NORTH-SOUTH INSTITUTE

DOMESTIC RESOURCE MOBILIZATION

Tanzania: A Case Study

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1. Introduction

Domestic resource mobilization (DRM) may be defined as the generation of savings from domestic resources and their allocation to socially productive investments. In broad sense, DRM entails the mobilization of both human and financial resources. The public as well as the private sector have important roles in DRM. The public sector mobilizes domestic resources through taxation and public revenue generation for investment in social services and infrastructure. In contrast, the private sector mobilizes the savings of the households and firms through financial intermediaries, which allocate resources to investment in productive activities. Accordingly, enhancing DRM in poor countries entails deepening the fiscal capacity of the country and improving the social rate of return to public investments. It must also involve deepening financial markets to enable them attract a growing portion of domestic savings and allocate them to commercially productive uses (Culpaper, 2008, p.1).

In developing countries such as Tanzania confronting widespread poverty, mobilization of domestic resources is a big challenge, which has led these countries to rely on foreign aid, foreign direct investment, export earnings, and other external resources. Nevertheless, there are compelling reasons to underscore DRM (Culpeper, 2008).

First and foremost, greater reliance on DRM is vital to elevating economic growth, accelerating poverty reduction, and underpinning sustained development. High-growth economies typically save 20-30 percent or more of their income in order to finance public and private investment. Second, DRM is more congruent with domestic ownership than external resources. Foreign (aid) resources invariably have strings attached to them and not to mention conditionality. FDI is basically oriented to the commercial objectives of the investor, not the principal development priorities of the host country. Finally, DRM is more predictable and less volatile than aid, export earnings, or FDI.

Tanzania like most developing countries has been running both fiscal deficits and balance of payments deficits. A larger portion of its fiscal budget (40 percent) is foreign financed. Poverty reduction is on the top of political agenda. Other development initiatives such as improvement in economic infrastructure, and above all, growth require adequate financial resources. The government has indicated the intention to reduce dependence on foreign sources of finance. But this is easier said than done, the extent to which this intention has been realized is questionable. Domestic resource mobilization requires a study to examine how best the government can achieve it.

The objective of this study is fourfold: (i) to assess saving mobilization performance in Tanzania; (ii) to examine the binding constraints to savings mobilization in Tanzania; (iii) to examine opportunities for enhancing savings mobilization; (iv) to discuss strategies for national policy makers and foreign donors to enhance domestic resource mobilization; and to make policy recommendations. Hopefully, this study will assist the government in designing policies that can enable it achieve domestic resource mobilization

2. The Overview of the Economy

Relative to most other sub-Saharan sovereign states, Tanzania has implemented the structural underpinnings necessary to sustain economic and social stability and attract needed resources required to develop its physical infrastructure. While the country is still amongst the world's poorest economies, Tanzania's government is taking important measures towards achieving substantial change.

Tanzania falls in the bottom ten percent of global economies in terms of per capita income. It had a per capita GDP of US$329 I 2006. Its UNDP HDI ranking was 162 in the same year. The World Bank, the IMF, and bilateral donors have provided funds to rehabilitate Tanzania's out-of-date economic infrastructure and to alleviate poverty.

Industries

Agriculture output accounts for more than 40 percent of GDP, provides 85 percent of exports, and employs 80 percent of the work force. Tanzania's agro-business grew at five percent in 2007 and is projected to continue growing around 5 percent for the next couple of years (African Economic Outlook, 2008). However, desertification of the region has affected the country's topography and seasonal climate. As a result, cultivated agricultural crops now account for only about 4 percent of the available land area.

Although agriculture continues to dominate the economy, growth across Tanzania's service sector has increased in the last few years relative to agriculture. Tourism, real estate and business services helped the broader service sector grow to an estimated 43.8 percent of Tanzania's GDP in 2007.

Tanzania also has robust natural resources including gold and natural gas. Since early 2000, the country has invested in infrastructure to extract domestic commodities of natural gas, which is now piped into the country's commercial capital, Dar Es Salaam, and exported to various markets overseas. Industrial production (including manufacturing, mining and quarrying) grew by approximately 9.2 percent in 2007 and was projected to grow by nearly 10 percent in 2008.

Continued investment in infrastructure is critical to continued macro-level stability. Roughly 60 percent of Tanzania's electricity supplies are generated by hydroelectric facilities and recent drought conditions have critically handicapped electricity generation. During 2006 and 2009, Tanzania had to ration power due to a shortfall of generated power. The country has plans to increase gas- and coal-fueled generation capabilities, but these plans take years to implement and are capital intensive.

GDP Growth

The Tanzanian economy has exhibited stable GDP growth over the past few years. Annual growth of approximately 6-7 percent was projected in 2007. In 2008, GDP growth accelerated to 7.1 percent. Nevertheless, negative impact associated with the global economic and financial crisis was envisaged to affect this growth trajectory (African Economic outlook, 2008). The Bank of Tanzania expected GDP growth to slow down to 5-6 percent in 2009 due to downward pressure from the country's tourism and natural resource industries. (Economic Intelligence Unit, March 2009)

Fiscal policy

Government expenditures have increased over the past several years. The country has made reasonable progress in boosting domestic revenues. Accordingly, levels of domestic revenue mobilization are more or less comparable to most countries in the region. Domestic revenues now accounts for 16.8 percent of GDP, which is up from 11 percent in 2002/03 (Ter-Mlnassian et al., 2008).

In 2007/08, government spending accounted for about 25-28 percent of GDP (AEO, 2008). Between 2001/02 and 2007/08 (Ter-Mlnassian et al., 2008):

(i) domestic revenue mobilization increased 5 percentage points (from 11 to 16 percent) of GDP; percent

(ii) external grants doubled as a share of national income from 3.9 percent to 7.8 of GDP;

(iii) external financing on concessional terms has almost trebled from 1.4 to 4.1 percent of GDP; and

(iv) bilateral and multilateral debt relief has reduced the county's annual debt-servicing obligations by between 0.5 percent and 1.0 percent of GDP.

Although these favorable trends which support increases in government spending from sources other than foreign aid/debt, current levels of domestic revenues and external aid flows are still inadequate for sustainability, without significant international subsidies. To this end, there is a scope to further increasing "fiscal space" along each of the above dimensions.

Foreign Aid

As a result of recent aid and debt relief (under the HIPC and MDRI initiatives), the NPV of Tanzania's external debt has fallen from approximately 70 percent of GDP in the late 1990s to about 15 percent of GDP today. (Ter-MInassian et al., 2008). Recent debt sustainability analysis conducted by the IMF and The World Bank suggest that Tanzania's overall sovereign debt burden of approximately 30 percent of GDP is sustainable and will not impact forward looking growth estimates.

Inflation

Year-over-year inflation rose to 13.4 percent in December 2008 – its highest level since 1998. (Country Report – Tanzania," Economist Intelligence Unit, March 2009). Inflation was expected to increase throughout 2009 as food prices (which account for 50 of Tanzania's consumer price index) fall due to a favorable harvesting season.

Public and Private Investment

Investment as a share of GDP has been rising given the country's continued focus on infrastructure development. In 2006, investments accounted for 8 of GDP up from 3.4 percent in 1999 (AEO, 2008). However, by any standards this investment-to GDP ratio is still considerably small.

3. Savings Mobilization Performance

3.1 Public Savings

Table 1 summarizes main components of public finances as percent of GDP. According to the table total revenue and grants constituted 22.2 percent of GDP in 2007/08. Out of this, tax revenue was 15 percent of GDP, making the country depend on external budgetary assistance. In the same fiscal year grants constituted 7 percent of GDP. This was about one-third of total tax collection in that year. However, due to its unreliability in terms of disbursement, reliance on external budgetary assistance has often led to domestic borrowing. This explains also the high levels of domestic interest rates. In contrast to poor performance of government revenue, public expenditure has on average been rising steadily from 15 percent of DGP in 1999/00 to 23.3 percent in 2007/08. The primary balance has improved considerably from 0.2 percent in 1999/00 to 1.2 percent in 2007/08. In contrast, the overall fiscal deficit has worsened; it grew from -1.4 percent of GDP in 1990/00 to -4.9 percent of GDP in 2005/06 and then improved to -4 percent in the following year (Table 1). This is an indication a low public savings.

