Domestic Resource Mobilisation and Debt Capacity for Public Investments in the Era of the COVID 19 Crisis

Strengthening Civil Society Advocacy on Monetary and Fiscal Policies

Sikika

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List of Abbreviations and Acronyms

BoT	Bank of Tanzania
DFA	Development Finance Assessment
DTA	Double Taxation Agreement
EAC	East African Community
EAMU	East African Monetary Union
FOA	Food and Agriculture
GDP	Gross Domestic Product
GFI	Global Financial Integrity
GNI	Gross National Income
IMF	International Monetary Fund
INFF	Integrated National Financing Framework
LIC	Low Income Countries
MoFP	Ministry of Finance and Planning
NFIF	National Financial Inclusion Framework
SSA	Sub-Saharan Africa
TANROADS	Tanzania National Roads Agency
TDV	Tanzania Development Vision
TRA	Tanzania Revenue Authority
TZS	Tanzanian Shilling
USD	United States Dollar
VAT	Value-Added Tax
WB	The World Bank

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To all of you, we say *asanteni sana*.

Irenei Kiria,

Executive Director of Sikika

Executive Summary

Tanzania's Development Vision 2025 and the Sustainable Development Goals (SDGs) call for social, economic, and environmental transformations that require substantial financing for public investments, social services, and social protection programmes for vulnerable groups. Based on provisional estimates, Tanzania's SDG financing need amounts to about 44.5% of the gross domestic product (GDP). However, the Government's Five-Year Development Plan (FYDP) III projects public revenues of only 18.1% of GDP in 2025/2026 due to a moderate increase in tax revenues and an expected reduction of development grants and non-concessional borrowing. With an estimated SDG financing gap of 26.4% of GDP, the country will require significant development assistance if it is to achieve the SDGs by the year 2030. For that reason, the development community needs to discuss the question: how will SDG 17 "Strengthen the Means of Implementation and Revitalise the Global Partnership for Sustainable Development" be achieved in Tanzania?

The Ministry of Finance and Planning and the United Nations Development Programme commissioned the Tanzania Development Finance Assessment Report 2021 to provide an overview of Tanzania's development financing landscape. The upcoming Integrated National Financing Framework will help Tanzania to raise more resources through coherent financing policies. To play a relevant role in this process, civil society needs to form a strong network with a joint advocacy strategy and realistic domestic resource mobilisation targets. Our analysis supports that effort by estimating Tanzania's domestic resource mobilization potential given its state of development and institutional framework and outlining several alternative fiscal and monetary policy options.

- Tanzania's greatest resource mobilisation potential is tax revenues. The FYDP III aims to increase tax collection to 14.4% of GDP in 2025/2026 while the country's tax capacity has been estimated at around 18.3% of GDP. A reduction of tax incentives and exemptions, a widening of the tax base to include digital transactions and the informal sector, taxpayer-oriented strategies to strengthen voluntary tax compliance, and curbing illicit financial outflows and capital flight may yield **additional tax revenues of 3.9% of GDP**.

- Another potential source of revenue is fiscal borrowing. The FYDP III projects fiscal net borrowing to shrink to 1% of GDP in 2025/2026. While foreign net borrowing will come to a complete halt, domestic net borrowing is going to stagnate at around 1% of GDP to avoid crowding out the private sector. However, the analysis shows that Tanzania's public debt is sustainable with a fiscal deficit of around 3% of GDP under a baseline scenario and close to 4% of GDP under a more optimistic FYDP III scenario. This means that the Government may **borrow an additional 2%-3% of GDP** to finance urgently needed public infrastructure projects.

- In June 2021, the Government of Tanzania announced plans to begin the construction of a delayed TZS 60 trillion liquefied **natural gas project** in 2023. The IMF (2014) estimated that **revenues may amount to an average of 1.2% of GDP** per year over the period of natural gas production.

- Monetary policy has the potential to create **additional seigniorage revenues of about 0.3% of GDP** if the inflation rate is raised from the FYDP III target of 4.4% to the East African Monetary Union target of 8%.

- The **development of the financial sector** is a strategic imperative. Bringing the sector to the expected level of development **could boost GDP growth by 1 percent** and make it more stable. Financial sector development would also promote international trade and investments, reduce tax evasion and the size of the informal economy, and mobilise domestic savings that would reduce the borrowing costs of the public and the private sector.

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1 Introduction

1.1 Overview

The first chapter outlines Tanzania's national and international development objectives and describes how its fiscal and monetary policies have evolved and shaped the development process since the country's independence. Over the past decade, Tanzania has been among Africa's fastest-growing economies and recently achieved the status of a lower-middle-income country. A result of the economic advancement is declining foreign development assistance and less access to concessional borrowing. These changes in Tanzania's development financing landscape and increasing fiscal deficits due to the COVID-19 crisis demand the consideration of alternative fiscal and monetary policy options to strengthen domestic resource mobilisation and promote the achievement of national and international development goals.

1.2 Background

1.2.1 Sustainable Development Goals

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

According to the Sustainable Development Solutions Network (2019), a Low-Income Country (like Tanzania at that time) needed to spend US$ 456.5 per person in 2019 to achieve the SDGs by 2030. For Tanzania, this SDG financing need is equivalent to about 44.5% of GDP in 2019. The major share of these expenditures (about 31% of GDP) is needed to finance public education, health services, and infrastructure requirements, while a minor share (about 6% of GDP) is required to finance critical non-SDG public expenditures such as public administration, police, and defence. However, Tanzania's public revenues amounted to only 17.3% of GDP in the fiscal year 2018/2019 (BoT, 2019) leaving an SDG financing gap of about 27.2% of GDP.

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

1.2.2 Tanzania's Development Vision 2025

Since the early 1980s, Tanzania has been undergoing structural and economic reforms to promote the country's socio-economic development. But three decades of implementing economic stabilization and recovery programmes did not produce satisfactory results and, therefore, the need for long-term planning became more pronounced. In 2011, Tanzania reverted to the long-term and five-year planning framework

to ensure the country is strategically organized to attain Tanzania's Development Vision 2025 which aspires to transform Tanzania into a middle-income and semi-industrialized nation by 2025 characterized by (i) high quality and sustainable livelihoods, (ii) peace, stability and unity, (iii) good governance and the rule of law, (iv) an educated and learning society, and (v) a strong and competitive economy.

The Tanzania Development Vision 2025 has been implemented through the Long-Term Perspective Plan (LTPP) which is divided into a series of Five-Year Development Plans (FYDPs) that are also aiming to implement regional and international strategic plans including the Sustainable Development Goals. The theme of the FYDP I 2011/12-2015/16 was "Unleashing Tanzania's Latent Growth Potentials"; the FYDP II (2015/16-2020/21) had the theme "Nurturing Industrialization for Economic Transformation and Human Development". Currently, Tanzania is implementing the FYDP III (2020/21- 2025/26) with the theme "Realizing Competitiveness and Industrialisation for Human Development". To promote a competitive economy, the FYDP III provides a stable environment with macroeconomic indicator targets for the fiscal year 2025/2026 including, among others: a GDP growth rate of 8%, an inflation rate of 4.4%, tax revenues of 14.4% of GDP, a budget deficit ≤ 3% of GDP, and public debt of 28.2% of GDP.[1]

Table 1: Projected Public Sector Financing for Five-Year Development Plan III (% of GDP)

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

Source: MoFP (2021).

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

1.2.3 Tanzania's Fiscal and Monetary Policy from Independence to Today

Domestic resource mobilization has been a concern since Tanzania's independence in 1961 and the formal adoption of the Ujamaa, the African socialist model for development, in 1967. The country's tax

[1] The 28.2% reflect the present value of public debt while the nominal value of public debt was 38.8% of GDP in 2019.

administration was facing all kinds of problems including the lack of an adequate legal system, a malfunctioning organization, limited human resources, and a weak tax culture. The absence of a modern tax collection system resulted in a chronic revenue shortfall under the socialist regime. This period was also characterized by monetary-financed government spending and credit rationing under which the vast majority of domestic loans were allocated to the public sector.

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

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

After a period of high inflation above 30% and falling GDP per capita growth rates in the early 1990s, the Tanzanian Government acknowledged that inflation was driven by the monetary financing of fiscal deficits. The Government and the International Monetary Fund agreed to impose a monthly cash budget system and strengthened the Central Bank's independence. The Bank of Tanzania Act, 2006, prevents the Central Bank from providing credit, directly or indirectly, to any public authority save for short-term advances to offset temporary cash fluctuations. The Act also made domestic price stability the primary monetary objective followed by supporting the integrity of the financial system (Bank of Tanzania Act, 2006, section 7).

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

Another important development that affects fiscal and monetary policy was the establishment of the East African Community in 2000. It includes four stages of integration: a customs union (that entered into force in 2005), a common market (that entered into force in 2010), a monetary union, and a political federation. The Protocol on the Establishment of the East African Monetary Union (EAMU) was signed in 2013 to use a common currency in 2024. To promote monetary and financial stability, the member countries agreed to harmonize and coordinate their fiscal, monetary, and exchange rate policies, and to phase out any

outstanding central bank lending to government and public entities. Moreover, all members need to attain a set of convergence criteria for at least three years before 2024.

1.3 Study Problem

Over the 2011 to 2019 period, Tanzania continued to be one of Africa's fastest-growing economies. Despite this success, recent economic growth has not translated into corresponding increases in employment, and the limited job creation has mainly taken place in the informal sector due to the capital-intensive and enclave nature of the extractive sectors that have been driving this growth. While the taxation of the informal sector is a formidable challenge by itself, there has also been a series of recent developments that affect Tanzania's domestic resource mobilisation efforts:

- After achieving the status of a lower middle-income country, the proportion of non-concessional debts has been rising over time reaching 41.8% of the total external debt in 2019 from 11% in 2011 (MoFP, 2021).
- External grants have dropped from 4.7% of GDP in 2011 to 0.3 % of GDP in 2019 (BoT 2011-2019).
- Moreover, the COVID-19 crisis led to an expansion of the fiscal deficit from 1.4% of GDP in 2019/2020 to 3.9% of GDP in 2020/2021 (BoT, 2021).

