KEY STRATEGIES TO STRENGTHEN DOMESTIC RESOURCE MOBILIZATION: TANZANIA

1. Introduction

Domestic resource mobilization (DRM) refers to the savings and investment generated by households, domestic firms, and government (Culpeper and Bhushan, 2008). Enhanced DRM can help to reduce the external resources (in the form of grants and loans) required to achieve Millennium Development Goals (MGDs). Each additional $100 million equivalent raised through domestic taxation potentially reduces external debt liability up to an equivalent amount, thereby helping to constrain the growth of debt to sustainable (MDG-sustainable) levels (Culpeper and Kappagoda, 2007: 16). In the face of these considerations, domestic resource mobilization is inevitable in developing countries. However, it is an obvious point that enhanced domestic resource mobilization will not, by itself, guarantee that the resources so mobilized through taxation and private domestic savings will be allocated efficiently or effectively.

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

Although revenue collection as a percentage of GDP has recently increased, from 11.8% in 2004/05 to around 16% in 2008/09, it is still not enough and ought to grow much faster. Domestic revenue is expected to contribute 56% to the total revenue in 2009/10, while 33% will be coming as foreign grants and loans. To increase the relative share of domestic revenue in the total spending and also as a percentage of GDP, boosting domestic revenue has to be a part and parcel of the MKUKUTA II's strategic objective for the next 5 years. This is a matter of concern as it is evident that the major sources of revenue have remained the same over the years.

2. Top Three Strategies to Enhance DRM

2.1 Exploit property tax potential

It is noteworthy that virtually all properties especially in towns and cities, and notably buildings both commercial and residential, are not adequately and effectively taxed. Thus their revenue contribution is insignificant. Although the property tax legislation spells out clearly that property tax has to be collected and that the TRA is mandated to collect the tax, collection effort in this category of taxes has been too low. This is possibly due to difficulties involved in making a follow up of the taxpayers, which means it is likely that collection cost is high. However, the taxpayers can be easily motivated to pay property tax by making sure that while they are forced to pay, there is also provision of noticeable social services, which in a way, reflects the use of the collected tax money. For example, in the residential areas of urban centres, compliance can be enforced strictly while at the same time; roads cleanliness and the removal of garbage are provided. This kind of two-way demands can become an effective incentive for the payers to comply.

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

2.2 Strategies to Collect Taxes from the Informal Sector

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

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

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

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

Table 2: Analysis of Tax Payers

	Tax payer group	Number of tax payer groups as percentage of total	collected by tax payer
Formal	Large	10	70
	Medium	5.25	10 to 25
	Small (SMEs)	70.95	0-10
Informal	Formalization	???	

Source: Kimungu and Kileva (2007)

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

2.3 Strategies to enhance private savings

Integrally connected to lack of credit in Tanzania is the high interest-rate spread between deposit and lending rates of interest. Interest rate spread averages 13.4 percentage points. The high spread in most countries including Tanzania indicates that loans are relatively expensive, particularly for long-term private investment. Such high spreads imply that commercial banks can make hefty profit rates on the loans they disburse but their volumes are still too low to make large profits. But in Tanzania since the amounts the banks lend are far less than the available financial resources, they don’t make much profit from lending. Instead they make profits from imposing multiple charges on their customers.

The government strategy to counteract this trend should be for the Bank of Tanzania to lower its prime lending rate about two percentage points. This reduction should give some boosts to growth and employment. Alongside this measure the government should moderately increase the fiscal deficit as a stimulus to aggregate demand.

In addition to this strategy, credit at concessionary terms should be provided to sectors of the economy with above average employment multipliers. There are three options of doing so: 1) expanding the lending activity of the country’s commercial banks; 2) obliging banks to hold 20 percent of their assets in loans to employment-intensive sectors; and 3) expanding the country’s guarantee scheme. The loan guarantee scheme should obligate no more than 1-2 percent of the government fiscal budget. A related strategy is to expand the banking network into rural areas by addressing the constraints that currently discourage commercial banking activities in rural areas. Implementation of this strategy will require cooperation between the government and commercial banks. The government should also seriously look into the possibilities of supporting the development of the capital market which currently is small, not well-known amongst the public and is inactive. What is required is massive education on stock market activities and the benefits from participation.

However, such expansionary measures are likely to raise Tanzania's inflation rate. Nevertheless, the increase is not expected to be more than moderate. If inflation threatens to increase beyond a moderate level, the government should institute an income policy and weaken the monopolistic pricing power that exists in some sectors of the economy. As a means to ensure stability of the exchange rate, the use of capital management techniques is recommended. Such measures will guide against volatility in capital flows as a result of any precipitous change in the perceptions of portfolio investors.

3. Why are these The Best Strategies?

The first and the second strategy are among the best ones because they both can address fiscal constraints to domestic resource mobilization, namely a narrow tax base. The alternative strategies of addressing fiscal constraints include raising tax rates and introducing new taxes. The former is likely to be counterproductive since it often leads low compliance and consequently to tax evasion. The latter would not be appropriate because Tanzania is currently levying so many taxes, introducing new taxes would reduce efficiency in tax collection. The third strategy is best suited to addressing financial constraints, particularly lack of credit. Lack of credit in Tanzania is not due to lack of funds in the banking system. In fact there is excess liquidity in the banking system. Lack of credit is mainly due collateral requirement and high lending interest rates which makes the cost of investment high. This strategy can best boost both private savings and investment.

4. Expected Pay-offs

First, effective payment of property tax will add a significant amount of revenue to the government. One means of ensuring compliance will be to set affordable rates but with effective enforcement to benefit from the economies of scale in collection. Second, since the informal sector constitutes a significant portion of the overall economy, effective taxation of the sector can generate substantial amount of revenue for the government. Third, reducing interest rate spread can be achieved by either reducing the lending rate while keeping the deposit rate constant, or by increasing the deposit rate but keeping the lending rate constant, or by simultaneously increasing the deposit rate and reducing the lending rate. Perhaps the third option is possibly the best one as it can increase both private investment and savings.

5. Conclusion

The three strategies outlined above, if properly and effectively implemented could significantly enhance domestic revenue in Tanzania. But the extent to which these strategies can be successful will depend upon the government commitment to implement them.