On revenue side, fiscal strategies adopted by the government of Tanzania have targeted raising revenues substantially as a percentage of GDP in order to finance part of public expenditures. Unfortunately, the country still suffers from tax collection capacity, and to improve tax mobilization, the country has focused on strengthening, tax administration, and taking into consideration that there is almost no scope for raising existing tax rates without distorting resource allocation and undermining incentives for voluntary taxpayer compliance. The government has implemented reforms to strengthen the management of tax administrations, to improve their internal systems, to enhance training of personnel and to improve taxpayer compliance. However, despite these measure taxes collection capacity is still inadequate.

On expenditure side, fiscal strategies entail maintaining strict budgetary discipline in order to minimize government borrowing from the domestic banking system which could either be inflationary or crowd out private sector borrowing. This means that the government must restrict its total expenditures to less than the sum of domestic tax and non-tax revenues and net inflows of external donor finance

Fiscal Revenue

Trends in the composition of different types of taxes show that the government relies more on international trade taxes to generate revenue. In the most recent period, trade taxes are the major source of tax revenue (over 6 percent of GDP and about 44 percent of total tax revenue). The share of income tax to total tax revenue has registered considerable growth, grew from 2.8 percent of GDP in 1999/00 to about 5 percent of GDP.

Tanzanian tax structure has also evolved over time to respond to the fiscal needs in different period. Table 2 shows that there are two major sources of tax revenue: direct taxes and indirect taxes. Direct taxes comprise PAYE, individual income tax and corporation income tax. Indirect taxes comprise taxes on domestic goods and services and taxes on imports. More specifically, they consist of excise taxes on domestic consumption, excise tax on imports, VAT on domestic consumption, and VAT on imports.

Total tax revenue as a percentage of GDP grew from about 9 percent in 1999/00 to about 15 percent in 2008/09, equal to growth of 0.6 percent per year. The Tanzania's tax to GDP ratio is below sub-Saharan Africa average of 18 percent.

Direct taxes contribute about 5 percent of GDP (or 33 percent of total tax revenue). The contribution of this tax category grew from 2.8 percent in 1999/00 to 4.9 percent in 2008/09. The observed growth in contribution from this tax category was attributable to PAYE relative to corporation income tax.

Table 1. Public Finances (percentage of GDP at current prices)

	1999/00	**2000/01**	**2001/02**	**2002/03**	**2003/04**	**2004/05**	**2005/06**	**2006/07**	**2007/08**
Total revenue and grants*	**13.8**	**15.7**	**16.2**	**18.3**	**18.8**	**18.5**	**17.9**	**19.0**	**22.2**
Tax revenue	8.9	10.6	10.6	11.0	11.7	10.8	11.5	13.0	15.0
Grants	3.6	3.8	4.3	6.2	6.1	6.6	5.4	4.9	7.0
Total expenditure and net lending*	**15.2**	**16.8**	**16.6**	**19.9**	**22.2**	**21.7**	**22.8**	**23.0**	**23.3**
Current expenditure	10.5	12.9	12.5	14.9	16.6	13.5	17.2	17.0	15.1
Excluding interest	8.9	11.3	10.2	13.9	15.7	12.5	15.9	15.8	14.0
Wages and salaries	3.7	4.1	4.2	4.0	4.0	3.7	3.9	5.0	5.1
Interest	1.7	1.6	2.3	1.0	0.9	1.0	1.3	1.1	1.2
Capital expenditure	4.7	3.7	3.9	5.0	5.6	8.2	5.6	6.1	8.1
Primary balance	**0.2**	**0.6**	**1.9**	**-0.6**	**-2.5**	**-2.3**	**-3.6**	**-2.9**	**1.2**
Overall balance	**-1.4**	**-1.1**	**-0.4**	**-1.6**	**-3.5**	**-3.2**	**-4.9**	**-4.0**	**0.0**

a. Only major items are reported

Source: Ministry of Finance and Economy data, AEO (2009) data; estimates (e) and projections (p) based on AEO (2009), Table 1.

Indirect taxes contribute a little over 10 percent of GDP (or about 70 percent of total tax revenue). The contribution indirect taxes as a percentage of GDP grew from 6.5 percent in 1999/00 to 10.2 percent in 2008/09 in 2008/09. The growth in contribution has mainly been due to tax revenue from VAT on domestic consumption and imports relative to excise tax revenue. The contribution of the excise tax on domestic consumption has been more or less constant. A single major contributor in the indirect tax category is VAT, which contribute 4.8 percent of GDP (or 33 percent of total tax revenue).

Trade taxes contribute 6.4 percent of GDP (or 44 percent of total tax revenue), which is not healthy for a growing economy. In a nutshell, Tanzanian economy is still much dependent on indirect taxes and particularly trade taxes.

Table 2. Itemized tax-to-GDP ratio

	1999/00	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09
Total Tax Revenue	8.9	9.7	9.6	9.8	10.3	10.9	11.6	13.3	14.6	14.7
DIRECT TAXES	2.8	2.5	2.6	2.8	3.1	3.4	3.8	4.4	4.8	4.9
P.A.Y.E.	1.0	1.1	1.2	1.2	1.4	1.6	1.7	2.1	2.2	2.4
B. Skills & Dev.Levy	-	0.2	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Individuals	0.2	0.1	0.1	0.1	0.1	0.2	0.2	0.2	0.2	0.2
Corporate Taxes	0.7	0.5	0.6	0.7	0.8	1.0	1.2	1.4	1.6	1.5
Other	0.9	0.6	0.4	0.4	0.4	0.4	0.4	0.4	0.5	0.5
	-	-	-	-	-	-	-	-	-	-
INDIRECT TAXES	6.5	7.5	7.4	7.4	7.7	7.8	8.2	9.1	10.2	10.2
Domesti Indirect	2.5	2.4	2.4	2.5	2.6	2.7	2.8	3.1	3.3	3.6
Excises	0.9	0.8	0.7	0.8	0.7	0.7	0.8	0.9	1.0	1.0
VAT On Domestic Consumption	1.7	1.6	1.7	1.8	1.9	1.9	2.0	2.2	2.4	2.5
OTHER Domestic Taxes & Charges	0.8	0.3	0.3	0.2	0.2	0.2	0.2	0.2	0.3	0.3
	-	-	-	-	-	-	-	-	-	-
INTERNATIONAL TRADE TAXES	3.1	4.8	4.7	4.6	4.8	5.0	5.2	5.8	6.5	6.4
Import Duties	1.2	1.1	0.9	1.0	1.0	0.7	1.0	1.3	1.4	1.4
Excise Duties On Imports	0.3	1.0	1.1	0.9	0.9	0.9	0.7	1.6	1.9	1.7
VAT on Imports	1.4	2.1	2.1	2.2	2.4	2.9	3.0	2.4	2.4	2.3
Other Taxes and Non Tax	0.3	0.6	0.5	0.5	0.5	0.6	0.8	1.1	1.1	1.1
Total VAT	3.1	3.7	3.8	4.0	4.3	4.8	4.9	4.6	4.8	4.8

Source: TRA

3. 2 Private Savings Performance

The analysis of the private savings requires the understanding of the financial structure of the economy. It is this analysis to which I now turn.

Formal Financial Sector

Overview of Financial System

The Bank of Tanzania (BOT), the central bank, is the primary regulatory body of the banking system. Its key objective and function, as the country's monetary authority, has been, since its 1995 Act, the pursuit of long-term price stability, through management and regulation of monetary growth. The other function of BOT has been to undertake the licensing of banks as well as their supervision. The financial system in Tanzania remains dominated by the banking sector. There are several non-bank financial institutions and pension funds. Tanzania also has a relatively young stock market, with only 14 listed stocks.