In such an environment, it is important to identify alternative fiscal and monetary policy options and strengthen the mobilisation of domestic resources to achieve the Tanzania Development Vision 2025 and the Agenda 2030 for Sustainable Development. The Ministry of Finance and Planning and the United Nations Development Programme conducted the Tanzania Development Finance Assessment (DFA) 2021 to provide an overview of Tanzania's development financing landscape, monitoring and evaluation systems, and governance structures. The upcoming Integrated National Financing Framework (INFF) will help Tanzania to mobilise more resources through coherent financing policies both across sectors and sustainable development priorities.

Tanzania's civil society organisations have been advocating the mobilization of domestic resources to promote the progressive realization of economic, social, and cultural rights and the achievement of national and international development goals. To play a meaningful role in the formulation of the National Integrated Financing Framework, civil society organisations need to form a partnership network with a coordinated, national advocacy strategy which directs their joint efforts to those macro-economic policy areas that will yield the greatest results. Therefore, the national advocacy strategy should be guided by realistic estimates of the county's domestic resource mobilization potential given its state of development, such as the difficulties of taxing the informal economy, and its institutional framework which is affected by national laws, international agreements, and treaties. These estimates will support the formulation of alternative fiscal and monetary policy options that will eventually help Tanzania to achieve the Tanzania Development Vision 2025 and the Agenda 2030 for Sustainable Development.

1.4 Study Objectives

The main objective of this report is to examine the current domestic resource mobilisation efforts and the potential of the United Republic of Tanzania to enlarge the fiscal envelope to achieve its national and international development goals. The report presents an analysis and innovative approaches to domestic resource mobilisation in Tanzania as financing for economic growth and poverty reduction is one of the major challenges. The main areas include Tanzania's capacity to mobilise tax revenues, its capacity to borrow at sustainable levels, the institutional framework, and the strategic role of financial sector development. The report intends to set the ground for a more comprehensive research agenda whose main role is to guide civil society organizations in Tanzania on domestic resource mobilisation opportunities and to promote wide dialogue and policy advocacy. Specifically, the report seeks to address the following study objectives:

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

1.5 Organization of the Report

The current section presented some background to the issues that are the subject of this report. The second section provides a detailed analysis of the tax revenue collection trends and Tanzania's tax capacity; it also describes issues relating to tax policy and the necessary modernisation of the tax administration and considers gender issues. The third section looks at the development of public debt and analyses Tanzania's fiscal borrowing capacity. The fourth section examines how the institutional framework of national laws, international agreements, and treaties are affecting fiscal and monetary policies. The fifth section examines the situation and strategic role of financial sector development, while the sixth section concludes by summarising the key findings and policy implications that may support devising an effective advocacy strategy to promote domestic resource mobilization in Tanzania.

2 Tax Capacity

2.1 Overview

The second chapter examines Tanzania's tax capacity. Section 2.2 analyses the trend of Tanzania's tax revenues from 2011 to 2019 and compares the performance with its African peers and its estimated tax capacity considering the country's state of development. Section 2.3 investigates various tax revenue gaps, and section 2.4 scrutinises cross-cutting issues related to tax administration and gender equity. Section 2.5 summarises the chapter and provides recommendations.

Box 1: Useful Concepts and Definitions in Discussing Taxation

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

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

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

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

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

2.2 Tax Revenue Performance from 2011 to 2019

2.2.1 Tax Revenue Collection

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

Table 2: Tax Revenues from 2011/12 to 2018/19 (% of GDP)

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

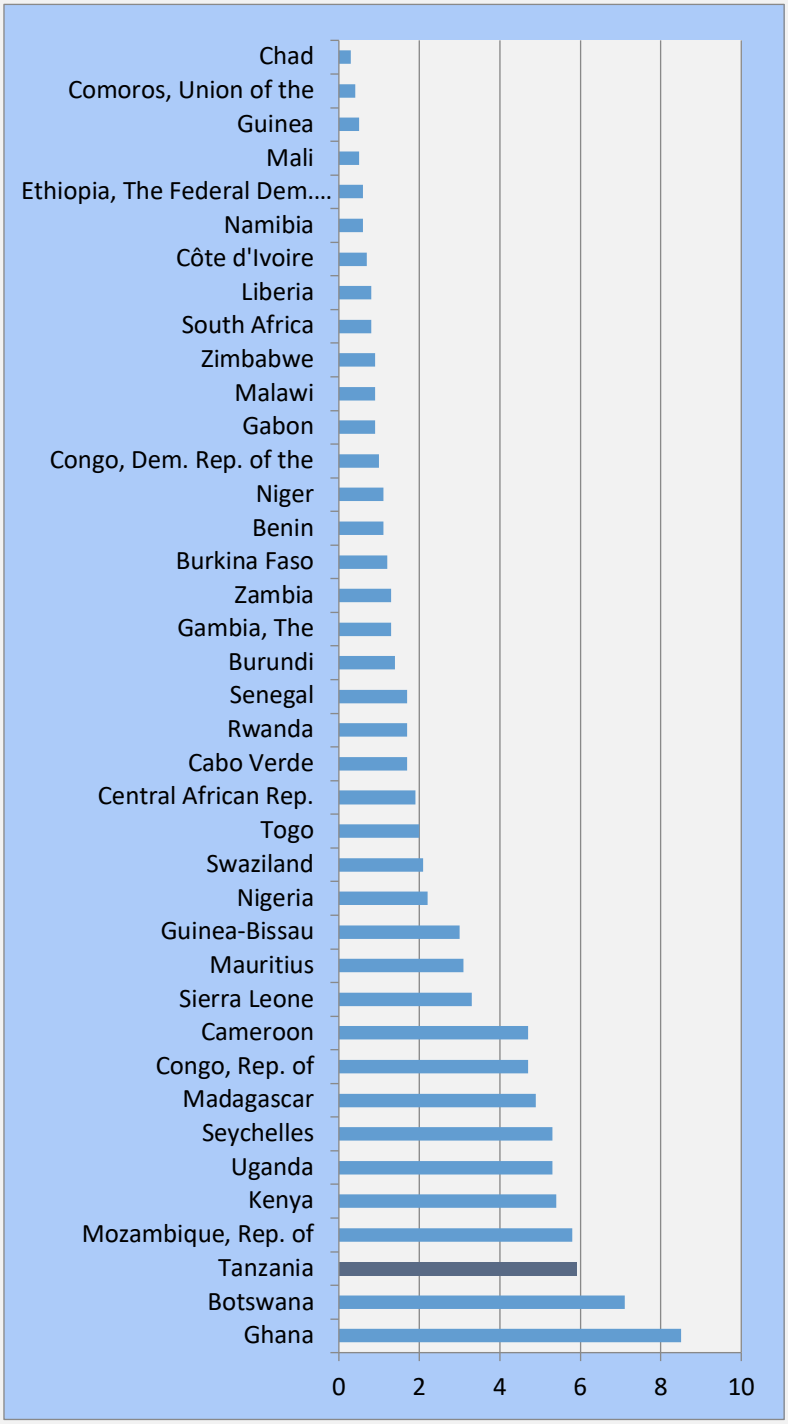
Source: Bank of Tanzania Database and the World Bank (2021).

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

2.2.2 International Comparison

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

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



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

2.2.3 Tanzania's Tax Revenue Capacity

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

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

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

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

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

2.3 Tax Revenue Gaps

A tax gap of more than 6% of GDP means that Tanzania's actual tax collection is far below its tax capacity. It also implies that the country could generate significantly greater public investments to achieve its Development Vision 2025 and Sustainable Development Goals. If Tanzania closed the tax revenue gap, the need for additional grants and external or domestic borrowing would also diminish.

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

2.3.1 Excise Taxes

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

2.3.2 Value Added Tax

Value-Added Tax (VAT) is collected as value is being added at every stage of production. The collection of VAT has also been stagnating at around 3.5% of GDP over the past years. That is almost a full percentage point of GDP below the average of EAC countries (4.4% of GDP) and almost equivalent to the entire gap between the overall tax-to-GDP ratio in Tanzania and the corresponding EAC average. Cnossen (2015) categorized Tanzania as a 'low tax effort' country with respect to VAT, defined as a country collecting 'two-thirds or less of the revenue that it can be expected to rise given its institutional and economic circumstances'.

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

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

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

2.3.3 Income Taxes

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

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

introduce a risk of income tax evasion through transfer pricing between resident companies located inside and outside the zones.

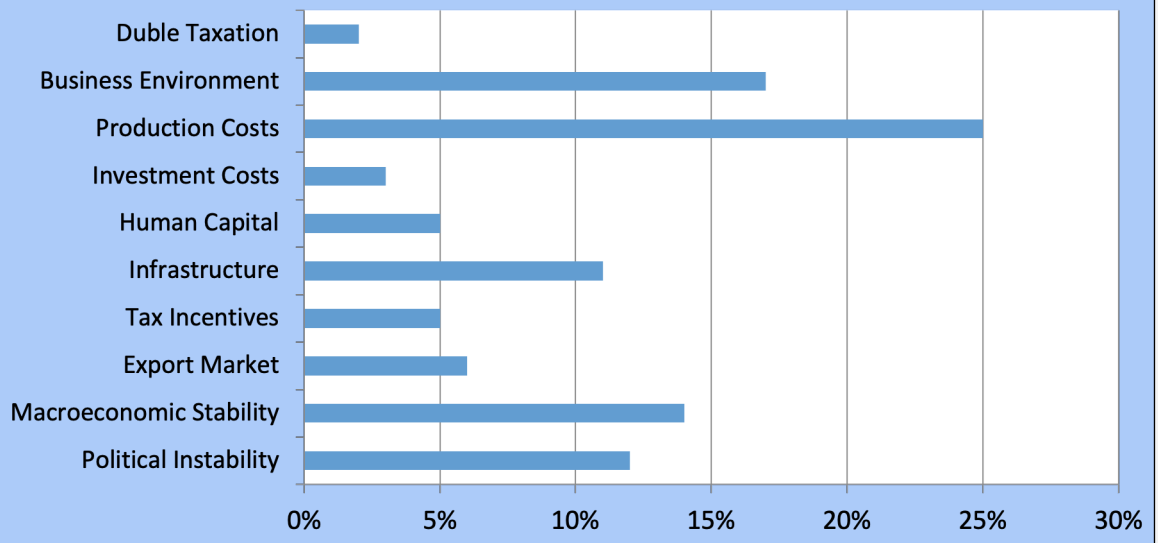
Various estimates have been made on revenue losses from tax incentives in recent years. ActionAid (2018) estimated that Tanzania loses 0.06% of GDP each year to tax incentives. A report conducted in 2013 for Tanzania's Ministry of Finance by the consultancy CRC Sogema concluded that:

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

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

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

Box 2: Are Tax Incentives Relevant in Tanzania?



