

Local Government Taxation Reform in Tanzania: A Poverty and Social Impact Analysis (PSIA)

Introduction and Key Findings

Is the objective of raising healthy local revenues at odds with those of poverty reduction and local economic development? Reforms in Tanzania's local taxation system abolished the Development Levy in 2003, and in 2004 removed a wide array of 'nuisance taxes' and radically reduced business license fees. This Poverty and Social Impact Analysis examines the distributional impacts of the reforms on households and businesses, as well as their implications for the fiscal viability of local governments. It explores:

- the changed burden of local taxation across social groups, especially on the poor and the informal sector;
- the responses of local governments to the threat of a local revenue shortfall;
- the changing relationship between local and central government brought about by the reforms;
- attitudes to taxation and tax reform on the part of the public, businesses, and local government officials;
- the prospects and mechanisms for shifting the burden of taxation to the non-poor, through means such as a property tax.

This PSIA had two principal aims:

- To assess the distribution of the tax burden across different social and income groups and business sizes before and after the reforms

- To inform other initiatives directed at fiscal policy reform in the context of Tanzania's decentralization.

Poverty and Social Impact Analysis (PSIA) is the analysis of the distributional impact of policy reforms on the well-being or welfare of different stakeholder groups, with particular focus on the poor and vulnerable. PSIA has an important role in the elaboration and implementation of poverty reduction strategies in developing countries. It promotes evidence-based policy reform options.

PSIAs typically seek to:

- Examine the assumptions underlying a specific reform
- Evaluate the potential poverty and social impact
- Assess the short-term and the long-term aspects of reform
- Provide policy options that maximize the benefit of a reform
- Involve a broad range of stakeholders in a debate of the reform being considered.

PSIA is often applied to contentious or sensitive reforms, or to reforms expected to have a large impact.

The main findings of the PSIA were that the impacts of the reforms varied between groups, but were broadly progressive for both households and businesses, with the exception of very small businesses. Councils were enterprising in replacing income lost from the development levy and market dues by intensifying collection of taxes that remained on the permitted schedule and were scarcely used before. The reforms were viewed positively by taxpayers. There was also broad support for the

idea that wealthier people should pay more tax for local services than the poor, possibly through a progressive property tax.

Research Instruments and Methodology

Fieldwork was conducted in two urban council areas (Ilala Municipal Council, Dar es Salaam; Moshi Municipal Council, Kilimanjaro Region) and one rural council area (Kilosa District Council, Morogoro Region). The choice of these councils reflected the urban emphasis of the study, the availability of existing empirical evidence on local taxation, and logistical considerations.

Field research methods and instruments were tailored respectively for urban and rural areas. The following were the main components:

- secondary data collection at council level
- key informant interviews at council, and business taxpayer levels
- household surveys in urban and rural council areas
- small business and marketplace surveys in urban and rural councils areas.

In each council, stratified sample surveys were conducted of better-off, middle income, and poorer households, and on medium-size, small, and micro-businesses. Altogether 270 households were interviewed (90 in each location, and, within each location, 30 in each income category). In addition, 58 business owners were interviewed, selected to represent three enterprise size categories.

Questionnaires focused on the categories and amounts of taxes paid by households and businesses before and after the reform, as well as attitudes toward the reform, and to taxation policy more widely. In addition, in-depth views of key informants were undertaken with local government staff and the business community regarding the current situation and the way forward for local government taxation in Tanzania.

The study faced a number of limitations: the sample points were relatively few, and are not claimed to be representative of the entire country, and the overall sample size was small. The strengths of the study included its sound methodology, the close management of the data collection phase, and the

triangulation of results from different methods and sources. The views of tax payers and council officials about the course and impact of the reforms and were given prominence. The findings are thus likely to apply more widely in Tanzania.

Context and Rationale for Reform

The Tanzania government is committed to decentralized local government, including fiscal decentralization. Local councils are responsible for the delivery of public services—including primary education, primary health, local roads, potable water, sanitation and agricultural extension. The bulk of the funding for these services comes from central government, as also do the salaries and emoluments of council civil servants.