Bank and Non-Bank Financial Sector

As of December 2008, the banking sector constituted 36 banking institutions consisting of 25 commercial banks, 11 financial institutions, 189 bureaux de change and 5 pension funds, the latter comprising the National Social Security Fund, the Parastatal Pensions Fund, the Public Service Pension Fund, the National Health Insurance Fund, and the Zanzibar Social Security Fund (BOT, 2008: 5). Currently, these pension funds are self-regulated, with the major funds being state-operated. The creation of a retirement benefits regulator is under consideration.

The central bank and the Deposit Insurance Board provide a deposit insurance facility. Three commercial banks provide micro-finance services, led by the National Microfinance Bank. However, the majority of micro-finance services are provided by savings and credit cooperatives and foreign NGOs. The BOT has slated a number of banks for restructuring and potential privatization.

The insurance and pensions sector, regulated and supervised by the Insurance Supervisory Department (ISD) within the Ministry of Finance, comprises 4 life insurance and 12 registered, general insurance companies, including life and non-life insurance activities. The sector holds just 3 percent of the financial system assets. The insurance sector remains dominated by the state-owned National Insurance Corporation (NIC). In the general insurance sub-sector, the National Insurance Corporation holds nearly 25 percent of premiums and has a near-monopoly market share in life insurance premiums.

Funding structure

Table 3 shows the funding structure of the banking sector. Total funding of the banking sector increased by 21 percent between 2007 and 2008. Deposits were the major source of funding, constituting 80 percent of the total funding. Other sources of funding included share capital (4 percent), other liabilities (8 percent). Other capital items increased by 30 percent, whereas share capital increased by 20 percent. In other capital items category, revaluation reserve, capital grants and retained earnings increased by 799 percent, 287 percent, and 53 percent, respectively during the 2007-2008 period.

Deposits from customers (other than banks) accounted for 96 of total deposits. Deposits from banks and other financial institutions (inter-bank deposits) stood at 3 percent at the end of 2008. Current and savings deposits accounted for 70 percent of total deposits, depicting a stable source of funding in the sector.

Table 3. Funding Composition

Item	Dec-2004	Dec--2005	Dec-2006	Dec-2007	Dec-2008
Deposits	82%	84%	83%	80%	80%
Other Liabilities	7%	6%	6%	9%	8%
Share Capital	6%	5%	4%	4%	4%
Other capital items	4%	5%	^5	7%	8%
Total Funding	**100%**	**100%**	**100%**	**100%**	**100%**

Source: Bank of Tanzania

Market share

The banking sector market is dominated by commercial banks that represent 96 percent of the total banking sector assets. Financial institutions market share remains at 4 percent. Three largest banks had by the end of 2008, 47 percent of the sector's total assets, 48 percent of the sector's total gross loans, 50 percent of the sector's deposits, and 41 percent of the banking sector's total capital (see Table 4).

By the end of 2008, 55 percent of the sector's assets were held by foreign owned banks. However, a declining trend has been registered in the market share of foreign banks (Table 4). This has been accelerated by growth and expansion of domestic banks and establishment of new banking institutions during 2008. Foreign owned banks are expected to lose much share of the sector's assets due to fast growing domestic banks coupled with licensing of more community banks, which require relatively less capital compared to nationwide commercial banks.

Table 5. Market share of Banks in Period 2006-2008

		Assets			Loans			Dep			Capital	
	2006	2007	2008	2006	2007	2008	2006	2007	2008	2006	2007	2008
Largest Banks	**17%**	**17%**	**17%**	**19%**	**20%**	**19%**	**18%**	**18%**	**19%**	**14%**	**14%**	**14%**
3 Largest Banks	**46%**	**47%**	**47%**	**48%**	**48%**	**48%**	**48%**	**50%**	**50%**	**37%**	**39%**	**41%**
5 Largest banks	**66%**	**64%**	**63%**	**66%**	**67%**	**65%**	**68%**	**66%**	**66%**	**55%**	**55%**	**56%**
10 Largest banks	**86%**	**86%**	**83%**	**85%**	**85%**	**83%**	**87%**	**86%**	**84%**	**82%**	**82%**	**81%**

Source: Bank of Tanzania

Capital Markets

Tanzania's capital market is centered on the Dar-es-Salaam Stock Exchange (DSE), which opened in 1996. By the end of 2007, the DSE had a market capitalization of USD 2.6 billion and 14 listed companies, two of which (Kenya Airways and East African Breweries) were cross-listed. The agency in charge of supervising the Tanzanian capital market is the Capital Markets and Securities Authority (CMSA).

The Capital Market and Securities Act, introduced in October 1994, paved the way for the subsequent introduction of the CMSA. Its responsibilities include regulating issuance and trade in securities as well as taking an active role in the development of the market. *The Guidelines for the Issue of Corporate Bonds and Commercial Paper* was issued by the CMSA in September 1999. The DSE approves the listing of issues, but usually only subject to prior approval by the CMSA. The capital market in Tanzania is characterized by:

a) Issuance of corporate bonds and commercial paper is subject to the approval of CMSA/BOT.

b) Commercial banks and other financial institutions that plan to issue are required to get central bank approval.

c) Although only listed companies may issue corporate bonds and commercial paper, the CMSA generally waives this requirement on the basis of the credit quality of the applicant.

d) In order to maintain a certain level of local ownership, foreign investors are not permitted to hold government paper, which remains a major holding for domestic investors.

The government has made efforts to make stock market more attractive to both stock issuers and investors. In addition, the government has offered several fiscal incentives to both.

Incentives to Issuers

Incentives to issuers include:

(i) Reduced corporate tax from 30 percent to 25 percent for the period of three years where the issuer has issued at least 355 of issued shares held by the public. The reduced rate is applicable for five years starting from listing date.

(ii) Tax deductibility of all Initial Public Offer (IPO) costs for the purposes of income tax administration. All IPO costs are accepted by the Tanzania Revenue Authority (TRA) as acceptable expenses used in generation of income and profits, and therefore are taken into account when determining profit for tax purposes.

(iii) Withholding tax on investment income made by Collective Investment Schemes (CIS) is final tax. Investors in CIS are not charged with tax on the income distributed by CIS after the scheme's income taxation.

Incentives to Investors

These include:

(i) Zero capital gains tax as opposed to 10 percent for unlisted companies.

(ii) Zero stamp duty on transactions executed at the DSE compared to 6 percent for unlisted companies.

(iii) Withholding tax of 5 on dividend income as opposed to 10% for unlisted company.

(iv) Zero withholding tax on interest income from listed bonds whose maturities are three years and above.

(v) Exemptions of withholding tax on income accruing to fidelity fund maintained by DSE for investor protection.

(vi) Income received by Collective Investment Scheme (CIS) investor is tax exempt.

Fixed Income Markets

Government Securities

Treasury bills for maturities of 35, 91, 182 and 364 days, as well as 2, 5, 7 and 10 year maturities for treasury bonds are all issued regularly by the BOT on behalf of the government. The auction is based on a multiple price system, with Treasury bill auctions being held on a weekly basis. Treasury bond auctions, usually on a monthly basis, are scheduled in advance via a quarterly-issue calendar, published by the BOT. All treasury bonds are listed on the DSE. Although primary dealers are active in the market, investors are also permitted to submit bids to the BOT directly. The yield curve extends to 10 years, and each of the existing benchmark issues, made up of 2-, 5-, 7- and 10-year bonds, are regularly auctioned by the BOT.

Secondary Market

In the absence of dedicated market makers, there is hardly any activity in the secondary market.

Clearing and Settlement

Delivery and settlement of bonds is conducted through the DSE, on T+2 for treasury bills and T+1 for treasury bonds. The day count basis convention used for treasury securities is actual/ 365.

Private Savings

Domestic savings are very low in sub-Saharan Africa (SSA). Gross national savings as a ratio of gross national income was only about 17 percent in 2003. Gross national savings is gross national income minus private and public consumption plus net current transfers. This compares to 23.1 percent for all low-income countries in 2003. Another measure of savings, which takes account of the impact of the depreciation of fixed capital, is net national savings. Gross domestic savings as a percentage of GDP averaged around 16.

