agriculture. If the figures are not accepted by the "big buyer", negotiations are opened. Livestock cess is collected by visiting the owners of the animals. In particular, cattle cess has proved to be problematic to collect, partly due to cultural reasons. In some areas it may also involve high personal risk for tax collectors to approach pastoralists.

Roadblocks are frequently used to control taxpayers. For instance, manned barriers are used to control buyers of certain crops like cashew nuts in the Coastal Region. The buyer has to produce the cess receipt before he is allowed to take any cashew nuts from the district. Similar checkpoints are used to control bicyclists with respect to bicycle tax. We were also informed that roadblocks sometimes were used to collect market fees, implying that the fees had to be paid even before the goods had entered the market place. Most licences and some fees have to be paid at the respective offices at the district headquarter. Licences are often issued on an annual or semi-annual basis. The council may carry out inspections of entrepreneurs and businesses to check that licences are paid.

2.3.3 Procedures for reporting and submitting tax revenues

The reporting and submission of the revenues collected follows the usual bureaucratic procedure in which each level reports to a level above it. The VEO submits the revenues to the WEO (or WRC), and the latter submits to the District Treasurer (DT),

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[8] *We do not have information on how many who actually were sent to court.*

through the revenue section. The DT or other staff members of the council treasury subsequently submit the revenues to the bank.[9] The collector receives a receipt on the money submitted, which is to be registered and filed in the collector's books.

The money collected is delivered personally by the VEO or the WEO to the level above. Before delivery the collected money is stored in the village or ward offices, or in the collectors' homes. None of the village and ward offices visited in Kibaha and Kilosa DC had any safety deposits where the money was stored. In general, the money was kept in unlocked boxes. To reduce the risks of theft, some councils have imposed rules that specify the maximum amount of money allowed to be stored at the village and ward offices before being transferred to the level above. Similar rules apply for the district treasury. When larger amounts are to be transferred, the police may be requested to guard the offices during night and to guard the transfer.

The frequency of reporting and submitting cash funds varies by the levels of revenue collected (which may vary on a seasonal basis), the distance between the lower level revenue collecting centre (e.g., village headquarters) and the higher level centre (e.g., ward headquarters), and transport accessibility between the centres. In principle, the VEOs and WEOs submit revenues on a weekly basis to the levels above, while the DT submits revenues to the bank on a daily basis.

2.3.4 Recording revenues

In principle, revenues are recorded at all three collection points, and the books are subject to auditing. In practice, records are often inaccurate and poorly organised. Data on specific revenue-generating activities at particular collection sites are rarely kept. In Kibaha DC, for instance, we found inconsistencies between the revenues recorded by the village executive officers and the records at the ward level. There were also inconsistencies between the records of the ward and district levels. Furthermore, the tax register books for development levy in the villages and wards visited were, in general, not updated. In Kibaha DC, some deceased persons were still registered as taxpayers years after they had passed away. Some persons who had moved from the area were still in the registers. In Chanzuru and Dumila wards in Kilosa DC the tax register books were not available. According to the Ward Executive Officers, the books had either been stolen and burnt or had just disappeared. Thus, lists of names were provided on hand-written sheets by the WEOs (see Fjeldstad and Semboja, 1998:8).

The councils prepare annual accounts. The stakeholders to the final accounts are:

- The full council.
- The Proper Officer (Ministry of Local Government).[10]
- The Prime Minister's Office.
- The Office of the Controller and Auditor General.
- The general public.

However, the detailed system of final accounts that are supposed to be prepared at the end of each financial year is a particular problem. Although some councils are reasonably current with these accounts, many are at least a few years behind.

[9] *Generally, this is the local branch of the National Bank of Commerce (NBC). In rural areas only NBC operates. In 1997, part of the NBC was privatised and renamed to NBC 1997 Ltd..*

[10] *In the Local Government Act of February 1999 the concept "proper officer" is abolished (see section 4.2).*

Thus, the most recent revenue data we were able to obtain from the Ministry of Local Government in Dodoma in July 1997, were almost 2 years old. For some councils only aggregate figures on tax revenues were available at the ministerial level,[11] while data disaggregated into the major bases were available for others. The figure for own revenues for all councils is not known by the ministry responsible for local governments.[12] This situation reflects differences in the routines and capacity of councils for record keeping, and also lack of routines and/or capacity at the ministerial level to record the data. Furthermore, it reveals inaccurate and disorganised financial recording in some councils.

The relatively complicated way the accounts are presented makes it often problematic for the local councillors to review them. Price Waterhouse (1998a) reports, for instance, that local politicians (councillors) in Moshi DC often found the annual accounts too technical and only a few understood them. This situation gives the council administration and treasurers the entire information powers, and may open up for misuse of such power and council resources (see section 5.3.3).

2.3.5 Auditing

The collector is supposed to deliver a receipt of a standard form to the taxpayer, a copy of which is retained by his superiors to be audited. The receipt books, printed by the official government printer for the specific council are kept in the council head-quarter's store (CHS) for distribution to the three revenue centres.[13] Usually the receipt or counterfoil-books are kept by the district revenue accountant (DRA) who, in principle, is not participating in tax collection.[14] Only revenue collectors at the council headquarter and the ward executive officers (WEOs) can collect receipt books from the CHS. The ward revenue collectors (WRCs) and the VEOs receive their allocation of receipt books from the WEOs.

As a rule, a new receipt book can be issued only after the earlier one has been returned and accounted for. The tax collector is required to return the old receipt books showing used counterfoils and unutilised receipts for audit so as to control their use before receiving new ones. In practice, this procedure is often not followed. In Kilosa DC, for instance, we found that many employees of the council received receipt books for a period of several years, but failed to submit them in the council head quarters after using them in revenue collection (see section 5.3.3).[15]

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[11] *These included, for instance, Kigoma and Mtwara Urban Councils, Bunda DC, Masasi DC, Sengerema DC and Magu DC.*

[12] *According to the Commissioner of Local Government (Ministry of Regional Administration and Local Government), such data did not exist (mid-March 1999). The only data he was able to provide for recent years were data from individual councils. Officials from the Ministry of Finance confirmed that aggregate data on local government own revenues were not available.*

[13] *There are five main types of receipt books; each assigned to specific taxes. All except one are named by the specific type of tax they are earmarked to collect. They are:(1) development levy (containing 150 receipts/leaves); (2) market fees (100 leaves); (3) local brew (100 leaves);(4) Universal Primary Education (UPE, 100 leaves); and (4) "other taxes" (HW5, 50 leaves).*

[14] *In practice, however, we have observed cases where the DRA also functions as a revenue collector (see section 5.3.3).*

[15] *The Commission on Corruption (URT, 1996a:318) also reports that government receipt books are not being returned. The Commission compares the present unsatisfactory situation with previous practises and states: "Under the old tax collection system, every collector was given receipt books and was required to return them at the end of every month showing used counterfoils and unutilised receipts for audit so as to control their use."*

In principle, financial control in local authorities is exercised through internal and external auditing. Internally, the revenue department of the council is responsible for the "daily" accounting work, including control.[16] According to Semboja (1995:13), the audit section in Kilosa DC had not been established. However, through a regional arrangement, councils in the Morogoro-region shared an internal auditor who was stationed in Morogoro Municipal council, but he had not been in Kilosa "since the beginning of the year [1995] due to poor health". By July 1997, internal auditing was still not carried out in Kilosa DC. This was also the case in Kibaha DC, according to the District Treasurer. Price Waterhouse (1998a) reports that the Masasi DC has no internal audit department; "however, the Treasurer realises the need for one" it is stated in the report. Although the efficiency and effectiveness of monitoring and auditing devices may vary between councils, the cases referred to above probably reflect the situation in many councils.

External audit is to be done by the Office of the Controller and Auditor General. The Auditor General is to send auditors to verify the accounts, cashbooks and ledgers. Audit queries arise from this exercise. However, the Auditor General's office is, in general, understaffed and has limited capacity to undertake comprehensive audits in all councils because of severe shortage of qualified and trained staff, especially at the senior professional levels. According to Sedigh and Muganda (1999:167), the Auditor General's Office has been hindered by financial constraints and its inability to attract, train or keep suitable staff since the private sector is offering more rewarding employment to professionals. In spite of these constraints, the number of councils whose accounts have been audited has risen recently. The audits show that financial performance of many councils is poor, and an increasingly number of cases has been reported in recent years where the Auditor General is not approving the councils' accounts (see section 5.3.3 and appendix 2). Price Waterhouse (1998a) reports that between 1993 and 1996, out of 64 councils audited, the accounts of 33 councils (52 percent) were classified as poor, 12 as average and 19 as good.

2.3.6 Budgeting

An examination of budgeted versus actual figures for several years in Kibaha and Kilosa DC, indicates that these two sets of figures bear little resemblance to each other.[17] Budget estimates often overstate revenues and sometimes understate expenditures. Some councils may also manufacture a budget reflecting a surplus to gain Ministry approval.[18]

Figure 2.2 illustrates the gap between budgeted revenues and what was actually reported to the district treasury in Kilosa DC in the period 1992-96. In 1993, for instance, the budget was about 100 percent higher than the revenues actually reported, and for 1996 about 50 percent above the reported revenues.

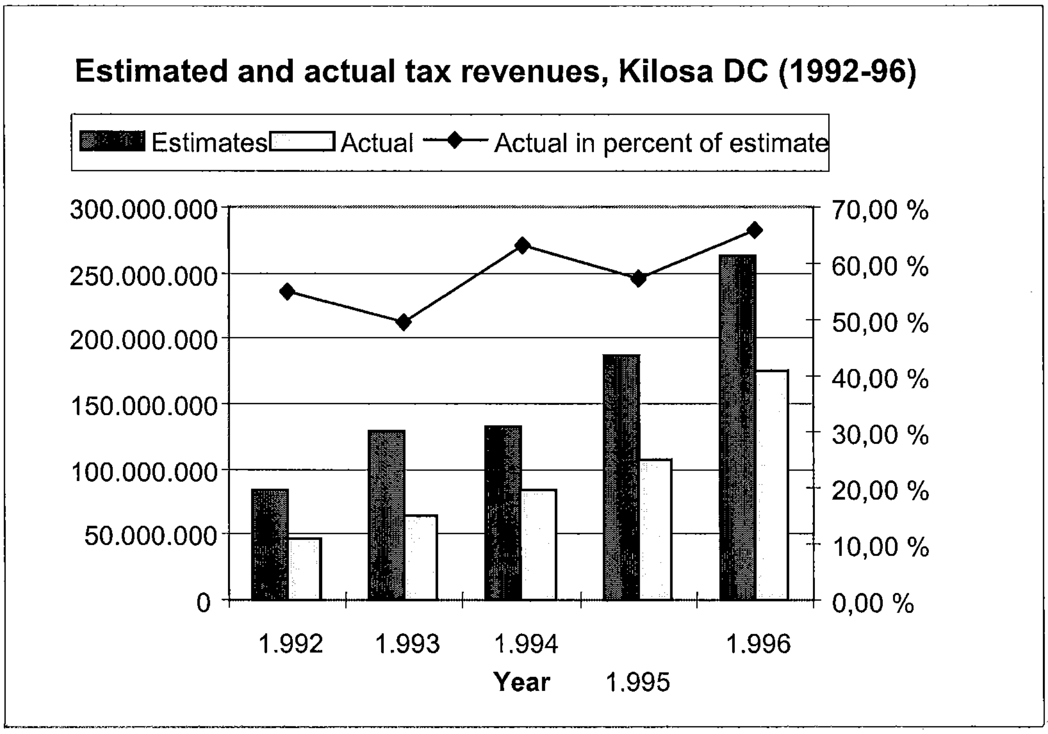
[16] *It should be noted that provision for internal audit does not substitute for revenue audit and investigation. The two have distinct functions.*

[17] *Smoke (1994:83) reports similar cases from local authorities in Kenya.*

[18] *Ingle (1972:254), referring to local authorities in Tanzania, argues that "[p]olitical systems under pressure from the center to produce solid development results were likely to exercise their own form of accommodation. The most common form of accommodation to date had been simply to pass false or inflated accounts of development results to superiors who were out of touch with local conditions".*

The differences between budgets and reported revenues become even more outspoken if we look at specific revenue bases. The collection ratio for development levy for Kibaha DC in 1996 was 26.7 per cent, measured as the ratio between actually reported and projected revenues based on population statistics. The corresponding figure for Kilosa DC was 45.6 per cent (Fjeldstad and Semboja, 1998).[19] Furthermore, we observed large differences in the collection ratio between areas within the same council. For instance, in 1996 the ratio between reported and budgeted levy in wards in Kibaha DC varied from 8.9 per cent to 38.7 percent. The corresponding figures for Kilosa DC were 13 per cent and 97 percent, respectively.

Figure 2.2 The gap between budgeted and actually reported revenues, Kilosa DC



The gap between the budget and what actually is reported may have several explanations. First, the estimates may be unrealistically high. Several studies show that the budgeting process in many councils are not based on realistic knowledge about the potential (see, e.g., Semboja and Therkildsen, 1989:43). For instance, with respect to agricultural cess, the financial planners seem to be unaware of the tax base in the districts. Price Waterhouse (1998a) reports, for instance, from Lindi DC that to "estimate the annual revenue from cashew nut cess for any given year the council simply adds 10 % of the previous years revenue". There are also cases where plans are revised upwards or downwards following good or bad performances in only one year. In Moshi DC, for instance, the planners take into consideration the previous year's trend and the prevailing

[19] *Projected revenue is estimated as taxable population in the council multiplied with the levy rate.*

weather conditions (Price Waterhouse, 1998a). According to some observers, revenue targets are based on the expenditure budgets that again are based on what the planners and councillors "want to do". Priorities based on resource constraints are not made in the expenditure budgets, implying that revenue targets, in general, are unrealistically high. Thus, in many local authorities the process of preparing budget estimates is not a very meaningful exercise.

It should, however, be added that produce cess, in particular, is an uncertain revenue base since agricultural output in Tanzania is very sensitive to unpredictable weather. This makes produce cess an uncertain source of revenue, something that renders financial planning difficult (Semboja and Therkildsen, 1989:43). Data on business licences also reveals lack of sufficient knowledge on the part of districts of the revenue potential of this source. Semboja and Therkildsen (1989:44) states that significant deviations between planned and actual revenue from this source is an indication of lack of criteria in arriving at these targets. One problem adding to this is the fact that most owners of businesses in district councils hardly keep any accounts, and often household and business accounts are not separated. If accounts are kept several books may be in use for different purposes, including one for tax purposes showing deficits.[20] Non-compliance further complicates the budgeting process. In particular, tax resistance is extensive for development levy (see Fjeldstad and Semboja, 1998). Corruption adds to the problem of proper budgeting (see section 5.3.3).

2.4 Summary

The local government revenue structure in Tanzania is extremely complicated and non-transparent. A large number of revenue bases, sub-bases and tax rates exist. Moreover, large variations exist among councils with respect to the number of revenue sources and rates. Revenues per capita vary significantly between councils indicating both differences in tax potential and differences in the effectiveness of the local tax administrations. No clear pattern can be discerned from this structure. Thus, in practice, a local government revenue structure for Tanzania does not exist. This is because each council has its own tax structure, implying that there are more than 110 local government revenue structures in the country (excluding village councils).[21] Furthermore, reporting, budgeting and auditing practises are weak in the councils studied. This characterises all levels, from the village to the Ministry.

[20] *According to an official in Tanzania Revenue Authority, some companies keep four different books: One for the tax purposes showing deficits; one for the shareholders showing balance; one for potential investors, including donors, showing profitable results; and one showing the correct figures for internal use only.*

[21] *In October 1998, there were 111 local authorities in Tanzania: 92 District Councils; 9 Town Councils; 9 Municipal Councils; and 1 City Council (Dar es Salaam). However, the number of councils is increasing. Due to attempts to equalise rates on some revenue bases among councils within the same region, some rates have tended to differ by regions.*

3 Qualitative characteristics of the local government revenue system

3.1 Introduction

In this chapter we briefly review the qualitative characteristics of some major local revenue bases. The basic principles or desirable characteristics of a revenue system are presented in section 3.2.

3.2 Principles of taxation

There are several general criteria against which any local revenue scheme might be judged (Bird, 1992; Bahl et al., 1990; Groenewegen, 1990; and Devas, 1988). These include the ability to raise revenues, effects on economic efficiency or neutrality, equity implications and administrative feasibility:

1. *Mobilising resources:* The main objective of taxation is to raise enough resources to fund public expenditures. Thus, the adequacy of a tax should be considered in relation to the functions that it is supposed to finance.[22] Revenue adequacy, depends on the levels of the rate and base. For instance, high rates will most likely produce excess burdens through reactions in behaviour by taxpayers attempting to avoid or evade the tax. Furthermore, the stability and predictability of the tax yield has to do with the elasticity of the revenue source.[23] Thus, as the resource needs of a local authority increase due to population growth, increased service demands, inflation, etc., a good revenue source will respond in the same manner. The ratio of tax yield in relation to collection costs is also relevant in this context.
2. *Economic efficiency:* Taxation nearly always affects some economic choice. However, a tax should be designed in such a way to minimise (or avoid) distorting consumer and producer choices or discouraging work or savings. To the extent that local taxes, licences and charges alter choices that otherwise would have been made, they are economically inefficient. Exemptions to this rule are taxes whose purpose are to discourage certain types of consumption (e.g., cigarettes and alcohol) and production (e.g., environmentally damaging industries). In such cases, taxes can be used to internalise negative external effects of such activities.
3. *Equity:* The tax ought to be fair in its relative treatment of different individuals. First, it should be horizontal equitable implying that the burden of taxation should be similar between different groups with similar economic positions. Second, it should be vertically equitable, which implies that those with greater economic resources should contribute more than those with less resources. Finally, it should be geographically equitable, in that there should

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[22] *The first systematic study of the functions and objectives of taxation was made by Adam Smith (1776) in his* "Inquiry into the nature and causes of the wealth of nations" *Smith emphasised the requirement that taxes must generate enough revenues to finance essential public expenditures. He then proposed four "canons" or guiding principles of taxation, usually referred to as the principles of (1) equity; (2) certainty on behalf of taxpayers (i.e., freedom from arbitrary levies); (3) convenience of payments; and (4) economy in collection. The fourth canon includes the aspects of efficiency costs, administrative costs, compliance costs for taxpayers and incentives for smuggling and tax evasion. Modern tax theory in essence repeats Adam Smith's focus on revenue adequacy, equity, efficiency, certainty, and cost-effective tax administration (Musgrave and Musgrave, 1989; and Stiglitz, 1988).*

[23] *The term elasticity is here referring to the percentage increase in revenues associated with each 1 percent increase in local income.*

not be substantial, arbitrary differences in tax burden between councils, unless these represent differences in service provision.

