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# Tanzania Economics of Domestic Resource Mobilisation (DRM) for Public Investments

*(A reflection of the current domestic resource mobilisation efforts and the potential of the United Republic of Tanzania to enlarge the fiscal and monetary policy envelope to achieve its national and international development goals)*

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***Abstract*-- Tax revenues play a crucial role in domestic resource mobilisation due to their productiveness, stability, and predictability. The loss of tax incomes has significant implication on national development and the provision of social services. Reports by tax stakeholders show that Tanzania has been losing tax revenues despite the efforts and commitment to control the loss and widen the tax base. This Paper provides an overview of DRM in Tanzania covering its centrality to the sustainable development agenda, revenue trends and gaps, and requirements for tax reform in areas of tax structure and tax administration in an attempt to assess the feasibility of increased domestic tax revenue mobilisation in Tanzania. The paper's objective is to provide actionable inputs towards improving tax policy and tax administration for achieving fiscal stability, economic growth, and poverty reduction in the country. Also, increasing domestic revenue mobilization awareness to government and wider-public. The study is anchored in the footsteps of public finance theory namely Domestic Resource Mobilization (DRM) theory which assert that "countries accelerate their economic growth by raising and spending their own funds for public goods and services". The study is typically desk research whereby it dwelled on analysing and synthesizing large amounts of complex secondary data/information and literature concerning the issue of under resource mobilization in Tanzania. Findings of the study show that, Tanzania's greatest resource mobilization potential is tax revenues. Tanzania's tax revenues have grown only marginally between 2011 to 2021. The revenue collection performance is low in comparison with African peers and the country's state of development. The estimated tax revenue gap is caused by tax policy decisions, such as incentives and exemption regimes, administrative challenges of taxing digital transactions, the presence of a large informal sector, weak voluntary tax compliance, and substantial amounts of money going out of the country through illicit financial outflows and capital flight. DRM calls for long-term measures to bolster tax capacity and tax effort.**

**Improved tax policy and administration remain essential for achieving fiscal stability, economic growth, and poverty reduction in lower- and middle-income countries (LMICs) and can help to reduce long-term aid dependency.**

**Unfortunately, no shortcuts exist for achieving these goals, but in the short run, steps may be taken toward tax reform to (1) achieve objectives beyond revenue generation; and (2) enhance government responsiveness and accountability. Tax reform will remain incomplete, however, without also addressing both tax structure reform and tax administration reform.**

***Keywords*-- Domestic Resource Mobilization, Public Investment, Personal income and Property taxes, Taxation potential, Fiscal Deficit, HNWIs, Inequality**

## I. Introduction And Background

In 2015, the United Nations adopted the Sustainable Development Goals (SDGs) – a set of 17 aspirational objectives with 169 targets guiding the actions of governments, international agencies, civil society, and other institutions. The Agenda 2030 maps a plan for the future shifting the World onto a sustainable and resilient course and leading to a transformation in standards of living and a transition to more inclusive, dynamic, and sustainable pathways to development. The 17 SDGs integrate the three dimensions of sustainable *development* – economic, social, and environmental – with closely interwoven targets (FOA, 2016). By 2019, Tanzania had performed reasonably well in addressing SDGs 2,3,4,5,6,8,10, and 16; while SDGs 7,9,11, and 12 are likely to be achieved with commensurate domestic partnership efforts and international support (MoFP, 2019). However, SDGs 1,13,14,15, and SDG 17 will need extra effort to be achieved.

According to the Sustainable Development Solutions Network (2019), a Low-Income Country (like Tanzania at that time) needed to spend US$ 456.5 per person in 2019 to achieve the SDGs by 2030. For Tanzania, this SDG financing need is equivalent to about 44.5% of GDP in 2019.

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The major share of these expenditures (about 31% of GDP) is needed to finance public education, health services, and infrastructure requirements, while a minor share (about 6% of GDP) is required to finance critical non-SDG public expenditures such as public administration, police, and defence. However, Tanzania's public revenues amounted to only 17.3% of GDP in the fiscal year 2018/2019 (BoT, 2019) leaving an SDG financing gap of about 27.2% of GDP.

Because such a large financing gap cannot be funded by one country alone, it is of paramount importance to pursue the SDG 17 "Strengthen the Means of Implementation and Revitalise the Global Partnership for Sustainable Development" through the mobilisation of domestic resources in developing countries, official development assistance (ODA) of developed countries, additional financial resources from multiple sources, attaining debt sustainability and providing debt relief and restructuring as appropriate, and by promoting financial investments.

Since the early 1980s, Tanzania has been undergoing structural and economic reforms to promote the country's socio-economic development. But three decades of implementing economic stabilization and recovery programmes did not produce satisfactory results and, therefore, the need for long-term planning became more pronounced. In 2011, Tanzania reverted to the long-term and five-year planning framework to ensure the country is strategically organized to attain Tanzania's Development Vision 2025 which aspires to transform Tanzania into a middle-income and semi-industrialized nation by 2025 characterized by (i) high quality and sustainable livelihoods, (ii) peace, stability and unity, (iii) good governance and the rule of law, (iv) an educated and learning society, and (v) a strong and competitive economy.

The Tanzania Development Vision 2025 has been implemented through the Long-Term Perspective Plan (LTPP) which is divided into a series of Five-Year Development Plans (FYDPs) that are also aiming to implement regional and international strategic plans including the Sustainable Development Goals. The theme of the FYDP I 2011/12-2015/16 was "Unleashing Tanzania's Latent Growth Potentials"; the FYDP II (2015/16-2020/21) had the theme "Nurturing Industrialization for Economic Transformation and Human Development". Currently, Tanzania is implementing the FYDP III (2020/21- 2025/26) with the theme "Realizing Competitiveness and Industrialisation for Human Development".

To promote a competitive economy, the FYDP III provides a stable environment with macroeconomic indicator targets for the fiscal year 2025/2026 including, among others: a GDP growth rate of 8%, an inflation rate of 4.4%, tax revenues of 14.4% of GDP, a budget deficit ≤ 3% of GDP, and public debt of 28.2% of GDP.1

**Table I: Projected Public Sector Financing for Five-Year Development Plan III (% of GDP)**

| Fiscal Year | 2021/22 | 2022/23 | 2023/24 | 2024/25 | 2025/26 |
|---|---|---|---|---|---|
| Domestic Revenue | 15.9% | 16.2% | 16.6% | 16.8% | 16.9% |
| Tax Revenue | 13.5% | 13.8% | 14.1% | 14.4% | 14.4% |
| Non-Tax Revenue | 1.8% | 1.8% | 1.9% | 2.0% | 2.0% |
| LGAs Own Sources | 0.5% | 0.5% | 0.5% | 0.5% | 0.5% |
| Grants | 0.7% | 0.5% | 0.5% | 0.4% | 0.2% |
| Borrowing | 1.8% | 1.7% | 1.3% | 1.1% | 1.0% |
| Foreign (net) | 0.7% | 0.6% | 0.2% | 0.0% | -0.1% |
| Domestic (net) | 1.1% | 1.0% | 1.0% | 1.0% | 1.0% |
| **Total** | **18.4%** | **18.4%** | **18.3%** | **18.3%** | **18.1%** |

*Source: MoFP (2021).*

These targets are to be achieved through various key interventions such as strengthening monetary policy, enhancing administrative and fiscal measures for domestic resource mobilisation, and directing current and future borrowing from commercial sources into projects with higher social and economic returns. The majority of projected public sector resources will be tax revenues reaching 14.4% of GDP in the fiscal year 2025/2026. External financing through grants is expected to decline from 0.7% of GDP in 2021/2022 to 0.2% of GDP in 2025/2026. Net domestic borrowing is planned to remain at an average of 1% of GDP to avoid crowding out the private sector, while net foreign borrowing is expected to fall from 0.7% of GDP in 2021/22 to -0.1% of GDP in 2025/26 due to planned foreign loan amortisation of 1.6% of GDP.

Domestic resource mobilization has been a concern since Tanzania's independence in 1961 and the formal adoption of the Ujamaa, the African socialist model for development, in 1967. The country's tax administration was facing all kinds of problems including the lack of an adequate legal system, a malfunctioning organization, limited human resources, and a weak tax culture.

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The absence of a modern tax collection system resulted in a chronic revenue shortfall under the socialist regime. This period was also characterized by monetary-financed government spending and credit rationing under which the vast majority of domestic loans were allocated to the public sector.

These policies, together with overlapping shocks in the late 1970s, plunged Tanzania into an economic crisis. This was manifested by deteriorating economic conditions, such as worsening terms of trade, double- digit inflation, and a recession. Economic growth decelerated from 5.8% in 1970 to negative figures in the early 1980s, while the inflation rate accelerated from 2% to 30% in 1980. The fiscal deficits excluding grants averaged 3.7% of GDP in the first five years after independence; but they increased to an average of 8.1% of GDP between 1977 and 1982 (Bank of Tanzania, 2011). This acceleration of fiscal deficits is attributed to excessive government borrowing and printing of money to bail out insolvent banks as broad money supply grew at an average annual rate of 24% over the same period.