The pre-reform tax system was characterized by multiple and complex taxes, some of which were distortionary. Variable market fees and dues distorted relative prices, small start-up businesses were taxed arbitrarily, collection costs were high relative to amounts collected, taxes were seen as unfair (the flat rate development levy was self-evidently regressive), there was little transparency regarding amounts collected and disbursed, and citizens saw little connection between tax paid and the provision of public services.

Central government intended to address these shortcomings with the reforms. The main elements were the abolition of the flat rate development levy in 2003 along with “nuisance taxes,” and the abolition of business license fees for enterprises below a certain size—and capping of those fees for larger enterprises—in 2004. After the reform, there was some uncertainty regarding the compensating payments by central government to local councils, and the steps that councils were permitted to take to develop new revenue alternatives.

Distributional Impact on Households and Businesses

The impact of the reforms varied among groups but were broadly progressive. On average, households recorded a very small decrease (0.8 percent) in overall tax payments. Nevertheless, the impact of the reforms across social groups was steeply progressive. Total taxes paid by the better off increased by 14 percent, decreased by 2 percent for the middle well-being category, and decreased by 34 percent for the poorest (figure 1).

Businesses recorded a 14 percent decrease in tax burden overall. Within this, medium businesses recorded 11 percent less tax, small businesses 36 percent less tax, and micro-businesses (under Tsh 54,000 turnover) 11 percent more tax (figure 2). The increased payment by microbusinesses (an exception to the otherwise progressive trend)

probably results from their nonpayment of previous business license fees, coupled with the wider use of other taxes (such as billboard fees) by councils after the reform: these were all imposed on micro businesses with greater vigor than were the defunct license fees.

Figure 1: Change in Taxes Paid by Socioeconomic Groups

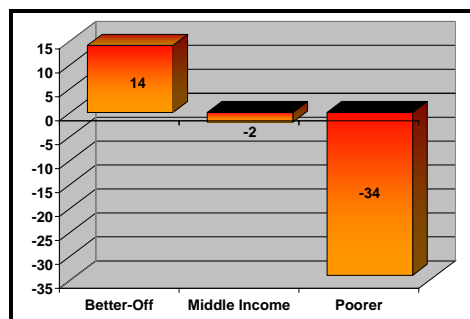


Figure 2: Change in Taxes Paid by Scale of Business

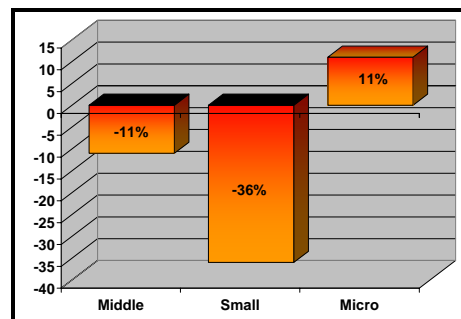


Table 1: Taxes paid before and after the reforms, by income group

Table 1 breaks down the changes in taxes paid by the three income groups by types of tax.

Tax type	Better-Off			Middle-Oncome			Poorer		
	Before	After	% change	Before	After	% change	Before	After	% change
Development levy	1,985	88	-96	2,043	426	-79	2,027	22	-99
Property tax	15,414	19,606	+27	10,711	12,491	+17	3,007	3,232	+7
Abattoir fees	0	0		14	21	+50	11	0	-100
Auction fees	0	0		0	0		0	0	
Council rents	706	1,735	+146	1,969	1,134	-42	1,752	830	-53
Business license	67,971	35,206	-49	14,319	8,106	-43	1,000	574	-43
Advert fees	1,088	1,088	0	21	0	-100	0	0	
Market fees	10,588	10,588	0	2,609	2,621	+0.5	9,193	5,359	-42
Plying Fees	47,294	75,529	+60	0	0		0	0	
Parking fees	8,471	30,024	+254	0	1,191	++	0	0	
Livestock levy	0	0		0	0		0	0	
Bicycle license	0	0		85	7	-91.8	612	37	-94
Cattle market fee	0	0		17	0	-100	0	0	
Local brew cess	0	0		0	562	++	330	1,087	+230
Forest product fees	0	0		477	2,092	+339	1,686	603	-64
Crop cess	0	0		638	0	-100	0	0	
Bus-stand fees	0	0		0	0		0	0	
Land rents	794	1,088	37	1,490	1507	+1	782	676	-14
Other	7,059	9,559	35	8,338	11580	+39	3,179	3,094	-3
Total:	16,1370	184,511	14.3	42,731	41,738	-2.3	23,579	15,514	-34

Table 2: Taxes paid by households before and after the reforms, by Council

Table 2 provides a breakdown by council in taxes paid.