4. *Administrative feasibility:* A tax should be capable of being implemented in terms of political, cultural, institutional, technological and economic constraints. Efforts to improve local revenue mobilisation must recognise the current environment in which the local government operates. Furthermore, a tax should not place undue strains on limited administrative capacity. This implies that it ought to be relatively easy and inexpensive to administer.

In the literature, three more criteria are sometimes added. First, is the criterion on *certainty on behalf of taxpayers* (Stiglitz, 1988). This implies that a tax should be designed in such a way that individuals can ascertain what they are paying. Thus, the political system can more accurately reflect the preferences of individuals (i.e., political responsibility). Transparency and accountability are incorporated into this criterion. Second, is the criterion on *suitability as a local government revenue source* (Devas, 1988). This criterion requires that it should be clear to which local authority a tax payment should be made. The tax should not be easily avoided by moving the tax object from one council to another. Finally, is the criterion related to *macroeconomic stabilisation*. Stabilisation is commonly associated with short-term fiscal policy and its primary responsibility usually assigned to the central government.[24]

On a general level, the degree of decentralised spending and revenue generation responsibilities may have significant implications for the central government's ability to conduct macroeconomic polices through the budget (Ter-Minassian, 1999:56). Changes in economic circumstances may require counter-cyclical policy changes in tax rates and bases, as well as in public expenditures. Thus, a loss of major tax instruments or of control over a large share of public expenditures can severely constrain the centre's room for manoeuvre, for instance in raising taxes or cutting spending to curb overheated domestic demand. The relevance of this last criterion may be questioned with respect to local government taxation in most developing countries, since taxes raised by local authorities often represent only a minor fraction of total tax revenues. However, the move towards substantial expenditure decentralisation in some countries may constrain the central government's ability to pursue stabilisation policy. Promoting fiscal responsibility at the sub-national level therefore calls for implementation of a stable and transparent system of transfers from the central to the local government level (see section 6.4). Thus, it is important to consider the consistency (or possible inconsistencies) between local governments' policies and the macroeconomic objectives of the central government.

No local tax will, of course, score well on all these criteria. Most likely, local taxes score less well on these criteria than do national taxes, since central governments usually and for good reasons take the most revenue productive taxes for the national level.[25] Nevertheless, these criteria do provide a useful way of evaluating existing (and proposed) local taxes.

[24] *The term fiscal policy normally applies to the use of fiscal instruments (i.e., public revenues and expenditures) to influence the working of the economic system in order to maximise economic welfare of the society. Stabilisation and fiscal policy are often used as synonyms.*

[25] *In particular, efficiency and administrative considerations argue for the centre to keep the major taxes, especially the corporate income tax, multistage income taxes such as VAT, and taxes on foreign trade.*

3.3 Evaluating local revenue bases

In this section we briefly review some major revenue bases according to the criteria outlined above. It is not our intention to carry out a detailed and rigorous evaluation, but to get some indications on the suitability of the present local government revenue bases.

3.3.1 Development levy

The poll tax, commonly referred to as "development levy, is in principle levied on every person above the age of 18 years and ordinarily resident in the area (Tax Commission, 1991).[26] Women are exempted in many councils.[27] In most areas, the tax is levied on a flat basis. However, in some urban areas, particularly in the wage sector, graduated rates based on income apply. In recent years, some councils have completely abandoned the tax. There is a widespread resentment among the public against paying the tax, and non-compliance is a serious problem (see Fjeldstad and Semboja, 1998).

In principle, a flat-rate head tax is highly regressive, and, thus, not in accordance with the vertical equity criterion. In practice, partly due to extensive evasion and partly due to collection procedures, development levy is probably less regressive than expected (Fjeldstad and Semboja, 1998). For instance, remote and less affluent areas may not be approached by collectors, partly due to the costs of visiting those areas, and partly because of the personal risk involved. Furthermore, widespread tax resistance has lead tax collectors to target those taxpayers that are able to pay and whose connections to the political and economic establishment in the council are limited. For instance, in our survey we found that the compliance rate of people who were migrants to the survey area from other regions in Tanzania was higher than the compliance rate of people born in the area. Migrants were also found to be relatively more wealthy than people born in the area.

Roadblocks and the local militia are frequently used as instruments of tax enforcement. Thus, collection costs are high. According to the ward executive officers and village executive officers interviewed, a significant part of their time was spent on collecting development levy. They also considered development levy to be the most problematic tax to collect.

The tax collection ratio measured as the ratio between actual reported and projected development levy varies both between and within councils, with implications for horizontal and vertical equity. From a sample of 27 councils we found that the effective development levy rate in 1995 varied from TSh 40 (Kilwa DC) to TSh 936 (Makete DC). The ratio between actual reported levy and projected revenue between wards in Kibaha DC in 1996, varied from 8.9 percent to 38.7 percent. The corresponding figures for Kilosa DC were 13 percent and 97 percent. There are also large variations in tax effort between villages in the same ward. According to figures obtained from the ward office in Mlandizi (Kibaha DC), only 4.5 per cent of the registered taxpayers in the rural village Disunyara had paid development levy for 1996 by the end of November, compared to 39.1 per cent in

[26] *A brief history of development levy, previously named "local rate", is presented in Lee (1965), Dryden (1968) and Bukurura (1991).*

[27] *The issue of women paying the levy has been controversial (Tripp, 1997:157). Supporters of the levy on women argue that women are equal to men according to the law and thus can own their own property. Opponents argue that women in rural areas rarely own their own property and therefore should be exempted. In particular, the development levy has revealed a conflict between upper- and lower-income women.*

the rural-urban village Mlandizi B.. We were not able to confirm these figures by the village executive officer (VEO). However, in some wards we found that the revenues reported by the VEOs were higher than those reported by the ward executive officers.

For formal sector employees the levy is withheld from their salaries. Development levy should be considered an extra income tax levied on the top of the income tax payable to the central government. In theory, a head tax has no impacts on resource allocation. However, due to resistance, many people put much effort into evading the tax, for instance, by hiding in the bush during tax campaigns. Thus, the tax distorts taxpayers' behaviour and may also have negative impacts on production.

3.3.2 Produce cess

Produce cess is levied by district councils on the sale of major crops such as maize, rice, coffee, tea, cotton, cashew nuts, sisal, oil-seeds, sweet-potatoes, etc., and on livestock.[28] Since produce cess is levied on physical units (weight or volume) rather than value, this makes the source inelastic unless adjustments become frequent enough to catch up with inflation. Besides, the revenue generated is dependent on officially marketed output, as the base is readily not known.

In 1987, the Minister for Local Government directed that crop cesses should be uniform throughout the country and should be paid by the buyer (Tax Commission, 1991:293). The ministry's intention was that the incidence of the tax should not fall on the producer, and thereby discourage production. Furthermore, the cess rates should be charged on the basis of volume or weight rather than crop value (Semboja and Therkildsen, 1989:40). By levying the tax on the crop buyers it was assumed that this would not discourage producers. We have not managed to trace the actual tax incidence. However, according to maize and cashew nut buyers (i.e., the taxpayers) interviewed, the cess was passed on to the producers through lower prices.

Tax incidence most likely varies between different crops. For instance, in the short run we would expect that cashew nuts (which is a tree crop) is relatively inelastic in supply compared to tomatoes. Therefore, lower producer prices on tomatoes may lead to a switch to higher priced alternatives. Lower prices on cashew nuts may in the short run not imply a switch to other crops but most likely less inputs of fertiliser, pesticides, etc., which will have negative impacts on produced volume in the longer run. Thus, by imposing high local cesses on export products, for instance, on cashew nuts, local taxes are inconsistent with the central government's policy to encourage export production. This is the case in Kibaha DC where the cess rate on cashew nuts in 1997 represented 20 percent of the price paid to producers, creating disincentives for producers.

The effective cess rates vary significantly between councils due to variations in market prices between geographical areas, and due to seasonal variations. The cess rates also vary between crops distorting the behaviour of producers (see table 2.4). Therefore, producers living in councils with high taxes, transport and sell

[28] For instance, in Kibaha DC the cess for pineapples in 1997 was TSh 5 per pineapple sold, TSh 100 per bag (tenga, i.e., 30-50 kg) of tomatoes, and TSh 200 per bag (à 100 kg) of maize and rice. Produce cess in Kilosa DC also includes charcoal cess of TSh 300 per sack sold, firewood cess of TSh 200 per bundle, and fish fee of TSh 300-500 per container (tenga).

their products in "low tax councils" where they can obtain higher after tax prices, or to neighbouring councils that do not levy the cess. For instance, cashew nut producers in Kibaha DC prefer to sell their produce in Dar es Salaam where prices are higher since no cess is imposed there. In border areas, smuggling has become extensive due to relatively high cess rates on some crops, for instance on tea and coffee. Thus, the peasants dodge and manoeuvre to avoid the deprivation inflicted upon them by public policy. However, such manoeuvres by the peasantry to manipulate the market to minimise their losses are neither voluntary nor an optimal alternative. As Bates (1981:87) comments: *"The fact is that peasants avoid the state by taking refuge in alternatives that are clearly second best. They move out of the production of the crops that are most profitable and into activities that have become more profitable only because they are less heavily taxed. In thus changing the way they employ their resources, they incur economic losses."*

Furthermore, variations in taxes and rates increase horizontal inequity between councils. Equity within councils also suffers since tax rates vary by tax item (or crop), and some items (crops) can only be found in specific areas. Opportunities to evade taxes also differ by individuals and areas. Similarly, livestock cess is often difficult to collect. In Kilosa DC, for instance, it has been almost impossible to collect livestock cess from pastoralists.

3.3.3 Business licences

Business licences are, in general, charged on the basis of the type of business undertaken.[29] Thus, two retail shops pay the same fee regardless of differences in their sizes and turnover (Semboja and Therkildsen, 1989:44). Being based on physical characteristics, the yield is quite inelastic in the short run (see table 3.2).

In principle, such taxes are attractive as a local revenue base, as they provide means for local government to tap the economic base of its area. However, they present a number of serious problems. First, is the conflict or duplication with national taxes creating disincentives for the business sector. Second, in terms of economic efficiency, such a tax is likely to have a negative effect on production and enterprise, and discriminates against service enterprises and manufacturing industries. Third, equity effects are uncertain, but there is generally a "regressive" tariff structure in that smaller enterprises pay relatively more. However, such equity and efficiency effects are likely to be small (not necessarily marginal). Finally, the tax benefits mainly larger urban centres.

[29] *Under the Business Licences Act no. 25 of 1972, all traders and professionals need a business licence every year as a pre-condition to trading (Tax Commission, 1991:293). The Minister for Trade has power, under the Act, to appoint any authority to issue licences in respect of any categories of business. Since 1987, the issue of licences has been divided between three authorities: (1) The Ministry of Trade, regarding businesses of a national or international character; (2) Regional trade officers regarding co-operatives, wholesale and manufacturing business, and building contractors; and (3) Local authorities regarding (i) retail business,(ii) insurance agents,(iii) hotels, restaurants, guest houses and tea rooms,(iv) auctioneers,(v) electrical contractors,(vi) itinerant traders, and (vii) other business not covered under businesses licensed by the central government.*

Table 3.2 Business licences in Kibaha and Kilosa DC (1997)

Type of business	*Rate per annum, Kilosa DC (in TSh)*	*Rate per annum, Kibaha DC (in TSh)*
Retail shop	18,000	10,000-40,000
Grocery		60,000
Wholesale		30,000
Kiosks	15,000	
Restaurant	24,000	25,000
Liqueur bar		64,000
Petrol station	50,000	50,000
Guest houses	24,000	25,000 + 1,000 per room if no liquor licence (or +2,000 if liqueur licence)
Butcheries	25,000	
Grinding mills	20,000	10,000-40,000
Second hand clothes	15,000	
Others	6,000	

Source: District Revenue Offices, Kibaha DC and Kilosa DC

3.3.4 Market fees

Market fees are often levied on a daily basis on people selling their goods at market places. In Kibaha and Kilosa the market fee at the ordinary markets is TSh 100 per trader per day (see table 2.3). At the weekend-market, however, the rate in Kibaha DC is TSh 200 per day. Kilosa DC has also a street-vending fee set to TSh 100 per day. There are also fees for selling goods and food in auction places. These rates vary depending on the type of good. In Kilosa DC these fees range between TSh 200 and TSh 600 per day.

The administrative costs of collecting these taxes are in general high. Taxpayers consider them to be nuisance taxes, and compliance costs are relatively high. In some areas the council has set up market stalls. In these areas, a market fee is comparable to a user charge. However, in many areas no services are provided at the market places. Thus, market fees should be considered equivalent to a local producer tax. Since the fees are relatively higher per unit for small scale traders, vertical equity suffers.

3.3.5 Property and land taxes

In principle, the central government should tax more mobile resources, while local governments (generally) should tax more immobile resources such as property tax. This is one of the main arguments for local property taxes, and probably also one of the main reasons why some consultants involved in the ongoing decentralisation reform in Tanzania argue in favour of the property tax (see section 6.2.2).[30] However, land and property taxes have rarely been effective for political and administrative reasons in developing countries (Tanzi, 1999:48).[31] In his seminal book on land taxation, Richard Bird (1974:223) argues; *"[T]he administrative constraint on effective land tax administration is so severe in most developing countries today that virtually all the more refined fiscal devises*

[30] In some Western countries, including Denmark and Norway, local property taxation is a good source of local taxation. In Denmark, for instance, property taxes are levied on land values (Lotz, 1997:188). The rate for a given municipality is the same for all types of property, and assessments of property are adjusted annually. Furthermore, the same rate applies to households and to enterprises. There are also rules to reduce the tax for elderly people.

[31] Strasma et al. (1987) provides a careful documentation of the difficulties inherent in the effective administration of the land tax.

beloved by theorists can and should be discarded for this reason alone. Not only will they not be well administered; they will in all likelihood be so poorly administered as to produce neither equity, efficiency, nor revenue." Furthermore, Bennett (1990:21) argues that the widespread use of property tax as a local revenue source is *"unsatisfactory in terms of much theory"*. For instance, property and land taxes are often regressive; they are distortionary on one factor input for business and one form of consumption for households; it is often difficult to maintain assessments; and they have often perverse effects on land markets.

According to the staff at the district revenue offices in Kibaha and Kilosa, property and land taxes are among the most problematic taxes to collect. An extra constraint arises in many local authorities because much land is unsurveyed and ungraded. In addition, absent landlords add to the administrative problems of tax enforcement.

Historical evidence from Tanzania also reports on serious problems related to valuation of property subject to the *site rate* and collection of the *urban house taxes*.[32] According to Lee (1965:45), the problems related to the urban *site rate* had arisen "because of shortage of staff, which at one point fell to a low of one professional valuing all urban property in the nation", creating long delays in the assessment of property value. However, few councils experienced problems in collecting the site rate. This was probably due to the fact that the site rate was levied only on the property owned by the relatively well-to-do. Lee adds that it may also reflect a generally low level of valuation compared to actual market value. In contrast, the *urban house tax* faced severe problems of collection. According to both tax officials and The Association of Local Authorities in Tanganyika there were problems in collecting this tax.[33] Landlords were claiming they could not afford to pay, and the difficulties of passing some of the tax to tenants were considered to be the major obstacles. Furthermore, property owners in Dar es Salaam complained about double taxation when they had to pay land rent to the central government and urban house tax to the city council (Lee, 1965:47-50).

3.3.6 Hotel levy

In Kilosa and Kibaha DC the guesthouse levy in 1997 was 20 percent of turnover. In addition, TSh 20 was levied per bed occupied in Kibaha DC (table 2.3). The tax is, in principle, based on self-assessments implying incentives to underreport. The high rates encourage evasion, for instance through double-bookkeeping.[34] In practice, however, since most of the smaller establishments do not issue receipts turnover has to be estimated. Thus, for the bulk of establishments which produce no receipts there has to be a process of negotiation between collectors and

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[32] *In the early 1960s two kinds of taxes were levied against real property by urban councils in Tangyanika (Lee, 1965). In areas under the jurisdiction of a town, municipal or city council, land held under government leasehold or long-term right of occupancy was subject to a* site rate. *This land included most of the developed business and commercial property, as well as more expensive residential and apartment dwellings. All other houses and buildings on land held either under a short-term right of occupancy or on the basis of customary tenure were subject to* urban house tax, *and this property comprised the great bulk of African housing. Finally, the central government paid to the urban councils a sum "in lieu of site rate" on property that it controlled. Valuations of all land in urban areas should in principle be conducted every five years by officials of the central government, while supplementary valuations were annually prepared in the interim periods to include property which had changed in character. The basis for the valuation under the law was the sum that would be paid in a voluntary sale for a government lease of 99 years if improvements to the land, if any, had to be made.*

[33] *This was the predecessor of the present Association of Local Authorities in Tanzania (ALAT).*

[34] *In 1996 controls organised by the District Treasurer in Kibaha DC revealed that one hotel in Mlandizi ward and three in Tumbi ward had underreported amounts equivalent TSh 1,000,000.*

taxpayers. Such direct assessments increase administrative costs, and opens up for corruption through the negotiations. Since the levy is based on percentage of turnover, the yield should be quite elastic.

As a local revenue source, it is quite suitable, since the tax object is clearly located, and the point of collection will normally be the same as the point of incidence. However, it is the larger urban centres that can derive the greatest revenue from this tax. Several of the arguments in the disfavour of property taxes also apply to hotel levy.

3.3.7 Bicycle tax

This is an annual tax imposed on owners of bicycles. For 1997 the bicycle tax in Kilosa DC was TSh 1,000. In Kibaha DC the tax is TSh 500. When the bicycle tax is paid a receipt in the form of a sticker to be attached to the bike is provided. This system is comparable to the "car stickers" used as receipts for various car-related taxes in many Western countries. In addition, a bicycle registration fee has to be paid. The registration fee for bicycles in Kilosa DC were TSh 100 in 1997.[35]

The tax is fairly easy to collect, for instance by using roadblocks. This may, however, imply high administrative costs since the local militia often is mobilised at checkpoints. From an equity perspective the bicycle tax may be favourable, since it is in general the relatively more wealthy segments of the rural population who can afford to buy bicycles. However, the tax imposes extra costs on the productive sectors, in particular on small scale agriculture. Bicycles are often the only available (and affordable) transport equipment in rural areas. These extra costs may, thus, have negative impacts on production.[36]

3.3.8 Advertising board fees (billboards)

Most local authorities levy a tax on advertisement signs in their area. Tax rates are based on size and duration, but require regular revision to keep up with inflation. Yield and growth rates have been reasonable, but collection costs can be high. The tax presents no particular equity or efficiency problems, and is relatively easy to implement. It may also have a certain regulatory function by internalising the costs of "billboard jungles".