The early 1980s marked the beginning of negotiations with the International Monetary Fund and the World Bank to transform the Tanzanian economy from a socialist macroeconomic policy regime to a free-market economy through trade liberalization and the privatization of the public sector. Yet, these reforms did not yield fruition due to the failure to meet credit ceilings and a lack of sufficient foreign inflows to finance Tanzania's current account deficits. The economic crisis persevered to the mid1980s with negative economic growth in the early 1980s, a worsening trade balance, high and increasing inflation, widespread shortages, and high parallel-market spreads. Until 1985, monetary policy operated through direct controls of credit and interest rates, while exchange rates were administered. Government securities were issued directly to state- owned institutions and fiscal policy dominated monetary policy.

After a period of high inflation above 30% and falling GDP per capita growth rates in the early 1990s, the Tanzanian Government acknowledged that inflation was driven by the monetary financing of fiscal deficits. The Government and the International Monetary Fund agreed to impose a monthly cash budget system and strengthened the Central Bank's independence. The Bank of Tanzania Act, 2006, prevents the Central Bank from providing credit, directly or indirectly, to any public authority save for short-term advances to offset temporary cash fluctuations.

The Act also made domestic price stability the primary monetary objective followed by supporting the integrity of the financial system (Bank of Tanzania Act, 2006, section 7).

As Tanzania's economy operates mainly on currency, the Bank of Tanzania decided to pursue a reserve- money targeting framework that follows quantitative assessment criteria set by the International Monetary Fund to limit the Bank of Tanzania's accumulation of domestic and foreign assets. While this approach was successful in reducing and anchoring inflation expectations, it also featured several disadvantages: it did not accommodate shocks to money demand resulting in extensive volatility of short-term interest rates and a weak transmission into long-term interest rates. The conduct of monetary policy was further complicated by unpredictable government operations: erratic disbursements of donor grants, the Government's own cash management problems, but also the banking systems' large precautionary reserves led to unforeseen injections or shortfalls in available money that needed to be sterilized to meet reserve money targets. To strengthen the monetary transmission mechanism and provide a more conducive environment for the development of the financial sector, the Bank of Tanzania moved in 2017 to an interest rate targeting framework that allows the Bank of Tanzania to stabilize short-term interest rates and influence long-term interest rates. Since these institutional reforms, headline inflation remained below 10% in most years.

Another important development that affects fiscal and monetary policy was the establishment of the East African Community in 2000. It includes four stages of integration: a customs union (that entered into force in 2005), a common market (that entered into force in 2010), a monetary union, and a political federation. The Protocol on the Establishment of the East African Monetary Union (EAMU) was signed in 2013 to use a common currency in 2024. To promote monetary and financial stability, the member countries agreed to harmonize and coordinate their fiscal, monetary, and exchange rate policies, and to phase out any outstanding central bank lending to government and public entities. Moreover, all members need to attain a set of convergence criteria for at least three years before 2024.

Financing for Tanzania's Development Vision 2025, the Agenda 2030 for Sustainable Development and the Sustainable Development Goals (SDGs) call for a need for increased Domestic Resource Mobilization. Tanzania's greatest resource mobilization potential is tax revenues.

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Based on provisional estimates, Tanzania's SDGs financing need amounts to about 44.5% of the gross domestic product (GDP). However, the Government's Five-Year Development Plan (FYDP) III projects public revenues of only 18.1% of GDP in 2025/2026, leading to an estimated SDG financing gap of 26.4% of GDP. Under such a situation therefore, it is important to identify alternative fiscal and monetary policy options and strengthen the mobilization of domestic resources to achieve the Tanzania Development Vision 2025 and the Agenda 2030 for Sustainable Development.

This paper therefore, provides an overview of DRM in Tanzania covering its centrality to the sustainable development agenda, revenue trends and gaps, and requirements for tax reform in areas of tax structure and tax administration. The paper's objective is to provide actionable inputs towards improving tax policy and administration for achieving fiscal stability, economic growth, and poverty reduction in the country. Also, increasing domestic revenue mobilization awareness to government and wider-public. The study is anchored in the footsteps of public finance theory namely Domestic Resource Mobilization (DRM) theory which assert that "countries accelerate their economic growth by raising and spending their own funds for public goods and services". The dependent variable of the researched topic being DRM while independent variables is constituted by tax reform.

### *A. Study Problem*

Financing for Tanzania's Development Vision 2025, the Agenda 2030 for Sustainable Development and the Sustainable Development Goals (SDGs) call for a need for increased Domestic Resource Mobilization. Tanzania's greatest resource mobilization potential is tax revenues. Based on provisional estimates, Tanzania's SDGs financing need amounts to about 44.5% of the gross domestic product (GDP). However, the Government's Five-Year Development Plan (FYDP) III projects public revenues of only 18.1% of GDP in 2025/2026, leading to an estimated SDG financing gap of 26.4% of GDP. In such an environment therefore, it is important to identify alternative fiscal and monetary policy options and strengthen the mobilization of domestic resources to achieve the Tanzania Development Vision 2050 and the agenda 2030 for Sustainable Development.

### *B. Study Objectives*

The main objective of this study is to examine the current domestic resource mobilisation efforts and the potential of the United Republic of Tanzania to enlarge the fiscal envelope to achieve its national and international development goals.

Specifically, the study presents an analysis and innovative approaches to domestic resource mobilisation in Tanzania as financing for economic growth and poverty reduction is one of the major challenges. The main areas include Tanzania's capacity to mobilize tax revenues, its capacity to borrow at sustainable levels, the institutional framework, and the strategic role of financial sector development. The study also intends to set the ground for a more comprehensive research agenda whose main role is to guide stakeholders in Tanzania on domestic resource mobilisation opportunities and to promote wide dialogue and policy advocacy.

#### *1. Specific Objectives:*

Specifically, the report seeks to address the following study objectives:

a) to estimate Tanzania's domestic resource mobilization potential given its state of development and institutional framework, and;
b) to outline possible strategies to realize the potential through alternative fiscal and monetary policy options.

## II. The Literature

### *A Theoretical review*

This study is guided by theory of public finance that suggests that we should decide on a desired tax base and rate structure and then mobilize domestic resource accordingly by imposing taxes.

#### *1. What is domestic resource Mobilisation:*

Domestic Resource Mobilization (DRM) - the process through which countries raise and spend their own funds to provide for their people – is the long-term path to sustainable development finance. DRM not only provides governments with the funds needed to alleviate poverty and deliver public services, but is also a critical step on the path out of aid dependence and is recognized as the foundation for self-sustaining development. Domestic resources are important in financing domestic investment and social programmes, which are essential for economic growth and for eradicating poverty. DRM does not necessarily mean new taxes or higher tax rates. Governments often see their revenues rise though improved audits or simplified filing processes. Financing for economic growth and poverty reduction is one of the challenges facing the least developed countries (LDCs). Due to inability of domestic resource to meet the financing requirements, these countries have resorted to external sources to finance development projects and social programs (Wangwe, et al 2004).

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Domestic revenues, notably tax revenue, as well as external financial flows such as foreign direct investment (FDI) and official development assistance (ODA) have the potential to significantly and positively affect the development trajectory of countries -AFRICA GROWTH INITIATIVE WORKING PAPER 19 | December 2016.

Domestic resource mobilization-defined here as the domestic generation of revenue-can serve as an important tool for developing countries to attain and sustain high rates of growth when they are allocated to socially productive investments (Culpeper and Bhushan, 2010). Given the volatility of FDI flows and the reduction in aid (ODA) budgets, domestic resource mobilization-specifically- tax revenue is becoming increasingly important for financing African development.