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

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

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

Source: Bishagazi, 2021.

Individual Income Tax is paid by professionals, sole traders, small businesses, self-employed individuals, and other non-corporate taxpayers. Like salaried employees whose emoluments are subject to Pay As You Earn (PAYE), all non-corporate taxpayers file tax returns with the domestic revenue department and are taxed at progressive individual income tax rates varying from the lowest marginal rate of 9% to the highest marginal rate of 30%. In Tanzania mainland, the taxable income threshold that does not attract income tax is TZS 170,000 per month. In addition, small businesses that do not keep books of accounts for tax purposes and have an annual gross turnover of less than TZS 20 million are covered by a presumptive tax scheme based on turnover.

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

Box 3: Taxing the Informal Sector in Tanzania

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

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

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

2.3.4 Customs Taxes

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

2.3.5 Property Tax

Property tax revenues provide a stable and reliable source of revenue that is less susceptible to short-term economic fluctuation. It is difficult to evade since property taxes can be secured by the property itself. A further benefit is improved service delivery and accountability where property taxes are collected by the local administration (IMF, 2018). Norregaard (2013) suggested that Sub-Saharan African countries can raise 0.5% to 1% of GDP via property taxation, and it is indeed becoming more common across the continent. In Tanzania, the growth rate of property tax revenue was 50% in 2016 when Local Government Authorities were collecting the tax. However, after the collection shifted to the Tanzania Revenue Authority, collection growth declined to 21% and then to 3% in 2017 and 2018, respectively (Martin et al., 2019). After a reform to change the property tax based on the value of properties to a flat tax amount, revenue dropped by 53%. This indicates that the reforms have not been effective and adequate efforts are needed to improve domestic resource mobilization.

2.4 Cross-Cutting Issues

2.4.1 Tax Administration

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

Box 4: Incorporating Digitalization in Domestic Resource Mobilization

The impact of digitalization on tax policy and administration is multifaceted. It empowers tax policymakers with quick access to more reliable information. It reduces costs for both tax administrators and taxpayers as digital infrastructure eliminates numerous manual processes related to recording, counting, and collecting tax files and payments. It can also deepen the tax base by reducing the use of cash and facilitating the analysis of chains of transactions.

Nonetheless, evidence shows that digitalization negatively impacts tax collection. For example, according to Bishagazi (2021), more than 50 percent of Micro-, Small and Medium-Size Enterprise (MSME) traders use online forums to effect transactions that are not regulated and not subject to any tax payments. According to the National Baseline Survey Report for MSMEs (2012), there are 3,000,000 MSMEs in Tanzania. On average, these earn a monthly profit of USD 230. If we use the estimate that 30 percent of MSMEs transactions are done online and not subject to tax, this implies that USD 2,484,000,000 per year is not taxed (i.e. [3,000,000 × 30%] × USD 230 × 12 months]. According to Mzomwe and Mutarubukwa (2015), an average trader in the MSME sector pays an income tax rate of 6 percent per year. Thus, the amount of tax not paid by MSMEs alone due to digitization is estimated at USD 149 million per year.

"One of the major challenges in taxing digital transactions is that, although the tax laws are okay, 99% of transactions in Tanzania are made in cash system. The only way to ensure digital transactions are captured for tax purposes is to advocate for the Bank of Tanzania to move from a cash system to a cashless system." TRA Officer

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

2.4.2 Gender Equity

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

Direct Taxes

The Income Tax Act, section 7, provides for the taxation of employment income, whereas the taxable employee is likely to benefit from tax exemptions on scholarship allowance, cafeteria services, medical

allowances, housing benefits, transport allowances, and pension contributions. The allowances are not available to non-employees, of which the majority are women. The issue of gender bias can be traced to the application of tax incentives granted to employees who give relief or saving which would otherwise be taxed. This enhances the disposable income of salaried employees and widens the gender income gap. However, the tax regime has a redress approach to marginalized groups whereby it provides cash outlays in terms of vocational training services and higher education through the skills and development levy.

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

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

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

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

Indirect Taxes

The Value Added Tax (VAT) is imposed on all taxable supplies, whether imported or manufactured domestically. Indirect taxes such as VAT and excise taxes are regressive taxes because high-income individuals spend less of their income than individuals with low-income. Households headed by a female individual spend a sizeable portion of their income on basic consumption commodities such as food, clothing, fuels, and mineral water, which are subject to VAT and excise taxes. These indirect taxes place a greater burden on women and other marginalized individuals than men. A possible measure to mitigate the tax burden is to use proper tax design and provide tax relief like zero-rating and exemption of particular items.

Real estate taxes refer to those compulsory payments which relate to the ownership or occupation of land and or buildings. They include premium, land rent, planning and survey fees, certification and registration of title fees, transfer fees and property tax. In Tanzania, property tax is levied and collected by the Tanzania Revenue Authority in collaboration with Local Government Authorities. The rate for estate taxes differs

depending on the type of the tax or levy and the authority that has been empowered to levy. Land rent and property tax are administered based on the value of the land or building. A specific rate or amount is also used to charge these taxes. For property tax, the specific or fixed amount is TZS 10,000 for all ordinary buildings regardless of the status quo or gender of the property owner. A storey building is charged TZS 20,000 in district areas while in urban areas each storey is charged TZS 50,000 (Written Laws Miscellaneous Amendments) Act, No. 2 of 2019).

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

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

2.5 Recommendations to Realise Tanzania's Tax Capacity

Tax revenues play a crucial role in domestic resource mobilisation due to their productiveness, stability, and predictability. However, Tanzania's tax revenues have grown only marginally between 2011 to 2019. The revenue collection performance is low in comparison with African peers and the country's state of development. The estimated tax revenue gap is caused by tax policy decisions, such as incentives and exemption regimes, administrative challenges of taxing digital transactions, the presence of a large informal sector, weak voluntary tax compliance, and substantial amounts of money going out of the country through illicit financial outflows and capital flight.

Excise Tax

- Apply a single rate of excise duty for both imported products and domestically produced goods within the same category of like and substitutable goods. An excise tax is meant to correct for an externality and is not intended to achieve a protectionist objective.
- The excise law provides the Government with the power to adjust excise rates yearly at a minimum by the inflation rate, but this provision is not consistently applied.

- Convert ad-valorem excises on alcohol and tobacco to specific (and higher) rates indexed for inflation to reflect external costs of consumption and production.

Value Added Tax

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

Income Tax

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

Property Tax

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

Other Tax Administration Issues

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

Gender Equity

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

3 Fiscal Borrowing Capacity

3.1 Overview

The third chapter examines the scope of Tanzania's fiscal borrowing capacity. Section 3.2 analyses the trend of Tanzania's fiscal deficits, expenditure arrears, and public debt. The following section 3.3 shows how the Bank of Tanzania has contributed to the financing of fiscal deficits through seigniorage revenues. Section 3.4 assesses the sustainability of Tanzania's public debt stock, while section 3.5 discusses the domestic resource mobilisation potential from natural oil and gas. Section 3.6 summarises the chapter and provides recommendations.

Box 5: Useful Concepts and Definitions in Discussing Fiscal Borrowing

The **fiscal balance is** the difference between a government's revenues and its expenditures.

The **primary balance** is the fiscal balance excluding net interest payments on public debt. That means the primary balance considers only expenditures on the provision of public goods and services (but not interest payments).

Expenditure arrears are outstanding obligations that the government has failed to pay within an agreed timeframe.

Seigniorage revenue is the profit made by the government by issuing currency, especially the difference between the face value of coins and their production costs.

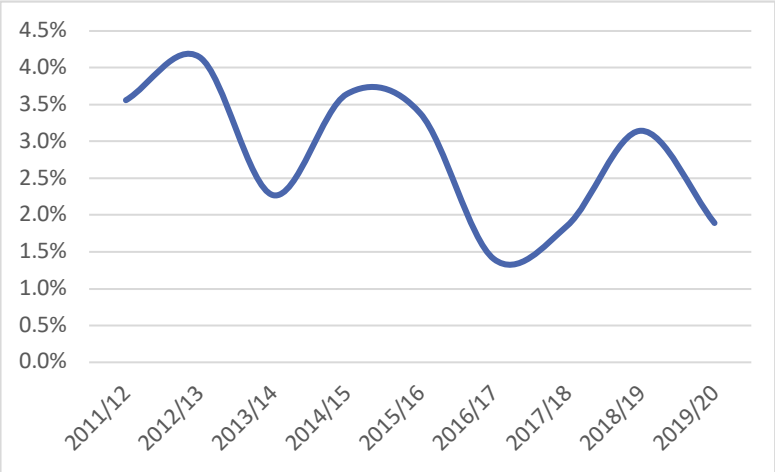
Fiscal sustainability is a situation when the government is able to indefinitely maintain its current fiscal policy without ever defaulting on its debt.

3.2 Tanzania's Fiscal and Debt Policy from 2011 to 2019

3.2.1 Fiscal Deficit

Achieving Sustainable Development Goals (SDGs) is one of the priorities of every government around the globe, and this requires borrowing as domestic resources are scarce. The Keynesian argument is that scaling up public investment through government borrowing may lead to an increase in the debt ratios in the short run, crowd-in private investment and boosts export growth, hence spurring higher economic growth in the medium to long-term and eventually lowering the debt ratios over time (Ramu, 2021). Therefore, what matters is the sustainability of long-run growth and development, for which debt sustainability is a necessary condition and not an end in itself. However, this is based on the implicit assumption of prudent public spending: efficiency and

Figure 2: Tanzania's Fiscal Deficit from 2011 to 2019 (% of GDP)



Source: Authors' Calculations based on BoT Annual Reports.

absorptive capacity play a role in determining the ultimate impact of public investment on economic growth and, hence, the government's ability to collect taxes and repay its debt.