3.3.9 Sand fee

Some councils levy sand fees. In Kibaha DC the fee per load of sand in 1997 was TSh 1,000 per 7 tons and in Kilosa TSh 500. The low price on sand, including the fee, and increasing demand for sand for building purposes, has resulted in extensive problems of erosion in some areas in recent years. Sand fees could have been used to regulate sand-mining by internalising the environmental costs in the price of sand. However, at present the low fee plays no regulatory role.

3.3.10 Abattoir fee

Many councils build and operate marketplaces, and many also provide livestock slaughter facilities and bus parks as well. In 1997, the abattoir fee in Kibaha DC was TSh 200 per animal slaughtered. In Kilosa DC the fee was TSh 200 per cow and bull, and TSh 20 per goat slaughtered.

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[35] *In 1997, the estimated number of bicycles in the Kilosa DC was 13,718.*

[36] *From an economic efficiency point of view, the government should probably encourage people to buy bicycles, instead of imposing restrictions through the tax system.*

The overall level and growth of yield has been reasonable. However, with rates fixed in shilling, regular revisions are required to keep up with inflation. Collection costs should be fairly low, since the fee is generally collected along with charges for the use of local governments' own abattoirs, where much of the slaughtering is done. On economic efficiency grounds it could be argued that it discourages meat production, and encourages unofficial and probably sub-standard slaughtering. Otherwise this tax presents few problems of implementation, and is generally suitable as a local tax, although large variations in tariffs between councils could cause shifts in the location of slaughtering.

3.3.11 Other taxes, licences, charges and fees

In line with the reduced importance of development levy, in particular after women were exempted in 1992, local authorities have searched for alternative revenue sources. This has led to a wide range of different taxes, licences, charges and fees, which we here refer to as "other taxes". For instance, many councils operate with a large number of different licence fees varying with the types of economic activity (see table 2.1).[37]

Some licences such as dog tax and the licence on the sale of alcohol, can be seen as having a regulatory function. However, the regulations imposed by local authorities are, in general, ineffective. Furthermore, the requirement for numerous permits creates obstacles in the path of economic development, and provides scope for corruption, thereby ensuring that the intended purpose of regulation is not achieved. Some of these licences, charges and fees overlap with the taxes for which a separate charge is made, as in the case of the sale of alcohol. Apart from yielding very little, many of these other taxes, charges and licences cost more to collect than they yield, if all the costs are accounted for. There are often problems of assessment and enforcement, while the effects in terms of equity and efficiency are frequently unsatisfactory. Much of the burden is falling on low-income producers, discouraging local production, encouraging smuggling etc..[38]

3.4 Summary

Many local taxes perform poorly with respect to the basic principles of taxation outlined in section 3.2. However, these issues do not appear to be recognised by most local governments, whose main concern simply seems to be to increase local

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[37] *Licenses and fees in Kibaha and Kilosa (1997):*

- *hunting licences (in Kilosa DC the rates vary depending on type of animal, while there is a flat rate in Kilosa DC of TSh 10,000),*
- *fishing licence (TSh 1500 in Kibaha DC, TSh 960 in Kilosa DC),*
- *cattle auction fee in Kilosa is TSh 200 per cow and bull, and TSh 50 per goat sold,*
- *licence for selling building poles (TSh 5,000 per year in Kibaha DC),*
- *petty trader licence (TSh 8,500 per year in Kibaha DC),*
- *licence transfer fee (TSh 1,000 per licence in Kilosa DC if a trader changes location area or type of business),*
- *local liquor licence,*
- *licence for holding a gun (TSh 500 per year in Kilosa DC, and TSh 100 in Kibaha DC),*
- *licence to sell traditional medicine (TSh 3,500 per year in Kilosa DC),*
- *push cart fee (in Kilosa TSh 100 per day - in addition, there is a registration fee for push carters of TSh 100 per year,*
- *cattle trekking fee (in Kilosa DC TSh 200 per cow/bull).*

[38] *According to Devas (1988), referring to Indonesia, such taxes have generally emerged as a result of desperate efforts by local governments to try to find anything in their local area from which they can derive some revenue, but most represent unsuitable forms of local taxation. Thus, it may well be that the burden of such non-tax levies, together with the compliance costs to taxpayers and the burden of any unofficial payments demanded, exceeds the burdens of the local tax system itself.*

tax revenues - at almost any cost. This concern has been encouraged by calls from the central government to local authorities to try harder to collect enough revenues to cover the council's wage bill. Furthermore, the lack of co-ordination between the local and central government levels when imposing new taxes and licences, has resulted in duplication of local and central government taxes, and added to the overall burden of taxation (see section 4.4).

The performance of each tax with respect to the criteria outlined above is summarised in table 3.3.[39] We should of course be cautious by using such "performance scales": Firstly, each criterion is given the same weight in the table. In practice the decision-makers at the council level put higher weights on revenue mobilisation and equity considerations than the efficiency criterion (see section 4.3). Secondly, the "performance" of individual tax bases may vary between councils and also between areas within councils due to differences in natural conditions, infrastructure and the institutional set-up of the tax administration. Thirdly, performance may also vary between sub-bases within each major tax base listed in the table. For instance, the impacts of produce cess most likely differ between various crops. However, the table indicates that many local taxes – such as those with a score of 2 or less – perform poorly.

Table 3.3 Review of the performance of local government revenue bases

Scoring:	+2	Very positive (good) effect
	+1	Positive (satisfactory) effect
	0	Neutral effect
	-1	Negative (poor) effect
	-2	Very negative (bad)
Criteria:	R	Revenue, net of administrative costs
	EE	Economic efficiency
	E	Equity
	A	Administrative feasibility

Revenue base	***Criteria***				
	R	EE	E	A	*Total*
Development levy	-1	-1	0	-2	*-4*
Produce cess	0	-1	-1	0	*-2*
Business licences	1	0	0	1	*2*
Market fees	-1	-1	-1	-1	*-4*
Property and land taxes	0	-1	-1	-1	*-3*
Hotel levy	0	-1	-1	-1	*-3*
Bicycle tax	0	-1	1	0	*0*
Advertising board fees	1	2	2	1	*6*
Sand fee	0	1	1	1	*3*
Abattoir fee	1	0	1	1	*3*

[39] *The table is based on a "performance scale" suggested by Devas (1988).*

4 How the current revenue system emerged

4.1 Introduction

In the previous chapters we have described the current local government tax system, characterised by large variations between local authorities with respect to revenue bases and rates. How did this revenue system emerge? In this chapter we present three main arguments to explain the rise of the current tax system:

(1) The by-laws facilitate the introduction of revenue bases.
(2) No clear criteria for tax design.
(3) Lack of capacity and poor co-ordination between local governments and the central government with respect to tax design.

4.2 By-laws

At present local authorities in Tanzania have a high degree of autonomy in proposing tax by-laws. The Local Government Finances Act of 1982, and regulations made by the minister responsible for local government specify sources of finance and procedures for imposing and collecting taxes. In principle, every activity located within the jurisdiction of an authority is taxable. Indeed, the Act provides that activities can pay tax to both central government and local government. Specific exemptions apply to publicly owned lands and buildings, cemeteries and burial grounds, charitable and educational institutions and tenements exempted by the minister for local government by order published in the government gazette. Furthermore, tax liability is the responsibility of all residents in an authority, except those proved to be completely dependent on others for their livelihood.

In principle, proposals about new taxes and rate changes are initiated by the Finance and Planning Committee (FPC) of the council, consisting of politically elected councillors. In practice, however, these proposals may originate from the council's Management Team (MT).[40] The FPC forwards its recommendations to the full Council for discussion and approval. The council's legal section, if available, drafts the by-law to match with legal requirements and jargon. Thereafter, the recommendations to introduce new taxes and rate changes are forwarded to the Minister of Regional Administration and Local Governments.[41] The Act requires the Minister of Local Government to approve the proposals for new taxes and rate changes before implementation. In practise, proposals from the councils on tax changes seem to be rarely turned down by the Ministry of Local Government.[42] The most substantial impact of the Ministry's involvement is to

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[40] *The MT consists of the District Executive Director (DED, chairman) and the heads of the departments (the District Treasurer, the District Water Engineer, the District Engineer, the District Educational Officer, the District Medical Officer, the District Land Officer and the District Administrative Officer).*

[41] *In practice, such issues were until recently forwarded to the Minister through the Proper Officer (PO). The PO was a central government officer with powers to oversee local government affairs. Until 1998, the PO for district councils was the Regional Commissioner (RC) and for urban councils the Minister for LG. The Regional Local Government Officer (RLGO) was the chief advisor of the RC on all matters of local government. Based on the advice given by the RLGO, the RC made decisions on the council's proposals. In the new Local Government Act of February 1999 the concept of Proper Officer has been abolished.*

[42] *In Kibaha DC, we were informed on one case dating a few years back where the Ministry of Local Government did not approve a proposal to increase the development levy rate. The Ministry returned the proposal, and requested the council to come up with a new proposal based on a lower rate.*

delay the process of approving new by-laws. Thus, by-law approvals may not be granted until well into the financial year in which it was expected to come into effect.

4.3 Criteria for tax design

The Local Government Finance Act is not explicit about the criteria to be followed when proposing and approving new taxes and rate changes (see section 3.2). Only implicit suggestions can be read in between lines, including considerations of ability to pay. The criterion of revenue generation can be taken for granted to be central to local government taxation. The LG Finance Act specifies that rates may be based on a uniform rate per capita, a graduated rate per capita, the value of immovable property and an assessment on the earnings, livelihood or possessions. Provision for graduated rates allow for ability to pay considerations, and implicitly emphasises the issue of vertical equity. Furthermore, the Finance Act encourages horizontal equity across local authorities by providing that residents who choose to pay taxes in another authority should pay the difference, if the rate is lower in the authority in which payment is made.

No clause in the Finance Act encourages local authorities to take the economic efficiency criterion into consideration (see section 3.2). Neither does it refer to the administrative costs implications of the tax system. However, provision for a uniform rate per capita may implicitly be aimed to lower the administrative costs of implementing the tax system. Furthermore, provision for consultations with and approval from the Minister responsible for local government may be aimed at introducing more specialised expertise in the area of taxation to include such considerations.

We would expect that the various decision-makers involved in tax design pursue different criteria more rigorously than the others. Therefore, there are inherent reasons in the local government institutional arrangement to design a tax system that points in many directions and are inconsistent with several of the stated criteria. However, in practice we would expect that the decision-makers at the council level emphasise the tax system's revenue generative capacity and equity considerations (i.e., taxpayers' ability to pay). Furthermore, we would expect that the criterion of economic efficiency and the issue of securing consistency between local and central government policies would be major concerns of the central levels. Our survey data from Kibaha and Kilosa show that both local politicians and the staff of the management team (MT) of the council highlight revenue generation for the provision of public services and taxpayers' ability to pay as the major concerns when new taxes and rates are proposed. However, the administrative staff, including tax collectors, put more emphasis on revenue generation than councillors who emphasise the ability-to-pay criterion. Neither cost effective tax collection nor economic efficiency seem to be of any concern.

Differences between the various stakeholders with respect to tax design seem to be exacerbated by internal and external pressure that contribute to strengthen or alter their priorities and choices (see section 5.3.4). Two examples to clarify the issue will suffice. First, central government pressure on bureaucrats to raise enough revenue to finance salaries of council staff will alter the relative importance of the revenue criterion at the expense of other criteria. Second, taxpayers' pressure on councillors to lower taxes will alter the relative weight between the ability-to-pay criterion and other criteria. Local politicians are interested in securing their political base at all levels, i.e., both horizontal across villages in the ward, and vertical from the ward level to the village and kitongoji levels. Thus, politicians most likely are influenced by their constituents when proposing changes in revenue bases and rates. In some councils this influence is reflected in the fine-tuning of the tax structure, based on equity considerations. The large number of sub-bases and rates observed in Kibaha DC may reflect the influence of local politicians in tax design (see section 2.2). Furthermore, this argument implies that we may observe large variations in tax design between local authorities depending on the relative power of councillors and bureaucrats.

4.4 Co-ordination between central and local government

The Finance Act requires the Minister for Local Government to consult with the Minister of Finance in making rules that prescribe limitations and impose conditions on local authorities' finance legislation. However, the Minister for LG has final authority over the issues. The reasons for incorporating top ministerial level decisions in the designing of local government taxes are not explicitly stated in the act. They may, however, be aimed at ensuring that inconsistencies between local government taxation and central government policies are avoided. In practise, there has until recently been little or no co-ordination between the ministry responsible for local government and the Ministry of Finance with respect to taxation. [43] This has partly to do with lack of capacity at all levels.[44]

Presently all the relevant decision making levels lack the required tax expertise for designing an appropriate tax system.[45] At the local level the serious shortage of qualified staff at the treasury and planning departments has been noted across almost all councils (Semboja, 1995). Even the available staff lacks expertise on tax issues. At the ministerial level, experience shows that the main concerns with respect to local tax design are raised by the Legal Department; the ministry has no tax experts.[46] However, even if it contained any they would easily be over-flooded by influx of proposals from more than 100 councils.

The lack of appropriate and adequate capacity at the relevant levels may lead to:

- misinterpretation of the statutes, guidelines and policies;
- unavailability of the relevant information to compute the necessary variables;
- misuse of the relevant information; and
- simply the lack of appreciation for the importance of information, including the above mentioned criteria for tax design.

[43] *In January 1999, a "Task Force on Rationalisation of Central and Local Government Taxation" was established. The Task Force presented its preliminary recommendations to the Government in March 1999.*

[44] *The administrative structures of the central and local governments are presented in appendix 3.*

[45] *The necessary skills are knowledge to read, understand and interpret the tax statutes and central government guidelines, regulations and policy directions; availability of the relevant information for estimating accurately the budgetary requirements (both revenues and expenditures), tax bases and rates. They require substantial human resources such as statisticians, tax experts, including accountants, auditors, lawyers, etc..*

[46] *One recommendation made by the "Task Force on Rationalisation of Central and Local Government Taxation" is to establish a tax unit within the Ministry for Regional Administration and Local Government since the Ministry at present does not possess such expertise (March 1999).*

Furthermore, the weak capacity that exists in both the councils (as proposers) and the ministry responsible for local governments (as the approving authority), have led to duplication of taxes.[47] In other cases local government taxes are inconsistent with the central government's policy. The case of cashew cess in Kibaha DC is an illustrative example of this (see section 3.3.2).

In short, the lack of technical staff at the various decision making levels raises serious concerns about the capacity of councils to design tax systems that comply with the stated criteria (section 3.2). The lack of expertise is a historical fact. The re-introduction of local government in 1984 after 12 years of absence did not bring with it its old resources, expertise, culture and credibility. Even the local government institute at Morogoro, the Institute of Development Management, had changed its curricula to cater for a different client. Thus, the present local government institutional arrangement operates as if tax design is anybody's business.

4.5 Summary

The by-law system gives local authorities in Tanzania quite a wide discretion to introduce new local taxes and to set tax rates, subject to ministerial approval. Due to lack of capacity and poor co-ordination between the central and local government only limited restrictions are in practice imposed by the central level on local governments' tax design. Therefore, the local revenue systems have developed without much interference from the central level. This has led to large variations in the tax structures of local authorities (see chapter 2). Furthermore, lack of co-ordination between the central and local levels has led to duplication of taxes and inconsistencies between taxes imposed by local authorities and the national government's priorities, for instance export promotion.

The stakeholders involved in local tax design reinforce the variations observed between councils. In particular, the emphasis by local politicians on equity considerations has led to a fine-tuning of the tax structure in councils where politicians have the power to influence tax design. Thus, we argue, the present local revenue structure are partly a result of the different interests of the stakeholders involved in tax design, and partly a consequence of the councils' and the ministry's inability to understand the financial, economic and social implications of the local tax system.

There are notable differences between the institutional arrangements of local government tax collection and tax design. However, in practice, the demarcations between the institutional environment of the two distinct activities are not as clear as they might appear above (see table 4.1).

[47] *Some observers argue that the central and local governments are competing for the right to exploit limited revenue sources. This might sometimes be the case. However, our findings indicate that poor co-ordination between the different layers of government instead of competition leads to double-taxation of the same revenue base. Increasing awareness of the problem of duplication by various stakeholders, including the business community, may, however, change this situation and lead to more competition.*

Table 4.1 The role of the different stakeholders in tax design and collection

Agents	*Degree of involvement in*	
	Tax design	***Tax collection***
1.District management team (DMT)	Direct and significant	Direct and significant
2.Sub-district level (ward/WEO and village/VEO)	Indirect, in general, insignificant	Direct and significant
3.Bureaucrats at the ministry level	Direct, in general, insignificant	Indirect, in some cases significant
4.Local government politicians	Direct, sometimes significant	Indirect (mobilisation), sometimes significant
5.Central government politicians	Indirect, insignificant	Indirect, sometimes significant
6.Donors (see section 5.3.4)	Indirect, insignificant	Indirect, sometimes significant

5 The gap between the statutory and the effective revenue system

5.1 Introduction

Revenue collection faces two major administrative problems. First, the administrative costs of revenue collection relative to reported revenues are high. Second, many councils are unable to realise fully (sometimes only a small share) of the revenues due to them. In this chapter we will explore these two issues, and provide possible explanations.

5.2 Administrative costs

One consequence of the present local revenue system is the high costs of tax administration.[48] The many sub-bases with different rate structures add to these costs. This seems, however, to be largely unrecognised by local authorities. There is little appreciation of the opportunity costs of the staff already employed by the council. One might even argue that for certain small taxes and charges the collection costs are the reason for the levy. In other words, the purpose is to create employment or at least an income-earning opportunity for someone who might alternatively be unemployed. Furthermore, the way in which budgets are compiled, whereby tax revenues appear under one heading and the costs of the local revenue office under another, does not encourage cost-effectiveness.[49] In addition, many costs are simply not made explicit, for instance the use of government owned buildings, or the use of co-operative officers to collect certain taxes, and the use of kitongoji-leaders in some villages to mobilise taxpayers.