Many studies highlight the importance of governance for building a strong tax base. A study by Ajaz and Ahmad (2010) looks at the effects of corruption and governance on tax revenue, using panel data from 25 developing countries-including Côte d'Ivoire, Nigeria, and South Africa-over the 1990-2005 period. They find that corruption has a negative effect on tax collection. Moreover, good governance improves countries' tax collection efforts (Ajaz and Ahmad, 2010). Gupta (2007) looks at the determinant of tax revenue efforts in developing countries. He finds that GDP per capita, agricultural share in GDP, trade openness, and aid are important determinants of tax revenue. Other determining factors include corruption and political stability. Specifically, the paper finds that corruption has a more significant effect than political stability on tax collection efforts (Gupta, 2007)

Increasing tax revenues in low-income countries is essential to address future development finance requirements. This is particularly important for aid recipients, the focus of this paper. Theory shows that although there are many ways in which aid can have indirect effects on tax revenue, the direct effects arise because aid and tax are alternative sources of revenue and political economy factors influence the choices made by government. Aid may discourage tax effort if viewed as a politically less costly source of revenue. Under different conditions, the policies and reforms associated with aid may increase revenue, through promoting growth, encouraging more efficient tax structures, or supporting reforms to tax administration. While cross-country evidence reveals no systematic pattern, country studies show that aid can be associated with administrative and efficiency reforms to increase tax revenue (Morrisey, 2015)

Moore and Prichard (2020) provide two different kinds of answers to the question of how governments of developing countries can increase tax revenues. First, they discuss seven potential revenue sources that governments of developing countries tend to use less than they should. Mining, tobacco and alcohol, the incomes and wealth of rich people, and property are typically under-taxed. Tax exemptions for investors and the use of transfer mispricing in international economic transactions can both be curtailed. There is considerable scope to improve the effectiveness of and collections from value added tax (VAT). Second, they examine the potential for increasing the tax take through changing domestic and international tax policies - including a shift to taxing companies on the basis of business turnover rather than profit.

The 2015 Addis Ababa Action Agenda of the Third International Conference on Financing for Development identifies domestic revenue mobilization as central to achieving the Sustainable Development Goals (SDGs). The Action Agenda also recognizes the importance of international finance in the development process (United Nations, 2015). At the same time, the process leading to the SDGs has emphasized good governance as a development priority.

According to the IMF (2018) and consistent with other studies such as Mebratu et al. (2020), Pessino and Fenochietto (2010), Basri et al., 2019; Africa Growth Initiative Working Paper 19 |2016, - …that good governance matters more for raising domestic, that good governance has a positive effect on domestic resource mobilization, in the form of increased tax revenue.

- ✓ Governments should work out to increase tax base by attracting and creating new businesses through effective implementation of the blue print that may create enabling business environment to attract new investors.
- ✓ This may be established through a round table dialogue with private sector to identify potential business hurdles which need to be addressed. The government should continuously address tax evasions, avoidance, and mismanagement of public funds and channel intended funds to support prominent public service delivery such as education and healthcare which are critical for betterment of a nation and its population. They are key and livelihood enhancing sectors:
  - While education sector creates mind to drive economic growth, the health sector keeps the workforce fit for economic endeavours
  - These sectors are most interactive with public and face public pressure

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*2. Tax Capacity*

**Box 1: Useful Concepts and Definitions in Discussing Taxation**

The **tax capacity** is defined as the maximum theoretical level of tax revenues that a country can achieve given certain underlying structural conditions (the level of development, trade openness, sectoral structure, income distribution, institutions, etc.).

The **tax effort** is defined as the ratio between actual tax revenue and tax capacity. It reflects both efficiency in the collection of revenue and the country's own tax legislation.

The **tax potential** is often used interchangeably with tax capacity, but there is subtle difference: the tax potential is the maximum revenue level a country can obtain from the effective application of its current tax legislation. Some countries can be efficient in revenue collection but still be below their tax capacity because of policy choices. For example, a country might choose to have lower tax rates consistent with a lower provision of public services.

The **tax policy gap** is the difference between tax capacity and tax potential and arises from reduced tax rates, exemptions, allowances, deductions, tax amnesty schemes and so forth. Streamlining tax incentives and broadening the tax base help reduce the tax policy gap.

The **tax collection gap** is the difference between tax potential (tax owed) and actual tax revenue (tax paid). Sources of the tax gap include underreporting of tax liability, underpayment of reported taxes and not filing. The tax gap shrinks with improving tax compliance and a more effective tax administration.

*B. Empirical Review*

According to the IMF (2018) and consistent with other studies, higher income levels, more trade openness, higher spending on education, and better government effectiveness are associated with higher tax-to- GDP ratios. Moreover, countries with lower income inequality and lower corruption levels also tend to have higher tax ratios. Furthermore, the level of development (proxied by the GDP per person) is positively and significantly related to the tax-GDP ratio indicating the importance of positive income per person to improve tax collection

Mebratu et al. (2020); Junquera Varela, F.R., Verhoeven, M., Shukla, P. G., Haven, B., Awasthi, R., & Moreno – Dodson, B. (2017), and Bogetic, Z., Naeher, D., Narayanan, R. (2021), also concluded that the tax ratio rises with the country's income level, which does not only reflect the taxable capacity of the population but also serves as an indicator for the general development of an economy. In addition, the effect of trade openness is considered an important determinant that occurs primarily through trade liberalization in form of the tariffication of quotas, eliminations of exemptions, reductions in tariff peaks, and improvements in customs procedures (Basri et al., 2019).

Moreover, the empirical results of Pessino and Fenochietto (2010) indicate a positive and significant relationship between tax revenue and (public expenditure on) education. The study also finds a negative relationship between tax revenue and income distribution (measured by the Gini coefficient).

Tanzania has the second-lowest excise tax to GDP ratio in the East African Community. The main reason for the underperformance of the excise taxes is a tax policy gap due to a narrow tax base and low tax rates. According to the World Bank (2020), excise taxes could add another 1.2% of GDP by applying a single duty rate to all imported goods irrespective of their origin, by increasing excise tax rates of alcoholic beverages to those of regional peers, and by indexing the tax rates to annual inflation. The World Bank (2020); Mawejje, N & Odhiambo, M (2020), and Kamagi, Deogratius. (2021), argued that some of the reasons for administrative tax gaps in Tanzania are the lack of tax compliance, enforcement, and assessments.

Although the reduction of the VAT rate from 20% to 18% has boosted revenue, Kisanga et al. (2021) indicated that a further decrease of the VAT rate to 17% or 16% will lead to a revenue loss of TZS 186 billion or TZS 371 billion, respectively. Generally, appropriate reforms of the VAT could increase gross tax revenue by 2.5% of GDP by including water services and petroleum products into the VAT base and by reducing VAT fraud through a better refund administration (IMF, 2016).

The VAT gap is also caused by tax administration issues (Manamba, E. (2015)). VAT collection has suffered from compliance issues and a weak refund mechanism. One administrative challenge is a large number of small manufacturers with an annual turnover below the VAT threshold of TZS 100 million. Some traders with turnover above the VAT threshold may be hiding in this group of taxpayers. Additionally, some traders with large capital and turnover use "machinga" (street vendors) to sell their goods without VAT because "machinga" are regarded as small vendors. A study by Fjeldstad et al. (2018) on the VAT in Tanzania concluded that there are still large challenges of compliance in issuing receipts using Electronic Fiscal Devices (EFDs). Another challenge is the administration of the VAT refund system (World Bank, 2020).

Various estimates have been made on revenue losses from tax incentives in recent years. ActionAid (2018) estimated that Tanzania loses 0.06% of GDP each year to tax incentives. A report conducted in 2013 for Tanzania's Ministry of Finance by the consultancy CRC Sogema concluded that:

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"*In countries with poor investment climates – that includes Tanzania and other developing countries, the effect of providing tax incentives is also non-existent. It is more efficient for developing countries to focus on improving their investment climate rather than granting tax exemptions to corporations*."

Tanzania may also be losing revenues from double taxation agreements (DTAs) that it has signed with other countries, although no estimates are available. Tanzania has signed double taxation agreements with nine countries: Sweden, Canada, Denmark, Finland, Norway, India, Italy, Zambia, and South Africa. Most of these double taxation agreements are old and contain taxation regimes that surrender Tanzania's taxing powers in favour of partners. The double taxation agreements have capped withholding tax rates that can be levied on interest, dividends, and royalties. For example, the South African double taxation agreement, which is the latest treaty signed in 2005, sets withholding tax rates at 10%. The double taxation agreements also limit Tanzania's taxation of profits derived from air and shipping operations.

Illicit capital flight is the ultimate reflection of a country's failure to mobilize and retain its domestic financial resources. Tanzania must stay abreast of evolving international corporate practices. With companies increasingly reliant on debt relative to equity, thin capitalization rules have been adopted to limit tax deductions on interest (IMF, 2018). The US-based Global Financial Integrity (GFI) is the pre-eminent body analysing illicit financial flows. It reported that an average of TZS 3 trillion of domestic capital is drained out of the Tanzanian economy illegally per year. At a corporate tax rate of 30%, this means that Tanzania loses tax revenues of about 0.6% of GDP per year. The key method for which figures are available is trade misinvoicing by deliberately misreporting the value of imported or exported goods to reduce tax payments. Evidence suggests Tanzania is continuing to lose large revenues from this method (Manamba, 2015).