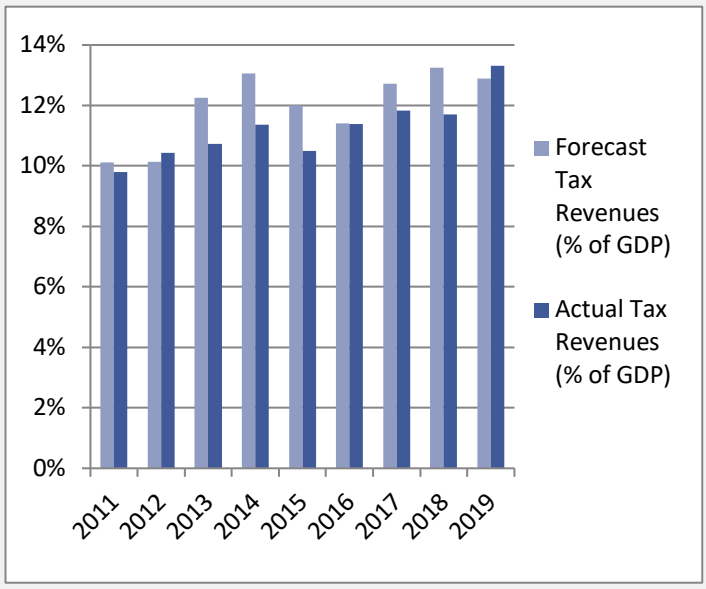
Over the past years, the fiscal deficit has been following an unsteady downward trend from 3.6% of GDP in the fiscal year 2011/2012 to 1.9% of GDP in 2019/2020. The trend coincides with a general reduction of grants declining from 3% of GDP in 2011 to 0.3% of GDP in 2019 (BoT, 2020). Since domestic revenue growth could not compensate for the contraction of grants and fiscal deficits, public expenditures had to be reduced from 18% of GDP in 2011/2012 to 16% of GDP in 2019/2020 with profound effects on the execution of public investment programmes (MoFP, 2020).

There is a co-movement between fiscal deficits and GDP growth: fiscal deficits tend to widen during years of high growth, and they tighten during periods of low growth. This suggests that fiscal deficits in Tanzania are procyclical. In addition, fiscal deficits tend to increase during high inflationary periods. There is also a co-movement between fiscal deficits and the current account balance. This observation is consistent with Arize & Malindretos (2008) who investigated 10 African countries from 1973 to 2005 that showed a positive long-run relationship between the trade deficit and the fiscal deficit.

3.2.2 Domestic Expenditure Arrears

Since the 1990s, the Government maintains fiscal discipline by imposing monthly cash limits on spending units. The cash rationing system ensures that overall revenues match overall expenditures and, hence, fiscal deficits are strictly controlled. However, in an environment of uncertain cash flows and weak budget control systems, spending units have difficulties planning and delivering public goods and services efficiently when their budgets are being cut during the fiscal year. Therefore, they often continue making expenditure commitments (formally or informally) hoping that the permission to spend is only delayed and not reduced permanently (Miller & Hadley, 2016).

Figure 3: Actual Tax Revenues and Forecast Tax Revenues from 2011 to 2019 (% of GDP)



Source: MoFP.

Such practice has led to the accumulation of (unverified) expenditure arrears of about 2.3% of GDP in 2018/2019 up from (verified) 1.8% of GDP in the previous fiscal year (IMF, 2021). One key driver is that actual revenue collection often falls short of revenue targets. These shortfalls seem to be driven by over-optimistic revenue forecasts rather than sluggish revenue collection. Figure 3 shows that, during the 2011 to 2019 period, the budget execution process experienced a revenue shortfall six out of nine times making it unavoidable to either scale back planned expenditures to maintain fiscal discipline or to enter expenditure commitments to deliver public goods and services efficiently while risking the accumulation of expenditure arrears.

The expenditure arrears pose a serious challenge to budget credibility, and they undermine the trust of private sector suppliers, pensioners, and potential investors who consider partnering with the Government. Although the issue has been known for several years, progress to clear expenditure arrears is slow: in the fiscal year 2019/2020, the clearance amounted to only 0.2% of GDP for goods and services and 0.3% of GDP for development projects. However, the total level conceals a significant reduction in expenditure

arrears to contractors and other suppliers, which was mostly offset by an increase in expenditure arrears of state-owned enterprises, especially TANESCO and public pension funds. However, a planned clearance of pension funds' expenditure arrears in 2017/2018 was suspended due to ongoing pension fund reforms (IMF, 2017). Persistent expenditure arrears do not only embody significant fiscal risks such as litigation and delayed or not completed projects, but they also undermine the effective utilisation of budget planning and control systems.

3.2.3 Public Debt

Tanzania's public debt to GDP ratio has been increasing in recent years causing intense discussion among policy-makers, academicians and politicians. The total debt stock increased by more than 13% points of GDP since 2011 to 39.6% of GDP at the end of 2019 (MoFP, 2020). Most of the increase was accounted for by external debt amounting to an average of 73% of the total public debt stock from 2011 to 2019 (MoFP, 2020). Most of Tanzania's external debt is non-concessional. Borrowing on concessional terms has decreased in recent years after the Tanzanian economy was upgraded from low-income status to lower-middle-income status in 2020 with a GNI of USD 1,080 (BoT, 2020). Moreover, the need to finance development and flagship projects arises at a time when the financing landscape is significantly changing, complex, risky, and costly. Non-concessional loans have increased from 11% in 2011 to 42% in 2019 (MoFP, 2020). The average primary balance, which excludes the net interest payments on government debt, stood at -1.35% of GDP over the 2011 to 2019 period.

External public debt remained dominant and grew by 11.1%, year-on-year, to USD 19,703 million in 2019. External debt service averaged USD 1,431 million of which USD 977 million was spent on principal repayments and the balance on interest payments. The largest creditors of external public debt were multilateral institutions (60%), followed by commercial banks and export credit (30%), and bilateral institutions (10%).

Table 3: Trend of the National Debt from 2011 to 2019

Year	Composition		Nature of Debt					
	External (%)	Domestic (%)	Concessional (%)	Non-Conc. (%)	**Total Debt** (% GDP)	**Primary Balance** (% GDP)	**Debt Service** (% GDP)	**Fiscal Deficit** (% GDP)
2011	74.2	25.8	89.0	11.0	26.8	2.8	0.8	3.6
2012	75.2	24.8	91.1	7.2	28.3	3.0	1.1	4.1
2013	73.0	27.0	87.9	12.1	30.7	1.0	1.3	2.3
2014	72.7	27.3	75.6	24.4	31.5	2.2	1.4	3.6
2015	76.2	23.8	68.9	31.1	32.3	1.9	1.5	3.4
2016	72.7	27.3	66.6	33.4	39.0	-0.1	1.5	1.4
2017	71.1	28.9	64.1	35.9	38.3	0.3	1.6	1.9
2018	71.0	29.0	61.2	38.8	39.1	1.4	1.8	3.1
2019	71.9	28.1	58.2	41.8	39.6	0.3	1.6	1.9

Source: BoT, MoFP, and IMF.

From 2011 to 2019, the domestic public debt stock recorded an increase of TZS 3,418 billion to TZS 18,934 billion. Treasury bills and bonds worth TZS 5,016 billion on average were issued to finance government budgetary operations of which 64.5% was Treasury bonds. Out of the borrowed amount, on average, TZS 3,010 billion was for rolling over maturing obligations and TZS 1,894 billion was for budget financing. Long-term instruments (Treasury bonds and stocks) kept on constituting the largest part of the debt during the 2011 to 2019 period in line with the Government's initiative to lengthen the maturity of domestic debt. In terms of the creditor category, commercial banks continued to dominate. In 2019, they accounted for 30.8% of domestic debt stock followed by pension funds at 25.2%. According to the IMF (2018), 20% of the total domestic debt was categorized as short-term debt. Credit from the central bank increased from TZS 978,439 million in 2011 to TZS 2,529,900 million in 2019 whereby, on average, 30% of the total credit was made on a short-term basis.

Table 4: Central Bank Credit from 2011 to 2019

Year	Actual (million TZS)	% GDP
2011	978,439	2.0
2012	989,285	2.0
2013	1,460,889	2.0
2014	1,659,800	2.0
2015	1,463,600	2.0
2016	1,463,600	1.0
2017	2,986,400	3.0
2018	3,641,000	3.0
2019	2,529,900	2.0

Source*:* Bank of Tanzania Annual Reports.

3.3 Seigniorage Revenues

Seigniorage revenues play a vital role in financing fiscal deficits in all developing countries. They are created through the Central Bank by issuing new reserve money to facilitate economic growth at a given rate of inflation. During the 2011 to 2019 period, the level of seigniorage revenue amounted to about 0.5% of GDP.

A limited amount of Central Bank money financing is feasible, and indeed desirable, without inducing unacceptably high inflation. Empirical evidence suggests that the growth-maximizing rate of inflation in developing countries might be in the range of 5% to 8% per year (Bevan, 2010). Attempts to finance spending by driving inflation above the single-digit range will eventually be at the expense of slower GDP growth (Gosh & Phillips, 1998; Khan & Senhadji, 2000).

3.4 Debt Sustainability Analysis

This subsection presents a simple textbook debt sustainability analysis based on Burnside (2005). The analysis indicates that the current fiscal policy provides for additional fiscal borrowing potential.

3.4.1 The Government's Intertemporal Budget Constraint

The basic building block of debt sustainability analysis is the government's budget constraint: it requires that the change in government net debt (including equivalent assets) between two fiscal years equals the interest paid on the accumulated debt, the primary balance (the difference of tax revenue and non-interest expenditure), and seigniorage revenue.[2]

$$\textit{Net issuance of debt} = \textit{interest payments} - \textit{primary balance} - \textit{seigniorage revenue} \qquad (1)$$

[2] Alternatively, the primary balance can be calculated by subtracting interest payments from the fiscal balance.

The equation (1) above can be reorganised to obtain the government's intertemporal budget constraint, which states that the government finances its net debt by running current and future primary balances and seigniorage revenues with an equal present value.

Net debt = present value of current and future primary balances and seigniorage revenues (2)

The intertemporal budget constraint (2) may also be understood in the sense that the government must balance its budget only in the long run, but not every fiscal year. This allows the government to balance a current primary deficit with a future primary surplus or the other way round.

One concept of debt sustainability relates to the government's ability to indefinitely maintain its current fiscal and monetary policy without ever defaulting on its debt service. With such a concept in mind, we perform a basic debt sustainability analysis using a long-run steady-state version of the intertemporal budget constraint (3): it assumes that all items of the equation are constant, and it expresses the net debt, primary balance, and seigniorage revenue as ratios to GDP. If the government plans to stabilise the current debt-to-GDP ratio in such a steady-state situation, it is required to maintain a sustainable level of primary balance and seigniorage revenue (relative to GDP) that is mainly determined by the difference between the (real) interest rate and the (real) GDP growth rate.