An illustrative example of this lack of concern for administrative costs is the poultry produce cess in Kibaha DC. According to the proposed by-law from 1990, a cess of TSh 2,- was to be levied on the sale of day old chicks:

> "The cess shall become due and payable by the seller to the council to the revenue collector duly authorised to receive the cess for and on behalf of the council." [....]
> "Any livestock owner who contravenes or fails to comply with any of the provisions of these by-laws shall be guilty of an offence and shall be liable to a fine not exceeding five thousand shillings or to imprisonment for a term not exceeding three months or to both such fine and imprisonment".

It is of course quite unrealistic to enforce a tax on chickens without substantial resources.

The total wage bill for the tax administration and revenues reported in Kilosa DC is illustrated in figure 5.1. The wage bill represented about 80 percent of total own revenues reported in 1995.[50] The corresponding figure for 1996 was about 64 percent. However, when disaggregating the figures to the ward level, we find large

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[48] *In comparison, the administrative costs of the central government "Tanzania Revenue Authority" constitute approximately 3 percent of gross revenues reported (TRA, 1998).*
[49] *Similar arguments are put forward by Devas (1988:78) in relation to the Indonesian local government tax system.*
[50] *The wage bill includes wages and allowances for the staff of the revenue department and the ward offices, including village executive officers. Revenues refer to the calendar year, while the wage bill refers to the fiscal year of the central government that runs from 1 July to 30 June.*

variations between individual wards.[51] In some wards in Kilosa DC, the administrative costs are higher than the revenues remitted to the council (figure 5.3). For instance, in Lumbiji ward the wage bill was 2.75 times higher than the revenues collected in 1996. The corresponding figures for Mwatani and Ulaya wards were 1.92 and 1.44 times higher, respectively. In Kidodi ward the wage bill corresponded to 18 percent of the reported revenues from the ward. In Kibaha DC we also found large differences between the wards. In 1996 the wage bill in Magindu ward represented about 25 percent of total revenues reported from the ward. The corresponding figure for Ruvu ward was 70 percent (figure 5.2).

[51] *The figures include the salaries of Ward Executive Officers and Village Executive Officers. These officials are also responsible for law and order and other administrative tasks in the ward and/or village. However, according to the WEOs and VEOs interviewed, they spend a considerable part of their time to organise and/or participate in tax collection.*

Figure 5.1 Tax revenues and wage bill, Kilosa DC

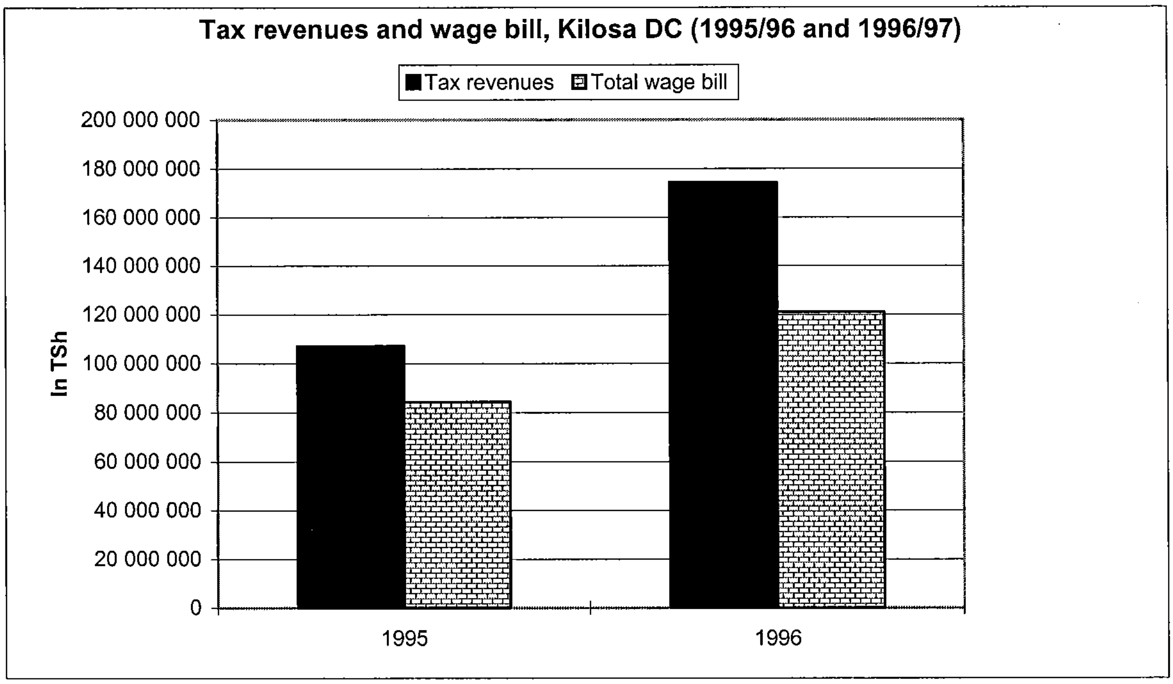
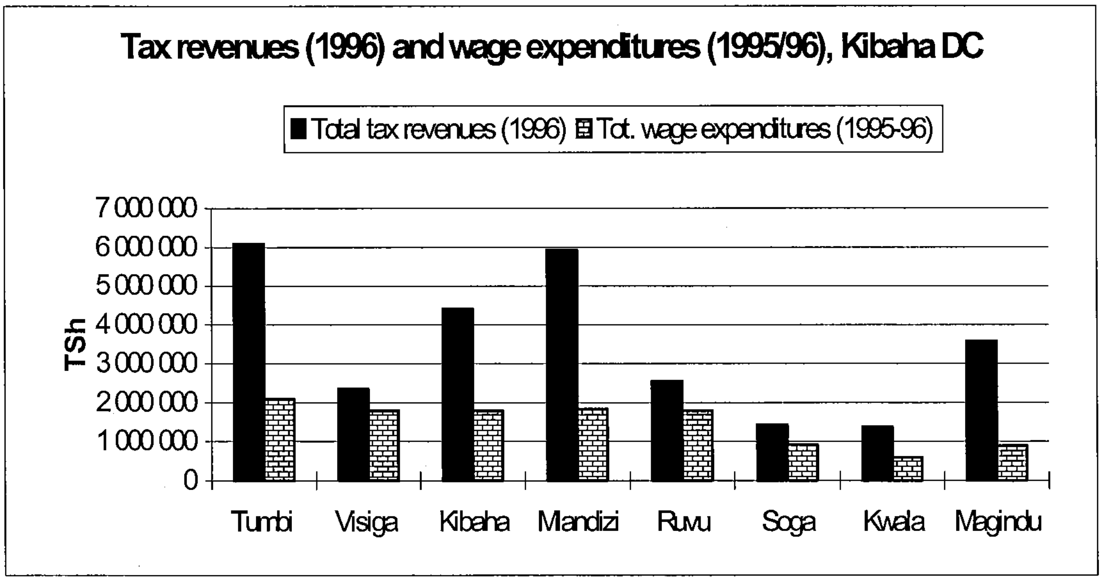


Figure 5.2 Tax revenues and wage bill by wards in Kibaha DC



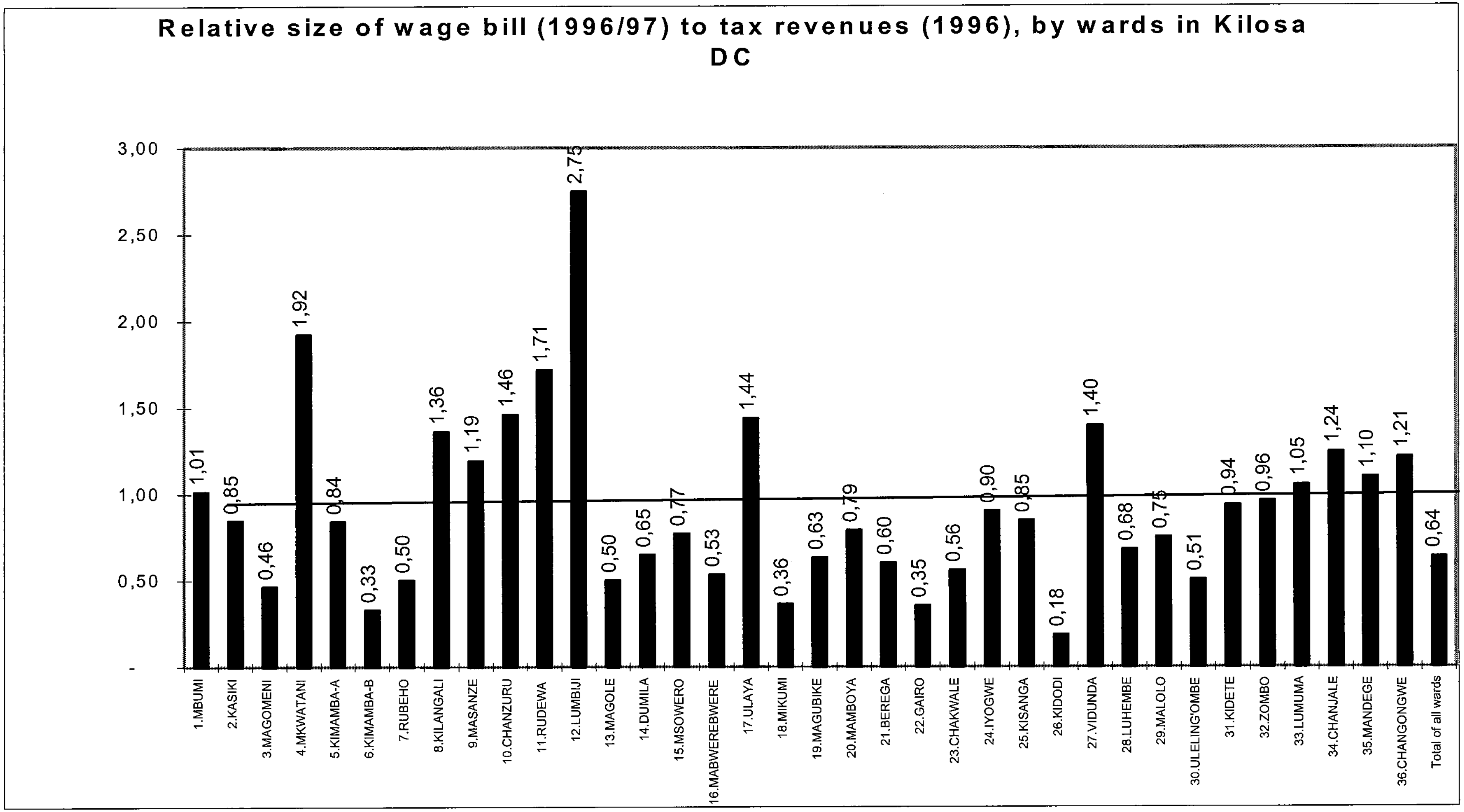


Figure 5.3 Relative size of wage bill to tax revenues by wards in Kilosa DC

The costs of tax enforcement also vary between different revenue sources. Some revenues are relatively easy to collect because there are clear ways to deal with defaulters. If, for instance, a resident does not pay water fees, it is, in principle, easy to turn off water (although there are sometimes political obstacles to do so). Similarly, businesspeople that fail to pay a licence fee can be refused services or closed down. Furthermore, bicycle tax can easily be collected at roadblocks, although often at relatively high administrative costs. Some revenues are not even collected directly by the council. For instance, civil servants and employees in formal sector businesses pay the development levy through a withholding system, where the employer acts as the collector. Many taxes are, however, relatively difficult to collect. According to our interviews with tax collectors at the ward and village levels in Kibaha DC and Kilosa DC, development levy is considered to be the most problematic tax to collect, followed by crop cess and livestock cess. Tax officials at the district headquarters also rank development levy as the most problematic tax to collect, followed by property and land taxes.[52]

5.3 Problems of revenue collection

One major administrative problem for many councils is their inability to realise fully the revenue due to them. Thus, the ratio between reported and projected revenues differs significantly both between councils and between areas within individual councils. From a sample of 27 councils, the effective development levy rate in 1995 varied from TSh 40 (Kilwa DC) to TSh 967 (Makete DC), indicating large variations in the effective tax enforcement. The ratio between actual reported levy and projected revenue between wards in Kibaha DC in 1996, varied from 8.9 percent to 38.7 percent. The corresponding figures for Kilosa DC were 13 percent and 97 percent (see section 2.3.6).

How do we explain the gap between the statutory and the effective tax system? Several factors may contribute in explaining this wedge, including:

(1) Poor administrative capacity to enforce the taxes.
(2) Explicit and intentional tax evasion and resistance from taxpayers.
(3) Corruption, including embezzlement of revenues.
(4) Political pressure on the local tax administration to relax on revenue collection.
(5) Negligence on the part of many government agencies and parastatals to pay taxes.

Furthermore, some councils may also manufacture their accounts and budgets to gain Ministerial approval (see section 2.3.6). This may be due to central government pressure on local bureaucrats to raise enough revenue to finance salaries of council staff (see section 4.3). According to Migdal (1988:253), political systems under pressure from the centre to produce certain development results are likely to exercise their own form of accommodation. The most common form of accommodation is simply to pass false or inflated accounts of development results to superiors who are out of touch with local conditions. Thus, where supervision is lax, district leaders, including local bureaucrats, may use their budgetary discretion and the force at their disposal for personal gain (see section 5.3.3).

[52] *The experiences of local government tax officials with respect to property taxes diverge significantly from the recommendations made by consultants involved in the ongoing reform process in Tanzania. Price Waterhouse (1998), for instance, recommends the local authorities to use "more easily collectible taxes, such as property taxes" (see section 3.3.5).*

5.3.1 Capacity

The organisational structures and staffing for local revenue offices have been devised in the Ministry for Local Government, and seem to be applied without considering differences in the size or revenue potential of the council. Thus, in the councils studied, revenue officers at the district centre and some wards claimed to be substantially understaffed, against the standard organisation chart (figure 2.1), even though collection costs already exceeded the yield for several of their local taxes. Lack of staff can of course be a crippling problem in rural councils where there are not enough collectors to post them to major market centres. In such cases, tax collectors must travel among market sites, making collection more occasional and difficult to enforce. Lack of reliable transport may further hamper collectors. In the councils surveyed, the capacity to enforce collection of unpaid development levy, land rates, licence fees, etc. is low. However, the local militia is frequently mobilised to enforce taxes, and sometimes also the police at roadblocks. Although such measures may boost collections significantly, the quality and regularity of such assistance vary and may be questionable in the long term.

Given the complicated revenue system, the large number of taxes, licences, charges and fees, and the various rates on different items, it is probably legitimate to argue that local governments do not have adequate collection personnel, and that a substantial strengthening of staff is needed to administer the present revenue system. However, there are about 110 local authorities in Tanzania, each with a different tax system. To establish adequate capacity for designing and administering the existing revenue system in all these councils will require more resources than can be available in the short to medium run in Tanzania. Even the central government revenue authority (TRA) faces problems in recruiting qualified accountants, assessors, investigators and collectors. Whilst there is, undoubtedly, room for improved tax administration, attempts to squeeze additional revenues from poorly designed taxes may have negative effects on the economy and the society in general. Thus, the major problem may not be lack of capacity, but the tax structure itself.

5.3.2 Resistance from taxpayers

Taxes are widely perceived to be unfair. Taxpayers see few tangible benefits in return for the taxes they pay.[53] Virtually no development activities are undertaken through councils' financial sponsorship and, even the existing capacities are not producing the expected services due to lack of operation and maintenance funds (Semboja and Therkildsen, 1995). The deterioration and in some cases non-existence of public services raises taxpayers perceptions of exploitation from an unequal contract with government, and promotes tax resistance. This contributes to undermine the legitimacy of the government both at the local and central levels.[54]

Taxpayers' perception of the quality of public services in Kilosa DC and Kibaha DC is presented in table 5.1. Dissatisfaction seems to be most widespread in

[53] *For instance, in our survey of taxpayers in Kibaha DC, 83 percent of the respondents answered that in their view taxes was "only partly" or "not at all" used to provide public services. The corresponding figure for Kilosa was 88 percent (the majority, i.e., 70 percent, answered "not at all"). Taxpayers' perceptions were supported by the tax collectors (Fjeldstad and Semboja, 1998).*

[54] *See Bennett (1990) for a discussion of the concept "legitimacy" in relation to public-sector management and accountability.*

Kilosa where 75 percent of the respondents considered the quality to be bad (compared to 66 percent in Kibaha). None of the respondents in Kilosa considered the public services to be good (compared to 6 percent in Kibaha).[55] 77 percent of the respondents in Kilosa said the quality of the services today was worse than three years ago (compared to 66 percent in Kibaha).

Table 5.1 Perceptions on the quality of public services (in percent of total number of respondents)

Perception	*Kibaha (N=128)*	*Kilosa (N=44)*
Good	6	0
Average	26	25
Bad	66	75
Don't know	2	0

Source: Fjeldstad and Semboja (1998)

The argument that tax resistance is correlated to deteriorating public services is supported by other studies. Bukurura (1991:91), for instance, refers to an investigation from 1987 by the Tanzania News Agency in Kigoma Town Council, which reported that "many people were defaulting apparently because they thought the council was not doing its best to serve the residents". Tripp (1997:233) refers to an article in Daily News (from 9 June 1985) in which she quotes a typical comment by a Dar es Salaam resident: "When it comes to Development Levy we have .... seen nothing as a result of the levy we pay..... the city is very dirty and the situation is deteriorating day in and out..... What we want to see is how such taxes are being spent."

Furthermore, taxpayers' compliance behaviour seems to be influenced by the manner in which the tax law is administered and enforced. We found that the severity of sanctions has tended to fuel tax resistance. Severe sanctions (e.g., strict enforcement and harassment of taxpayers), and discontent with what people feel they get in return from the government seem to increase tax resistance, and, thus, contribute to explain the widespread tax evasion observed. Thus, tax authorities' unresponsive, disrespectful and unfair treatment of taxpayers may foster disrespect for and resistance against tax authorities and tax laws. Accordingly, harsh enforcement and harassment by collectors may induce tax evasion, especially if no expected services are provided in return.