Property taxation in Tanzania is one among sources that the government can potentially and largely use to widen its tax base and increase revenue collection. Being directly visible to taxpayers, by design it is relatively easier from the taxpayers' perspective to easily link the collected revenue to improved provision of local services. Thus, property tax has a prospective to act as a basis for bargaining between taxpayers and governments over revenue collection and public spending, hence increasing the tax compliance rate (Ali, Fjeldstad and Katera, 2018); Fenochietto, R., Pessino, C. (2010).

Despite this revenue potential, the amount collected from it is far less than what could potentially be collected (Chegere, M., Ruhinduka, D.R., Pantaleo I., & Martin, G. (2020)). Essentially, property tax in Tanzania is narrowly applied only to buildings. Land fees, for a small fraction of planned (and often urban based) plots, are collected through a system of annual land rents administered through the Ministry of Lands. Practically, rural property is not taxed under the Local Government Authorities (Rating) (Collection of Property Rates) Regulations of 2019, and further, non-surveyed rural land is not even required to pay land rent. This implies that a large portion of potential revenue from rural property is untapped by the government.

## III. Methodology

The study has been researched primarily through a desk review of a range of secondary data sources including reports, books, journals and government statistics. The study screened a range of documents to assess their relevance to the research objectives and or questions, selecting for inclusion a range of published research reports and studies covering issues related to Domestic Resource Mobilization (DRM)- specifically tax revenue and non-tax revenue in Tanzania. A range of documents authored and/or commissioned by Civil Society Organizations, United Nations agencies, OECD, World Bank and respected research institutes and Organisations were considered reliable. In addition, a significant number of sources from the Government of Tanzania were referenced, including the Tanzania Revenue Authority (TRA), Bank of Tanzania reports (various) and a range of National Development Plans, which provided remarkably interesting and useful data. Data gathered was subjected to content analysis (analysis based on the content of materials). With no algebraic jargon, this study is purely a descriptive survey utilizing secondary data to interrogate narratively and quantitatively the economics of DRM in Tanzania and way forwards

## IV. Findings

### *A. Tax Revenue Performance from 2011 to 2019*

#### *1. Tax Revenue Collection*

Domestic revenues consist of tax revenues, non-tax revenues, and Local Government Authority (LGA) own source revenues. Tanzania's domestic revenue to GDP ratio has improved from 12.6% to 13.8% between the fiscal year 2011/12 to 2018/19. However, most of that increase can be attributed to a steady increase in non-tax revenues from 1% to 1.8% of GDP (see Table 2).

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**Table II: Tax Revenues from 2011/12 to 2018/19 (% of GDP)**

| Fiscal Year | 2011/12 | 2012/13 | 2013/14 | 2014/15 | 2015/16 | 2016/17 | 2017/18 | 2018/19 |
|---|---|---|---|---|---|---|---|---|
| Excise Taxes | 1.8% | 1.8% | 1.9% | 1.9% | 2.0% | 1.8% | 1.8% | 1.8% |
| VAT | 3.5% | 3.4% | 3.3% | 3.3% | 3.3% | 3.5% | 3.6% | 3.5% |
| Income Tax | 4.2% | 4.6% | 5.0% | 4.2% | 4.5% | 4.5% | 4.3% | 4.0% |
| PAYE | 1.9% | 2.0% | 2.0% | 1.9% | 2.1% | 2.0% | 1.9% | 1.8% |
| Corporate Tax | 1.3% | 1.5% | 1.9% | 1.3% | 1.3% | 1.4% | 1.5% | 1.3% |
| Individuals | 0.1% | 0.1% | 0.1% | 0.1% | 0.1% | 0.2% | 0.2% | 0.2% |
| Customs Taxes | 0.9% | 0.8% | 0.9% | 1.0% | 1.2% | 1.3% | 0.2% | 1.2% |
| Other Taxes | 1.0% | 1.0% | 1.3% | 1.1% | 1.2% | 1.3% | 2.3% | 1.0% |
| Total Tax Revenues | 11.3% | 11.7% | 12.3% | 11.4% | 12.2% | 12.4% | 12.2% | 11.5% |
| Non-Tax Revenue | 1.0% | 0.7% | 0.8% | 0.8% | 1.1% | 1.8% | 1.9% | 1.8% |
| LGA Own Source | 0.3% | 0.3% | 0.4% | 0.4% | 0.4% | 0.5% | 0.4% | 0.5% |
| Total Domestic Revenues | 12.6% | 12.8% | 13.5% | 12.6% | 13.7% | 14.7% | 14.5% | 13.8% |

*Source: Bank of Tanzania Database and the World Bank (2021).*

Nevertheless, tax revenues remain the single largest resource to finance sustainable development in Tanzania. Their particular role in domestic resource mobilization lies in their greater productiveness, stability and predictability compared to other sources of long-term financing. Table 2 shows that Tanzania's total tax revenues grew only marginally from 11.3% in 2011/12 to 11.5% of GDP in 2018/19. The largest source in 2018/19 was 'income taxes' amounting to 4% of GDP followed by Value Added Tax (VAT) (3.5% of GDP) and 'excise taxes (1.8% of GDP). 'Customs taxes' and 'other taxes' made up only 1.2% and 1% of GDP, respectively.

*2. International Comparison*

Tanzania's tax-to-GDP ratio is low in comparison with its peers. Over the 2011 to 2019 period, Tanzania had an average tax-to-GDP ratio of 11.9% of GDP, well below the average of 13.1% of GDP in East African Community (EAC) countries and the average of 14.7% of GDP in Low-Income Countries. Tanzania has the second-lowest tax-to-GDP ratio in the East African Community, and also performed relatively poorly compared to other frontier economies, such as Cote d'Ivoire, Ghana, and Senegal (IMF, 2018).

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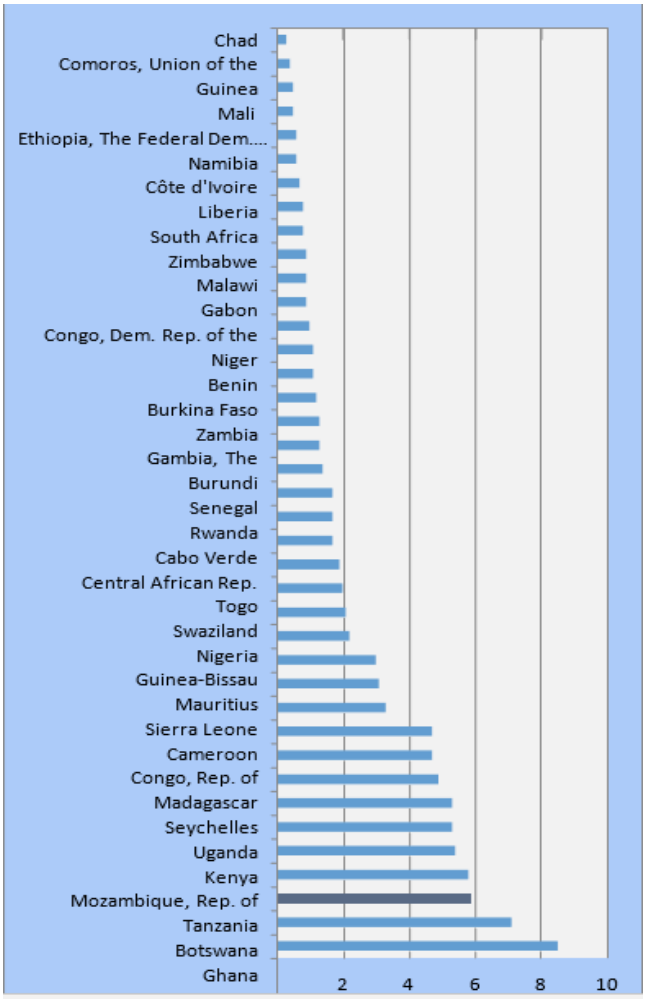



**Figure 1: Tax Gap in Sub-Saharan Africa (% of GDP)**

*Source: Authors' calculations based on IMF Database, 2018.*

*3. Tanzania 's Tax Revenue Capacity*

The tax-to-GDP ratio is also low with respect to Tanzania's state of development. One way to assess the amount of additional taxes that a country can potentially collect is to compare its tax-to-GDP ratio with that of other countries with similar characteristics, including the level of economic and institutional development. According to IMF (2018), Tanzania's tax capacity was estimated at 18.3% of GDP in 2015 while the actual tax collection stood at 12.2% in the fiscal year 2015/16. This implies an estimated tax effort of 66%. It also means that tax administration gaps and tax policy gaps cost more than 6% of GDP in tax revenue annually (World Bank, 2020). The tax gap is also among the largest in Sub-Saharan Africa (compare Figure 1).

Several factors conspire to limit the growth of tax revenues in a developing country like Tanzania. Some factors are unavoidable as they stem from exogenous shocks or from the deep and chronic poverty of the majority of the population who cannot be regarded as significant sources of taxation until they leave the subsistence sector and enter the formal economy. According to the IMF (2018) and consistent with other studies, higher income levels, more trade openness, higher spending on education, and better government effectiveness are associated with higher tax-to- GDP ratios.