(net debt) × (interest rate – GDP growth rate) = primary balance + seigniorage revenue (3)

If the interest rate is persistently larger than the GDP growth rate, primary surpluses and seigniorage revenues are needed to stabilize the debt-to-GDP ratio; and the higher the current debt-to-GDP ratio, the higher the primary surpluses and seigniorage revenues need to be (relative to GDP). Conversely, if the interest rate is persistently smaller than the GDP growth rate, then the debt-to-GDP ratio can be stabilized even in the presence of primary deficits.[3]

3.4.2 Testing for Debt Sustainability

To assess the sustainability of the current fiscal policy, we use the long-run steady-state version of the intertemporal budget constraint to estimate the sustainable level of primary balance based on historical and latest trends of the public debt stock, and real interest rate, real GDP growth rate, and seigniorage revenues.

- At the end of 2019, Tanzania's present value of public debt was about 28% of GDP (IMF, 2021).
- The real interest rate is (approximately) the difference between the nominal interest rate and expected inflation. The nominal (weighted average of external and domestic) interest rate amounted to 4.3% (MoFP, 2021). However, since Tanzania has become a lower-middle-income country, we assume that the future nominal interest rate will increase by about 100 basis points to 5.3%. We chose core inflation as a measure of inspected inflation (as it is less volatile than the consumer price index), which amounted to 3% in 2019. Subtracting the core inflation rate of 3% from the nominal interest rate of 5.3%, we obtain an estimated real interest rate of about 2.3%.
- Over the 2011 to 2019 period, Tanzania achieved an average GDP growth rate of about 6.7% (IMF Database). However, the IMF (2021) predicted a more moderate real GDP growth rate of 5.3% despite the impetus from the new administration due to the Government's past reform implementation track record, the poor business climate over the past years, and the lasting effects of the COVID-19 pandemic. Thus, with a predicted real interest rate of 2.3% and a predicted real GDP growth rate of 5.3%, the interest rate-GDP growth differential amounts to -3%.
- Seigniorage revenue is created by issuing reserve money to facilitate economic growth at a given rate of inflation. From 2011 to 2019, the stock of reserve money was about 5% of GDP. Using the

[3] Escolano et al. (2017) point out that the sizable, negative interest rate-GDP growth rate differentials commonly observed in developing countries will gradually disappear once domestic financial markets are becoming more competitive and cause the real interest rate to rise.

FYDP III target inflation rate of 4.4% and a predicted real GDP growth rate of 5.3%, we expect seigniorage revenues of about 0.5% of GDP.[4]

- Thus, if we assume a steady-state baseline scenario with an interest rate-GDP growth differential of -3% and seigniorage revenue of 0.5%, the Government can maintain a sustainable primary deficit of about 1.3% of GDP.[5]

The estimated sustainable primary deficit of 1.3% of GDP is equal to the average actual primary balance between 2011 to 2019 indicating that the Government's fiscal policy is sustainable under the current **baseline scenario**. By adding debt service of 1.6% of GDP to the sustainable primary deficit of 1.3% of GDP, we obtain **a sustainable fiscal deficit of 2.9% of GDP**.

Table 5: Debt Sustainability Analysis Under Alternative Scenarios

Macroeconomic Variable	Baseline Scenario	FYDP III Scenario
Present Value Public Debt (% of GDP)	28%	28%
Real Interest Rate	2.3%	2.3%
Real GDP Growth Rate	5.3%	8%
Expected Inflation Rate	4.4%	4.4%
Reserve Money (% of GDP)	5%	5%
Seigniorage Revenue (% of GDP)	0.5%	0.6%
Sustainable Primary Deficit (% of GDP)	**1.3%**	**2.2%**
Debt Service (% of GDP)	1.6%	1.6%
Sustainable Fiscal Deficit (% of GDP)	**2.9%**	**3.8%**

Source: Authors' Calculations.

On the other hand, the Five-Year Development Plan III predicts that the implementation of various sectoral strategic plans is going to lead to an acceleration of the GDP growth rate to 8% by 2025/2026. In such a favourable **FYDP III scenario**, the sustainable primary deficit would increase to 2.2% of GDP permitting **a sustainable fiscal deficit of 3.8% of GDP**. Nevertheless, the Government's Medium-Term Debt Management Strategy (2021) is to develop the domestic debt market and also reduce refinancing risks and exchange rate risks. Therefore, the debt strategy focuses on the domestic market and long-maturity Treasury bonds. The Government plans to limit domestic borrowing to 1% of GDP to avoid crowding out the private sector, while net foreign borrowing will taper off by 2025/2026 due to planned foreign loan amortisation. Mwakalila (2020) confirmed that domestic public borrowing is, indeed, crowding out private sector credit in Tanzania by increasing the lending rates in the long run. The author concluded that the Government should instead borrow more from external sources.

3.5 Revenue Potential of the Oil and Gas Sector

Public assets are also a crucial element for the sustainability of public finances as assets can be sold to offset public debt. In June 2021, the Government of Tanzania announced plans to begin the construction of a delayed TZS 60 trillion liquefied natural gas project in 2023. The discovery of large deposits of natural gas

[4] Seigniorage revenues are predicted by multiplying the stock of reserve money per GDP with the sum of the expected inflation rate and the expected real GDP growth rate. Compare Burnside (2005), Fiscal Sustainability in Theory and Practice: A Handbook, The World Bank, p. 76.

[5] Note that the estimate derived from our simplified model is broadly in line with a more sophisticated IMF (2021) projection of 1.2%.

has led to expectations that the export of liquefied natural gas could transform the economy and drive human development providing hope for twelve million Tanzanians living in poverty.

According to Natural Resource Governance Institute (2017), if the project does go ahead, the government revenues it will generate are unlikely to be transformative. Based on a historical average of liquified natural gas prices,[6] the IMF (2014) estimated that government revenue would average approximately TZS 4.6 trillion a year (in real terms) over the period of gas production, equivalent to only TZS 43,000 per person or 1.2% of GDP a year.[7] The natural gas revenues are not expected to reach the 3% of GDP threshold set by the Oil and Gas Revenues Management Act, 2015, at which they are required to be deposited into the Oil and Gas Fund's Revenue Saving Account and therefore will only finance the Government's budget. The binding deficit limit is likely to be the East Africa Monetary Union's ceiling, which mandates that the country's overall deficit cannot exceed 3% of GDP. But so far, Tanzania is on the path to meeting that ceiling. If the liquified natural gas project goes ahead, a modest increase in spending in the longer term (once gas revenues start flowing) seems possible.

3.6 Recommendations to Realise Tanzania's Fiscal Borrowing Capacity

The fiscal deficit has been following an unsteady downward trend between 2011/2012 to 2019/2020 limiting the available funding for infrastructure projects in the country. Meanwhile, overly optimistic forecasts create revenue shortfalls that disrupt the budget execution process and lead to an accumulation of expenditure arrears. Although most debt is still concessional, its share has declined to less than 60%, while the proportion of commercial and short-term debt has risen. As the Government's Medium-Term Debt Management Strategy is focussing on the domestic debt market, the costs of debt service are expected to increase. Despite this development, the debt sustainability analysis indicates that the risk of public debt distress is low albeit sensitive to rising interest rates and lower GDP growth rates. Although the natural gas revenues will not dominate the budget, they are expected to play an important role in offsetting a decline in grants and concessional loans.

Fiscal Deficit

- Expand the fiscal deficit to the sustainable FYDP III target of 3% of GDP to fund urgently needed public investment programmes.
- Enhance external borrowing to reduce pressure on domestic lending rates and to avoid the crowding out of private sector credit.

Expenditure Arrears

- Develop a medium-term plan to settle the stock of existing expenditure arrears.
- Avoid the accumulation of new expenditure arrears by making the revenue forecasting process more transparent to reduce bias and interference.
- Improve the predictability of funds for spending units by issuing conservative quarterly warrants.
- Once revenue forecasts are realistic, the Treasury should use short-term borrowing to ensure that authorised spending is sufficiently financed throughout the fiscal year.

Debt Management

- There is a need to build capacity for managing an increasingly market-based debt profile and the associated risks, particularly as Tanzania continues to gravitate towards non-concessional sources of credit. The capacity for public debt management should be improved with the assistance of

[6] In April 2015, the IMF forecast that the price of LNG in Asian markets would be USD 16 per mmBtu in 2020. By October the following year, the IMF forecast prices to be only USD 7 per mmBtu, over 50% lower.
[7] Natural Resource Governance Institute (2017), Uncertain Potential: Managing Tanzania's Gas Revenues.

international financial institutions and other agencies and encompass the establishment of an appropriate policy and regulatory framework for public debt management, staff training, establishing a debt information system, and a risk management framework for the loan portfolio of the public sector.

Oil and Gas Revenue Management

- The potential benefits from the oil and gas sector need to be managed through a fiscal policy framework that ensures (a) growth-enhancing development expenditures in line with absorption and institutional capacity constraints and (b) the accumulation of financial assets to ensure macroeconomic stability and inter-generational equity.

4 Institutional Framework

4.1 Overview

The fourth chapter assesses how the institutional framework for fiscal and monetary policy affects domestic resource mobilization efforts. Section 4.2 discusses how national legislation limits the Bank of Tanzania's authority to provide short-term and long-term credit to the Government. Section 4.3 compares the East African Monetary Union (EAMU)'s convergence criteria with Tanzania's fiscal and monetary policy performance and assesses if the criteria are commensurate to the country's state of development. Section 4.4 applies the same approach to the International Monetary Fund's (IMF) quantitative assessment criteria. The last section summarises the chapter and provides recommendations.

Box 6: Useful Concepts and Definitions in Discussing the Institutional Framework

The **East African Monetary Union's convergence criteria** are used support the adoption of a single currency with a common monetary policy.

The **International Monetary Fund's indicative targets** are used to assess compliance with conditionalities that have to be met to access IMF financing programmes.