It is generally acknowledged that savings rates in Africa, especially in SSA are lower than in any other region in the world. In Eastern Africa, savings rate ranged between 10 and 15 percent of GDP. In Tanzania, gross domestic savings rate has remained more or less constant over the 2000-2005 period at around 16 percent, averaging 16.3 percent. This is still far above the average for Eastern African countries which improved from 5.3 percent in 2000 to 7.5 percent in 2005, but slightly below that for sub-Saharan Africa of 17.6 percent in 2005. However, this high savings rate of Tanzania relative to Eastern African countries should be interpreted with care. Perhaps a close look at money growth, GDP growth, and inflation may be useful. Normally the sum of the rate of inflation and GDP growth should be equal or close to the money growth. The reason is because money growth is meant to finance both GDP growth and inflation. In the Tanzanian case there is a big gap between the sum of GDP growth and inflation and money growth (see Table 5). This signals a potential problem. The first possible problem is that in computing GDP estimates it is mainly the monetary GDP which is captured, while the non-monetary is not captured in the estimates. This possibly tends to underestimate the GDP. Underestimation of the GDP leads to overestimation of savings rate.

Table 5. GDP growth, money growth and inflation

	1998	*1999*	*2000*	*2001*	*2002*	*2003*	*2004*	*2005*	*2006*	*2007*	*2008**
GDP Growth	4.0	4.7	4.9	5.7	6.2	5.7	6.7	6.7	6.2	7.1	7.4
Money growth (M2)**	11.1	15.0	12.5	12.3	18.5	14.2	19.2	36.9	13.7	28.8	19.8
Money growth (M3)**	10.8	18.6	14.8	17.1	25.1	16.1	19.3	38.2	22.0	21.4	24.4
Inflation**	12.8	7.9	5.9	5.1	4.6	3.5	4.2	7.9	6.9	7.5	10.3

* Provisional

** Average for the year

Money + Inflation	*1998*	*1999*	*2000*	*2001*	*2002*	*2003*	*2004*	*2005*	*2006*	*2007*	*2008**
M2	**23.9**	**22.9**	**18.4**	**17.4**	**23.1**	**17.7**	**23.3**	**44.8**	**20.6**	**36.3**	**30.1**
M3	**23.6**	**26.5**	**20.7**	**22.3**	**29.7**	**19.6**	**23.4**	**46.1**	**28.9**	**28.9**	**34.7**
GDP	**4.0**	**4.7**	**4.9**	**5.7**	**6.2**	**5.7**	**6.7**	**6.7**	**6.2**	**7.1**	**7.4**

Money +Inflation - GDP	*1998*	*1999*	*2000*	*2001*	*2002*	*2003*	*2004*	*2005*	*2006*	*2007*	*2007**
M2	19.9	18.2	13.5	11.7	16.9	12.0	16.6	38.1	14.4	29.1	22.7
M3	19.6	21.7	15.8	16.6	23.5	13.9	16.7	39.4	22.7	21.8	27.3

Source: Bank of Tanzania

Considering private savings in Tanzania, a similar trend can be seen as the share of private savings has been more or less constant averaging 14.1 percent over the same period (Table 6). The share for Eastern African countries has been rising but remained below 10 percent of GDP far much below that of Manutius, where private savings had exceeded 30 percent of GDP. Such high rates of private savings are imperative for the economic transformation.

Table 6. Gross Domestic Savings and Private Savings (percentage of GDP)

	2000	2001	2002	2003	2004	2005
Gross Domestic Savings-to-GDP ratio	16.1	15.9	17.7	15.8	16.0	16.1
Private Savings-to-GDP ratio	14.1	13.7	15.6	13.6	13.8	14.0

Source: ECA, 2009, pp. 7-8, tables 6 and 8

Microfinance

Microfinance in Tanzania began with NGOs and SACCOS (Savings and Loans Cooperatives) in 1995 and has continued to grow with the increased success of microfinance internationally.

Microfinance is still a relatively new concept in Tanzania. Beginning in 1995, it was mainly linked to women and poverty alleviation. The government tried to convince commercial banks to support small and medium businesses. Once the National Microfinance Policy was implemented in 2001, microfinance was officially recognized as a tool for poverty eradication and with its increased use and exposure to the country; banks have taken an interest in offering microfinance. The National Microfinance Bank is an institutional provider of microfinance services, and the AKIBA Commercial bank and CRDB Bank are also two big supporters of microfinance. There are additional organizations involved in microfinance in Tanzania, including FINCA, PRIDE and SEDA as well as the Tanzania Postal Bank. Community banks and small banks have taken an interest in this, as well as many NGOs and non-profit organizations.

A 2005 survey done by the Bank of Tanzania (the overseer of microfinance under the Ministry of Finance) updated the directory of microfinance practitioners and includes basic information on microfinance institutions including commercial banks, financial institutions, financial Non-Governmental Organizations (NGO), Savings and Credit Cooperatives Societies (SACCOs) and Savings and Credit Associations (SACAs). The directory includes a total of 8 banks, 45 CBOs, 2 companies, 95 Government programs, 1,620 SACCOs, 48 SACAs and 62 NGOs.

The principal providers of financial services to the poor and low income households in the rural and urban areas of Tanzania consist of licensed commercial banks, regional and rural unit banks, savings and credit cooperative societies, and several NGOs whose micro credit delivery operations are funded and supported with technical assistance by international donors. Table 7 summarizes microfinance institutions type, products, market area of operation, basis for status as legal entity, and main source of funds.

Table 7. Institutional Providers of Microfinance Services

Type / Name of Institution	Microfinance Products Offered	Market/Area of Operation	Basis for Status as Legal Entity	Main Source of Funds
Registered but Unregulated and Unsupervised Providers of Microfinance Services (Other People's Money)				
FINANCIAL NGOS				
Solidarity/Group -based microfinance loans, such as: Presidential Trust Fund, Poverty Africa, YOSEFO*, PRIDE Tanzania*, CREW, SIDO*, SELFINA*, FINCA	Mandatory savings (except those marked *) & group-based loans	Urban and peri-urban areas; selected rural areas	Societies Act; Trust	Donor funds
Individual microfinance loans, such as: SIDO*, Tanzania Gatsby Trust*, Mennonite Economic Development Association*, Poverty Africa	Mandatory savings (except those marked *) & individual loans	Urban and peri-urban areas	Societies Act ; Trust	Donor funds
VILLAGE SAVINGS CREDIT ASSOCIATIONS (SACAS)	Individual savings & group-based loans	Rural villages	Societies Act, Ministry of Home Affairs	Donor grants
Registered and Regulated Providers of Microfinance Services (Members' Money)				
SAVINGS & CREDIT COOPERATIVE SOCIETIES				
Urban SACCOs 251 Registered SACCOs	Member loans only	Urban areas	Cooperative Societies Act	Share capital, loans, grants
Rural SACCOs 395 Registered SACCOs	Member savings deposits & loans	Rural areas	Cooperative Societies Act	Share capital, loans, grants
Other (savings-based) SACCOs Number not available	Voluntary savings and withdrawals only	Rural and Urban areas	Cooperative Societies Act	Share capital, loans, grants
Regulated and Licensed Providers of Microfinance Services (The Public's Money)				
COMMERCIAL BANKS				
National Microfinance Bank	Savings deposits	Nationwide	Act of Parliament	Deposits/capital
Akiba Commercial Bank	Savings deposits; Group and individual microenterprise loans	Nationwide	Companies' Act;	Deposits/capital
CRDB Bank	Newly-organized microfinance dept.	Nationwide	Companies' Act;	DANIDA
Tanzania Postal Bank (Licensed as NBFI)	Savings/Fixed deposits	Nationwide	Act of Parliament	Deposits/capital
REGIONAL BANKS				
Kilimanjaro Cooperative Bank	Savings deposits and micro loans	Kilimanjaro Region	Companies' Act; BoT	Deposits/capital from regional SACCO Union and SACCOs
RURAL UNIT BANKS				
Mufindi Community Bank	Savings deposits and micro loans	Mufindi District, Iringa Region	Companies' Act; BoT	Deposits/capital
Mwanga Rural Community Bank	Savings deposits and micro loans	Pare District, Kilimanjaro	Companies' Act; BoT	Deposits/capital