Tax resistance sometimes also takes more violent forms. In Kilosa DC we were informed about tax collectors being attacked by the public. One collector had been seriously wounded after being hit in the head with a panga (a large chopping knife used by peasants) when he approached an assumed tax defaulter. In 1996 the ward office in Chanzuru was destroyed during night and the Tax Register Books were

[55] *The response from people in Kilosa is interesting considering the long-term involvement of international development aid agencies in the area. For instance, the main roads in Kilosa have a fairly good standard due to donor funding. Furthermore, donors are involved in the education and health sectors. However, people seem to be well aware about who is providing the various services, and distinguish between "council services" and "donor provided services". Thus, the main roads are referred to as "Irish roads", and the almost non-passable feeder roads are named "council roads". Donors' presence in Kilosa may have contributed to reveal the poor standard of local services for the constituents.*

burnt. In Kilosa, tax collectors avoided certain villages due to the high personal risk involved in tax collection. Other villages were only visited by collectors accompanied by the local militia. Cases of tax revolts are also reported from councils in other regions, including Kilimanjaro Region and Coastal Region. For instance, *Daily News* (28 November, 1997:5) reports that "[o]ver twenty Moshi Municipal Council workers who were on a special operation to net development levy defaulters were attacked by a mob at Mbuyuni Market on Wednesday afternoon and eight of them were injured, some seriously, it was learned yesterday."

5.3.3 Corruption

Fiscal corruption is extensive in the councils studied.[56] It takes many forms and varies by types of taxes, methods of tax collection and location. It cuts across all levels of the local government, from the village to the district council headquarters. Magnitude in terms of the amounts of money involved seems to rise by the administrative level of the council.[57]

Although many cases of collusion between taxpayers and collectors are reported, our findings show that the most common type of corruption is embezzlement of revenues by tax collectors.[58] Embezzlement is the form of tax revenues, which does not accrue to the accounts of local governments, but is siphoned off by tax collectors and administrators (Prud'homme, 1992). By definition the amount of embezzlement is not recorded. The prevalence of embezzlement can be identified on the basis of indirect methods (see section 5.3.3.4). Furthermore, embezzlement can be assumed on the basis of three observations:

- the level of wages makes it necessary;
- the nature of the tax structure is a strong inducement to it; and
- the lack of controls makes it possible.

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[56] *Fiscal corruption is here defined as any action in which tax collectors use their position to extort money from taxpayers or collude with taxpayers to defraud the treasury or find some other means to embezzle money from the tax authorities (Fjeldstad, 1999).*

[57] *In a survey organised by Commission on Corruption (URT, 1996a), focusing on corruption in service deliveries in the police, judiciary, revenue departments and land services, corruption was also found to be extensive (CIET International, 1996). The survey data indicated that around a third of recent users of the four services had to pay, on request from the civil servant, a bribe in order to get service. Long delays in service were reported, together with lack of useful information about the service. Such payments are often referred to as "kitu kidogo" ("something small") or "chai" ("tea money"), or sometimes "lunch allowances" or were said to be for "stationary to open the file". The "cheapest" service was the police, and the most expensive one the lands service.153 civil servants employed in the four services in 10 district councils were also interviewed. They were asked for their views about the level of corruption in public services in Tanzania. More than half of them (57 percent) thought there was "very much" corruption in public services. This proportion corresponds to the Tanzania average of 60 percent of the surveyed households who thought corruption in public services was "very much". About two thirds of the civil servants interviewed thought corruption had worsened in the last five years.*

[58] *We were informed about several cases of collusion in Kibaha and Kilosa DC. For instance, in 1995 three Village Executive Officers in Kibaha DC (Bokomnemela village in Soga ward; Mwendapole village in Kibaha ward; and Twendepamoja village in Tumbi ward) were fired due to dubious deals with taxpayers on cashew cess. In this case, no receipts were issued, and TSh 1,000,000 was evaded. The incident was discovered by accident and reported by an official from the District Treasury Office. In Kilosa DC in 1996, 10 ward revenue collectors and seven militiamen were retrenched due to mismanagement of funds.*

5.3.3.1 The official wage level

The official wages of local government employees in Tanzania are very low. This point is well documented in several studies, including World Bank (1994) and Mans (1994).[59] During the 1970s and 1980s, there has been severe erosion in the real wages and salaries of civil servants. Semboja and Therkildsen (1992), based on Valentine (1983), estimate that real wages of civil servants in 1984 had fallen to around 40 percent of the 1969 level for the lowest paid employees and to almost one-tenth for the highest paid. The decline continued up to 1988 when real minimum wages were only 25 percent of the real minimum wage 20 years before. Thus, in the late 1980s average salaries provided only one-fifth the purchasing power of the 1970s.

Civil servants also receive monetary allowances of, on average, 35 percent of wage remuneration. However, allowances differ significantly between the different categories of civil servants. The upper ranks of the civil service also enjoy several in kind benefits, such as free housing, telephone, and transport (World Bank, 1994). According to Mans (1994:378), the average civil servant's package of wages and monetary allowances covers only about 40 percent of the expenses of a typical household. To say that civil servants cannot live on their wages is not a metaphor, but a statement of fact.

In a recent survey on corruption in service deliveries in Tanzania, 78 percent of the respondents mentioned low salaries of public service workers as being a major incentive to seeking and accepting bribes (CIET International, 1996:24). One responded stated:

> You may find someone having not received salary for at least three or four months. What do you think he will eat? He will eat us!

As administrators and tax collectors do live, it means that they have other sources of income in addition to their salaries. Other sources often include income from their shambas or from a second or third job in the private sector.[60] There is, however, a strong presumption that embezzlement constitutes a third additional source of income.[61]

5.3.3.2 The tax structure

The characteristics of the local government tax system in Tanzania make corruption relatively easy. As described above, there are dozens of different taxes for any given local government. In addition, each of these taxes is expected to be collected from hundreds of different taxpayers and/or different activities. Most of these tax contributions are relatively small. The tax structure is such that not all of these taxes can be collected, or are too costly to collect from an administrative

[59] *The structure of wages for civil servants is fixed unilaterally by the Government. This does, however, not include the staff of Bank of Tanzania and Tanzania Revenue Authority.*

[60] *In our survey in Kibaha and Kilosa, the majority of the tax administrative staff interviewed said that they had experienced to wait one to three months for their salary. When asked how they managed to survive, the majority answered that they survived on products and incomes from their "shamba" (plot of land). Some also said they had to borrow money from relatives.*

[61] *These observations do not imply that increased salaries will curb corruption. Wage incentives will only function in combination with other measures, including credible policies of monitoring and penalty schemes (Fjeldstad, 1999). Thus, under a non-transparent tax system, poor or no auditing and weak sanctions against culprits, it may in fact be optimal for the government not to increase the pay package. Increased salaries in such a situation most likely will increase the administrative costs, without necessarily raising the tax revenues reported to the council treasury.*

point of view. Thus, budgeted taxes are not expected to be fully collected, and they are indeed not. But if it is considered appropriate with a 80 percent ratio of revenues collected to revenues budgeted, why not a ratio of 60 percent (or 50 percent) that would leave room for 20 percent (or 30 percent)?[62]

In addition, the revenue target for tax collection does not necessarily refer to the budget, but to collect sufficient revenues to cover the wage bill of the council. When this is achieved, the central government will usually not interfere into the affairs of the local authority. Since revenue estimates are based on information from the administrative staff, including revenue collectors at the council headquarter and the ward levels, there is room for under-budgeting. Thus, the collectors can report enough revenues that cover the wage bill and pocket whatever is left.[63]

These arguments are supported by observations from Kibaha and Kilosa. The performance of tax collectors at the ward and village levels is related to their capability to collect enough revenues to cover their wage bills. In Kibaha DC, for instance, several village executive officers (VEOs) and some ward revenue collectors (WRC) had been fired in recent years, due to poor performance. Ward executive officers were, in general, transferred to less attractive or remote wards if they did not perform according the wage bill criterion.[64]

5.3.3.3 Controls

The lack of effective controls also facilitates embezzlement. In principle, financial control in local authorities in Tanzania is exercised through several mechanisms, generally grouped into internal and external. However, as discussed in section 2.3.5, both functions are weak. In some councils no internal audit units are in place, and the Controller and Auditor General's Office suffers, in general, from limited capacity to carry out proper auditing.

5.3.3.4 Case studies

The combination of low wages, a non-transparent tax system, and lack of controls facilitates corruption. To illustrate the mechanisms and scope of corruption we will present a few cases:

Most taxes are collected in the form of cash (see section 2.3.2). The collector is supposed to deliver a receipt of a standard form to the taxpayer, a copy (counterfoil) of which is retained by his superiors to be audited. In principle, the tax collector is required to return the old receipt books showing used counterfoils and unutilised receipts for audit so as to control their use before receiving new ones. In practice, however, this procedure is often not followed. In Kilosa DC we found evidence that large numbers of tax receipt counterfoils were not returned to

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[62] *See Prud'homme (1992).*

[63] *This system has some similarities with sharecropping systems in agriculture, and with ancient systems of tax farming. Sharecropping is a land-tenure system where the landlord gets a (percentage) share of agricultural output, and the tenant keeps the remaining output (Sah and Stiglitz, 1992). In tax farming the right to collect taxes in a specific area is auctioned off to private agents (Stella, 1993). The auction bid or part of it is often paid in advance to the government. Then it is left to the tax farmer to collect (and keep) whatever is collected. Since profit maximisation usually is the objective of tax farmers, tax enforcement may imply extortive methods of collection and harassment of taxpayers (Webber and Wildavsky, 1986).*

[64] *We observed one exception from this practice: The Ward Executive Officer in Lumbiji ward, Kilosa DC, was fired in 1997 due to poor performance.*

the council headquarters as required by the financial regulations.[65] It is reasonable to assume that the counterfoils not returned are used to embezzle tax revenues. A note from the district chief executive supported this proposition.

For development levy, we could estimate that the amount embezzled in this way in 1995 corresponded to more than 35 percent of the council's actual revenues from development levy. The corresponding figure for 1996 was about 15 percent. It is not possible to estimate the amount embezzled in this way for other categories of taxes such as crop cess, livestock cess and market fees, since the receipts issued will vary from one transaction to the other, depending on the specific tax item, rates and units. However, for 1995 more than 30 percent of the receipt books issued for such taxes were not returned.[66]

Thus, in practice, these receipts are often not available (by neglect or purpose), and when they are utilised, they can easily be modified. One well-known method of stealing money paid in by taxpayers is through the use of *the carbon shipping system* (see, for instance, URT, 1996a:318; and TCCIA, 1995). The taxpayer is given a receipt showing the amount paid. Since no carbon paper is put under the original receipt in the process of writing, the collector later enters a lesser figure on the copy and pockets the difference. Another method used by collectors is to write receipts noting a lower amount than the amount paid by the taxpayer. Collectors may use this method when dealing with taxpayers that cannot read or write. In other cases, the carbon paper is placed in such a way that the counterfeit only registers a part of the figure on the taxpayer's receipt, for instance, omitting some zeros.

In another case, which we followed over a period of three months in 1997, we found evidence that only a small share of the maize cess collected at a maize market in Kilosa DC actually was reported to the council. Maize is the major cessable crop in this council. Sellers and buyers meet at a designated area close to the main road allocated to this purpose. The cess is collected by the ward officers (i.e., the Ward Revenue Collector (WRC) and Ward Executive Officer (WEO)) from the buyers at the market area. According to the collectors, the maize cess is easy to collect. By comparing the amount of cess collected, with the revenues reported in the accounts of the district treasury for the same period, we found that less than 5 percent of the cess was actually reported, or to put it differently more than 95 percent of the revenues were embezzled.[67]

As noted in section 2.3.4, we found inconsistencies between the revenues recorded by the village executive officers and the records at the ward level. There were also inconsistencies between the records of the ward and district levels. We were informed about cases where tax collectors reported less revenue to the level above than what was actually collected. However, we could not trace any systematic

[65] *In total, 771 receipt books were not returned in the period 6 January 1995 to 26 February 1997. The number of receipts in each book varied from 50 to 150, depending on the type of tax (see section 2.3.5).*

[66] *A large number of the missing books were issued to the District Revenue Inspector (DRI) and the District Accountant (DRA), both based at the district headquarter. The DRI is responsible for controlling and inspecting collectors at lower levels. In the two-year period from January 1995, the DRI had not returned 126 receipt books. The corresponding figure for the DRA was 114 books. They continued to receive new receipt books in spite of the fact of not having returned previously issued books.*

[67] *During the visits to the market, the number of maize bags loaded on to lorries and the presence of the collectors were recorded. In 1997, the cess was TSh 200 per bag à 100 kg.*

pattern that revenues reported decreased from one level to the one above in the collection and reporting process.

We were also informed that embezzlement took place through collusion between staff of the council's treasury department and bank officials, leading to the non-banking of tax revenues: Bank officials issue a receipt on the correct amount to the treasury official. The receipt is brought back to the council's revenue office for control, and is consistent with the money remitted. However, only a part of the tax revenues is actually deposited into the council's account. The rest is shared between the bank officials and the collectors involved. This method may be sustained over time since what actually is deposited in the council's bank account is rarely controlled. In our study, we were not able to trace any inconsistencies between taxes reported by the revenue department of the councils studied and what actually was deposited in the councils' bank accounts. However, experiences from other councils indicate that large amounts are embezzled in this way. Recently, one such case was brought to court, involving several staff members of the council's revenue department. The amount embezzled in this specific case during the first 6 months of 1997, corresponded to 10 percent of the total own revenues of that council in 1996. In early 1998, the Controller and Auditor General uncovered cases from 31 councils where cashbook-receipts were not reflected in the bank statements (see appendix 2).[68]

We should, of course, be cautious when generalising on the basis of the cases referred to above. They are specific for the councils studied. However, a survey of newspaper articles on corruption in local authorities (appendix 2)[69] and other studies (including CIET International, 1996) indicate that corruption is an extensive problem. Furthermore, embezzlement seems to be the major form of corruption.

Prolonged embezzlement of large amounts of tax revenues requires the involvement of relevant senior officials from the councils' headquarters. In one council we found evidence of a corruption network involving the head of district treasury, the district revenue inspector, the district accountant and ward executive officers. Furthermore, the prolonged existence and performance of such corruption networks requires that:

(i) the tax collectors and tax inspectors are stationed relatively permanently in their positions, i.e., they are rarely transferred;
(ii) the network is limited to a relatively small number of people in the tax administration; and
(iii) taxpayers are not directly involved.

The exclusion of taxpayers from the embezzlement corruption network is possible because the tax collectors may indeed provide genuine receipts to taxpayers on taxes paid. In some cases two sets of similar receipt books are used.

[68] *In the case referred to above, the embezzlement-network was revealed when a new treasurer took over and initiated internal controls.*

[69] *The survey covers the period March 1998 to January 1999. To collect this information we engaged a person to read through as many Tanzanian newspapers as possible (both daily and weekly newspapers, in English and Swahili). Due to other obligations some newspapers were not read in periods. Thus, it is fair to say that the newspaper reports provide a picture of the situation, although they most likely underestimate the extent of corruption revealed.*

Whether fiscal corruption is more widespread at the local level compared to the central government tax administration is beyond the scope of this study. The Warioba-report (URT, 1996a) shows that corruption is extensive at all levels of the public sector in Tanzania. We have not come across any empirical studies comparing corruption at the local and central levels. However, some recent review studies conclude that corruption is likely to be more prevalent at the local than at the national level. According to Manor (1999:101), decentralisation "is always attended by an increase in the number of persons who are involved in corrupt acts", although this need not imply that the overall amount of money diverted by corrupt means increases. Prud'homme (1995:211) argues that there are probably more opportunities for corruption at the local level: Firstly, local officials usually have more discretionary powers than national decisionmakers. Secondly, local bureaucrats and politicians are likely to be more subject to pressing demands from local interest groups in matters such as taxation. Tanzi (1996) supports these views.

5.3.4 Political pressure

Political pressure is a major impediment to revenue collection in some councils (see Semboja and Therkildsen, 1992:1107). This problem stems from the fact that taxes are universally disliked and councillors who want to be re-elected need to be popular among the constituents. In some local authorities councillors are reluctant to raise local taxes and charges, not only due to concerns about their popularity, but also because they may be major local landowners or businesspeople who consider higher taxes as having direct negative impact on them. As a result councillors intervene in revenue collection. This intervention sometimes results in conflicts between revenue collectors and the local politicians. For instance, a general view expressed by the tax collecting staff in our survey was that councillors obstructed tax collection and were talking "cheap politics". In particular, this conflict was evident in Kilosa DC. In Kibaha DC we did also observe certain tensions, although less pronounced than in Kilosa. Furthermore, councillors in Kibaha seemed to have a relatively stronger influence on tax collection and design compared to the situation in Kilosa (see section 4.3). Such conflicts seem to be rooted partly in divergent objectives with respect to tax design (see section 4.3), and partly in lack of trust between administrators and politicians at the local level. Jacobsen (1999), based on data from 14 district councils, finds that there is a "trust deficit" in the political-administrative relations at the local level in Tanzania. Furthermore, lack of trust seems to reduce the flow of information between politicians and bureaucrats.[70]

Indications on the impacts of political intervention in tax collection can be found in the councils' financial statements. For instance, some councils experience revenue shortfalls in election years, particularly with respect to development levy. In a sample of 48 councils, 31 experienced a drop in revenues in the election year 1995. This might be due to the influence of politicians (both local and central government politicians). For instance, we were informed that CCM-politicians (the ruling party) tried to moderate the tax collectors' efforts to enforce taxes during election years by issuing statements such as "don't harass taxpayers" or "relax on tax collection". Politicians from the opposition parties, in contrast, approached taxpayers directly and advised them "not to pay taxes", since taxes, according to their view,

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[70] *Conflicts between council employees and local politicians are not of any new date in Tanzania. For instance, Dryden (1968:144-149), referring to the mid-1960s, describes some areas of conflict between these stakeholders.*

were used to "finance the CCM-government". Such statements are said to be common during election years.

The influence of local politicians on tax design and collection vary, as noted above, between councils. This may have to do with the influence of international donors. Through district development programmes donors have often exerted strong influence on the behaviours, decisions and actions of local authorities' administrators and politicians (see table 4.1). In general, donors co-operate with council administrators and staff to implement their activities, usually through the creation of parallel structures. This has increased the influence and power of the bureaucracy, most likely at the expense of the political system. In Kilosa District Council, which has a long history of donor support, we found indications that this was indeed the case, and that it had implications for tax collection in two ways:

- Firstly, tax collection in Kilosa DC is facilitated through harsh and violent approaches that are mainly advocated and implemented by council administrators, with minimum support from local politicians.
- Secondly, donor support may cushion council administrators against possible taxpayers' opposition. Service provision through donor supported activities provides a free riding opportunity to council administrators who often claim to be the providers of such services. This has provided opportunity for corruption.