4.2 National Legislation

The Bank of Tanzania (BoT) is the sole institution empowered to maintain price and currency stability in Tanzania. The Bank of Tanzania Act, 2006, made domestic price stability the primary monetary objective followed by supporting the integrity of the financial system (Bank of Tanzania Act, 2006, section 7). Since 2006, the Bank of Tanzania allows headline inflation to deviate from its target (that means 'single digit', as stated in its recent medium-term monetary policy) and it sets its focus on core inflation, which excludes food and energy prices and is generally viewed as a better proxy for expected inflation.

The Bank of Tanzania Act prevents the Central Bank from providing credit, directly or indirectly, to any public authority (Bank of Tanzania Act, 2006, section 37) save for short-term advances to offset temporary cash fluctuations (Bank of Tanzania Act, 2006, sections 34-36). The reason for the legal limit is that the financing of government deficits with central bank money can fuel inflation and have negative implications for welfare and the current account. However, there are numerous historical examples where central banks have been involved in the (temporary) financing of fiscal deficits, supporting industrial policy objectives, and stimulating economic growth without excessive inflation (see Collins and Lerven, 2018). Therefore, the discussion about the central bank's role in achieving development objectives has regained importance, particularly in the aftermath of the recent global financial crisis.

Placing strict legal limits on the Bank of Tanzania's role in fiscal deficit financing may jeopardize the Government's ability to mobilise domestic resources considering the country's large informal economy and volatile sources of revenues. According to the Bank of Tanzania Act, 2006, sections 35-36, the limit of Central Bank advances is one-eighth of the average of actual collected domestic revenues of the previous three fiscal years. Table 6 compares the actual advances with the legally permitted level. The results

Table 6: Bank of Tanzania Advances and Legal Limit from 2011 to 2019 (% of GDP)

Year	Advances	Legal Limit
2011	0.3%	1.1%
2012	0.4%	1.1%
2013	0.8%	1.1%
2014	1.0%	1.1%
2015	1.5%	1.2%
2016	1.3%	1.2%
2017	0.7%	1.3%
2018	1.6%	1.4%
2019	1.1%	1.5%

Source: Authors' Calculations based on BoT Annual Reports.

indicate that the Government has not always been able to keep the advances below the legal limit throughout the study period.[8]

An underlying cause for the high dependence on Central Bank advances is the repeated overestimation of revenues. From 2010/2011 to 2018/2019, domestic revenue collection fell short of budget estimates by an average of 1.6% of GDP. Since the Central Bank is not allowed to cover revenue shortfalls of such magnitude, planned expenditures have to be cut back during the fiscal year, which often results in the accumulation of expenditure arrears.

4.3 East African Monetary Union

Tanzania has been generally successful in achieving the East African Monetary Union's (EAMU) macroeconomic convergence targets for deepening integration. The country has pursued a sound monetary policy that has kept inflation at low and stable rates. The inflation target has been set at 3-4% in the past few years and the EAMU's inflation target has been achieved in most years. According to the IMF (2019), Tanzania has the East African Community's (EAC) best inflation differential.

Table 7: Tanzania's Performance against EAMU Convergence Criteria from 2011 to 2019

Criteria	Benchmark	2011	2012	2013	2014	2015	2016	2017	2018	2019
Tax-to-GDP ratio	25%	11.3	11.7	12.3	11.4	12.2	12.4	12.2	11.5	11.3
Headline Inflation	<8%	12.7	16.0	7.9	6.1	5.6	5.2	5.3	3.5	3.5
Reserve Import Cover	4.5 months of imports	3.5	3.6	3.9	3.7	3.7	4.5	6.6	6.5	6.0
Fiscal Deficit (including grants)	<3% of GDP	3.6	4.1	2.3	3.6	3.4	1.4	1.9	3.1	1.9
Gross Public Debt as % of GDP	<50% of GDP	26.8	28.3	30.7	31.5	32.3	39.0	38.3	39.1	39.6
Central Bank Credit to Government	<5% of GDP	2.0	2.0	2.0	2.0	2.0	1.0	3.0	3.0	2.0

Sources: BoT, MoFP, IMF.

The country has also maintained a sound fiscal policy stance geared toward having low budget deficits and a low debt-to-GDP ratio as shown in Table 7. The country has a strong balance of payments with the level of international reserves well above the target to cover 4 months of imports. Although the external debt as a percentage of GDP has been increasing over time, it is still within the EAMU criteria. However, Tanzania has not been able to meet the EAMU's tax revenue criteria of 25% of GDP. The tax-to-GDP ratio ranged from 12.6% to 14.6% of GDP during the 2011 to 2019 period. However, the EAMU's tax criteria are not in line with the country's estimated tax capacity of 18.3%.

Moreover, the EAMU allows an inflation rate of up to 8%. At that rate, the amount of seigniorage revenue is about 0.8% of GDP. The analysis above (section 3.3) showed that the level of actual seigniorage revenue from 2011 to 2019 was about 0.5% of GDP. This means the Government is underutilizing seigniorage as an alternative source of revenue. The Government could generate additional seigniorage revenue of 0.3% of GDP by using the EAMU's inflation target rate of 8% to maximize domestic resource mobilization.

[8] Note that the Central Bank's advance pertains to the calendar year while the Government's legal limit pertains to the fiscal year, which ends six months before the calendar year.

4.4 International Monetary Fund

Tanzania was one of the major recipients of foreign aid and concessional loans, mostly to finance government-owned enterprises that were dominant after the country's independence. Foreign aid was needed due to mismanagement and inefficiency in the operations of these enterprises which led to the drainage of domestic resources, while some plunged into heavy debts (Were & Mollel, 2020). Thus, Tanzania was initiated into the IMF's Heavily Indebted Poor Countries (HIPC) in 1996. By 2001, the estimated debt service relief for Tanzania amounted to USD 3 billion (Were & Mollel, 2020).

To facilitate the achievement of desired fiscal adjustment, the HIPC program included a range of conditions that countries seek to fulfil to receive support from the International Monetary Fund. The Bank of Tanzania's reserve-money targeting programme follows quantitative assessment criteria set by the International Monetary Fund to limit the Central Bank's accumulation of domestic and foreign assets. Kessy et al. (2017) found that the policy dialogue between the Bank of Tanzania and the International Monetary Fund allowed for flexible conduct of monetary policy as reserve money targets were adjusted to observed, supposedly appropriate, performance deviations.

In 2017, Tanzania met five out of seven criteria, including the upper bound for average reserve money, the floor for priority social spending, a floor for the cumulative fiscal balance, a floor in the change of international net reserves, and a ceiling on the accumulation of external payment arrears. On the other hand, Tanzania missed the floor on tax revenues and the ceiling on the accumulation of domestic expenditure arrears.[9] The analysis also shows that the IMF indicative tax revenue target in 2017 was lower than Tanzania's estimated tax capacity of 18.3% of GDP as shown in Table 8.

Table 8: IMF Indicative Criteria for Tax Revenue and Fiscal Deficit in 2017

Assessment Criteria	Indicative Target	Actual	Estimated Capacity
Tax Revenue (% of GDP)	13.1%	13.0%	18.3%
Fiscal Deficit (% of GDP)	2.9%	1.5%	2.8%

Source: Authors' Calculation and IMF (2017).

However, this should be no surprise since the realisation of Tanzania's tax revenue potential will require considerable time. Tanzania's actual fiscal deficit amounted to only half of the IMF's indicative fiscal balance target, which is commensurate with the sustainable fiscal deficit of 2.8% of GDP (comprising of the estimated sustainable primary deficit of 1.3% of GDP and debt service of 1.5% of GDP in 2017).

4.5 Recommendations for the Institutional Framework

Tanzania's institutional framework for fiscal and monetary policy is largely determined by the Bank of Tanzania Act, 2006, the convergence criteria of the East African Monetary Union Protocol, and the indicative criteria of the International Monetary Fund's financing programme. The Bank of Tanzania Act, 2006, prevents the Central Bank from providing credit, directly or indirectly, to any public authority save for short-term advances to offset temporary cash fluctuations. The analysis indicates that the Central Bank's legal limit on short-term advances has been occasionally exceeded due to persistently over-optimistic revenue estimates. Furthermore, most of the EAMU's and the IMF's fiscal and monetary policy criteria are commensurate with Tanzania's state of development; only the tax revenue criteria deviate markedly from the country's estimated tax capacity.

[9] International Monetary Fund (2017), Seventh Review Under the Policy Support Instrument – Debt Sustainability Analysis, p. 37.

National Legislation

- Avoid exceeding the Bank of Tanzania's legal limit for advances by strengthening the revenue forecasting process through transparent, scientific methods. Retrospective analysis can uncover persistent over-optimism in predicting key revenue aggregates, such as domestic revenues, grants, and financing from external or domestic sources. Realistic revenue forecasts will also reduce the need for in-year expenditure adjustments and diminish the risk of new expenditure arrears.

East African Monetary Union criteria

- Based on the EAMU's inflation criterion, the Government can allow an inflation rate of up to 8% to generate additional seigniorage revenue as a source of domestic resources without affecting economic growth.

International Monetary Fund criteria

- The International Monetary Fund's indicative criterion for tax revenue should be set with the goal of achieving Tanzania's tax capacity within an ambitious and realistic timeframe.

5 Financial Sector Development

5.1 Overview

The fifth chapter examines Tanzania's financial sector development potential. Section 5.2 describes the central bank's key role in realising that potential. Section 5.3 analyses the latest trends in access to financial services, financial depth, and financial service efficiency, and section 5.4 compares Tanzania's level of financial sector development with that of other East African countries. Section 5.5 describes the financial sector's strategic role in domestic resource mobilisation, and the last section summarises the chapter and provides recommendations.

Box 7: Useful Concepts and Definitions in Discussing Financial Sector Development

Financial sector development can be defined as a combination of access (ability of individuals to access financial services), depth (size and liquidity of markets), and efficiency (ability of institutions to provide financial services at low costs and with sustainable revenues, and the level of activity of capital markets).

5.2 The Central Bank's Role in Financial Sector Development

Financial sector development constitutes a potential driver of domestic resource mobilization for Tanzania. According to Were et al. (2021), countries with developed financial systems mobilise more tax revenues than those with less developed financial systems. The UN Conference on Financing for Development in Addis Ababa in July 2015 paved the way for the implementation of the post-2015 development agenda, and many central banks in developing and emerging economies are now looking beyond the narrow mandate of ensuring price stability and placed renewed emphasis on the promotion of economic development and structural transformation. The greater appeal of alternative approaches to central banking is related to failures of the neoliberal economic model and the apparent success of more interventionist, developmental approaches followed by several East Asian economies including Japan, Korea, and China. This marks a shift from the orthodoxy that has dominated central banking since the 1980s according to which central banks should primarily focus on price stability.