Source: Randhawa and Gallardo, 2003, table 1, p.7

Tanzania shows that microfinance institutions have been successful in mobilizing deposits, while the outreach of the banking sector remains limited. In Tanzania, the banking system has a very limited penetration. Only about six percent of the population has a bank account (4 percent in rural areas). MFIs have a total of about 2 million deposit accounts (6 percent of population). They hold about 60 percent and 11 percent of total commercial bank deposits and credits, respectively (2002). The primary sources of microfinance services are about 650 savings and credit cooperatives (SACCOs) with a total of 130,000 members (0.4 percent of the population) and NGOs relying on foreign donor assistance. There are three commercial (or deposit-money) banks—the National Microfinance Bank (NMB), Cooperative and Rural Development Bank (CRDB) Ltd, and Akiba Commercial Bank (ACB)—which are relatively new entrants in the microfinance sector. In addition, there are a few regional and rural banks engaged in deposit-based microfinance operations, but these have been limited in scope because these banks have lacked a branch network. Among nonbank financial institutions, the Tanzania Postal Bank (TPB) has used its country-wide network of post-offices to promote and mobilize savings, provide transfer and remittance services, and a loan guarantee service to small borrowers to cover a part of the necessary security requirement of their loans.

MFIs and commercial banks work together in providing financial services. In a number of African countries, banks and MFIs have successfully cooperated in extending their outreach and achieving economies of scale. Branch network sharing is seen as effective in servicing a larger client base while containing costs. In Tanzania, the example of the CRDB developing banking relationships with savings and credit cooperatives to channel funds for micro-lending is illustrative. Cooperation also entails channeling credit from banks and MFIs to clients with obvious business synergies. The NMB of Tanzania is developing relations between credit to its large corporate clients and credit to micro-enterprises that supply inputs and distribute the products of the former. The NMB lends to micro-enterprises to finance their purchases and inventories, and provides large corporate clients with collection and payment services to and from micro-enterprises.

4. Binding Constraints to Savings Mobilization in Tanzania

The binding constraints to savings mobilization include constitutional constraints, financial and monetary constraints, fiscal constraints, and other constraints.

Constitutional/Legal Constraints

The legislative 'power of the purse' is said to be fundamentally important for democratic government. Yet, even a cursory comparison of legislative arrangements for financial scrutiny has to conclude that legislatures differ widely in the way with which they exercise the 'power over the purse' (Wehner, 2005). The US Congress has broad constitutional powers in financial matters, makes budgetary decisions through a complex system of specialized committees in both houses, and has access to extensive analytical support in the Congressional Budget Office (CBO). The UK Parliament, by contrast, has abdicated the right to financial initiative to the executive, does not have a specialized budget committee, and has no parliamentary budget office to provide analytical support.

Given that the authorization of taxes and public expenditures is a primary function of the legislature in any democratic system, such an amount of variation among modern democracies is perplexing. In East African Parliaments the role of Parliaments is embedded on the UK model commonly referred to as the commonwealth parliament model. However, several modifications have been done on the commonwealth model in some cases; for instance, in Uganda the role of Parliament in public finances was enhanced by the Budget Act 2001 which empowered parliament to roles similar to the US system. The Parliament of Uganda has powers in addition to making budgetary decisions but also in domestic resource mobilization. In addition to these powers, like the US system, it has access to technical analytical support in the Parliamentary Budget Office. The other parliaments in the region though have not modified their role in the budget and domestic resource mobilization signs are that they are in the process of adapting the Ugandan model. Indeed parliaments of Rwanda, Kenya and Southern Sudan are in different stages of reforming their roles. These powers provide an important role to parliament in domestic resource mobilization.

In contrast, the Tanzanian Parliament has very limited constitutional powers in financial matters. Tanzanian constitution is one of the weakest pertaining to financial and particularly in taxation matters. In the entire constitution, there are only two articles on taxation matters: Article 99 and 138. According to Article 99:

(1) Parliament will not involve itself in any of the matters relating to this paragraph except if the President has recommended that a particular matter be dealt with by parliament, and if the President's recommendation has been submitted to Parliament by a Minister.

(2) Issues involved in this paragraph are as follows:-

(a) A bill or any changes in a bill in respect of any of the following matters-

(i) Imposing taxes or modifying taxes in any other way other than reducing it;

(ii) Ordering that expenditure or spending be done from the Treasury of the Government or any other Government Fund, or to change the ceiling in any way other than reducing it;

(iii) Ordering that expenditure or spending of money be done from the Treasury of the Government of from any other Fund when it is clear that no funds were reserved for such expenditure or spending, or to order that payments or spending from these funds be increased;

(iv) To withdraw or cancel any loan owed to the Government of the Union;

(b) A motion or any changes in a motion in respect of any of the things mentioned in sub-section (a) of this sub-paragraph.

(3) The conditions of this paragraph will not apply to a bill submitted to Parliament or any motion submitted to Parliament by a Minister or Deputy Minister.

According to Article 138(1) “No tax of any kind shall be imposed save in accordance with a law enacted by Parliament or pursuant to a procedure lawfully procedure lawfully prescribed and having the force of law by virtue of a law enacted by Parliament”.

Such a weakness in constitution limits the scope of the Parliament in contributing to domestic resource mobilization.

In contrast the Brazilian and Ethiopian constitutions are very rich in taxation and expenditure issues. They have more provisions on fiscal issues than most developing countries. Ugandan constitution comes next.

According to the Ugandan constitution article 152 on taxation, '*no tax shall be imposed except under the authority of an Act of parliament*'. In addition, if a tax is waived under the same law the waiving authority is obliged by law to report back to parliament. In due regard, the executive annually presents the finance bill to parliament which signifies changes in tax policy/rates, tax bases and tax administration policy. With the guidance of technical analysis within parliament, the legislature is mandated to scrutinize these proposals and make necessary amendments and consequently pass them. Here parliament plays an important role in domestic tax mobilization. It can propose ways of improving tax mobilization, it can remove or introduce a new base, it can alter the rates imposed, and propose tax administration reforms. However, in Tanzania, Tax reforms are initiated by the executive.

The ultimate power for government to borrow rests with parliament. Indeed, Article 159 (2) of the Ugandan constitution states 'Government shall not borrow, guarantee, or raise a loan on behalf of itself or any public institution, authority or person except as authorized by or under an Act of Parliament. Under this law domestic loan mobilization powers are embedded within parliament. This is not the case in Tanzania.

In addition, any resources which are expended on the consolidated fund can only be done by an approval from Parliament. Here resources mobilized directly by government borrowing from the Central Bank fall into this category.

Under section 4 of the Budget Act 2001, the executive is obliged to submit to parliament a macro-economic plan and indicative framework (of which revenue estimates are included) for the upcoming budget. Under the macro-economic plan, domestic revenue mobilization from the monetary policy perspective is influenced. Parliament is expected to propose revisions and recommend alternatives in the executive's submission. Again technical capacity withstanding, Parliament here can play an important role in the way government will mobilize resources from inflationary financing of the budget.

Parliament oversight role provides for a monitoring role and supervision of executive organs under which domestic revenue collecting functions fall. In due regard, parliament is expected to monitor the performance of government programs of which is domestic resource mobilization is pertinent. Parliament of Uganda, for instance periodically receives reports on the performance of domestic revenues both taxes and non tax revenue. In so doing, Parliament can play a role in ensuring government entities perform better in domestic resource mobilization. Thus capacity withstanding parliament can recommend and influence the performance of domestic resource mobilization.

However, the role of Parliament hinges mainly on the level of separation of powers and respect for respective roles embedded in each arm of government by different players.

Financial constraints

There are many reasons for Africas's low savings rates. These include: inadequate financial services; physical distance from banking institutions and high minimum deposit and balance requirements. All these factors make it difficult for the majority of the population to get access to banking services. As a result, only 20 per cent of African families have bank accounts (Dovi, 2008, p.3). The same are reasons for Tanzania's low savings rate.