Moreover, countries with lower income inequality and lower corruption levels also tend to have higher tax ratios. Furthermore, the level of development (proxied by the GDP per person) is positively and significantly related to the tax-GDP ratio indicating the importance of positive income per person to improve tax collection.

Mebratu et al. (2020) also concluded that the tax ratio rises with the country's income level, which does not only reflect the taxable capacity of the population but also serves as an indicator for the general development of an economy. In addition, the effect of trade openness is considered an important determinant that occurs primarily through trade liberalization in form of the tariffication of quotas, eliminations of exemptions, reductions in tariff peaks, and improvements in customs procedures (Basri et al., 2019). Moreover, the empirical results of Pessino and Fenochietto (2010) indicate a positive and significant relationship between tax revenue and (public expenditure on) education. The study also finds a negative relationship between tax revenue and income distribution (measured by the Gini coefficient).

To assess the impact of institutions, some variables measuring corruption are also included in the IMF's empirical model. According to Transparency International (2019), Tanzania's level of corruption has significantly improved from 30/100 in 2011 to 37/100 in 2019 (higher scores indicate lower corruption). Generally, countries with lower corruption levels, such as Tunisia and Seychelles, also tend to have higher tax ratios. These factors determine the tax capacity for Tanzania and other countries in Sub-Saharan Africa. Thus, continuous improvement in institutional quality is key to improving tax revenue performance.

*B. Tax Revenue Gaps*

A tax gap of more than 6% of GDP means that Tanzania's actual tax collection is far below its tax capacity.

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It also implies that the country could generate significantly greater public investments to achieve its Development Vision 2025 and Sustainable Development Goals. If Tanzania closed the tax revenue gap, the need for additional grants and external or domestic borrowing would also diminish.

The tax revenue gap is made up of a tax policy gap and a tax administration gap. One of the major reasons for domestic resource mobilisation falling short of its potential is deliberate tax policy design. Marginal tax rates can be kept lower than optimal, user fees may not be charged even when the circumstances are appropriate for such charges, and there can be deliberate exemptions or under-taxation of some economic activities. However, tax collection can also fall short of its potential because of inadequate administrative capacity or/and enforcement. The World Bank (2020) argued that some of the reasons for administrative tax gaps in Tanzania are the lack of tax compliance, enforcement, and assessments. Thus, this section provides an account of tax revenue gaps with respect to tax policy and tax administration for specific types of taxes including excise taxes, value-added tax, income tax, custom taxes, and property tax.

*1. Excise Taxes*

Excise taxes are levied on selected commodities and services to discourage the consumption of certain goods and to generate revenues. They are relatively simple to implement and do not require making fundamental changes to the tax system. During the 2011 to 2019 period, most domestic excise tax revenues were collected from telecommunications and beers. The performance of excise tax collection has been stagnating at 1.8% of GDP in recent years close to the average of Sub-Saharan Africa of 1.7% of GDP but down from the 2.5% of GDP that was collected in 2009/10 (World Bank, 2020). Tanzania now has the second-lowest excise tax to GDP ratio in the East African Community. The main reason for the underperformance of the excise taxes is a tax policy gap due to a narrow tax base and low tax rates. According to the World Bank (2020), excise taxes could add another 1.2% of GDP by applying a single duty rate to all imported goods irrespective of their origin, by increasing excise tax rates of alcoholic beverages to those of regional peers, and by indexing the tax rates to annual inflation.

*2. Value Added Tax*

Value-Added Tax (VAT) is collected as value is being added at every stage of production. The collection of VAT has also been stagnating at around 3.5% of GDP over the past years.

That is almost a full percentage point of GDP below the average of EAC countries (4.4% of GDP) and almost equivalent to the entire gap between the overall tax-to-GDP ratio in Tanzania and the corresponding EAC average. Cnossen (2015) categorized Tanzania as a 'low tax effort' country with respect to VAT, defined as a country collecting 'two- thirds or less of the revenue that it can be expected to rise given its institutional and economic circumstances'.

Tax policy decisions that cause the VAT gap include exemptions. Figures provided by the Government show that VAT exemptions granted to large taxpayers resulted in revenue losses of 0.6% of GDP in 2013 and 0.4% of GDP from January to September 2014 (ISCJEC, 2017). TANROADS, the domestic road authority, was the largest recipient of VAT exemptions. Among the foreign companies that were granted VAT exemptions, two received more than any other: Norway's Statoil and Britain's gas corporation – the BG Group. Together, these two companies were given VAT exemptions worth 0.5% of GDP in 2013-14 (ISCEJIC, 2017). Recent research by the UN-based Better Than Cash Alliance calculated that the Tanzania Revenue Authority (TRA) lost nearly 0.7% of GDP to VAT tax evasion in the fiscal year 2014/2015 alone, a figure amounting to 43% of the VAT collections.

Although the reduction of the VAT rate from 20% to 18% has boosted revenue, Kisanga et al. (2021) indicated that a further decrease of the VAT rate to 17% or 16% will lead to a revenue loss of TZS 186 billion or TZS 371 billion, respectively. Generally, appropriate reforms of the VAT could increase gross tax revenue by 2.5% of GDP by including water services and petroleum products into the VAT base and by reducing VAT fraud through a better refund administration (IMF, 2016).

The VAT gap is also caused by tax administration issues. VAT collection has suffered from compliance issues and a weak refund mechanism. One administrative challenge is a large number of small manufacturers with an annual turnover below the VAT threshold of TZS 100 million. Some traders with turnover above the VAT threshold may be hiding in this group of taxpayers. Additionally, some traders with large capital and turnover use "machinga" (street vendors) to sell their goods without VAT because "machinga" are regarded as small vendors. A study by Fjeldstad et al. (2018) on the VAT in Tanzania concluded that there are still large challenges of compliance in issuing receipts using Electronic Fiscal Devices (EFDs). Another challenge is the administration of the VAT refund system (World Bank, 2020).

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*3. Income Taxes*

Pay As You Earn (PAYE) is a direct tax levied on wages, salaries and fringe benefits of employees. From 2011/12 to 2018/19, it has contributed average tax revenues of 1.9% of GDP. PAYE is the easiest income tax to collect, especially from the public sector but not necessarily from the private sector. High compliance for PAYE results from the tax payment method: it is paid by the employer withholding the tax amount from the salaries of its employees. Existing shortfalls are mainly caused by inadequate tax administration whereby more collaboration between the Tanzania Revenue Authority (TRA) and other government institutions is needed to help the TRA to get accurate information on the wage bill from the employers, especially from the private sector.

Corporate Income Tax (CIT) is charged on profits of entities, such as limited companies and other organizations including clubs, societies, associations, and other unincorporated bodies. Despite the small size of the corporate sector, its taxes contribute an average of 1.4% of GDP. However, generous tax incentives are undermining the Corporate Income Tax base. Tanzania offers extensive tax incentives for companies located in Special Economic Zones (SEZ) and Export Processing Zones (EPZ) including 10- year exemptions (holidays) from income tax, withholding taxes, property tax and other local government taxes and levies. While it is difficult to assess the magnitude of revenue forgone from the income tax holidays since tax exemption data only includes indirect taxes, they do conflict with good tax policy principles and introduce a risk of income tax evasion through transfer pricing between resident companies located inside and outside the zones.

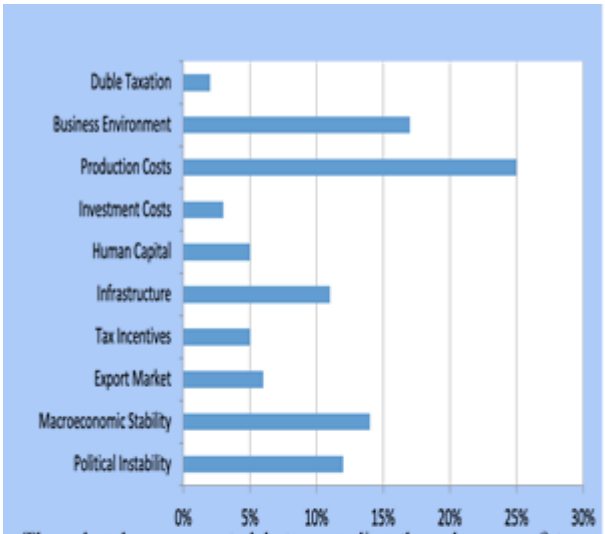
Various estimates have been made on revenue losses from tax incentives in recent years. ActionAid (2018) estimated that Tanzania loses 0.06% of GDP each year to tax incentives. A report conducted in 2013 for Tanzania's Ministry of Finance by the consultancy CRC Sogema concluded that:

*"In countries with poor investment climates – that includes Tanzania and other developing countries, the effect of providing tax incentives is also non-existent. It is more efficient for developing countries to focus on improving their investment climate rather than granting tax exemptions to corporations*."

