TANZANIA

USAID ASSISTANCE IN FISCAL REFORM TO THE GOVERNMENT OF TANZANIA: 1997-2003

I. PROJECT DATA

Level of Funding: $0.5 million

Periods of Assistance: 1997-99

Types of Assistance:

1. Technical assistance
2. Training

Areas of Assistance:

1. Tax Policy and Administration
2. Institutional and Organizational Development
3. Materials and Equipment

Main Counterparts:

1. Tanzania Revenue Authority (TRA)

II. THE PROJECT: BACKGROUND, PRINCIPAL RESULTS AND IMPACT

Introduction

The Tanzania Revenue Authority (TRA) was established in 1995 under parliamentary Act No. 11 as a semi-autonomous revenue authority (SARA) responsible for the collection *cum* administration of all central government taxes (as well as several non-tax revenues). It became operational in July 1996. Prior to its establishment tax collection had been a function of three revenue departments within the Ministry of Finance (MOF), and, as such, fell within the normal civil service framework. The rationale for the TRA's inception was similar to that of most SARAs: weaknesses in tax administration and tax policy formulation; widespread tax evasion; the desire to limit political interference and to free tax administration from civil service constraints; one of the lowest tax ratios in Sub-Saharan Africa (averaging 11.3% from 1990 to 1995); and a fiscal deficit (after grants) of 5% and 7.9% of GDP in FY 1994 and FY 1995, respectively. These and the financing of quasi-fiscal budget shortfalls generated a money supply expansion of some 25% between 1994 and 1996, with subsequent high inflation rates and domestic debt growth.

At the outset (FY 1995/96), all tax administration staff in the MOF's revenue departments were dismissed and were required to reapply for positions in the TRA. More than a third of the original 3,300 were not reappointed. The tax administration staff was whittled down to 2,200 by July 1996, and to 1,900 by the end of 2003. Using its autonomy regarding the personnel system, large salary raises (which increased salaries up to ten times those in comparable civil service positions) were offered to attract competent personnel.

Establishment of the TRA was accompanied (and, in some cases, preceded) by gradual tax reforms aimed at simplifying and broadening the tax base. A value-added tax (VAT) became operational as of July 1998, replacing the highly resource-distorting multi-rate (turnover) sales tax as well as part of the low-yield stamp and entertainment taxes. Export taxes were abolished in the early 1990s, were later re-introduced in 1996, and again abolished on traditional export crops in 1999. Trade liberalization policies have led to reduced across-the board import duty rates, and are currently subsumed in four above-zero bands ranging from 5% to 25%. During the 1990s excises were simplified and rates lowered, as a base covering several hundred items was reduced to nine principal groups, with a mere five goods (beer, other alcoholic beverages, tobacco and petroleum products, and motor vehicles) generating some 90% of the excise total. The income tax structure (personal and corporate) was simplified and marginal rates reduced. And over the past few years more than a dozen low-yield taxes, levies, and duties have been abolished.

A. *Background and Context of Assistance*

USAID/Tanzania technical assistance during the years 1997-99 was targeted at developing the research and institutional capabilities of the TRA's Research and Policy Department (later renamed the Research, Policy, and Planning Department). The TRA's First Five Year Corporate Plan (FY1998/99 to FY 2002/03) called for the establishment of a Research and Policy Unit. However, several months after the Unit's operations began, the TRA's Commissioner General upgraded it to a department. This gave the Department greater influence both within the TRA and with Parliament and other government ministries. The Department reports directly to the TRA's influential Deputy Commissioner General, a key figure in administering the TRA's daily operations.

The main responsibility of the Research, Policy, and Planning Department (RPPD) is to formulate tax policy both for the TRA itself and (indirectly) for the Ministry of Finance (MOF). In fact, the principal responsibility for making tax policy recommendations for the TRA to pass on to the MOF falls upon the RPPD. In particular, the RPPD's mission statement, which was developed with the help of the technical assistance team, included analyzing tax policy alternatives, making recommendations, evaluating the effectiveness of policies and administrative changes already implemented, and projecting revenue collections in order to set MOF revenue targets and gauge the availability of domestic financing for public expenditure programs.