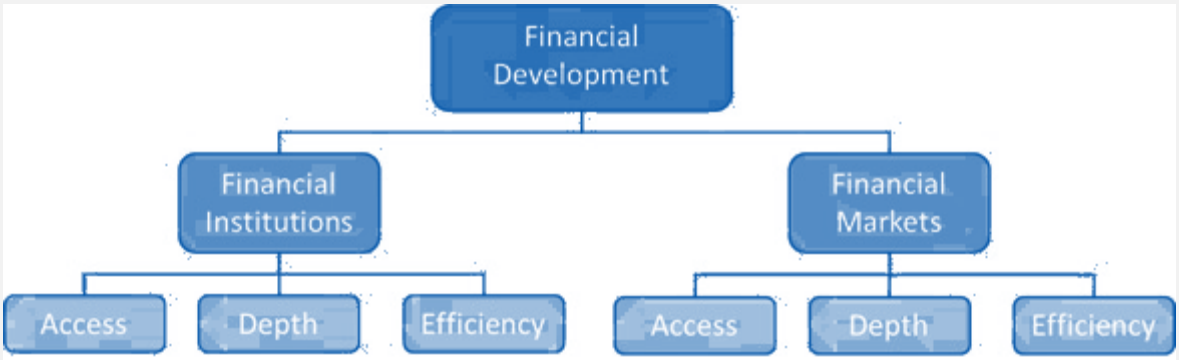
After the global financial crisis, it has also become clear that central banks ought to take responsibility for promoting the stability and development of the financial sector. Proportionate regulation has become a guiding principle for many central banks to align the financial sector with a sustainable development approach. Kenya's central bank has been at the forefront of providing an enabling regulatory environment for the provision of mobile payment services, which allowed for their rapid expansion. Compared to the period before the 1980s, the policies to promote financial inclusion in developing countries tend to be more market-based, more focused on institution-building, and they rely more on technical solutions to reduce the costs of financial service provision rather than on public subsidies and direct interventions in financial institutions' lending activities. Like many other central banks, the Bank of Tanzania has a wide mandate with the responsibility, without prejudice to its primary objective of maintaining domestic price stability, for "ensuring the integrity of the financial system […] and promoting sound monetary, credit, and banking conditions conducive to the development of the national economy."[10] Therefore, it plays a key role in the implementation of the Financial Sector Development Master Plan 2020/21 to 2029/30 which promotes "a stable, sound, efficient and inclusive financial sector that will contribute significantly to resource mobilisation for economic growth of the Nation."

[10] Bank of Tanzania Act, 2006, section 7.

5.3 Financial Sector Development in Tanzania

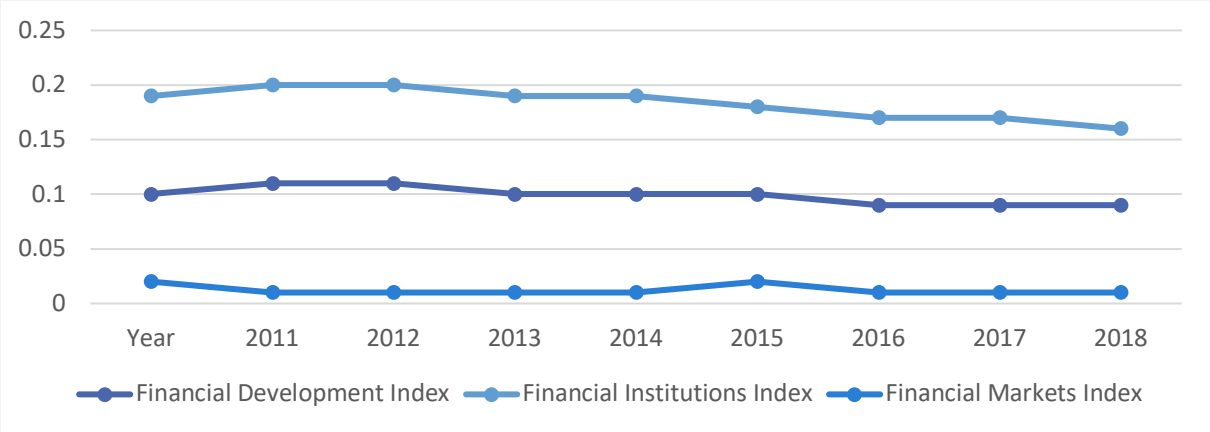
This section describes the trends of financial sector development in Tanzania based on the IMF's Financial Development Index which combines three measures, namely (a) accessibility, (b) depth, and (c) efficiency of both financial institutions and financial markets. Financial institutions include banks, insurance companies, mutual funds, and pension funds. Financial markets include mainly stock and bond markets.

Figure 4: Composition of the Financial Development Index



The findings show that the financial sector development has been stagnating at large – both in terms of financial institutions and financial markets, despite some progress with respect to financial access to financial markets, which has increased from 4% to 6% over the 2011 to 2019 period. The rest of the indicators have decreased, leading to a minor decline in the overall financial development index from 10% in 2011 to 9% in 2019 (Figure 5). The increase in financial access has mainly been driven by the widespread uptake of mobile banking; the growth in the telecom sector has been a key enabler of this trend.

Figure 5: Financial Development Index Indicators 2011 to 2018



Source: Authors' calculations based on IMF database (2018).

5.3.1 Access to Financial Services

With 2.5 bank branches and 6.4 Automatic Teller Machines (ATMs) per 100,000 adults, Tanzania ranks in the bottom quartile of countries in terms of access to traditional financial access points (IMF, 2017). This low level of coverage is not surprising in a large, low-income country with a low population density. In such a context, a traditional bank-centric, branch-based delivery of financial services can only provide for a small share of the population, mostly in the larger urban centres. More than half of the people without a bank account report that excessive distance from a bank branch is the main reason for their failure to hold an account.

However, the mobile money revolution has significantly improved access to basic financial services reaching customers that banks and traditional financial sector players have not been able to. Since 2008, Mobile Network Operators (MNOs) have introduced innovative Mobile Financial Services (MFS) delivered through mobile phones and agent networks. Mobile money has helped to bridge the vast distances in a sparsely populated country enabling a much lower threshold for profitable service provision, enhancing the convenience of service, and reducing delivery times. Digital banking services continue to expand due to increasing financial inclusion and mobile phone availability. In May 2020, the Bank of Tanzania increased Mobile Network Operators' daily transaction limit to customers from TZS 3.0 million to TZS 5.0 million and daily balances from TZS 5.0 million to TZS 10.0 million to encourage the use of digital payment platforms for transactions. The interoperability of mobile money services has also contributed to the overall growth of mobile money transactions of 6.9% in transaction value. The number of active registered accounts for mobile money stood at 29.4 million at the end of 2020 compared with 24.4 million and 27.2 million at the end of 2019 and June 2020, respectively. This has been a crucial element of the National Financial Inclusion Framework 2018-2022. As a result of this progress, Tanzania reached its 50% financial inclusion target originally set for 2016 already in 2014. Currently, more than 60% of adult Tanzanians have a financial account, a dramatic increase that places Tanzania ahead of most countries in Sub-Saharan Africa.

Box 8: The National Financial Inclusion Framework

The National Financial Inclusion Framework establishes the context for the financial inclusion vision based on the concrete improvements that Tanzania would like to see in the lives of all Tanzanians through the use of financial services. It galvanizes all relevant stakeholders in the financial services sector through the formulation of one common vision of success and provides strategic direction for all initiatives for financial inclusion in the country.

In working towards the long-term vision and achieving set targets in the medium-term, the Framework has identified fundamental barriers that limit the growth of financial inclusion in Tanzania. These include supply-side barriers ranging from high interest rates, inappropriate services that do not meet demand-side needs, and high costs due to inefficiencies of service delivery. There are also demand-side barriers such as information asymmetry, irregular income patterns, and financial literacy.

Hence, the Framework attempts to address the broad barriers on financial inclusion through the implementation of key priority areas for identified core enablers to build a robust infrastructure that will enable growth and outreach of all financial services. The key priority areas include proximity, robust information, easy client on-boarding, and informed customers.

Mobile Financial Services (MFS) and other Non-Banking Financial Institutions' MFS accounts rose from 1% of adults in 2011 to 61% in 2015. Over 50% of electronic transfers in Tanzania go now through Mobile Financial Services, reaching a transaction volume of 50% of GDP. The high degree of access to payment services is possible due to the network of more than 260,000 active mobile money access points throughout the country (in 2016) equivalent to one for every 103 adults.

Though Tanzania is reported to have fast and large Internet penetration, individual Internet penetration is relatively low at around 28.7% and mostly in urban areas, although the target is to grow the country's broadband penetration to 70% by 2025. Tanzania ranks 112th out of 137 countries in The Economist Intelligence Unit's Technological Readiness Ranking for 2018. Tanzania's broadband penetration level is currently 31.5%. Mobile and Internet penetration increased rapidly in the decade to 2011, but it has slowed since then. For much of the population, affordability remains a barrier to access (Deloitte, 2015). By the end of 2018, 3 and 4 networks covered around 61% and 28% of the Tanzanian population, respectively. The lack of Internet access deprives many Tanzanians of the opportunity to participate fully in the digital economy including online financial transactions and other online services.

5.3.2 Financial Depth

The value of financial assets in Tanzania amounted to 38% of GDP in 2018. The banking sector holds the largest share of financial assets (26% of GDP) followed by pension funds (10% of GDP), and insurers (0.8% of GDP), while collective investment schemes hold only 0.2% of GDP. The capitalisation of companies listed on the Dar Es Salaam Stock Exchange amounted to 16.5% of GDP in 2018 (MoFP, 2020).

Financial Institutions

The banking sector is dominated by large banks. Due to ongoing consolidation in the banking industry, the share of large banks' total assets increased from about 65% in 2016 to 76.6% in 2020. As a consequence, the share of total assets by medium-sized banks has been reduced from about 30% in 2016 to 20% in 2019, while the share of total assets by regional and small banks remained mostly unchanged. In 2020, the major components of the banking sector's assets were loans, advances, and overdrafts, which accounted for 54.1% of total assets followed by investment in government and debt securities (17.1%), cash and balance with the Bank of Tanzania (10.8%), balances with other banks (5.2%), and other assets (12.8%).

