SUMMER 2010

DOMESTIC RESOURCE MOBILIZATION IN AFRICA
TANZANIA

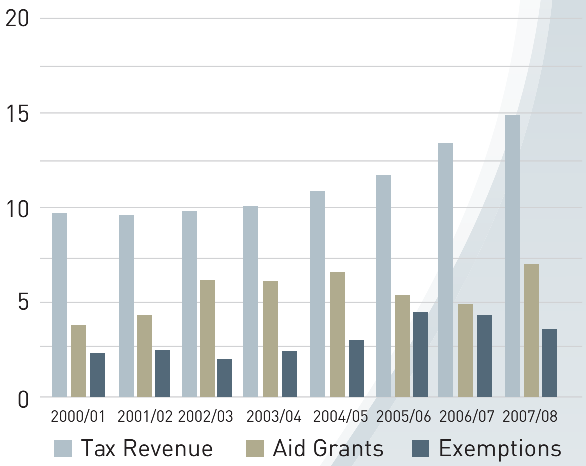
The project: The North-South Institute has been working with African, UK and Canadian partners on case studies exploring the potential for domestic resource mobilization (DRM) in five Sub-Saharan countries: Burundi, Cameroon, Ethiopia, Tanzania and Uganda. DRM refers to savings and investments that are generated by both the public sector (primarily through taxation) and the private sector (as a channel for private savings by households and domestic firms). Interest in DRM as a means to support sustainable growth and reduce dependence on external aid has been growing: in 2002, the Monterrey Consensus made improved DRM the first of its leading recommended actions; and, the current global economic crisis has only drawn more attention to DRM's potential, due to declining flows in external assistance and global remittances. This summary sets out our key project findings for Tanzania.

Context: GDP expansion has stepped up in the past decade to about 7% a year, but this has not yet translated into sustainable growth. Tourism and mining now supplement agriculture, but 80% of Tanzanians still live in rural areas, many as subsistence farmers. Per-capita GDP was US$1,163 (PPP) in 2008, well below the Sub-Saharan average of US$2,056 (PPP). Aid plays an important role in Tanzania; it accounts for nearly a third of the revenue base. However, revenue is unable to keep pace with spending growth, underlining the need for DRM.

Key constraints to DRM: Widespread **abuse of discretionary exemptions, a large informal sector and non-enforcement of property taxes** all contribute to a ratio of tax revenue to GDP of 15%. Tax exemptions in 2006-07 averaged 32% of total tax revenue or nearly 5% of GDP.

Tax Revenue, Aid Grants and Exemptions

(% GDP)



Source: Author's calculations of data from the Ministry of Finance, Tanzania.

Rank in Doing Business Database 2010:	131/183
Tax revenues (% GDP):	15.0*
Savings rate (% GDP):	11.0*
Sub-Saharan average:	16.6 (2000-08)

*latest available figures

Sources: World Bank, Doing Business Database, 2010 and World Development Indicators Database; International Monetary Fund, International Financial Statistics

In the informal sector, which accounts for more than half of the economy, mistrust is prevalent due to years of oppressive enforcement by tax officials and the feeling by taxpayers that they see few returns for their compliance. Tanzania has received considerable support in building tax capacity and is widely considered a "good performer" by donors. But concern remains that the wealthiest Tanzanians have a vested interest in resisting measures to increase new sources of revenue such as property taxes.

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With few banks outside the cities, high fees and negative interest rates, Tanzanians lack both opportunity and incentive to save. The **savings rate** has nonetheless risen slightly in recent years to 16%, but remains just below the Sub-Saharan average. Outside cities, savings are often held in non-financial form despite a growing microfinance movement. The formal financial sector is relatively sound, with non-performing loans stable at just under 7%, but excess liquidity suggests more resources could be channeled to productive investment. Poor risk-management capacity stands in the way of longer-term lending, and also makes for wide deposit-lending spreads. A stock market exists but only 14 companies are listed, and insider trading is a concern. Capital flight from Tanzania was estimated at US$806mn in 2004.

The way forward: To aid in **mobilizing tax revenues**, the government should recognize that much of the gains have been realized from such reforms as establishing a semi-autonomous revenue authority, paying officials better, and using information technology. Lack of political will remains an obstacle to further improvement. Leadership is required to **enforce property taxes and eliminate discretionary exemptions**. Broadening the domestic tax base is key since Tanzania will likely further lose trade tax revenues as it enters into a customs union with neighbouring countries.

Tanzania must also intensify the fight against corruption and provide more even-handed enforcement to encourage tax compliance. The **informal sector also needs to be tapped** through presumptive taxation and by creating incentives, such as providing basic business services, to become part of the formal sector.

The country could improve the ability of its **financial sector** to meet the needs of savers and borrowers by taking steps to narrow the spread between interest on deposits and loans, and by addressing constraints, such as the lack of basic infrastructure, including roads and electricity, that discourage commercial banks from operating in rural areas.

Donors have been playing a major role in Tanzania through direct budget support, support for building tax capacity and through microfinance and other financial sector initiatives. Donors, however, have not explicitly recognized the value of DRM or its role as part of a longer term "exit strategy" from aid programs. **Donors could also contribute to raising awareness of the benefits of capital market financing** by supporting the development of financial market and informational infrastructure such as credit reference bureaus and electronic land registries.

This is a summary of ***Domestic Resource Mobilization in Sub-Saharan Africa: The Case of Tanzania*** *by Nehemiah Osoro. Mr. Osoro is Associate Professor of Economics, University of Dar es Salaam, in Tanzania. To read the full case study, go to www.nsi-ins.ca and follow the research project links.*

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