Tanzania may also be losing revenues from double taxation agreements (DTAs) that it has signed with other countries, although no estimates are available. Tanzania has signed double taxation agreements with nine countries: Sweden, Canada, Denmark, Finland, Norway, India, Italy, Zambia, and South Africa. Most of these double taxation agreements are old and contain taxation regimes that surrender Tanzania's taxing powers in favour of partners. The double taxation agreements have capped withholding tax rates that can be levied on interest, dividends, and royalties. For example, the South African double taxation agreement, which is the latest treaty signed in 2005, sets withholding tax rates at 10%. The double taxation agreements also limit Tanzania's taxation of profits derived from air and shipping operations.

Illicit capital flight is the ultimate reflection of a country's failure to mobilize and retain its domestic financial resources. Tanzania must stay abreast of evolving international corporate practices. With companies increasingly reliant on debt relative to equity, thin capitalization rules have been adopted to limit tax deductions on interest (IMF, 2018). The US-based Global Financial Integrity (GFI) is the pre-eminent body analysing illicit financial flows. It reported that an average of TZS 3 trillion of domestic capital is drained out of the Tanzanian economy illegally per year. At a corporate tax rate of 30%, this means that Tanzania loses tax revenues of about 0.6% of GDP per year. The key method for which figures are available is trade misinvoicing by deliberately misreporting the value of imported or exported goods to reduce tax payments. Evidence suggests Tanzania is continuing to lose large revenues from this method (Manamba, 2015).

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There has been a great debate regarding the relevance of tax incentives particularly in developing countries including Tanzania. Studies such as ISCEJIC (2017) in Tanzania have also advocated for the tax reforms to reduce the amount of tax incentives. During the first study of *Pilot4Dialogue*, the Minister for Mining, Hon. Dr Dotto Biteko opined that the Government will not use tax incentives anymore in future mining contracts. This survey provides additional evidence on the relevance of tax incentives using primary data for future policy implications.

During the survey, investors were asked of the main factors that affect their investment decisions. As shown in the graph above, production costs, business environment, political and macroeconomic stability are the most important factors affecting investment decisions in Tanzania. Most surveyed investors acknowledged that tax incentives are not important in their investment decisions.

ISCEJIC (2017) suggested that tax incentives are not only inefficient mechanisms for facilitating investment, but they are quite costly to the fiscal balance, an obvious point that cannot be overemphasized in the Tanzanian context. In fact, a lot of countries have used this approach that in the past, such as Morocco, Indonesia, and China, have started to phase out tax incentives.

Source: Bishagazi, 2021.

**Box 2: Are Tax Incentives Relevant in Tanzania?**

Individual Income Tax is paid by professionals, sole traders, small businesses, self-employed individuals, and other non-corporate taxpayers. Like salaried employees whose emoluments are subject to Pay As You Earn (PAYE), all non-corporate taxpayers file tax returns with the domestic revenue department and are taxed at progressive individual income tax rates varying from the lowest marginal rate of 9% to the highest marginal rate of 30%. In Tanzania mainland, the taxable income threshold that does not attract income tax is TZS 170,000 per month.

In addition, small businesses that do not keep books of accounts for tax purposes and have an annual gross turnover of less than TZS 20 million are covered by a presumptive tax scheme based on turnover.

The large extent of informal economic activities in the country makes it difficult to identify and include all eligible taxpayers in the tax base (Alliance for Financial Inclusion (2021)). Therefore, individual income tax has only marginally increased from 0.1% to 0.2% of GDP between 2011/12 and 2018/19 with the presumptive income tax scheme contributing about half of the individual income tax. Assuming a compliance rate of 50% (up from the current 32%), the presumptive income tax potential may be estimated at around 0.3% of GDP (World Bank, 2021).

Box 3: Taxing the Informal Sector in Tanzania

*4. Customs Taxes*

During the period from 2011 to 2019, Tanzania collected a third of its nonrecourse revenue through customs at its borders. Reflecting the fairly advanced customs duty harmonization and liberalization process within the East African Community (EAC), custom revenue is relatively modest. Customs tax revenue amounted to an average of 0.9% of GDP between 2011/12 and 2018/19 – slightly below the average of 1.2% of GDP for EAC countries but quite far from 2.7% of GDP for Low-Income Countries (Maskaeva, et al., 2019). The Government estimates that from January to October 2016, it lost revenues equivalent to 0.33% of GDP caused by importers under-valuing the worth of imports (ISCEJIC, 2017). A report by the Confederation of Tanzanian Industries in 2017 estimated that revenue losses are highest concerning industrial equipment, motor vehicle spare parts, and agricultural inputs. Low custom taxes are caused mainly by tax administration gaps as Tanzania has a highly porous border with little surveillance.

5. *Property Tax*

Property tax revenues provide a stable and reliable source of revenue that is less susceptible to short-term economic fluctuation. It is difficult to evade since property taxes can be secured by the property itself. A further benefit is improved service delivery and accountability where property taxes are collected by the local administration (IMF, 2018). Norregaard (2013) suggested that Sub-Saharan African countries can raise 0.5% to 1% of GDP via property taxation, and it is indeed becoming more common across the continent. In Tanzania, the growth rate of property tax revenue was 50% in 2016 when Local Government Authorities were collecting the tax.

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However, after the collection shifted to the Tanzania Revenue Authority, collection growth declined to 21% and then to 3% in 2017 and 2018, respectively (Martin et al., 2019). After a reform to change the property tax based on the value of properties to a flat tax amount, revenue dropped by 53%. This indicates that the reforms have not been effective and adequate efforts are needed to improve domestic resource mobilization.

*C. Cross-Cutting Issues*

*1. Tax Administration*

ISCEJIC (2017) reported that there is an additional loss of revenues from corruption in the government budget, which diverts money away from public services. Government officials estimated that during each fiscal year, corruption is responsible for a 20% loss from the Government's budget. In 2016/2017 government expenditure was about TZS 29.5 trillion, of which 20% is TZS 2.9 trillion. However, the Government is acting against the misuse of public funds. In November 2016, for example, the President dissolved the Tanzania Revenue Authority's board and sacked its chairperson after depositing TZS 26 billion in fixed deposit accounts in three different banks. The President accused the board of irregularly diverting the money meant for the taxman's recurrent expenditure to fixed deposit accounts where it would generate interest that was to be shared among the agency's top officials (ISCEJIC, 2017).

**Box 4: Incorporating Digitalization in Domestic Resource Mobilization**

In Tanzania, many transactions occur in the informal economy which is typically not subject to taxation. Large parts of the population survive in subsistence agriculture and conditions of chronic poverty outside the formal economy and beyond the tax system. According to IMED (2016), the informal sector in Tanzania accounts for 80% of employment, 70% of the services consumed by the poor, and it contributes 39% of the country's GDP. It absorbs over 62.5% of the urban workforce compared with 8.5% of the formal sector.

The Tanzania Revenue Authority states that only 1.6 million out of a potential 15 million Tanzanians pay taxes. Sectors in the informal economy that make a disproportionately low contribution to taxes include agriculture, construction, and trade. Only some of these sectors are genuinely hard to tax. For example, there are over 7,000 construction businesses that report five or more employees which should be quite visible to the tax authorities. Many professional consultancies are also believed to avoid paying withholding tax, and the rate of 5% of the contract amount is also extremely low by international standards. This figure is also very low compared to public procurement contracts awarded to the consultants in tenders.

Recent efforts to formalize the economy and increase tax revenues included the issuing of special ID cards which required informal operators to pay an annual fee of TZS 20,000. However, the strategy did not materialize well as wealthier taxpayers (large businesses) used this ID card system to evade taxes.

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Reforms to digitize tax collection at the national level through the Tanzanian Revenue Authority's iTAX system have been associated with a ten-fold increase in revenues between 1996 and 2007 Nathan Associates (2011). However, low technical proficiency among taxpayers and unreliable network infrastructure hinders the use of Electronic Fiscal Devices.

*2. Gender Equity*

Domestic resource mobilisation efforts can be more successful if tax policy is promoting gender equity. Tax policies usually have two key aims: to raise revenue for the provision of public goods and to change taxpayers' behaviour in line with broader public goals. Gender equity analysis underpins both these goals. Incorporating a gender dimension in fiscal policies is also crucial to ensure the mainstreaming of gender equity and to overcome existing biases in society. The following section discusses crucial issues that need to be addressed to improve domestic resource mobilization in a gender-sensitive manner.