<i>N=270: Tsh '000</i>									
<i>All councils</i>	<i>Ilala</i>			<i>Moshi</i>			<i>Kilosa</i>		
<i>Type of Tax</i>	<i>Before</i>	<i>After</i>	<i>% change</i>	<i>Before</i>	<i>After</i>	<i>% change</i>	<i>Before</i>	<i>After</i>	<i>% change</i>
Development levy	150	60	-60	188	3	-98.4	209	2	-99
Property tax	1,290	1,342	+4	1,052	1,468	39.5	1	0	-100
Abattoir fees	0	0		0	0		3	3	0
Auction fees	0	0		0	0		0	0	
Council rents	285	174	-39	155	45	-71	0	0	
Business license	2,187	1,308	-40	2,133	1,032	-52	62	54	-12
Advert fees	0	0	0	40	37	-7	0	0	0
Market fees	108	74	-31	394	432	+10	1,090	727	-33
Plying fees	1,608	2,568	+59	0	0		0	0	
Parking fees	252	625	+148	36	564	+1,467	0	0	
Livestock levy	0	0		0	0		0	0	
Bicycle license	0	0		0	0		71	5	-93
Cattle market fee	2	0	-100	0	0		0	0	
Local brew fee	0	0		0	0		31	181	+483
Forest product fees	0	0		0	0		226	352	+56
Crop cess	0	0		0	0		90	0	-100
Bus-stand fees	0	0		0	0		0	0	
Land fee	214	217	+1	39	43	+10	1	0	-100
Other	3,063	3,785	+24	397	507	+27	147	75	-49
Total	9,159	10,153	+11	4,434	4,131	-7	1,931	1,399	-28

Residents of Kilosa DC seem to have benefited most from the abolition of the development levy and “nuisance” taxes (a reduction of 28 percent in total taxes paid). Ilala MC residents bore steep rises in

plying and parking fees paid to Dar es Salaam CC, though these were not directly related to the tax reforms, and residents of Moshi MC recorded rises in property taxes paid to the town council.

Table 3: Local taxes paid by businesses before and after reforms, by business turnover

Table 3 shows how individual taxes have changed for the three business size groups.

<i>Tax type</i>	<i>< 54,000/- (micro)</i>			<i>54,000–156,600/- (small)</i>			<i>> 156,600/- (medium)</i>		
	<i>Before</i>	<i>After</i>	<i>% change</i>	<i>Before</i>	<i>After</i>	<i>% Change</i>	<i>Before</i>	<i>After</i>	<i>% Change</i>
Development levy	1.0	0.0	-100.0	1.1	0	-100.0	2.1	0	-100.0
City Service levy	0	0		0	0		5.1	5.1	0
Property tax	0	0		5.9	6.9	16.9	9.1	12.2	34.1
Council rents	0	0		1.3	1.3	0	17.1	0	-100.0
Business license	23.3	11.8	-49.4	41.1	15	-63.5	197.9	110.3	-44.3
Advertisement fee	0	0		2.9	2.9	0	5.4	7.3	35.2
Market fees	16.0	15.9	-0.6	23.2	18.5	-20.3	36.7	31.2	-15.0
Parking fees	0	0		0	0		0	12.9	
Plying fees	0	0		0	0		0	102.9	++
Other fees and taxes 1	3.0	18.3	510.0	32.3	24.6	-23.8	59.9	60.4	0.8
Other fees and taxes 2	0.4	2.6	550.0	0	0		64.6	10.6	-83.6
Average	43.8	48.6	11.0	107.7	69.1	-35.8	398	353	-11.3

Table 4: Local taxes paid by businesses before and after reforms, by council (Tsh '000)