In East Africa, Ethiopia, Uganda and Tanzania each have less than one bank branch per every 100,000 people. The ratio is better for some Southern African countries. Namibia has more than four, Zimbabwe more than three and Botswana nearly four (p. 3).

Banks' minimum balance requirements and the cost of maintaining an account are too high for many people. Opening a bank account in one of the largest commercial bank, the National Bank of Commerce (NBC) Limited in Tanzania requires a TZS 50,000 (equivalent to US$40) deposit. That is more than the annual income of many Tanzanians.

Many banks also insist on considerable documentation to open an account. Banks in Tanzania require at least three documents, including an identity card or voter's registration card or passport, recommendation letter, and proof of address. In a country where many people work in the informal sector and more than 80 percent live in rural areas, gathering such documentation can be a challenge.

In the face of this, even those people with extra money, may have little incentive to save. In Tanzania, the interest paid on savings is around 3 percent, while the annual interest rate on loans ranges from 12 to 26 percent. Thus considering the current rate of inflation of around 13 percent, the real interest ranges from -10 to-23 percent. This is too low a real interest rate by any standards.

The low level of formal savings deposits would mean that many banks have limited funds to lend out and enables them to charge high interest rates. However, in Tanzania the situation is different. Banks have excess liquidity and hence excess money to lend. The source of excess liquidity emanates from a myriad of bank charges on account holders not from lending on one part (see Table 8). On the other part is because banks don't lend due high collateral requirement and high rejection rate of loan applications. In Kenya collateral requirement is high but rejection rate is low compared to Tanzania.

Stock Markets

Stock market in Tanzania is small and inactive. Currently only 14 companies are listed with market capitalization of US$2.6 billion in 2007/08, with US$2.03 value of shares traded, with daily average of 95,622 shares traded and with stock market index of 1,081.5 in the same fiscal year. In the same year DSE registered a loss of US$9,400 compared a profit of US$12,359 in the previous year, which was possibly due to the global economic and financial crisis. The small number of listed companies is due to a number of reasons. First and foremost is the disclosure. Many private companies are reluctant to list because of disclosure in fear that if they go public they will expose themselves to the public. They have company information that they would like to keep to themselves and don't see a significant tradeoff that can attract them to list. The issuers' fiscal incentives that I earlier outlined is not enough an incentive. Second, on the side of investors, there is lack of knowledge on stock market. Very few people in Tanzania even educated ones are ignorant of the operation of stock market. Third, is awareness, many people are not aware of stock market activities. Fourth, is the management of the stock market. Fifth, is insider dealing/trading. Since market capitalization is small and only less than a host of companies are listed, it is possible for an individual to get information on a future change in share price of a listed company. Finally, there are very few buyers of shares relative to sellers in the secondary market. That is, supply of shares in the secondary market is much higher that demand for them. Thus, it is very difficult to sell shares on the secondary market. The DSE will remain narrow for a long period unless the government takes drastic measures to stimulate the market. Accordingly, there is need to undertake such measure since the stock market is one of the major vehicle for domestic resource mobilization.

Interest rates

Interest rates continue to be market determined. Policy efforts have been directed towards narrowing the spread between commercial banking lending and deposit rates as well as maintaining positive real interest rates. During the 1999-2008 period, the weighted-average interest rate on time deposits improved from 3.4 percent in 2002 to 6.8 percent in 2008 (Table 8). Despite such a rise, the real deposit rate still remains negative. However, the overall commercial bank lending rate has dropped to 15.1 percent down from 22.7 percent recorded in 1999 (Table 8). The margin between overall lending and saving deposit rates declined from 15.6 percent in 1999 to 12.4 percent in 2008. The spread, which is one of the major constraints to access to credit, remained more or less constant averaging about 12.5 percent during the 2003-2008 period. The real deposit rate declined from -0.8 percent in 1999 to -7.6 in 2008.

Financial policies

The record of financial liberalization accordingly has not been stellar. Its impact is at most been neither pro-growth nor pro-poor. In responding to liberalization, commercial banks in Tanzania have concentrated their activities in major urban areas. Although aggregate statistics of financial deepening indicate improvement, access to credit has become, if anything, more unequal. The rural population remains deprived of credit in Tanzania, and is likely worse off compared to the access to credit that state owned agricultural banks such as the old Cooperative and Rural Development Bank (CRDB) had previously provided.

Table 8. GDP growth, Inflation, and Interest Rates

	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
GDP Growth	4.1	4.8	4.9	6.0	7.2	6.9	7.8	7.4	6.7	7.1	7.4
Inflation	12.8	7.9	5.9	5.1	4.6	3.5	4.2	6.0	6.2	8.8	10.3
Exchange rate (TZS/USD)	681.0	797.3	803.3	916.3	976.7	1063.6	1043.0	1165.5	1261.6	1132.1	1280.3
Lending rate		22.7	23.1	18.0	15.7	13.8	14.8	15.0	16.4	15.3	15.1
Time deposit rate		7.2	5.8	4.0	3.4	3.9	4.4	5.3	7.2	8.3	6.8
Savings deposit rate		7.1	4.7	3.6	2.7	2.5	2.6	2.6	2.6	2.7	2.7
Real Deposit rate		-0.8	-1.2	-1.6	-1.8	-1.0	-1.6	-3.4	-3.6	-6.1	-7.6
Interest rate spread		15.6	18.4	14.5	13.0	11.4	12.2	12.4	13.8	12.6	12.4
M3 to GDP ratio	13.2	14.9	16.3	18.0	21.0	22.9	25.3	32.6	37.3	42.2	30.0
M2 to GDP ratio	10.8	11.9	12.7	13.6	15.5	16.5	18.2	23.3	24.8	29.8	22.1

Source: Bank of Tanzania

One reason that has affected growth in Tanzania is due limited access to long-term investment. Understandably, risk averse, particularly in conditions of economic stagnation, commercial banks focus more on short-term lending, such as consumer durables for high-income households, working capital for enterprises or purchase of short-term government securities. The risks are too high for banks to commit loans for long-term investment purposes. When they do so, they provide loans to the few large corporations in urban areas that they consider credit worthy, however at high interest rates.

Yet an aspect that is connected to lack of credit in Tanzania is the high interest-rate spread between deposit and lending rates of interest, i.e., over 12 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. Instead they make profits from imposing multiple charges on their customers. For Example one of the largest commercial banks in Tanzania imposes a monthly charge of US$30 on US dollars checking account holders. This is apart from other charges

Low incomes

Most Tanzanians are poor. Even after four decades of independence Tanzania remains one of the poorest countries in the world. Its GDP per capita was US$329 (based on 2006 estimates), is far low and far less than the average for SSA and East Asia of US$500 and US$970, respectively. Poverty remains wide spread and deep with half of Tanzanians living under conditions of deprivation. Poverty is concentrated in rural areas where over 80 percent of Tanzanians live (Randhawa and Gallardo, 2003). When incomes are low, a very large portion of the total has to be devoted to "survival consumption". In other words, Tanzanians are 'too poor' to save. Yet poor countries in other regions of the world, particularly in East Asia, have succeeded in saving, accumulating capital and developing. What is holding back Tanzania from doing so?

Lack of financial institutions

Tanzania lacks financial institutions, namely institutions that that can mobilize and monetize domestic savings particularly in the rural areas. This could indeed be an important factor. As a ratio of GDP, banking sector credit was about 75 percent in 2003 in SSA, compared to about 45 percent for all low income countries. Of course the ratio for South Africa was about 158 percent, which weighs heavily in the aggregate for Africa. Lack of credit is not the only problem, however. Very little credit seems to be financing productive investment in Tanzania.

Lack of investment opportunities

Yet another explanation for low savings is that there is a lack of investment opportunities in Tanzania. For some forms of investment, such as in land, for example, the act of investment is simultaneously an act of saving. There is also the Keynesian explanation that investment creates its own savings, through the 'multiplier-accelerator' model (Pollin, 2002). This approach emerged in opposition to Pre-Keynesian view that the savings rate is the main determinant of investment. However, the Keynesian model does not explain how the first burst of autonomous investment, which initiates the 'multiplier accelerator' process can be financed (Pollin, 2002, p.4).