B. *Outcomes and Impacts*

1. <u>Institutional and Organizational Development for Tax Administration and Policy Analysis</u>

The USAID-funded program, initially helped the RPPD define the types of staffing required to initiate tax policy work, including position descriptions and qualifications. The lead consultant participated as part of the committee that vetted curriculum vitae and selected the personnel that initially began working with the RPPD. The consultants worked hand-in-hand with the staff to define and carry out the types of research required of the policy analysis unit. Subsequently, the consultants worked with the RPPD staff to develop methodologies and to provide direction on many of the studies that were carried out by the RPPD during the 1997-99 interval.

In the early stages of operation, the consultants offered a series of short workshops in such areas as strategic planning, the economics of taxation, macroeconomics and the fiscal sector, international best practices in tax policy and tax administration, quantitative analysis, and model building. As part of the training, each RPPD staff member undertook research projects either working directly with short-term consultants or working under the guidance of the consultant. This training included such areas as international trade analysis, rent-seeking and political economy, statistical analysis, tax reform, and the design of studies and scopes of work. The most important analyses carried out by the RPPD's staff in conjunction with the consultants were:

- A Comprehensive Tax Policy Reform Proposal. This analysis was "home-grown" in the sense that most of the input was generated by the RPPD's staff working under the guidance of and in close conjunction with the consultants. Among the principal results of this tax reform package was tax simplification, i.e., elimination of many low-yield "nuisance" excise taxes and minor taxes on exports; the reduction of the large number of income tax brackets; a voucher program for tax expenditures; and an increase in the income tax threshold that took many low-income taxpayers off the tax rolls, thereby significantly reducing administrative costs. By developing this reform proposal, the RPPD became a principal player in establishing Tanzanian tax policy and in subsequently dealing with tax policy under IMF programs.

- A Proposal for the Establishment of a Large Taxpayer Unit. This proposal, completed in early 1999, was subsequently employed by the TRA to establish a Large Taxpayer Department (LTD) in 2001. Interviews conducted in February 2004 with the TRA's present Commissioner General and with its Commissioner for Large Taxpayers revealed that this proposal was adopted with few modifications from the original recommendations. In early 2004 the LTD had 116 taxpayers in its registry, and planned to increase this number to approximately 200 by end-2004. As of late 2003, approximately one-half of total non-customs tax revenues were being collected by the LTD, with a post-expansion goal of 70% having been set.

2. Tax Policy Analysis and Forecasting: Development and Use of Statistical Methods and Models

Under the guidance of the project consultants the RPPD's staff and personnel from the Bank of Tanzania (the central bank), the Ministry of Finance, and the Planning Commission developed a Tax Revenue Projection Model (TRPM). The TRPM is a spreadsheet-based model that is employed to make revenue projections for all the taxes falling within the TRA's purview. It gives the MOF and other government agencies a planning and policy tool that did not previously exist. It uses two types of inputs: exogenous macroeconomic data and the parameters that generate the elasticities and effective rates required for the projections. It is presently used to make monthly and annual revenue projections.

Using sampling techniques initially limited to the Dar es Salaam region (by far the most important tax region in Tanzania in terms of collections), this effort represented the first profile of Tanzanian taxpayers (for all taxes) ever developed. The same method was subsequently applied to two additional tax regions by the RPPD staff members who had been trained by the lead consultant. This database permits statistical analysis of the incidence of taxes under proposed reforms.

The project's institutional development efforts in the 1997-1999 period were highly successful. The RPPD played (and continues to play) a significant role in the formulation of Tanzania's tax policy, especially in the context of international trade negotiations. RPPD has consistently been a key player in budget discussions (although the MOF retains final responsibility). On several occasions the Director of the RPPD has been appointed acting Commissioner General in the absence of the Commissioner, a tribute to the esteem in which he and his analyses are held, due in significant part to support from the project.