In Kibaha, which has experienced limited donor support, local politicians, in contrast, seem to play a more important role in the design and collection of council revenues. Thus, tax collection is characterised with more laxity compared to Kilosa. The level of corruption also seems to be lower in Kibaha. This may have to do with the fact that local politicians to some extent monitor the collectors. However, based on our data for the period 1992-95 we can not ascertain the robustness of these observations.[71]

5.3.5 Negligence by government institutions, parastatals and co-operative unions

A final major administrative problem faced by many councils is the negligence of government institutions and parastatals in submitting the taxes and charges they owe to local authorities'. Local government officials cannot easily turn off the water supplies to schools and hospitals, and they cannot force central government ministries, district commissioners or other local authorities to pay for such services.

Furthermore, many councils have experienced huge problems in collecting crop cess from the co-operative unions. Semboja and Therkildsen (1989:40) argue that the change from the seller to the buyer as the payer of cess has resulted in increased liquidity problems for many councils since they have to wait to receive the tax until the buyers (in particular, unions) have sold the crops and received the payment (see section 3.3.2). Our interviews with district and union officials in Kibaha and Kilosa revealed that co-operative unions often were reluctant to pay cess owed to the council.[72] In 1995, for instance, the Mlandizi Disunyara Co-operative Union in Kibaha DC was brought to court for not paying the cashew nut

[71] *Fjeldstad (1999a) provides a set of propositions to explain these observations.*

[72] *These observations are consistent with the report of the Tax Commission (URT, 1991). Skoog (1998) argues that non-payment of taxes by the parastatal sector is an application of the soft budget constraint where the state tends to bail out state-owned companies in financial trouble, in spite of the tremendous problems of the entire system that result.*

cess, and thereby forced to pay the TSh 800.000 it owed. In June 1997 Kilosa DC was preparing a court case against the sugar company due large arrears in cess remission.[73] The maize co-operative in Kilosa was also plagued with continued financial problems with implications for remitting cess to the council. This was to some extent the case for the cashew nut co-operative in Kibaha, too. Similar cases have been reported from other councils. For instance, ERB (1997) reports that the company SHIRECU owed Mashwa DC TSh 50 million in crop cess, which was equivalent to more than 50 per cent of the council's total tax revenues in 1995. The same company also owed Meatu DC TSh 33 million (equivalent to 34 per cent of the council's tax revenues in 1995), and Kahama DC TSh 10 million (equivalent to 5 per cent of the tax revenues in 1995). Altogether various companies owed Meatu DC TSh 60 million equivalent to more than 60 per cent of its tax revenues in 1995.

5.4 Why the current revenue system has been maintained

Why has the present tax system persisted for such a long period of time in spite of all its weaknesses? One proposition may be that the important stakeholders, including bureaucrats and politicians, as well as powerful taxpayers, resist changes in an attempt to protect their influence and control of the local tax system.[74] For instance, some observers argue that extensive public sector regulations, complicated tax systems, etc. are the result of a deliberate strategy by civil servants, including senior tax officials, to facilitate corruption (Tanzi, 1998; Winters, 1996; Flatters and Macleod, 1995; and Myrdal, 1968;).[75] We have no indications that this is the case in local authorities in Tanzania. A deliberate strategy requires capacity and detailed knowledge on how the tax system works, and the capacity at the local level is in general poor. However, the combination of a complicated tax system and poor administrative capacity breeds corruption and facilitates evasion. Thus, when the non-transparent tax system is in place, it is rational for the stakeholders to maintain the system in spite of the inefficiencies it generates because it also performs other functions. Firstly, it offers informal incomes for civil servants and their social network members. Secondly, the tax system provides a visible arena for local councillors to play out their political aspirations vis-à-vis their constituents. Thirdly, some powerful taxpayers, in particular businesspeople, landowners, parastatals and the co-operative unions may be interested in keeping the tax system as it is since it facilitates evasion and tax exemptions. Finally, lack of trust between the stakeholders involved may increase their risk aversion and thereby contributing to maintain and even reinforce the existing tax structure. We have not been able to trace the explanatory power of this proposition, which should be considered an issue for further research.

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[73] *Information provided by council officials.*

[74] *Therkildsen (1999) has an interesting discussion on the role of various stakeholders, including foreign donors, in public sector reforms in Tanzania. He argues, for instance, that the Ministry of Health resisted the restructuring of regional administration and the subsequent reform of local government in Tanzania, as it regarded these reforms to be a threat to the ministry's plans to centralise health services.*

[75] *According to Winters (1996:166), the strongest resistance to tax reforms in Indonesia came from the tax officials themselves, since they had the most to lose from the depersonalisation and simplification of the tax system. Flatters and Macleod (1995:409), also referring to Indonesia, assert that tax collectors actively opposed simplifications in property tax administration, income tax laws and tariff structures.*

5.5 Summary

This chapter has focused on administrative problems in tax collection. First, the administrative costs relative to the revenues reported are high. Second, large gaps exist between the revenue potential and what actually is reported to the council treasury. A set of five arguments are presented to explain this wedge: (1) Poor administrative capacity to enforce taxes; (2) tax evasion and resistance from taxpayers; (3) widespread corruption, mainly in the form of embezzlement; (4) political pressure on the tax administration to relax on revenue collection; and (5) negligence from government agencies and parastatals to pay taxes. We have not been able to trace the explanatory power of each of these factors. Most likely their combined effects contribute to explain the observations. Probably there are also variations between councils.

6 Options for fiscal reforms

6.1 Introduction

It is clear from the above analysis that the local government tax system in Tanzania is overripe for reform. Although local taxes represent less than 5 percent of total tax revenues in Tanzania, the large number of these taxes, together with their unsatisfactory nature means that their economic, political and social impacts are considerably more significant than their figure implies.[76]

The current local tax system is partly a result of poor administrative capacity for tax collection and tax design, political pressure and lack of co-ordination between the local and central government (see chapter 5). Thus, redesigning the tax structure and building local administrative capacity may contribute to reduce revenue losses caused by inefficiencies and corruption. However, tax resistance is likely to increase without improvements in service delivery, necessitating costly and coercive methods of tax enforcement that will further undermine the legitimacy of the government. Improvement in service delivery - a key objective of public sector reforms in Tanzania - is therefore a necessary condition to improve tax compliance.

6.2 Tax compliance and service delivery

There is a widespread discontent among people regarding their terms of trade with the government (section 5.3.2). Peoples' tax resistance seems to be correlated to deteriorating public services (Fjeldstad and Semboja, 1998). It might be argued that individuals pay taxes because they value the goods provided by the government, recognising that their payments are necessary both to help finance the goods and services and to get others to contribute (Alm et al., 1992:313).[77] Thus, a taxpayer may be seen as exchanging purchasing power in the market in return for government services. Fiscal exchange, however, requires trade-off gains that may be seen as prerequisites of voluntary compliance (Levi, 1988:56). Without a material benefit, compliance becomes less assured. The existence of positive benefits may increase the probability that taxpayers will comply voluntarily, without direct coercion.[78]

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[76] *We have not yet obtained aggregate figures on local government own revenues from the Ministry of Regional Administration and Local Government (June 1999). Thus, our most recent figures refer to 1993 and 1994 (obtained from Tanzania Revenue Authority). The fiscal year of local authorities follows the calendar year, while the fiscal year of the central government is from 1 July to 30 June (see appendix 4). In 1993, for instance, the local government own revenues corresponded to 5 percent of total central government revenues for 1993/94, and in 1994, the percentage was 4 percent (of central government revenues for 1994/95). It is reasonable to assume that the percentage is even lower today due to the improved central government tax collection after the establishment of Tanzania Revenue Authority (TRA) in 1996. Total central government revenues (tax and non-tax revenues) in 1997/98 were TSh 571.4 billion. 4 percent of this amount represent TSh 22.9 billion.*

[77] *Fjeldstad and Semboja (1998:25) found that people in the villages surveyed in Kibaha and Kilosa understood the relationship between taxes and public services. One respondent used the metaphor that "one can't build a house without first buying concrete". Furthermore, a majority of the respondents said they would be willing to pay more taxes if services were improved, although some expressed the reservation that it depended on their ability to pay.*

[78] *The potential for free riding is, however, obvious when the government offers collective goods in return for taxes (see, e.g., Cowell and Gordon, 1988).*

Most taxpayers are of course not able to assess the exact value of what they receive from the government in return for taxes paid. However, it can be argued that the taxpayer has general impressions and attitudes concerning his own and others' terms of trade with the government (Richupan, 1987:154).[79] If this is the case, then it is reasonable to assume that a taxpayer's behaviour is affected by his satisfaction or lack of satisfaction with his terms of trade with the government. Therefore, if the system of taxes is perceived to be unjust, tax resistance may, at least partly, be considered as an attempt by the taxpayer to adjust his terms of trade with the government.[80]

To minimise the costs of tax enforcement and to maximise the output that can be taxed, the government must create voluntary compliance through non-coercive strategies that produce a high level of taxpayer co-operation.[81] It must create confidence in its capacity to deliver returns for taxes paid. Furthermore, it must convince taxpayers that taxpayer contributions make a difference in producing the desired goods, and it must co-ordinate the actions of taxpayers so that each perceives others doing their share, too (Levi, 1988). Thus, the challenges facing the government are to improve public service delivery, and to secure funding to provide basic services. However, whatever is done to improve the local government revenue system, the reality is that local authorities in Tanzania will continue to be heavily dependent for their sustenance on fiscal transfers from above.[82] Transfers should therefore be considered an important component of the decentralisation programme.[83]

In this setting, the fundamental problems to be addressed in the context of local government fiscal reforms are:

(1) To redesign the current revenue structure.
(2) To build tax compliance through improved service delivery.

6.3 Redesigning the current revenue structure

There is undoubtedly room for improved fiscal and financial management in local authorities, and improved co-ordination between the different levels of government. Measures may include, as suggested in a recent report to the government (Price Waterhouse, 1998), capacity building, including training programmes for all actors involved in revenue mobilisation and collection. However, attempts to squeeze additional revenues from poorly designed taxes may have negative effects on the economy and the society in general (see section 5.3.1). In general, improved tax administration cannot compensate for bad tax

[79] *Survey research from Western countries also suggests that taxpayers make judgements about the fairness of particular taxes. See, for instance, Spicer and Lundstedt (1976), and Smith (1992).*
[80] *Non-compliance might be an important resource of political change. Scott (1985), argues that one of the most important "weapons of the weak" is the ability to withdraw compliance. This can take a passive form, such as shirking, or an active form, such as rebellion. Historically, unwillingness of the population to comply with a tax that is deemed unjust has been a catalyst for political action. The Boston tea party and the Thatcher poll tax are illustrative examples, while Bates (1983) provides some examples from Africa.*
[81] *In the context of taxation there will always be an element of coercion. Thus, "quasi-voluntary compliance" is probably a better concept.*
[82] *This has been the situation since independence. Referring to the mid-1960s Dryden (1968:128) writes: "The dependence of rural councils upon support from central government and the ruling party is a prominent feature of local government at its present stage of development".*
[83] *Transfers are a large part of sub-national finance in most countries. Rare exceptions are the Scandinavian countries that have allocated substantial taxing powers to local authorities.*

design. Thus, reforming the tax structure should precede the reform of tax administration since there is not much merit in making a bad tax system work somewhat better.

In redesigning the tax structure, the following options should be considered:

(i) the abolishment of unsatisfactory local taxes;
(ii) improvements to remaining revenue bases; and
(iii) cost recovery through user charges.

6.3.1 Abolishment of unsatisfactory local taxes

Given the poor performance of many local taxes, any reform programme should include the abolition of a large number of these taxes. In particular development levy should be abolished. This is a tax that we have found to be costly to enforce. The levy is extremely unpopular among taxpayers and tax resistance is widespread (see section 3.3.1). Furthermore, the levy represents an extra income tax on formal sector employees.

Furthermore, a reform should include the abolition of nuisance taxes like bicycle tax, livestock levy, entertainment levy, etc.. Many of the licences should also be abolished since they rarely have a regulatory function. This should also be the fate of many fees that simply have a high nuisance value and that costs more to enforce than what they yield in terms of revenues, including push cart fees, cattle trekking fee, bicycle registration fee, etc. (see table 2.1).

6.3.2 Improvements to remaining taxes

In particular, there is a need to simplify the licence and fee structures by reducing the number of rates and coverage. Charges should in principle only be levied when services are provided. For instance, advertisement board fee, sand fee and business licences may be retained since they have a certain regulatory function. However, there is a need to harmonise fees and licenses with central government taxes, to avoid double taxation. Furthermore, the establishment of uniform rates on some major crop cesses at the national level should be considered. In this context one may consider the appointment of revenue collection agencies, including the possibility to centralise the collection of certain taxes. For instance, cess on export crops could be collected at their points of export by Tanzania Revenue Authority.[84]

Export taxes should, in general, be discouraged. But at present many local cess rates are very high, discouraging export production. The 20 percent cess on cashew nuts in Kibaha DC provides an illustrative example (see section 3.3.2). High local cess rates can also be found on other export crops, including coffee and tea. Thus, by abolishing all local cesses and imposing a lower (flat) national cess rate on export crops across all councils, the effective tax rate on these products can be reduced. For instance, a 10 percent tax on export crops would levy TSh 21 billion, equivalent to 3.7 percent of total central government tax revenues in 1997/98.[85]

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[84] *It is sometimes argued that the central government needs to exercise tight control over money that comes from the centre, but local governments should be free to do what they like with their "own" revenues, such as local taxes. However, the fact is that all money comes from the taxpayer, and it is largely a matter of convenience which level of government collects particular taxes. Thus, Devas (1997:358) argues that tight control over certain sources of money and wide discretion over others is somewhat illogical if the objective is to ensure proper use of public resources and to protect citizens.*

[85] *This estimate is based on a total export value in 1997 of TSh 213.45 billion (USD 355.75 million) for the major export crops coffee, cotton, sisal, tea, tobacco and cashew nuts (URT, 1998:55).*

For larger establishments the hotel levy has been subsumed into the VAT rate of 20 percent, collected by the central government. Thus, local governments' should not impose hotel levy on the top of VAT. Since, smaller hotels and guesthouses with an annual turnover of less than TSh 20 million are not registered for VAT, the levy could in principle be retained for the smaller establishments. However, the incentives to evade are large and the possibilities to monitor small. It is therefore a need to reconsider the suitability of hotel levy as a local revenue source.

Property tax may continue to be an important source of revenue in urban councils (see table 2.2). It may also become important in semi-urbanised centres in district councils.[86] In recent years, some rural councils have passed by-laws levying taxes for commercial land use (for instance, Hai District Councils and Simanjiro DC). Commercial land use includes agriculture, mining operations, sand extraction etc.. Some consultants even claim that commercial land tax "will be one of the principal revenue source for most of the rural councils" (Price Waterhouse, 1998).

Land and property taxes have some attractions as local bases since they are imposed on immobile resources, and therefore are difficult to avoid - at least in principle. However, as noted in section 3.3.5, they also have some obvious weaknesses that need to be taken into consideration before too heavy reliance is placed on them as major local government revenue sources. These weaknesses are partly of political and partly administrative character, manifested in problems of valuation and tax enforcement.[87] In theory, assessment of property value and revenue collection are straightforward: conduct a cadastral survey that assesses the market or site value of each plot of land or property, and send a tax bill to each owner. In practice, cadastral surveys are expensive and time-consuming. Tax offices are, in general, short on assessors, if they have any at all. Thus, it is often difficult to maintain assessments, and assessments are often eroded by inflation. In principle, non-compliance of property tax can be enforced by confiscation and sale of the owner's personal effects in the building initially, and, ultimately, upon the collateral of the real estate itself (Price Waterhouse, 1998). However, it may prove difficult to carry out such tax enforcement: Firstly, courts are often swamped by appeals from angry property- and landowners (see Skinner, 1993:364). Secondly, harsh enforcement mechanisms may result in intervention from politicians facing complaints from their constituents.

Experience from other countries and historical evidence from Tanzania advocate cautiousness when (1) extending the present property tax to district councils, and (2) when imposing a commercial land tax in local authorities (see section 3.3.5). At this stage of the reform process it is important to identify the fundamental causes of the problems experienced in depth and with open minds, avoiding counterproductive biases. In particular, it is important to seriously consider the administrative capacity to maintain assessments of property value. Furthermore, the enforcement

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[86] *In some Western countries, including Denmark and Norway, local property taxation is a good source of local taxation. In Denmark, for instance, property taxes are levied on land values. According to Lotz (1997:188), the rate for a given municipality is the same for all types of property, and assessments of property are adjusted annually. Furthermore, the same rate applies to households and to enterprises. There are also rules to reduce the tax for elderly people.*

[87] *According to Clark (1997:33), in Canada the property tax has been more difficult to find a tax base for than any other tax. One problem is related to valuation of real property based on market prices.*

mechanisms must be carefully designed to avoid a mushrooming number of court cases.

In general, a fundamental requirement when redesigning the local tax system is a greater concern with the cost-effectiveness of revenue collection, taking into account not only the direct costs of tax administration, but also the overall excess burden to the economy, including the compliance costs to the taxpayers (Devas, 1988). To these aims increased staff productivity and reduced losses through corruption and tax evasion are needed. Such improvements may take a long time to achieve, although a simplification of the local revenue system should be a positive contribution towards these aims.

As discussed above, the capacity of local governments is very weak in tax design (see section 4.4). The resource requirements for building this capacity at the local level are high, and can only be done in the medium to long run. Therefore, in the short run, very clear guidelines and limits should be given by the central government regarding tax design. Furthermore, the current system of approving tax by-laws should be strengthened (Semboja, 1999). In particular, there is an urgent need to improve co-ordination with the national tax system. Thus, one may consider establishing an expert committee (a "Finance Commission") to advise both the Ministers of Finance and Local Government on the local government tax system. This committee should advise the two ministers before the by-law is approved. The expert committee is not aimed at substituting the work of staff at the council and Ministry of Local Government. However, since it may require more resources than is available in the short term to build relevant capacity at the councils and the Ministry of Local Government, the importance of a "Finance Commission" can not be overemphasised.