When savings are low, it might be difficult to jumpstart the initial phase of self-sustaining capital accumulation. The state might have to intervene not to generate an initial pool of national savings, but also to direct it to long-term productive investment. This factor appears to be one of the explanations of the rapid economic progress of some East Asian economies.

Fiscal constraints

Tax policies

Public revenue is low in Tanzania. Domestic resource base of Tanzania is too small currently, not too big. A widespread 'small government ideology' has masked the reality that many governments do not command resources necessary to finance many essential public services. To put matters in perspective, for all developing countries, tax-to-GDP is only 18 percent. For Tanzania it is 15 percent, compared to 30 percent for industrial countries (Tanzi and Zee 2001). The revenue of many poor countries is below this average. It is therefore important for Tanzania to find ways to boost its revenue base towards 20 percent, if not towards 25 percent of DGDP over the long-term. Such process will not be easy though.

Although Tanzania has in recent years been successful in maintaining decent rates of economic growth, it has not been able to translate this success into self sustaining process of development.

Apart from low tax-to-GDP ratio, the current Tanzania tax structure indicates that the country is still much depended on trade taxes, which is not a healthy. Such heavy reliance on trade taxes is a possible serious future constraint to domestic resource mobilization in the public sector.

Other constraints

High inequality

Part of the explanation of low savings in Tanzania may be relatively high inequality. The argument would be that a highly skewed income and wealth distribution leads to wasteful elite consumption, instead of high savings (the latter being what conventional wisdom assumes).

An extension of this argument would be that the rich in Tanzania are involved in causing substantial capital flight. Some analysts have argued, for instance, that far from being heavily indebted, many sub-Saharan African countries are net creditors to the rest of the world (Boyce and Ndikumana, 2000). While the government of these countries might be net debtors, the countries themselves are net creditors because well-to-do Africans spirit much of their wealth out of the continent. Boyce and Ndikumana estimate, for example, that cumulative capital flight totaled about US$285 billion (including imputed interest earnings) for 25 SSA countries during 1970-1996. This was about 1.6 times their total stock of external debt. Capital flight is undoubtedly a significant factor in explaining the relatively low domestic savings rates in Africa.

5. Opportunities for Enhancing Savings Mobilization

Private Savings

In Africa and Tanzania inclusive, many economic activities are carried out in the informal sector. Although many households have notable savings, they are not being held in the non-financial form. Instead they are not being significantly channeled into productive investments (Dovi, 2008, p.4). In addition, many Tanzanians like most Africans still keep most of their savings in livestock, stockpiles of goods for trading, grain, jewellery or construction material. Data are limited, but some experts estimate that about 80 per cent of all household assets in rural Africa are in non-financial forms (p. 4).

To tap into such assets, it is necessary to “introduce new financial products or instruments that respond to the saving needs of households,” says Mr. Gayi of UNCTAD. Savings products that “permit easy accessibility” and allow for “small transactions at frequent intervals” would encourage households to shift to the formal system, thereby making such assets available for productive investments, he says.

The role of financial intermediation is to provide the crucial link between savings and investment. Despite households’ demand for adequate savings instruments and firms’ need for credit, the financial sector in Tanzania performs poorly in terms intermediation. The formal sector suffers from poor risk-management capacity. This translates to its activities being limited to meeting the needs of government and small number of formal sector reforms. Most commercial banks in Tanzania have excess liquidity. Unfortunately, banks' resources are dominated by short-term deposits that cannot be invested in long-term projects (ECA, 2009, p.10). How can these resources be used for long-term investments? There are opportunities for enhancing savings mobilization by improving financial intermediation.

The informal sector is known to succeed in mobilizing considerable resources from households and small business. However, its institutions do not make these resources available for further investment. To promote microfinance institutions in the semi-formal sector and enhance them with new information technologies that lower the cost of providing services to rural and poor areas would provide a good opportunity for enhancing savings mobilization.

High risk and generally poor business environment are key determinants of low investments in Tanzania. Poor infrastructure discourages investment as it increases production costs. Countries in Eastern Africa, Tanzania inclusive are ranked low in the World Bank Report, "Doing Business 2009" and main barriers to private investment include: labor market constraints; low investment protection; high taxes and cumbersome tax system, lack of long-term credit for investment, etc. These barriers explain why the FDI is still low in many countries in the region.

Public savings

Informal sector and domestic resource mobilization

Structure of the informal economy

Seven key characteristics of informal sector activity include:

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

Thus, the informal activities can take on various forms such as vending, hawking, petty trading, small and micro-scale enterprises, food manufacturing, carpentry, hairdressing, shoe repair, construction, but also selling agricultural crops outside the formal market systems and even informal networks of exchange such as bureaucratic favors, clietelism and various forms of corruption.

The informal sector has often been viewed as marginal and backward part of the national economy. However, by considering the motives for certain actors to enter the sector it becomes evident that it is in fact lucrative sector able to supply a sufficient outcome. Furthermore, it has also been discovered that the informal economy is in fact a largely important component of the national economy.

The size of the informal sector depends on the size of the formal sector. If the formal sector cannot supply jobs to absorb surplus labor and if real wages are too low, people will, seek employment within the informal sector. Thus the product of the failed economy and people seek entry into the sector due to poverty.

Maliyamkono and Bagachwa (1990)discovered that the informal economy constitutes more than half of the official GDP, figures ranging from 25 percent of real official GDP in 1969 to 51 percent in 1985. Osoro estimates indicate that the underground economy was 31 percent of GDP in 1990. Osoro (2009) estimates the underground economy at 48 percent for 2006. It is clear that the informal sector is of great importance to the national economy as opposed to once thought.

The current financial crisis has created financial difficulties for many developing countries, given the lack of liquidity on the international market, putting into question the robustness of their development process. In this regard, the informal sector, which constitutes a major portion of the economy in Tanzania (Osoro 1995 and 2009), by and large, seems to be a potential source for funding and enlarging the tax base. Collecting taxes from the informal sector is undoubtedly a difficult task, but the potential gains justify thinking about incentive mechanisms that improve commitment to pay tax. Ultimately, long-term policies to bring the informal sector into the informal sector are inevitable and must be pursued. As a short-term measure, a more flexible and adaptive tax system, the integration of informal sector into development process, and a better supply of public goods could encourage the informal sector to help fund productive public services (Drine, 2009).

Thus the possible way to tax the sector is 'presemptive assessment' for this purpose as a transitory method, mainly because its imposition may in fact also help better accounting practices being adopted if assessment based on 'presumptive characteristics' are contested by the tax payer. In this case since the assessed would have to submit accounts that would be a desirable outcome (Drine, 2009)

Property taxes

Properties are not effectively taxed in Tanzania for various reasons. First, big property owners are the rich, the bureaucrats and policy maker. Thus they are generally not in favor of a policy that would affect them. Second, effective taxation of properties requires funds with which to evaluate properties. Properties constitute a great potential tax base.

6. Strategies to Enhance Domestic Resource Mobilization

Various actors can play an important role to enhance DRM. The actors include donors and government. This section briefly outlines what roles these actors can do to facilitate DRM.

Donors

In general most donors apparently do not attach much importance to the objective of enhancing DRM *per se*. They often assume that the aid relationship facilitates greater economic growth from which will automatically follow greater domestic savings, government tax generation, and higher levels of domestically-driven investment. Accordingly, donor's support to ostensibly growth-oriented macroeconomic policies can be seen as implicit facilitation of greater DRM. In addition, certainly, those donors may indirectly facilitate grater DRM through projects aimed at reforming tax policy or tax administration, or improving governance through reforms of the medium-term expenditure framework and the budgetary process. But in general, donors typically have other objectives in mind rather than DRM.

After all, donors may undermine DRM through support of other policies, for example, trade liberalization, which has been shown to undermine tariff revenues in the poorest countries, a key source for government revenues in low income countries. Likewise, favorable tax treatment and other incentives to attract FDI entail an opportunity cost in the form of foregone revenues. Other examples include the shift of aid toward budget support, which may have the unintended consequence of reducing the incentive of governments to levy and/or collect taxes from citizens. The Millennium Development Campaign provides a good example of how donor strategies may unwittingly undermine DRM. Ultimately, unless national authorities are able to shoulder the continuing investment and recurrent costs of these initiatives, they may prove unsustainable if aid flows are reduced.