*Direct Taxes*

The Income Tax Act, section 7, provides for the taxation of employment income, whereas the taxable employee is likely to benefit from tax exemptions on scholarship allowance, cafeteria services, medical allowances, housing benefits, transport allowances, and pension contributions. The allowances are not available to non-employees, of which the majority are women. The issue of gender bias can be traced to the application of tax incentives granted to employees who give relief or saving which would otherwise be taxed. This enhances the disposable income of salaried employees and widens the gender income gap. However, the tax regime has a redress approach to marginalized groups whereby it provides cash outlays in terms of vocational training services and higher education through the skills and development levy.

Investment income means the profit earned from investments, either from the appreciation of the value of the assets or compensation from using the assets. These may include land and buildings, shares, bonds, treasury bills, bank fixed deposits, and intangible assets like copyrights and patent rights. With these assets, one can earn an income in terms of rents, dividends, interests, royalties, and capital gain upon the disposal of an asset. The issue of gender bias relates to the question "who owns the assets?" and "how are the taxes imposed?" In Tanzania, men own the majority of assets. An individual's income from an investment is only taxed upfront (a final withholding payment) at a relatively low rate (5%, 10%, and 15%) compared to the traditional progressive rate of employment taxes, which range from 9% to 30%.

The Income Tax Act section 2 exempts income tax for a private residence upon disposal with the condition that the individual must have lived in it at least for three years and which does not have a gain that exceeds TSZ 15,000,000. Likewise, there is also an exemption from income tax when an individual realizes farmland whose market value is less than TZS 10,000,000 and the farmland has been used for at least two of the last three years. Also, the law exempts rental income which does not exceed TZS 500,000 per year as per section 86(4)(c). With such arrangements of the tax regime, the income tax law implicitly favours the male and affluent population by reducing the tax burden.

Self-employed individuals are subject to taxation on their income from business as provided under section 8 of the Income Tax Act, Cap 332 of 2004. The law has developed a dual system of taxing income from the business: the presumptive tax system and the net profit system. With the presumptive system, the individual qualifies if the turnover is within the range of TZS 4,000,000 to TZS 100,000,000. If an individual maintains sales records, it is taxed based on the annual turnover. In the absence of complete records, the annual turnover is estimated based on the best judgment of the commissioner TRA, 2022). The disadvantage of this system is that it does not consider all incurred costs. As women-led businesses are largely unincorporated, the presumptive tax regime tends to be biased against women-dominated occupations and sectors. A higher burden of unpaid care leaves many women unable to grow their businesses.

The progressive personal income tax system may also discriminate against low-income earners (mainly women) who do not benefit from specific tax incentives which are available mainly to high-income earners. Section 11 of Tanzania's Income Tax Act states that persons will not be allowed deductions for expenditures of "costs incurred in the maintenance of a person or a person's family". Whenever social protection programmes are tied to income (including tax deductions for pension savings), they tend to favour men, who are more likely to be formal taxpayers.

*Indirect Taxes*

The Value Added Tax (VAT) is imposed on all taxable supplies, whether imported or manufactured domestically. Indirect taxes such as VAT and excise taxes are regressive taxes because high-income individuals spend less of their income than individuals with low-income. Households headed by a female individual spend a sizeable portion of their income on basic consumption commodities such as food, clothing, fuels, and mineral water, which are subject to VAT and excise taxes.

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These indirect taxes place a greater burden on women and other marginalized individuals than men. A possible measure to mitigate the tax burden is to use proper tax design and provide tax relief like zero-rating and exemption of particular items.

Real estate taxes refer to those compulsory payments which relate to the ownership or occupation of land and or buildings. They include premium, land rent, planning and survey fees, certification and registration of title fees, transfer fees and property tax. In Tanzania, property tax is levied and collected by the Tanzania Revenue Authority in collaboration with Local Government Authorities. The rate for estate taxes differs depending on the type of the tax or levy and the authority that has been empowered to levy. Land rent and property tax are administered based on the value of the land or building. A specific rate or amount is also used to charge these taxes. For property tax, the specific or fixed amount is TZS 10,000 for all ordinary buildings regardless of the status quo or gender of the property owner. A storey building is charged TZS 20,000 in district areas while in urban areas each storey is charged TZS 50,000 (Written Laws Miscellaneous Amendments) Act, No. 2 of 2019).

Real estate taxes do not take into consideration gender equity as exemptions are awarded based on other aspects than gender and other marginalized groups. For example, exemptions from land rent are automatically given to government properties. Section 33A (1) of the Land Act, Cap 113 of 1999 provides for the exemption of payment of rent for a right of occupancy over lands exclusively for central or local government use; government institution or organization use, and for non-profit organizations, including religious institutions, which provide health, education, or other social services which are not profit-oriented (Kitilya, 2019). Women, widows, and orphans do not qualify automatically for an exemption, but they can be excluded from the obligation to pay upon a waiver to be granted by the Commissioner for land under section 33(10) of the Land Act, Cap 113. One residential rentable property which is owned and resided by a person above the age of sixty years or a person living with disabilities who has no source of income is exempt from payment of property tax (Finance Act, 2016). Thus, the tax regime in Tanzania ought to provide gender-sensitive exemptions instead of providing general criteria which give an advantage to men who are largely the owners of real estate properties. The design of land rent and property tax is structured to focus on land and the property itself whereas, in most cases, the incidence may not directly fall upon the occupiers (property) owners.

When these taxes are not paid as required by the law, the consequence may adversely affect women and other marginalized individuals who depend, solely, on the particular property. Failure to pay property tax and land rent may result in the revocation of the right to occupy land and properties. The design and administration of these taxes should, if possible, be reformed to focus on individuals registered as owners and ensure the incidence affects only the owners, and when they fail to pay, they should be punished individually instead of revoking the right to occupy the land.

There is growing evidence that market traders pay a range of user fees and informal payments that affect women to a greater extent than men. In a study done in Tanzania with a focus on Dar es Salaam's city markets, Siebert and Mbise (2018) found that the gendered impact of fees for the use of public toilets was considerably higher for women as a result of more frequent needs and fewer alternatives. Fees for the use of public toilets (TZS 200-300 per use) exceeded market fees (TZS 100-200 per day). As a consequence, the average costs for women were twice as high as those for men, and women were paying up to 20% of their daily income for using public toilets.

*D. Recommendations to Realize Tanzania's Tax Capacity*

Tax revenues play a crucial role in domestic resource mobilisation due to their productiveness, stability, and predictability. However, Tanzania's tax revenues have grown only marginally between 2011 to 2021. The revenue collection performance is low in comparison with African peers and the country's state of development. The estimated tax revenue gap is caused by tax policy decisions, such as incentives and exemption regimes, administrative challenges of taxing digital transactions, the presence of a large informal sector, weak voluntary tax compliance, and substantial amounts of money going out of the country through illicit financial outflows and capital flight.

*Excise Tax*

- Apply a single rate of excise duty for both imported products and domestically produced goods within the same category of like and substitutable goods. An excise tax is meant to correct for an externality and is not intended to achieve a protectionist objective.
- The excise law provides the Government with the power to adjust excise rates yearly at a minimum by the inflation rate, but this provision is not consistently applied.
- Convert ad-valorem excises on alcohol and tobacco to specific (and higher) rates indexed for inflation to reflect external costs of consumption and production.

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*Value Added Tax*

- Widen the VAT base and capture the digital economy by including services between non-resident suppliers and non-registered residents and require online platforms to act as withholding agents.
- Redesign VAT registration requirements considering the existing capacity to enforce VAT compliance.
- Use simplified VAT filing requirements to lessen the administrative burden around peak filing periods.
- Consider the automation of routine compliance interventions to free up skilled auditors for interventions with higher revenue and compliance returns.

*Income Tax*

- There is a significant revenue mobilization potential through the elimination of corporate income tax holidays and exemptions.
- Prevent the artificial avoidance of permanent establishment status.
- Limit tax base erosion involving interest deductions and other financial payments.
- Develop a multilateral instrument to modify bilateral tax treaties and prevent the granting of treaty benefits in inappropriate circumstances.
- Measure and monitor Base Erosion and Profit Shifting (BEPS).
- Curb capital flight at the source, in transit, and at the destination of illicit transfers through internationally coordinated actions.
- Guide transfer pricing documentation and country-by-country reporting.

*Property Tax*

- Allow for variation in tax rate determination without compromising the simplicity of the tax. There could be area-based flat tax amounts which adjust for the location or diverse types of buildings and their purposes such as residential, commercial, industrial, or vacant properties.
- Strengthen the coordination and capacity of Local Government Authorities (LGAs) to collect or assist in the collection of the property tax. While LGAs may not have enough resources compared to the TRA in collecting property tax, they may support the tax collection because they are more aware of the location and use of properties in their area of jurisdiction.
- Make the use of property tax visible to taxpayers. Publish property tax revenue collected within an LGA and its wards and villages or streets. Use the information to verify payments against the number of eligible properties in their areas of jurisdiction.