Perhaps the most significant achievement of this technical assistance was that it enabled the RPPD to become an influential and effective leader in the important national dialogue on tax reform. This view has been expressed strongly by the former RPPD Director, who is today one of the most respected economists in Tanzania, and who, in 2003, was given the responsibility (as Commissioner for Policy Analysis) of establishing a similar unit in the Ministry of Finance.

In sum, for only one-half million dollars, USAID/Tanzania will likely turn out to have generated a multiplier effect far exceeding its disbursement. The technical assistance provided led to a comprehensive, home-grown, and ongoing tax reform, converted the TRA into a major player and interlocutor in setting the tax policy agenda, and developed the tools that permit the TRA (and therefore the MOF and the Tanzanian Government) to better plan, monitor, and evaluate revenue performance. Whether the potential improvements in performance made possible by these results will fully materialize cannot yet be judged. But by creating the potential, the project has been substantially successful.

III. FACTORS OF SUCCESS

1. Strong Rapport With Counterparts. The consultant team responded to the true "felt needs" of the TRA (and of the MOF and the GOT) very close to its inception. It adopted a hands-on approach by working closely with the RPPD's staff, and established a relationship of mutual trust and respect. This relationship was evident from the very beginning of the technical assistance, when the lead consultant was invited to participate in interviewing and selecting RPPD staff as well as in writing the pertinent job descriptions. The project team did not impose its will upon RPPD staff. Rather, it was responsive to its counterpart's expressed needs, and acted accordingly by directly involving the RPPD's staff in the analytical work. This is the essence of sustainable development, and should serve as a valuable lesson for all USAID-financed projects.

2. "Esprit de Corps" in the New Unit (RPPD). Other success factors also came into play. Given that the TRA was a new institution with a sense of its own uniqueness, its staff entered with a very positive attitude toward both its mission and the technical assistance that was offered. Much credit also must go to the RPPD's Director, who recognized his own needs and inadequacies and was able to put aside any considerations of ego. A rapport was immediately established between the consulting team and the RPPD's staff, and was maintained for the project's duration (and even afterwards).

Rivalry with other fiscal institutions (MOF, Planning Commission, Bank of Tanzania, etc.) was avoided by including their staff in training programs. The need for better quantitative analysis was recognized by the RPPD and the TRA, and its development and use was welcomed. The fact that it remains part and parcel of present-day RPPD activities testifies to this.

A *CAVEAT:* Although USAID-financed technical assistance was limited to the RPPD, it must be recognized that the RPPD by itself forms part of a much larger organization (the TRA). As such, the RPPD is clearly not responsible for administrative operations (and deficiencies) within all the remaining parts of the TRA. It can merely suggest that the TRA (and subsequently the Parliament) adopt tax policy and tax administration changes that buoy revenue collections. This must be taken into account, because from a "bottom-line" perspective, the TRA's revenue performance has not lived up to initial expectations.

After attaining a tax ratio (tax revenues as a percentage of GDP) of 12.1% in FY 1996/97, through FY 2002/03 Tanzania's tax ratio has consistently fallen below the 12.1% level. Part (if not most) of this stagnant tax collection effort is due to factors outside the control of the TRA; i.e., a narrow tax base diminished by an increase in the number of tax exemptions and incentives granted, the declining role of parastatals and the rise of informal sector activities, and the large GDP share of the hard-to-tax agricultural sector. On the other hand, gauging tax performance by an alternative method generates different results. Deflation of nominal tax revenues by the consumer price index reveals significant rises in real tax revenues after FY 1999/2000. Moreover, the VAT, which generates some two-fifths of total tax revenues, in recent years has displayed an up-tick in several indices that can be used to estimate its efficiency/productivity.