Table 4. shows the changes of business taxes by council

Tax Type	Ilala			Moshi			Kilosa		
	Before	After	% change	Before	After	% change	Before	After	% change
Development levy	21.0	0	-100.0	38.5	0	-100.0	68.0	0	-100.0
City service levy	72.0	72.0	0	0	0	0	0	0	
Property tax	50.0	65.0	30.0	160.0	203.0	26.9	0	0	
Abattoir fees	0	0		0	0		0	0	
Auction fees	0	0		0	0		0	0	
Property rents	240.0	0	-100.0	18.0	18.0	0	0	0	
Business license	2,115.6	860.0	-59.3	1,557.0	1,059.0	-32.0	185.9	50.0	-73.1
Advert fees	40.0	40.0	0	75.0	102.0	36.0	0	0	
Market fees	648.0	564.0	-13.0	415.0	355.0	-14.5	757.8	863.2	13.9
Parking fees	0	180.0		0	0		0	0	
Plying fees	0	1,440.0	++	0	0		0	0	
Livestock levy	0	0		0	0		0	0	
Bicycle license	0	0		0	0		12.0	0	-100.0
Cattle Market fee	0	0		0	0		0	0	
Local brew fee	0	0		0	0		7.6	28.8	278.9
Forest Prod fees	0	0		0	0		72.0	0	-100.0
Crop cess	0	0		0	0		90.0	0	-100.0
Bus-stand fees	0	0		0	0		0	0	
Land fee	0	0		0	0		0	0	
Other	1,114.8	1,207.8	8.3	1,127.0	422.0	-62.6	0	0	
TOTAL:	4,193.4	4,425.2	5.5	3,390.5	2,178.2	-35.8	1,193.3	942.0	-21.1

All councils were enterprising in replacing income lost from the development levy and market dues by intensifying collection of taxes that remained on the permitted schedule and were scarcely used before. These include parking, billboard, and bus-stand fees. There is a risk that this strategy of diversification will

reproduce the previous multiplicity of taxes with a new array of minor (though permissible) 'nuisance' taxes. While councils are required to seek Ministry of Finance permission before implementing new taxes, this applies only to new sources of revenue not envisaged in a previous or current local tax law.

Stakeholder Perceptions: Households, Businesses, and Local Government

Households and businesspeople were asked a range of questions concerning their experience of local government, their perceptions about local taxes and tax reform, and their attitudes toward service delivery by the public sector. Both households and businesses were strongly in favor of the reforms. While businessmen were less critical

than households, responses often revealed negative attitudes toward local government's service delivery performance and accountability. Typical comments made included:

- Citizens get very little or nothing from their councils.
- The abolition of these taxes allows increased investment; previously citizens were overtaxed.
- At last the government has done something reasonable.
- More people are now free to start small businesses.
- The social disturbance due to the collection of unpopular taxes has abated – the collection of the development levy used to be accompanied by officials' brutality.
- The reform has helped in the fight against poverty.

The reservations about local government reflected in these replies coexisted with some positive perceptions. Indeed, the predominant view was one of recent improvements in service standards. Citizens' stated that by and large taxes were collected fairly, that receipts for taxes were issued, and that unofficial payments were rare in their direct experience—though informants were more sceptical in their views about corruption levels more generally. Citizens supported moving the taxation system toward greater equity. Local officials, on the other hand, felt that the way in which the reforms

were implemented disempowered and frustrated the councils, who were subsequently obliged to resort to the remaining list of permissible taxes in order to restore their revenues.

Who Should Pay Taxes?

Households were asked who should pay taxes for public services, selecting a response from “rich should pay more,” “everyone pays equally,” or “user-based charges” (Table 5). Almost one in three considered that the rich should pay more.

Table 5: Responses on Relative Wealth and Payment for Services

Who Should Pay?	Ilala		Moshi		Kilosa		All Sites	
	No.	percent	No.	percent	No.	percent	No.	percent
Rich More	29	32.2	27	30.3	26	29.2	82	30.6
Everybody or Equal	38	42.2	24	27.0	40	44.9	102	38.1
Other Replies	23	25.6	38	42.7	33	37.1	94	35.1
TOTAL:	90	100.0	89	100.0	89	100.0	268	100.0

The acceptability of user-based charges (classified under “other” in the table) may well have been higher than indicated, since many who considered that “everybody should pay” qualified their answer by saying that the more use is made of a service the more the user should pay. Overall, responses to this question showed a strong preference for progressive taxation among ordinary citizens, together with a view that all citizens should make at least some contribution to the cost of services.