*Other Tax Administration Issues*

- Effective domestic resource mobilization also requires a solid database that allows the identification and location of the individuals, firms, or real estate properties on which to levy taxes.
- Revenues from the informal economy can be increased by simplifying the presumptive tax system to improve tax compliance and broaden the tax base.
- Voluntary compliance will be instrumental in increasing domestic resource mobilization. Awareness campaigns on the importance of tax compliance could help.
- Address the tax challenges of taxing the digital economy.
- Harness digital technology. E-invoices allow governments to track sales using, for example, cash registers to record transactions and send information electronically (in real-time) to a server accessed by tax authorities.
- Merge the three tax revenue agencies, the Customs, Income Tax and VAT and provide a holistic approach to strengthen departmental information flow, improve service delivery, and reduce administrative and tax compliance costs.

*Gender Equity*

- Encourage gender-disaggregated tax data, especially about men and women working in the informal economy and their consumption patterns.
- Create opportunities to participate in the policymaking process to promote gender-transformative tax policies.
- Ensure that the total revenue mix is pro-women by advocating for the reduction of tax exemptions, incentives and avoidance by large corporations and multinationals; and ensure high net worth individuals pay the taxes for which they are liable.
- Provide taxpayer education to support women participating in the formal economy.
- Introduce special tax clinics for women to help them better understand the advantages of keeping records, the disadvantages of staying outside the VAT net, VAT and tax compliance issues, and the advantages of formalization.

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- Conduct further research to assess the social value of tax allowances on small incomes and exemptions.

## V. Conclusions

Tanzania's Development Vision 2025 and the Sustainable Development Goals call for social, economic, and environmental transformations that require substantial expenditures to finance public investments, social services, and social protection programmes for vulnerable groups. Provisional estimates suggest that Tanzania's SDG financing need amounts to about 44.5% of GDP. However, the Government's Five-Year Development Plan III projects that public revenues are going to amount to only 18.1% of GDP in 2025/2026 because the expected moderate increase in tax revenues will not be sufficient to compensate for the expected reduction of development grants and non-concessional borrowing. With the current projections, Tanzania's SDG financing gap amounts to about 26.4% of GDP.

Such a large financing gap cannot be closed by a single country. This means that Tanzania – like any other developing country – will require significant development assistance if it is to achieve the SDGs by the year 2030. For that reason, the development community, including the Tanzanian Government, international development partners, civil society, and the private sector need to discuss the question: how will the SDG 17 "Strengthen the Means of Implementation and Revitalize the Global Partnership for Sustainable Development" be achieved in Tanzania? This discussion must include the mobilisation of domestic resources, official development assistance (ODA), additional financial resources from multiple sources, sustainability debt, and the promotion of financial investments.

The Sustainable Development Solutions Network (SDSN) (2019) estimated that the average annual financing gap of 59 Low-Income Countries amounts to about US$ 400 billion from 2019 to 2030. This amount is equivalent to roughly 0.7% of the world's advanced countries' combined GDP. The SDSN considered 6 measures to fill the SDG financing gap from global sources: i) mobilizing blended financing for SDG infrastructure (US$ 50 billion), ii) international corporate tax reform to crack down on profit shifting and the abusive use of tax havens (US$ 50 billion), iii) new globally harmonized taxes on wealth, financial transactions, and carbon to be earmarked to the SDGs (US$ 50 billion), iv) increasing official development assistance by donor countries to the agreed target of 0.7% of GNI (US$ 100 billion), v) increased SDG-directed philanthropic spending, most notably through the 'Giving Pledge' (US$ 30 billion), and vi) debt relief of highly indebted Low-Income Countries (financial scope unknown). These six measures have an estimated financing potential of US$ 430 billion per year – enough to cover the estimated SDG financing gap of US$ 400 billion. However, collecting and distributing these resources will require strong civic activism and political commitment on a global scale. Another question is how these resources can be spent efficiently considering developing countries' absorption and institutional capacity constraints.

These questions merit attention, but their answers may not be as satisfactory and timely as desired. In the meantime, Tanzania should put its focus on domestic resource mobilisation to achieve its development goals with an appropriate sense of urgency and realism. Our analysis supports that effort by estimating Tanzania's domestic resource mobilization potential given its state of development and institutional framework and outlining several alternative fiscal and monetary policy options.

- Tanzania's greatest resource mobilisation potential is tax revenues. The FYDP III aims to increase tax collection to 14.4% of GDP in 2025/2026 while the country's tax capacity has been estimated at around 18.3% of GDP. A reduction of tax incentives and exemptions, a widening of the tax base to include digital transactions and the informal sector, taxpayer-oriented strategies to strengthen voluntary tax compliance, and curbing illicit financial outflows and capital flight may yield additional tax revenues of 3.9% of GDP.
- Another potential source of revenue is fiscal borrowing. The FYDP III projects fiscal net borrowing to shrink to 1% of GDP in 2025/2026. While foreign net borrowing will come to a complete halt, domestic net borrowing is going to stagnate at around 1% of GDP to avoid crowding out the private sector. However, the analysis shows that Tanzania's public debt is sustainable with a fiscal deficit of around 3% of GDP under the baseline scenario and close to 4% of GDP under the more optimistic FYDP III scenario. This means that the Government may borrow an additional 2%-3% of GDP to finance urgently needed public infrastructure projects.
- In June 2021, the Government of Tanzania announced plans to begin the construction of a delayed TZS 60 trillion liquefied natural gas project in 2023. The IMF (2014) estimated that revenues may amount to an average of 1.2% of GDP per year over the period of natural gas production.

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- Monetary policy has the potential to create additional seigniorage revenues of about 0.3% of GDP if the inflation rate is raised from the FYDP III target of 4.4% to the East African Monetary Union target of 8%.
- The development of the financial sector is a strategic imperative. Bringing the sector to the expected level of development could boost GDP growth by 1 percent and make it more stable. Financial sector development would also promote international trade and investments, reduce tax evasion and the size of the informal economy, and mobilise domestic savings that would reduce the borrowing costs of the public and the private sector.

Taken together, these alternative fiscal and monetary policy options may enhance the public sector resource envelope of the FYDP III by more than 7% of GDP. However, these figures are provisional. Further studies are needed to provide more precise estimates of Tanzania's domestic resource mobilisation potential. It is also necessary to conduct a cost analysis of Tanzania's SDG financing need and to re-estimate the SDG financing gap. The Ministry of Finance and Planning and the United Nations Development Programme are following such a process through a two-step approach: the Tanzania Development Finance Assessment (DFA) Report 2021 provided an overview of Tanzania's development financing landscape, monitoring and evaluation systems, and governance structures. The upcoming Integrated National Financing Framework (INFF) will help Tanzania to raise resources through coherent financing policies both across sectors and sustainable development priorities. These financing policies require a governance framework with strong commitment and leadership at the political and technical level, access to knowledge and perspectives to ensure that policy-makers have the information they need, and coordination of stakeholders to maximize synergies in the design and implementation of financing policies.

To play a relevant role in this process, Tanzania's civil society organizations need to form a strong network with a joint advocacy strategy to promote alternative fiscal and monetary policy options with realistic domestic resource mobilisation targets. These efforts will eventually help Tanzania to achieve its development goals with an appropriate sense of urgency and realism.

At large, the main purpose of taxation is the mobilization of resources to finance public expenditures. Whatever the prevailing political or economic ideology of the less developed country, its economic and social progress depends largely on its government's ability to generate sufficient revenues to finance an expanding program of essential, non-revenue-yielding public services such as health, education, transport, legal and other institutions, poverty alleviation, and other components of the economic and social infrastructure.

Many developing countries face problems of large fiscal deficits-public expenditures greatly in excess of public revenues-resulting from a combination of ambitious development programs and unexpected negative external shocks. With rising debt burdens, falling official development assistance (ODA), growing trade imbalances, and declining foreign private and public investment inflows, developing-country governments had little choice but to undergo severe fiscal retrenchment. This meant cutting government expenditures (mostly on social services) and raising revenues through increased or more efficient tax collections.

In general, the taxation potential of a country depends on five factors:

1) The level of per capita real income
2) The degree of inequality in the distribution of that income
3) The industrial structure of the economy and the importance of different types of economic activity (e.g., the importance of foreign trade, the significance of the modern sector, the extent of foreign participation in private enterprises, the degree to which the agricultural sector is commercialized as opposed to subsistence-oriented)
4) The social, political, and institutional setting and the relative power of different groups (e.g., landlords as opposed to manufacturers, trade unions, village or district community organizations)
5) The administrative competence, honesty, and integrity of the tax-gathering branches of government

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