Nevertheless, for donors to play a more active and constructive role in facilitating DRM, they must first recognize it as an objective in its own right. Such an objective is entirely consistent with other objectives that are fundamental to donors' aid programs.

Finally, donors should conceptualize explicit support for DRM as part of an "exit strategy". In most cases, aid was never meant to represent an unending subsidy of transfer of resources from rich to poor countries. At the same time donors have hoped for, and should not, be time-dated, but more explicitly linked to DRM by recipient countries. Given growing "aid fatigue" and skepticism about the effectiveness of aid programs in donor countries, the recognition of the need to adopt exit strategies linked to greater autonomy and "self help" by recipient countries would likely be welcomed by taxpayers in donor countries. In a nutshell, donors support is crucial in facilitating and enhancing DRM initiatives.

While donors could support Microfinance Institutions (MFIs), lending operations with resources, they could also encourage efforts to build the resource base through domestic saving mobilization. Emphasizing full intermediation does not necessarily preclude donor involvement in assisting the MFIs with capacity building (in both physical, and human resources), which will remain essential. The experience of countries in SSA suggests that NGOs and donors can play an important role in the dissemination of best practices tested internationally and regionally and remain important in building borrowers' entrepreneurial skills and capacity to graduate to the formal banking sector.

NGOs

In some situations, NGOs have been engaged in building local capacity through the creation of institutions specifically dedicated to training. In many cases, NGOs and donors have tended to focus on social programs and services for which they have particular expertise, including programs aimed at reducing poverty. NGOs have in some cases also focused on providing welfare and socially-oriented microfinance, when the push toward financial sustainability was seen to induce a reorientation of MFI focus from the very poor to the lower-middle and middle classes. While NGOs may continue to play an important role in providing social services to the very poor and the more remote areas, it is debatable whether this is more efficient in promoting poverty reduction than direct subsidization of social services (such as primary education and basic health care).

Government

In several African countries—for example, Ghana, Guinea, Tanzania and Uganda— governments have in the past relied on state-owned banks to extend rural credit and microfinance services. In most cases, these banks have incurred large losses and have had to be restructured, recapitalized, privatized or liquidated. This experience of failed state-owned banks has led African governments to focus on financially viable approaches to providing microfinance and on developing regulatory and supervision frameworks that are well adapted to supporting such an effort. In Tanzania, NGOs and donors are heavily involved with all layers of the microfinance system, from regulators to rural MFIs, in staff capacity building and technology transfer. To mention only one of many examples, the Department of International Development (DfID) works and provides funds for capacity building to the Microfinance Capacity Building Programme for Africa (AFCAP), and to Microsave Africa—a joint initiative with UNDP to provide technical assistance to organizations to strengthen the development of saving services.

Privatization can be an effective way to improve efficiency. Private firms have a stronger incentive to build and run infrastructure industries in cost-effective ways and to be more responsive to end-user needs, as long as privatization goes hand in hand with the development of market institutions and contracting mechanisms that exert competitive pressure on the private firms. The extent to which such institutions can be put in place will also vary with the types of services and infrastructure to be provided: for example, the ability to recover costs differs by the type of service or infrastructure. Privatization also encourages and facilitates the imposition of cost-covering tariffs or user fees, thus addressing the problems of under-pricing that have afflicted many publicly provided infrastructure services. Greater efficiency and cost recovery allow firms to make investments and provide services that might not otherwise have been possible. They simultaneously improve efficiency and the government's fiscal condition by making available the same quality and quantity of service with smaller budgetary subsidies. But privatization is not a panacea. Policymakers should consider both efficiency and equity implications when deciding what and how to privatize.

Revenue policies

A big part of DRM effort should concentrate on making tax systems more efficient—starting with better administration of consumption taxes and eliminating exemptions and loopholes on income taxes. However, making tax system more equitable would also help augment revenue. For example, tax exemptions as a percentage of total tax revenue in Tanzania averaged over 32 percent during the fiscal year 2006/07, which is close to 5 percent of GDP. Annual tax exemption figures as a percentage of total taxes were 27.6 percent, 38.6 percent, and 31.8 percent in fiscal years 2004/05, 2005/06, and 2006/07 respectively (Mugoya, 2009). Direct taxes on income and wealth tend to be more progressive than indirect taxes, such as the Value Added Tax (VAT), but tax reforms often emphasize indirect taxes over direct taxes. This weakens 'vertical equity', namely obliging those with greater ability to pay taxes to contribute a larger share of their income or wealth.

Even with progressive tax system, the rich often benefit from myriads of loopholes, exemptions, and deductions. Apart from this, they benefit from poor enforcement of tax laws.

Furthermore, the tax system often allow 'powerful vested interests' to escape progressive taxes because conventional wisdom regards such taxes as an efficient means to redistribute income. This has led to widespread efforts to lower the top marginal tax rates on personal and corporate incomes. As a result, for example, taxes on corporate incomes have been in marked decline in Tanzania, though in the past have contributed, on average more revenue than personal income taxes.

7. Conclusions and Recommendations

7.1 Conclusions

The importance of domestic resource mobilization cannot be overemphasized. The government has indicated the intention to reduce dependence on foreign sources of finance. Tanzania macroeconomic indicators are in general quite encouraging. Public finances have improved over the last decade. However, domestic savings are still low.

The major binding constraints to DRM are: negative real deposit rates; high lending interest rates; wide interest rate spread; lack of long-term credit; lack of formal financial institutions in the rural areas; low investment; narrow tax base, high tax rates, multiplicity of taxes, generous exemption, global economic and financial crisis, and corruption.

Despite these constraints, there are various opportunities for enhancing savings mobilization. First, is the utilization of the existing excess liquidity in the banking system to increase credit to the private sector. Second, there is a wide scope for widening the tax base through proper and effective taxation of the informal sector, taxation of agriculture and property.

Various strategies can be mounted to enhance DRM. These include making the tax system more efficient, smooth transition from trade taxes to domestic consumption taxes, reducing corruption in the tax administration, and designing ways to enhance stock market.

7.2 Recommendations

Public savings

Considering low domestic savings, constraints and opportunities to enhance DRM, the following key recommendations are made:

(i) The government should widen the tax base by designing better and more effective ways of taxing the informal sector. One way to go around this is by imposing presumptive taxes.

(ii) The government should widen the tax base by strengthening taxation of property. Presumptive taxes can be used as a short term solution to boost revenue from this source. However, the long run solution should be for the government to set aside funds for property valuation exercise. It may take long to mobilize funds for the task but it is worth doing.

(iii) The government should widen the tax base by reducing the existing numerous exemptions. This can be accomplished by removing all discretionary exemptions. Only a few crucial exemptions should be obtained and they should be statutory to avoid abuse of exemptions.

(iv) The government should gradually take measures to reduce reliance in trade taxes and strengthen direct taxation.

(v) The government should intensify its fight against corruption in the tax system to enhance revenue collection. This can be accomplished by strengthening the tax administration and plugging tax evasion loopholes, reducing the high tax rates.

(vI) The national constitutions should be amended to accommodate more provisions pertaining to financial and tax matters. This would empower parliament and parliamentarians to effectively contribute to DRM.

Private Savings

(i) There is a need to reduce the interest rate spread. This can be done by either reducing the lending rate or increasing the deposit rate. Financial sector in Tanzania is fully liberalized and therefore interest rates are market determined. However, since the lending rates are extremely high and the banks seem not to be interested in reducing them, there is a need for the government to intervene to have this reduced.

(ii) In view of the existing financial constraints, there is need to establish development banks particularly in the rural areas. Setting up these banks will increase people's access to credit.

(iii) To stimulate stock market performance and increase it size, the government should impose a threshold above which a company must list, educate people on stock market activities.

(iv) The government should also encourage banks to diversify their services to rural areas.

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