Household and Business

Attitudes Towards property tax

The study revealed that a progressive property tax would command wide acceptability in Tanzania as a means of funding improved services. Two-thirds of the respondents were in favor of a residential property tax while less than one-third thought it was a bad idea, and about 5 percent did not have a view either way (Table 6). These results provide quite a powerful mandate for residential property taxes.

Table 6: Attitudes toward Residential Property Taxes

Good or Bad	Ilala		Moshi		Kilosa		All Sites	
	no.	%	no.	%	no.	%	no.	%
Good	34	58.6	47	72.3	26	61.9	107	64.8
Bad	23	39.7	13	20.0	14	33.3	50	30.3
Don't Know	1	0.1	5	7.7	2	4.8	8	4.8
Respondents No.	58	100.0	65	100.0	42	100.0	165	100.0

Sixty-two percent of business operators were in favor of property taxes. Significantly, several businesspeople said that they would be strongly in favor of all local taxes being consolidated into a single property tax.

The perceptions and suggestions of both households and business regarding local taxation are generally very encouraging. Citizens were broadly in favor of taxes being progressive (a trend which our findings show these reforms to have reinforced), considered property taxes a means of

improving the equity of local tax collection, and also emphasized the importance of the link between tax paid and services used. Citizens took a forward-looking view of tax collection as potentially leading to improving services (a finding confirming that of other studies). In all three study locations, the service priorities citizens expressed were, in order of priority: potable water supply, health, education, garbage collection, and roads. Citizen's views on progressive taxation, user fees, and residential property taxes provide important pointers for the

development of a new policy consensus on local taxation.

Council perspectives

Council officials and councilors in Kilosa, Ilala, and Moshi were almost unanimous in taking strongly negative views on the 2003 and 2004 tax abolitions. While these individuals recognized the beneficial impact on the poor and acknowledged the problematic nature of nuisance taxes, they were critical of the reforms on the following grounds.

- The legitimacy of local governments has been undermined.
- There has been a high level of local revenue loss outside metropolitan areas.
- The link between local governments and service provision has been further weakened.
- It has become more difficult to collect the taxes not abolished.
- The dependency of local governments on central government has increased.
- The reform has created confusion at the local government level in terms of what new taxes are permitted.
- The reforms have eroded the basis for citizens' voice being heard locally.

Filling the gap left by the taxes abolished has proved more problematic for rural than for urban councils, which have a broader tax base to exploit. The compensation of districts by central government may not solve this problem, both because compensatory mechanisms have not been established as a permanent formula, and because such mechanisms deepen councils' dependency on central government, undermining the spirit of decentralization. Moreover, the reforms may have adversely affected other important taxation objectives, such as stability, adequacy, and predictability of revenue, in addition to the social contract at the local level inasmuch as this is based on an association of local services provided with local taxes paid.

A minority of council officials did see benefits in the reform, which they enumerated as follows:

- The popularity of central government has increased.
- Local taxes for citizens and businesspeople have become significantly more progressive.

- Urban areas with diversified tax base have been able to adjust rapidly.
- There is evidence that tax savings have been invested in local enterprise, with a concomitant increase in microbusiness start-ups.
- The number of taxes levied has been (to a degree) reduced
- Time and resources spent on tax collection have been reduced.

A few key informants supported the deepening of property taxation. It is interesting to note the generally low levels in Tanzania of what is internationally the most common type of local council tax. In 2003, the share of property tax in average council own revenue was less than 7 percent. Many difficulties have been noted in a range of studies of property and land taxes in Tanzania. These may be summarized as

- administrative problems of collection and enforcement;
- valuation capacity and information systems;
- dispute and litigation levels in land and property ownership;
- political will.

Local Government Taxation in Tanzania: Conclusions, Policy Dialogue, and the Way Forward

The PSIA suggests or reaffirms directions in tax policy that would follow fundamental principles of good taxation, improve the links between tax collection and service delivery, strengthen the legitimacy of local councils, and be acceptable and fair to the citizenry at large. Some key policy options for consideration include:

- A simplification and consolidation of currently fragmented local taxes
- The possibility of a reformed business tax
- The amplified use of property tax, property valuation, and improvements in property tax coverage and collection
- Exploration of combining property tax and land tax regimes
- Enhanced service delivery links
- Further expansion of user fees

- A concerted effort among national and international partners to develop a strategic approach to the expected amount of local own-source revenues, the purposes to which these should be put, and the relationship to central government funding.