6.3.3 Cost recovery through user charges

To obtain a better relation between demand and supply of public services, then taxes are not the best mechanism. Better links can be achieved through cost-recovery charging systems. Moreover, user charges may contribute to simplifying many of the present intergovernmental problems (Bennett, 1990: 21).

User charges tie the amount paid directly to the amount of a service a consumer uses. Thus, responsiveness to customers may be achieved through cost recovery mechanisms. User charges can also reflect differences in ability to pay by incorporating sliding scales for type of user or amount of usage (Rondinelli et al., 1989:71), although this will require adequate administrative capacity. By committing resources contributors may become more concerned with the success of development investments. Accordingly, user charges may have the potential of:[88]

- improving resource allocation;
- controlling the possibility of "crowding out" by imposing a uniform basis for competition which allows alternative suppliers in the non-governmental area to survive and develop;
- stimulating a closer response of service producers to customer demands which in turn should raise quality and remove unnecessary production; and
- improving social equity and environmental policy by incorporating the social costs of externalities.

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[88] *See Bennett (1990) and Jimenez (1987).*

There are obviously a number of constraints on user charges and other means of cost recovery in Tanzania. These arise, for instance, from equity considerations, fluctuations in demand, and the relations between services financed by charges and private sector provision compared to those financed by public general revenues. However, within these constraints there is a scope for innovation (Bennett, 1990:22). The government as well as the public opinion have too readily seen general revenue, particularly tax revenue, as the "normal" financial source. It has been the easy way out of difficult decisions, illustrated by the large and increasing number of taxes in local authorities. However, general sources are not only frequently less efficient compared to user charges, but are also frustrating the objective of achieving proper relation of supply and demand. Thus, there is a need for greater use of mechanisms of exchange based on realistic pricing and other cost-recovery methods.

6.4 Intergovernmental fiscal transfers

The basic rationale for a system of transfers is the existence of a fiscal gap at the local government level arising out of own-revenue and own-expenditure assignments (Ahmad, 1997). In addition, the national government may wish to ensure that people in different regions and localities have access to an established "minimum" standard of public services. It is beyond the scope of this study to quantify the financial resources needed in the form of transfers from the central government. Magnitudes are also difficult to estimate because of lack of reliable information on expenditures, size and conditions of existing infrastructure, and absence of realistic and appropriate operation and maintenance standards. However, as argued by Semboja and Therkildsen (1992:1104), to achieve adequate service standards expenditures need to be raised to a certain threshold level. This applies both to salary and non-salary funding. Increments below this funding level will only have limited impacts.

Promoting fiscal responsibility at the local government level calls for implementation of a stable and transparent system of transfers from the central government to the local authorities, geared to filling any *ex-ante* gap between the assigned spending and revenue-raising responsibilities of the latter (Ter-Minassian, 1999:57). The definition of such a system is far from easy, especially given the need to preserve adequate incentives for tax effort and cost effectiveness in spending by the local governments.

Stability and transparency considerations call for formula-based revenue-sharing (see section 6.4.2) and other general-purpose transfer systems (see section 6.4.3). However, in this process of fiscal decentralisation it is important to be aware of the risks for macroeconomic management and fiscal discipline. Mechanisms of fiscal transfers may impose considerably rigidity to the central government budget. Therefore, substantial devolution of revenues and spending responsibilities to local authorities can affect the central government's ability to carry out stabilisation and macroeconomic adjustment through the budget.

The destabilising potential of local governments' is greatest when they face no hard budget constraint (World Bank, 1999).[89] Expectations of bail-out in case of financial trouble weaken the incentives to economise on costs, and thus generate resource waste and rigidity within local authorities. These inefficiencies, in turn, may spill over into macro-economic imbalances. Thus, short-run macro-economic management considerations call for effective limits on local governments' deficits, consistent with national objectives for growth, inflation and balance of payments. The creation of institutional forums to ensure a regular and frequent dialogue between the central government and local authorities on budget trends may help in this respect (Ter-Minassian, 1999:58).

There are a number of methods to close the fiscal imbalances of local authorities, some of which also reduce imbalances between councils (Ahmad, 1997:6). In this respect we may distinguish between:

- revenue sharing, and
- grants.

6.4.1 Revenue sharing

The most satisfactory tax fields according to the criteria outlined in section 3 belong to the central government. Based on efficiency and administrative considerations the central government should keep the major taxes, especially the corporate income tax, multistage taxes such as the VAT, and taxes on foreign trade (Tanzi, 1996; Ahmad, 1997). Thus, if the sole concern of the central government is simply to fill a vertical fiscal gap one way would be to give local authorities a share of major national taxes collected in the council. Local governments may assist in revenue mobilisation by providing information on local taxpayers, and thereby increasing the pool of tax revenues. For instance, by sharing a mere 5 percent of national taxes would provide around TSh 35 billion, equivalent to 1.5 times the estimated local government own revenues for 1997 (see section 6.1).[90]

Tax revenues can be shared on a tax-by-tax basis or on the entire pool of central government tax revenues. The problem with the tax-by-tax sharing arrangement is that it may give the central government an incentive to concentrate its collection and enforcement efforts on the taxes that are either not shared or shared to a lesser degree (Ahmad, 1997:5). Furthermore, the central government may have an incentive to concentrate increases in rates (for instance for stabilisation purposes) on the shared taxes, something that may distort the tax system. Therefore, revenue sharing based on the entire pool of government revenues may be preferable. Revenue sharing, which transfers a portion of the national proceeds of a tax according to a predetermined formula, is much like a general-purpose unconditional block grant.

To secure the local governments a certain predictability to revenues, which is important for budget planning, the coefficients of revenue sharing between the two levels of government should be set in law. However, this may imply considerably rigidity to central government budget, and may contribute to dilute

[89] *Skoog (1998) provides an interesting analysis of the origin and persistence of the soft budget constraint within the parastatal sector in Tanzania.*
[90] *Based on budget estimates for 1998/99 (URT, 1998).*

the impact of fiscal tightening. For example, if the central government tries to tighten fiscal policy by raising shared taxes, this move will also give the local governments more resources for spending. This outcome may be avoided if the portion of revenue going to the local governments is levied at a constant rate on the shared tax base. Fixed revenue-sharing arrangements may also have pro-cyclical effects as tax revenue automatically rises during a boom, and thereby increasing the spending capacity of the local governments, while declining revenue during economic downturns forces them to cut back spending suddenly. To address this problem, some element of flexibility could be introduced in these sharing arrangements, for instance, by relating the transfers to a moving average of central government revenues or by requiring local governments to build up revenue stabilisation funds to even out cyclical fluctuations in shared taxes.

The distribution of shared revenues among local governments can be made on a derivation basis, with each council getting the same share of the revenue collected in its district. In this way revenue sharing avoids the problems associated with local government tax administration and policy harmonisation. However, this does not address the problem of horizontal imbalances. Local government autonomy over revenue bases and rate structures are also sacrificed.

6.4.2 Grants

Besides revenue sharing, the main mechanism for intergovernmental transfers is grants from central to local governments. In principle, there are three broad categories of grants (Ahmad, 1997):

(1) Unconditional grants: These are general-purpose transfers aimed at addressing vertical imbalances.
(2) Conditional grants: These grants carry conditions regarding the use of the funds. Sometimes the conditions are tied to the performance to be achieved in the programmes financed through them.
(3) Equalisation grants: These are used to address horizontal imbalances between local authorities. The purpose of horizontal equalisation is to equalise the capacity of local governments to provide a "national standard" level of public goods and services. The grants also have the effect of closing the vertical fiscal gap.

A key element in the ongoing decentralisation reform in Tanzania is the provision of conditional block grants from the centre to local authorities. These are planned to be introduced as a pilot project in 35 local authorities in January 2000. Conditional block grants are earmarked to finance major nationally defined services, such as primary education, primary health, water supply, agricultural extension and roads, rather than specific programmes. The conditionality refers to earmarking to certain broad-based services (education, water, etc.), but not to particular budget lines (personal emoluments, etc.). According to Price Waterhouse (1998), the grants will be based on minimum standards of service to be defined by the sector ministries in negotiation with representatives of local governments. These grants relate only to recurrent costs. Such earmarking of grants will of course limit the autonomy of local governments, and thereby partly negating the arguments for decentralisation (Wolman, 1990). However, imposing conditions may be justified by distributional considerations, such as the need to ensure minimum nation-wide standards for the provision of services of national concern. Thus, to even out income among jurisdictions, a formula could be based on redistributive criteria which may combine population, income per capita, indicators of backwardness, etc..

In addition to the major services set out above, other services will be funded by unconditional block grants. These include district culture, community development, natural resources (Price Waterhouse, 1998). In the past these sectors have been supported by the central government through the payment of salaries. As unconditional grants there are no minimum standards of service defined nor any performance indicators. Thus, these grants may be used at the discretion of the council to provide services in line with the objectives of the area, and will be accounted for through the council's accounting system.

Based on experiences with the present transfers system, two factors seem to be critical to ensuring the effectiveness of the block grant system.[91] These are:

- accountability, and
- predictability

Regarding accountability, financial management and control of the recurrent grants suffer from several weaknesses. These relate to the absence of internal audit sections, poor reporting systems and non-compliance with established financial regulation. Furthermore, large shares of the grants disbursed for the education and health sectors are diverted to other issues (Semboja, 1999:12). Financial reports are complicated and unclear, and are not easily understood by professionals. Therefore, the local government Finance and Planning Committee and the Full Council meetings allocate little time on the accounting of recurrent grant funds. Thus, the current system of disbursing grants gives the district treasurers the entire information power and opens room for misuse of such power and council resources (Semboja, 1999:15).

Regarding predictability, local authorities have experienced delays and irregularities in the receipt of grants. In principle, all the budgeted grants approved by Parliament shall be disbursed at the same time. However, in practice, priority is given to personal emoluments (PE) and public debt (including pensions), while other charges (OC) has received a residual status. Semboja (1999:5), reports that in general councils receive less than the budgeted OC. For instance, during the five months period October 1998 to February 1999, Kisarawe DC received only 45 percent of the approved budget. The respective percentages were 66 percent for Dar es Salaam, 87 percent for Kibaha, 89 percent for Rufiji, 91 percent for Mafia, and 95 percent for Bagamoyo. According to Semboja (1999), predictability is further weakened since there is no obvious criterion for determining the level of OC disbursed to the various councils.

Thus, experiences indicate that it may be problematic in practice to design and enforce appropriate conditions for grants. Without substantial capacity building in

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[91] *For a long time, central government grants to local governments in Tanzania have been earmarked by purpose and sector. In the former, the central government specifies the amounts to be paid as personal emoluments (PE) and other charges (OC). In general, PE has received priority over OC that has received a residual status. Until now, the earmarked sectoral grant has been confined to education, health, water and roads for both PE and OC. Furthermore, it covers the personal emoluments of all the staff of non-grant sectors earning a salary of at least GS2, except those in the Administration and Finance Departments whose salaries are covered from the council's own revenues. Procedures for disbursement and the role of the various stakeholders involved are described in Semboja (1999).*

financial management and monitoring, controls may end up being more formal than substantive, opening up for increased mismanagement and corruption. It may even become more difficult to specify and enforce conditionality on the performance of the sectors supported by the block grants.

6.5 Summary

In this chapter we have argued that a reform of the local government tax structure should precede the reform of tax administration since there is not much merit in making a bad tax system work somewhat better. Thus, given the poor performance of many local taxes. A large number of these taxes should be abolished. There is also room for improvements in the design of some current taxes, including uniform national rates on major local taxes such as crop cess. Furthermore, a fundamental local government fiscal reform must address the issue of tax compliance, and thereby the relationship between taxes and service provision. Without improvements in service delivery tax resistance is likely to increase, and thereby further eroding the legitimacy of the government at both local and central levels. Thus, the challenges facing the government are to improve public service delivery, and to secure funding to provide basic services. However, whatever is done to improve the local government revenue system, the reality is that local authorities in Tanzania will continue to be heavily dependent for their sustenance on fiscal transfers from above. Transfers should therefore be considered an important component of the decentralisation programme.

7 Concluding remarks

Tanzania is now implementing a local government reform. An important component of the reform is to increase the fiscal autonomy of local authorities. This policy is encouraged and partly initiated by the donor community. The above findings suggest that care must be taken in implementing this policy. It is unrealistic to expect that the present administration in many councils has adequate capacity and the required integrity to manage increased fiscal autonomy. In fact, there is a real danger that, in the absence of substantial simplification and restructuring of the current revenue system combined with capacity building and improved integrity, increased autonomy may raise mismanagement and corruption in many councils.

It is particularly important for the time being to impose hard budget constraints on the local authorities, through a design of intergovernmental fiscal relations that ensures for the local governments an adequate balance between expenditure responsibilities and their own revenues, in addition to clearly defined transfers from the centre.

It is beyond doubt that large and dramatic changes are necessary to improve performance and to re-establish legitimacy of the local government system. However, the present speed with which the decentralisation programme seems to impose reforms may prove counter-productive. Furthermore, substantial decentralisation is likely to make it more complicated for the central government to carry out macroeconomic stabilisation through budgetary policies. Therefore, due to Tanzania's acute fiscal imbalances and its aid dependency, decentralisation should probably progress more slowly and cautiously.

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Appendix 1: Objectives and Coverage of the 1996-1998 Field Studies

The field studies aimed at providing data and analyses of the capacities and constraints of the local tax administrations, especially in relation to tax design, revenue collection, incentive problems and service delivery. Furthermore, the studies aimed to assess the extent and problems of (non)-compliance behaviour, by trying to unravel peoples' perceptions regarding taxation and the decisions they made, especially in relation to other taxpayers, tax collectors, politicians and the local government council, including service delivery.

The studies covered all three council levels, namely district headquarter, the wards and the village levels. In Kibaha DC, four wards and four villages were selected for in-depth study, including three rural villages, and one peri-urban village. In Kilosa DC the study comprised three wards and three villages, of which two rural and one peri-urban village (see Fjeldstad and Semboja, 1998). The villages were selected on the basis of (1) representativeness, which required a balanced representation of rural and urban life, and (2) accessibility. Information was collected from a variety of sources and through different methods. At the district headquarter, official documents and data were collected, primarily the final financial statements and accounts of the council disaggregated on revenue bases, wage bills and lists of staff members in the revenue department, and by-laws. At the ward and village levels tax files and lists of taxpayers were obtained where available. In addition, staff members of these bodies and local politicians were interviewed on matters relating to tax design, decision-making processes, tax collection and revenue reporting procedures, incentive problems, and perceptions of the provision and quality of public services. These interviews were organised as semi-structured interviews, which also included questions on the background of the respondent, including education, salary, and how long he had had the present position. Furthermore, two surveys of taxpayers' were carried out. One questionnaire was designed for development levy, and comprised 172 respondents (see Fjeldstad and Semboja, 1998 for details). The other questionnaire focused on crop cesses and comprised 36 respondents. These questionnaires were organised around five main headings: (i) Background information on the respondents; (ii) admitted (non-)compliance; (iii) tax enforcement; (iv) perceptions of other taxpayers' behaviour; and (v) perceptions of the terms of trade with the government. In addition, following up field visits and data collection on specific issues, including corruption, were carried out during 1997 and 1998.

Data on tax revenues for about 50 councils were collected from the Ministry of Local Government in Dodoma. Data on central government taxes were acquired from the Ministry of Finance and Tanzania Revenue Authority, where we also interviewed officials on the relationship between local and central taxation. Furthermore, representatives from the donor community were interviewed.

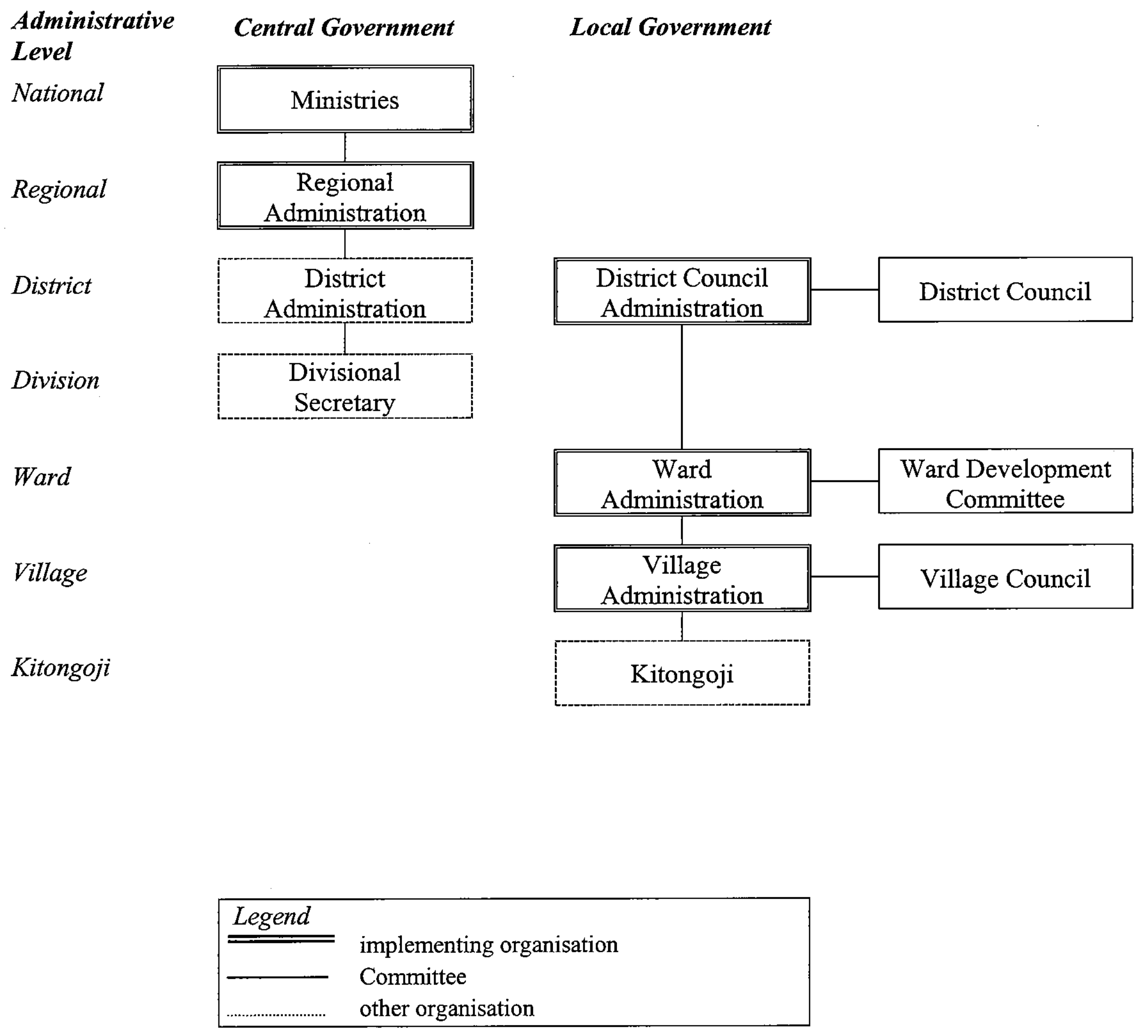
Appendix 2: Some Alleged Cases of Corruption at the Local Government Level