In 2015, the Bank of Tanzania increased minimum capital requirements to ensure the stability of the financial sector and to promote consolidation in the banking industry to enhance the sector's operating efficiency. As a consequence, nine merger & acquisition transactions were announced. In 2019, the Bank of Tanzania also introduced Bancassurance Guidelines to promote the distribution of insurance products through banks' branch networks. So far, this has led to the licensing of ten commercial banks, which can now serve their customers as a one-stop-shop for banking and insurance services (Ernst & Young, 2020).

Financial Markets

The Government bond market has maturities of 2, 5, 7, 10, 15, and 20 years. In 2019/2020, the majority of domestic public debt was held by commercial banks (34%), pension funds (28%), and the Bank of Tanzania (13%), while private investors held only 5% of domestic public debt. In 2017, the Bank of Tanzania moved from a reserve money-targeting framework to an interest rate-targeting framework that allows the Central Bank to stabilise short-term interest rates and strengthen the pass-through to medium-term and long-term interest rates. When the Central Bank cut the discount rate from 6.9% in January to 2.2% in July 2017, the yield of Treasury bills also dropped from 15.3% to 9.1%. However, commercial banks' overall lending rate did not respond to the accommodative monetary policy creating a large interest rate spread between short-term deposits and long-term lending. In 2018, Tanzania's lending rates of 17.5% were the highest in Sub-Saharan Africa with a regional average of 10.9% (Mwakalila, 2020).

5.3.3 Efficiency of Financial Services

A major reason for Tanzania's high lending rates is the high share of non-performing loans in the banking sector. The ratio of non-performing loans to gross loans increased from 6.8% in 2011 to 12.5.% in September 2017 and then stabilised around 10% in recent years. These ratios are far above the target rate of 5%. For that reason, the Bank of Tanzania is collaborating with banks and financial institutions to improve the credit-underwriting process, the use of credit reference systems, and enhance loan recovery efforts (BoT, 2011-2020).

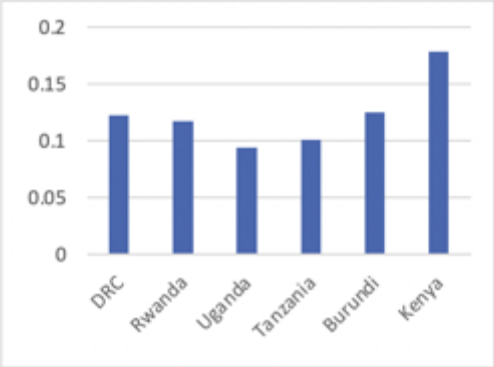
Generally, large banks tend to have lower non-performing loan ratios, and they are also more efficient than medium-sized banks and other non-banking financial institutions as they benefit from economies of scale. Following the consolidation in the banking industry, the sector's operating efficiency, measured as the ratio of expenses to loans and advances, improved from 15.3% in 2016 to 12.8% in 2020. However, the improving operating efficiency has been overcompensated by declining portfolio yields, measured as the ratio of interest income to bank loans and advances, from 16.7% in 2017 to only 13.4% in 2020. As a consequence, the portfolio yield to operating efficiency ratio diminished from 1% in 2016 to 0.7% in 2020 (Ernst & Young, 2020).

Another structural characteristic of the banking system is the short-term nature of the deposits held by the banking system with an average maturity of only 136 days reflecting the high share of "sight deposits" in the system (these are deposits that could be withdrawn at any time). This makes it very risky for banks to undertake what is called "term transformation" which means financing long-term loans with a short-term deposit base. This feature makes banks a funding vehicle for short-term consumption of individuals and short-term working capital of enterprises, but the funding of long-term investment projects remains a challenge.

5.4 International Comparison

The level of financial development in Tanzania remains well below what is needed to support public and private investment to achieve its development objectives. This can be observed by comparing Tanzania with other members of the East African Community: Tanzania has the second-lowest average financial development index score in East Africa in the 2011 to 2019 period (compare Figure 6). Tanzania also ranks at the bottom among East African Community countries concerning firms' access to credit and other financial services. In the 2013 Global Enterprise Survey, almost 44% of the firms identified 'access to finance' as a major constraint – the highest proportion in the East African Community. Access to financial infrastructure is another weak point as branch penetration is particularly poor. However, the efficiency measures of Tanzanian banks are in line with their regional peers. The overall costs as a proportion of income rose gradually after 2007, but since 2012 they have stabilized.

Figure 6: Financial Development Index in East Africa 2011 to 2019



Source: IMF Database (2018).

Generally, Tanzania's financial sector remains less developed, and the lack of depth of financial institutions reflects the low level of domestic financial assets which contributes to low levels of domestic savings with the ultimate effect of limiting the financial resources that are available to manage the post-COVID-19 recovery and other future crises.

5.5 The Financial Sector's Strategic Role in Domestic Resource Mobilisation

Notwithstanding the observed improvement in comparison with its regional peers, Tanzania's level of financial development is low given its fundamentals. While there is a gap relative to the expected levels of development for both financial institutions and financial markets, it is the latter where the difference is particularly stark.

For emerging market economies and less developed countries like Tanzania, Sahay et al. (2015) found evidence that a more developed financial system (proxied by a higher value of the financial development index) results in higher real GDP growth per capita. This relationship appears to be non-linear whereby the positive effect on GDP growth diminishes at higher levels of financial development. Further, their analysis showed that most of the growth effect in Sub-Saharan African countries comes from the support of financial institutions while that from financial markets is positive but not significant due to lack of financial infrastructure and competition. Nonetheless, the exact optimum for each country depends on several factors, including the quality of institutions, particularly those related to financial regulation and supervision: stronger institutions would allow countries to derive greater benefits. Closing the gap between actual and

predicted levels of financial development in Tanzania could boost GDP growth by up to an additional 1% while reducing growth volatility (proxied by the standard deviation of GDP growth).

There is a large literature (King & Levine 1993; Levine 1996; Levine & Zervos 1998; Rajan & Zingales 1996; Levine et al. 2000; Levine 2001, 2005; Ang & McKibbin 2007; Greenwood et al. 2013) that provides empirical evidence of a positive impact of financial development on economic growth. Generally, financial systems improve the productivity of investments through two mechanisms: (i) by assessing potential borrowers and investing in the most promising ones, and (ii) they may also provide research, assessment, and supervisory support more cost-effectively than individual investors. Thus, the improved screening of borrowers promotes efficient investments and stimulates economic growth.

Economic growth is the main indirect channel through which financial development could affect domestic resource mobilization. First of all, a developed financial system facilitates the international trade of goods and services promoting the competitiveness of companies in the international market. This results in increasing exports and imports which generate tax revenues. Moreover, financial development contributes to lower tax evasion: large companies whose financial statements are reviewed by external auditors are less likely to escape taxes. Access to loans is exceedingly difficult for companies with tax avoidance practices. Therefore, financial development encourages companies that depend on external financing to be transparent. Financial development also helps to reduce the size of the informal economy: for example, improving property registers allows borrowers to establish ownership of collateral to access credit more easily. According to Capasso & Jappelli (2013), when companies or individuals work informally, their ability to report income and assets is lower and the costs of credit are higher. Thus, as financial markets become more developed, more efficient intermediaries penetrate the market, and the costs of credit decrease, increasing the opportunity costs of operating in the informal economy. Therefore, financial development leads to formalization and encourages firms to reveal information about their income and assets to financial intermediaries and tax officials.

A stronger financial sector may also enhance the Government's sustainable fiscal borrowing capacity through a reduction of the interest rate-GDP growth rate differential as more savings would reduce the level of interest rates and more investment would increase the GDP growth rate.

5.6 Recommendations to Realise Tanzania's Financial Sector Development Potential

The Bank of Tanzania is responsible for the promotion of sound credit and banking conditions in Tanzania. The Financial Sector Development Master Plan 2020/21-2029/30 has been designed to create an inclusive and efficient financial sector. While financial access has improved due to the widespread uptake of mobile banking, financial depth and the efficiency of financial services are constrained by a lack of appropriate saving opportunities and products and also high spreads between deposit interest rates and lending interest rates. In comparison with its East African neighbours, Tanzania has the second-lowest level of financial sector development. Better financial sector development would mobilise domestic savings and investments and also increase tax revenue collection and the level of sustainable fiscal borrowing.

Access to Financial Services

- Promote the development of a regulatory framework for cross-border mobile payments.
- Promote the financial education of active and potential low- and middle-income financial service users through well-designed education programmes and awareness campaigns.
- Foster consumer protections in the access and use of financial services.

Financial Depth

- Promote the inexpensive and flexible use of technology, favourable conditions for banks to develop new products and areas of financial services and keep the legal framework open and adaptable.

- Strengthen the diversity of non-banking financial institutions through regulatory reforms in pension and insurance systems and by upgrading legislation to allow for setting up saving vehicles.
- Adopt flexible regulations for microfinance allowing for further growth and development while minimizing the spread of unlicensed institutions.
- Establish a long-term yield curve through regular auctions of benchmark instruments (government securities) and, where feasible, promote primary dealership systems with two-way pricing responsibilities to facilitate price discovery and enhanced market liquidity.

Efficiency of Financial Services

- Require banks with a high non-performing loan ratio to develop a non-performing loan strategy with time-bound reduction targets, regular reviews, and independent monitoring.
- Develop a central credit information system for sharing and verifying client credit information among various financial institutions.
- Promote insurance companies and social security schemes to mobilise long-term savings through Bancassurance and digitisation strategies.

6 Conclusions

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

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

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

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

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

- In June 2021, the Government of Tanzania announced plans to begin the construction of a delayed TZS 60 trillion liquefied **natural gas project** in 2023. The IMF (2014) estimated that **revenues may amount to an average of 1.2% of GDP** per year over the period of natural gas production.
- Monetary policy has the potential to create **additional seigniorage revenues of about 0.3% of GDP** if the inflation rate is raised from the FYDP III target of 4.4% to the East African Monetary Union target of 8%.
- The development of **the financial sector** is a strategic imperative. Bringing the sector to the expected level of development **could boost GDP growth by 1 percent** and make it more stable. Financial sector development would also promote international trade and investments, reduce tax evasion and the size of the informal economy, and mobilise domestic savings that would reduce the borrowing costs of the public and the private sector.

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

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

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