(March 1998 to January 1999)

Case	*Date*	*Source*	*Issue*	*Location*	*Amount alleged*
1	March 11, 1998	Guardian	Kisarawe DC education officers arrested over 49.4m/= theft. Funds earmarked for materials	Kisarawe	49.4m/=
2	March 20, 1998	Daily News	Councils misuse 3.5bn/= during 1993 to 1996 [Auditor General]	Sixty four councils	3.5bn/=
3	March 21, 1998	Daily News	1.6b/= imprest, salary advances not retired between 1993 and 1996	30 local authorities	1.6b/=
4	March 23, 1998	Daily News	Dar es Salaam City Commission loses 581.4m/= from revenue collected between June 1996 and November 1997	DCC	581m/=
5	March 23, 1998	Daily News	1bn/= cash book receipts not reflected in Bank statements [Auditor General]	31 local authorities	1.1bn/=
6	March 24, 1998	Daily News	Council in Dubious 50m/= road deal	Sumbawanga DC	50m/=
7	March 29, 1998	Sunday News	20 Councils fail to remit 445m/= deducted from staff salaries (1995 and 1996) for Local authorities Provident fund (LAPF), NIC, OTTU & WADU	Various councils	445m/=
8	April 1, 1998	Daily News	6.2m/= pay for teachers disappears from cashiers office	Arusha	6.2m/=
9	April 18, 1998	Daily News	District councils fail to remit 4.4b/= to LAPF	Various Councils	4.4b/=
10	May 21, 1998	Daily News	Iringa farmer complained being charged 1,000/= per head as cattle fee.	Iringa	650,000/=
11	June 1, 1998	Guardian	WEO arrested for having fake receipts	Nzega, Tabora	55,000,-
12	June 29, 1998	Guardian	Village Executive Officers arrested for stealing 947,000/=	Kagera Region	947,000/=
13	July 2, 1998	Daily News	Bandits wound three, steal 20m/=	Moshi MC	20m/=
14	July 3, 1998	Mtanzania	DCC officials arrested on charges of bribery	DCC	-
15	July 10, 1998	The African	City denies corruption in resettlement scheme	DCC	-
16	July 14, 1998	Nipashe	Residents demand accounting for council revenues and expenditures	Korogwe DC	-
17	July 27, 1998	Majira	The Masai demand accounting for development levy	Muheza DC	-
18	July 31, 1998	-	Village chairman alleged to have misused village funds	Mbarali DC	-
19	Aug. 1, 1998	Majira	WEO is alleged to have stolen 871,000/=	Nzega DC	871,000/=
20	Aug. 10, 1998	Majira	VEO sentenced to five years imprisonment for failing to surrender receipt books	Karatu TC	1m/=
21	Aug. 14, 1998	Majira	Councillor alleged to have misused (donor) women funds	Arumeru DC	4.2m/=
22	Aug. 26, 1998	Nipashe	Police asked to investigate village chairman over alleged misuse of public property	Gairo DC	-
23	Aug. 28, 1998	Daily News	Mismanagement of funds irks the Vice President	Handeni DC	-

24	Aug. 29, 1998	Mtanzania	Municipal Director fired over misuse of funds	Zanzibar MC	-
25	Aug. 29, 1998	Mfanyakazi	31.4m/= misused up to December 1995	Bukoba MC	31.4m/=
26	Sept. 6, 1998	Mtanzania	Division Secretary looses 600,000/= development levy collections	Songea Rural	600,000/=
27	Sept. 8, 1998	Nipashe	DCC sends auditors to audit Olympio Primary School accounts	DCC	-
28	Sept. 10,1998	The Guardian	Probe team suspended for unvailing misuse of funds	Kahama DC	1.6m/=
29	Sept. 11, 1998	Majira	Councillors arrested for alleged misuse of funds	Arumeru DC	-
30	Sept. 12, 1998	Uhuru	Arrested for allegedly stealing staff salaries	Bukoba Rural	5.8m/=
31	Sept. 19, 1998	Nipashe	Villagers demand accounts for village govt. activities since 1992	Moshi Rural	-
32	Sept. 20, 1998	Taifa Letu	Headteacher alleged to misuse parents contributions	DCC	-
33	Sept. 24, 1998	Daily News	District Council gives deadline to village government leaders to refund misappropriated funds	Handeni DC	430,000/=
34	Sept. 30, 1998	The African	3bn/= cess feared embezzled [Auditor General]	Various	3bn/=
35	Oct. 3, 1998	Uhuru	DCC officers alleged to demand bribery	DCC	-
36	Oct. 13, 1998	Nipashe	WEO arrested over revenue 2.6m/= loss	Kongwa DC	2.6m/=
37	Oct. 15, 1998	Nipashe	Council looses money through unfaithful WEO	Maswa DC	-
38	Oct. 21, 1998	The Guardian	Kongwa leaders quizzed over desk fund	Kongwa DC	3m/=
39	Oct. 31, 1998	The African	Simanjiro Council misuses 8m/= teachers contributions	Simanjiro DC	8m/=
40	Nov. 13, 1998	Alasiri	VEO disappears with Development Levy collections	Bagamoyo	78,000/=
41	Nov. 17, 1998	Nipashe	VEO fired over theft	Kahama DC	-
42	Nov. 23, 1998	Nipashe	DCC misuses 1.7b/n= earmarked for roads rehabilitation	DCC	1.7bn/=
43	Nov. 23, 1998	Nipashe	VEOs demand bribes from businessmen	Dodoma Rural DC	-
44	Dec. 1, 1998	The African	Tax collectors accused of cheating: they carry two sets of receipts	Coast Region	-
45	Dec. 27, 1998	Taifa Letu	Temeke education office alleged to have misused school (parents) contributions	DCC	-
46	Dec. 28, 1998	Guardian	Municipal officials swindling millions from parks, game researves	Various	-
47	Dec. 30, 1998	Majira	Rungwe DC fires District Treasurer on misuse of funds	Rungwe DC	14m/=
48	Dec. 30, 1998	The African	City Commissioner orders teachers to account for parents contributions	DCC	-
49	Dec. 30, 1998	Mtanzania	WEO sent to court over 2.9m/= theft	Songea DC	2.9m/=
50	Jan. 29, 1999	Uhuru	Councillor required to explain expenditure of 3m/= earmarked for roads rehabilitation	Sumbawanga TC	3m/=
51	Jan. 29, 1999	Mtanzania	Musoma MC misuses 2.1m/= earmarked for retirees, deceased and x-employees	Musoma MC	2.1m/=
52	-	-	Urambo Councillor arrested over 11.4m/= robbery	Urambo DC	11.4m/=
53	-	Daily News	Officials sacked over alleged embezzlement	Sengerema DC	6.7m/=

Appendix 3: The Administrative Structures of Central and Local Government



Source: Based on Semboja and Therkildsen (1991)

Appendix 4: Central Government Taxation and Tax Administration

This appendix provides a brief presentation of the central government tax-collecting agency, Tanzania Revenue Authority. Furthermore, the central tax system, including the major tax bases and their revenue productivity, is outlined.

The central government tax administration
Tanzania Revenue Authority (TRA) became operative on 1 July 1996, the beginning of the fiscal year 1996/97. TRA replaced the former independent Treasury Departments of Income Tax Department, Customs Department and Sales Tax and Inland Revenue, and also the Institute of Tax Administration (ITA).

The revenue departments within TRA are:

1. VAT and Inland Revenue Department (responsible for VAT and excise duties on domestic goods).
2. Income Tax Department (responsible for direct taxes, including PAYE, company taxes, withholding taxes, and personal income taxes).
3. Customs Department (responsible for import duties and excise duties on imported goods).

In addition, the Authority has seven support departments:

(1) Tax Audit and Investigation.
(2) Finance and Human Resource.
(3) Information Technology.
(4) Publicity and Taxpayers Education.
(5) Internal Audit.
(6) Legal Affairs.
(7) Research and Policy.

TRA is set up as an autonomous agency of Government reporting to the Minister of Finance, and operates under the supervision of a Board of Directors. The Commissioner General is the Chief Executive of the Authority. TRA's main functions are to administer, assess, collect and account for all revenues due under Tanzania's tax laws, and to advise the Ministry of Finance (MoF), inter alia, both on changes to those laws and fiscal policy in general. The TRA-act provides for retention of a percentage of target revenue collected by the Authority as shall be determined by the MoF from time to time. The principal objective of TRA is to increasing the revenues accruing to Government. The revenue target (T) for fiscal 1998/99 was TSh 699,521 million, equivalent to a T/GDP ratio of 13 percent (Budget Speech 1998/99, para. 30).

The central government tax structure
The central government tax structure and its changes over the last 20 years are shown in Table A4.1 and A4.2. The composition of taxes has fluctuated much since fiscal year (FY) 1989/90. In FY 1991/92, for instance, there was a considerable drop in direct tax revenues (on income and wealth), mainly caused by reduced revenues from company taxes. In FY 1992/93 there was a significant

drop in revenues from indirect taxes, on both domestic goods and services and international transactions, partly caused by reduced tax rates introduced as part of the then ongoing tax reforms. In the more recent fiscal years 1995/96, 1996/97 and 1997/98 the share of tax revenues between the three main categories have been fairly stable;

- taxes on income and wealth contribute with approximately 30 percent of total tax revenue;
- taxes on international transactions contribute with approximately 30 percent; and
- taxes on domestic goods and services about 25 percent of total tax revenues.

In addition, "other taxes" (mainly road toll and stamp duty) contribute with about 15 percent of total tax revenues. However, this share is likely to be reduced in the future since stamp duty from FY 1998/99 was partly incorporated into the VAT-system.

Indirect taxes

The main source of tax revenue is taxes on goods and services. These taxes include value added tax (VAT), excise duties and import duties. From table A4.1 we see that the share of import duties collected at the border first fell in the early 1980s and then rose substantially in the latter half of the decade, reflecting both increased tax rates and the expansion of imports accompanying the early phase of the Economic Recovery Programme (ERP). The abolition of export taxes in 1985/86 (included in "other taxes on international transactions") was more than compensated for by the considerable growth of sales and excise taxes levied on imports. In fact, all of the growth in sales and excise taxes over this period is accounted for by taxes on imports. In 1992/93, however, there was a significant drop in revenues from taxes on international transactions, partly due to reduced rates. This was also the case for indirect taxes on domestic goods and services. During FY 1993/94 and 1994/95 tax revenues from these bases have stayed almost at the 1992/93 level relative to total tax revenues and GDP (see table A4.2). However, in FY 1995/96 the revenue share of taxes on international transactions increased to about 30 percent, mainly due to improved tax enforcement by the administration.

Direct taxes

Direct taxes are, according to the Income Tax Act of 1973, classified into four main categories:

1. Corporation tax.
2. Pay-As-You-Earn (PAYE).
3. Individual income tax.
4. Withholding taxes.

In addition, a charge known as "Payroll levy" is specified in the payroll Levy Act of 1985. This levy is charged at 4 percent of employees' emoluments paid by employers other than the government and charitable NGOs. The charge is levied on the gross wage bill of employers with four or more employees. The gross wage bill includes wages, salaries, leave pay, sick pay, fees, commissions, bonus, gratuity and any subsistence, travelling, entertainment or any other allowance paid by the employer.

- In recent years taxes on income and wealth have contributed with 25-30 percent of total tax revenues.
- By far the biggest source of income tax revenue is the company income tax, representing 40 percent of total income tax revenue in FY 1996/97 and 1997/98, and more than 11 percent of total tax revenues.
- Most personal income taxes are collected from PAYE (pay-as-you-earn). PAYE is a technique, which charge a third party, usually the employer, with the tasks of deducting the tax from the payment (wages and salaries) made to the taxpayer (employee), and remitting the proceeds to the government. Ideally, the tax withheld should equal the tax due. In most low income countries the personal income tax system encompasses only a relatively small part of the potential tax base, usually, the civil service and parastatal sectors employees where withholding systems may function. In 1997/98 PAYE contributed with approximately 30 percent of total income tax revenues, corresponding to 8.4 percent of total tax revenues. This share is almost unchanged from the mid-1980s, although there has been large fluctuations in revenues generated from this source in the intermediate period. Revenues from individuals reporting their own income tax files represented less than 7 percent of total income taxes in FY 1997/98, corresponding to less than 2 percent of total tax revenues.
- Since 1992/93, income taxes have increased their relative importance, and now contribute with approximately the same share of total tax revenues (about 30 percent) and GDP (above 3 percent) as taxes on international transactions.

Other taxes

The most import revenue bases within this group are Road Fund Tax (RFT) and stamp duty. The "road toll" was renamed to Road Fund Tax in July 1999 to make the name reflecting the purpose of the tax. Part of the stamp duty was incorporated in the VAT-system in FY 1998/99. In addition, motor vehicle taxes and property taxes are included. In recent years, this revenue source has generated about 14 percent of total tax revenues, corresponding to less than 2 percent of GDP. Part of the stamp duty was incorporated in the VAT-system in FY 1998/99. Revenues from stamp duties will therefore decline. Tentatively, comparing data for the first 6 months of FY 1998/99 with the corresponding figures from FY 1997/98, the decline is about 60 percent. In principle, however, this decline in stamp duty-revenues should be recovered through the VAT-system.

Non-tax revenue

The most important components of this revenue source are revenues generated by Regions and Ministries (e.g., sales of Government stores and vehicles, fees and charges from the police force, home affairs, tourism, etc.), and parastatal dividends (mainly from Bank of Tanzania). It also includes appropriation in aid. In recent years, this base has contributed with revenues corresponding to about 1.5 percent of GDP.

Summary

To sum up, Tanzania's central government tax base by the late 1990s appears to rest on three sources. The first is the "traditional" excise and sales tax base of the so-called "demerit goods", i.e. beer, tobacco, spirits and so on. The second source is taxes on imports, particularly consumer goods, and the third is taxes on company profits and personal income (PAYE).

Table A4.1 The structure of central government taxation, 1979-98 (in percent of total central government taxes)

YEAR	*1979/80*	*1984/85*	*1989/90*	*1991/92*	*1992/93*	*1993/94*	*1994/95*	*1995/96*	*1996/97*	*1997/98*
Taxes on income and wealth	**36.2**	**29.1**	**27.8**	**18.8**	**31.0**	**26.5**	**26.6**	**29.2**	**26.6**	**28.3**
PAYE	10.3	9.0	4.3	3.2				*6.7*	*7.6*	*8.4*
Individuals	2.4	2.4	2.0	1.9				*1.4*	*1.8*	*1.7*
Companies	21.6	15.7	19.0	13.7				*12.4*	*10.8*	*11.5*
Other	1.9	2.0	2.5							
Taxes on domestic goods and services	**41.8**	**54.5**	**44.0**	**40.9**	**31.5**	**31.9**	**33.1**	**24.9**	**25.5**	**24.8**
Sales and excise tax – local[1]	40.2	51.2	37.4	40.9						
Other	1.6	3.3	6.6							
Taxes on international transactions	**22.0**	**16.4**	**28.2**	**28.7**	**21.6**	**22.8**	**24.0**	**31.6**	**33.1**	**31.9**
Import duties	11.9	8.8	14.3	14.8	10.8			*16.0*	*15.4*	*14.4*
Sales and excise tax – imports	3.0	7.4	13.7	13.9	10.8			*15.6*	*16.8*	*17.5*
Other[2]	7.1	0.2	0.2						*0.1*	*0.1*
Other taxes[3]				**11.6**	**15.9**	**18.7**	**16.3**	**14.2**	**14.8**	**14.1**

[1] VAT replaced sales tax in FY 1998/99 (introduced 1 July 1998).
[2] Includes export duty.
[3] The most important bases in this category are stamp duty and road toll (renamed to Road Fund Tax in 1998). It also includes motor vehicle taxes and property taxes.

Source: Fjeldstad et al. (1999)

Table A4.2 Structure of central government taxation, 1979-98 (in percent of GDP)

YEAR	*1985/86*	*1986/87*	*1987/88*	*1988/89*	*1989/90*	*1990/91*	*1991/92*	*1992/93*	*1993/94*	*1994/95*	*1995/96*	*1996/97*	*1997/98*
Taxes on income and wealth	4.5	3.8	4.3	6.7	4.8	3.6	3.9	3.6	3.6	3.5	3.5	3.3	3.3
Sales and excise taxes	7.7	8.7	8.4	9.1	9.1	10.4	11.4	3.6	4.4	4.4	4.8	5.2	4.9
Import duties	1.1	2.1	2.0	2.3	2.5	2.6	3.1	2.5	3.1	3.2	1.9	1.9	1.7
Other taxes	0.7	0.8	1.6	1.7	*1.8*	1.5	2.4	1.8	2.6	2.2	1.7	1.8	1.7
Tax revenues	**14**	**15.4**	**16.3**	**19.8**	**18.2**	**18.1**	**20.8**	**11.5**	**13.6**	**13.3**	**11.9**	**12.2**	**11.6**
Non-tax revenue	**0.7**	**0.9**	**1.7**	**1.8**	**1.8**	**1.6**	**2.7**	**1.4**	**1.4**	**1.4**	**2.0**	**1.6**	
Current revenue	**14.7**	**16.3**	**17.1**	**21.6**	**19.9**	**19.7**	**23.5**	**12.9**	**15.0**	**14.7**	**13.9**	**13.8**	
Total expenditures	**23.1**	**27.1**	**25.3**	**28.7**	**26.7**	**35.3**	**26.4**	**26.7**	**25.4**	**19.5**			
Deficit before grants	**(8.4)**	**(10.8)**	**(8.2)**	**(7.1)**	**(6.6)**	**(15.6)**	**(2.9)**	**(13.8)**	**(10.4)**	**(4.8)**			
Deficit after grants								**(8.3)**	**(5.7)**	**(3.1)**			

Source: Fjeldstad et al. (1999)