Policy Dialogue

This study reveals some lack of clarity and consensus about the objectives and means of fiscal decentralization in Tanzania. Debate on the PSIA findings presents an opportunity for improving dialogue in this critical area. These show that the impact of the reforms has been, by and large, positive, as far as equity and productivity are concerned. Nevertheless, the reforms removed key sources of local revenue without debate or discussion with local government, its representatives, or other key stakeholders. The suddenness, and indeed air of arbitrariness, with which the reforms were promulgated created an impression of *re-centralization* that was at odds with the spirit of local government reform and has left a legacy of ill will.

Substantively, too, the opportunity to rethink systematically the haphazard and inefficient system of local revenue collection was lost. The need now is for the development of a consensus around a broad strategic framework that will define the respective fiscal and developmental roles of local and central government within the context of decentralization. In particular, greater clarity would be beneficial with respect to the following:

- Objectives of local revenue generation
- Respective responsibilities of central and local government for service provision
- Levels of central government support to local governments (including equalization policies and criteria)
- The most efficient methods for realizing the target amount in terms of unit costs of collection
- Ensuring that the impact of tax collection on income distribution is a progressive one, so that the poor are taxed less than the better-off, and the extreme poor — those who require a safety net in bad years — are excluded from the tax net altogether.

This dialogue would need to bring together central and local government, representatives of businesses

and citizens and of taxpayers and service users, as well as international development partners. Drawing on such wide participation, the dialogue would best be facilitated by the organizations charged with taking forward local government frameworks — that is, the Local Government Reform Programme and Local Government Support Project.

Analytical Work

Policy dialogue should be informed by further analytic work. Target amounts for local revenue generation — per capita and total — can be defined drawing on existing knowledge of revenue and expenditure for councils of different types. A range of simple models of households and businesses can then be used to explore various scenarios, such as the imposition of residential and business property tax at different levels, and assess the impact of each.

More systematic modelling can be used to assess the extent which new tax options can substitute for the abolished taxes as source of revenue, taking into account the differential impact between urban and rural councils. Regarding user fees, although these emerge as an effective means of recovering operating costs, it is not yet clear whether they are a sufficient mechanism to widen access to goods and services, especially for the poor.

Georgia State University researchers are reviewing the policy framework underpinning the structure of the financing of local government and local government revenues. Other data and analytic tasks that could inform the policy dialogue as it progresses:

- Distributional data on current local tax impacts at the top of the income scale and for the largest firms. Such data seem critical to productive dialogue about future local tax policy, especially with the Ministry of Finance and the Tax Reform Task Force.
- Further comparison of the profile of receipts reported by LGAs with the reported profile of payments by taxpayers. This would indicate the degree and location of any leakage of funds.
- Gathering data from additional LGAs to remedy the small sample size of the present study.

- Research on the aggregate impact burden of taxes (and other revenue-raising measures), up and down the income and firm-size scale, including both local and national taxes and revenue-raising measures.

This list is merely an indicative one; more important than the themes of the research themselves will be the emergence from a process of policy dialogue of demands for analytic work that can contribute to the consultative development of a simple, fair, transparent, equitable, and sustainable tax system. Since there is considerable overlap among political decision makers and the class of people who own property and businesses, debate will need to broach frankly the divergent vested interests served by the

present system—including the political and social barriers to greater emphasis on property taxation, and to a more legitimate business tax—as well as the transparency of the revenue collection system.

This note was prepared as a summary of World Bank Report Number Report No. 34900-TZ. The study was supported by several trust funds, generously provided by the Governments of Germany and Belgium, as well as by DFID Tanzania and GTZ Tanzania. It was written by Sholto Cross and Frank Ellis (Overseas Development Group, University of East Anglia), Joseph Semboja, Joanita Magongo, Lucas Katera, Erasto Ngalewa, Mary Kombe and Samuel Ebeneri (Research on Poverty Alleviation - REPOA), Paul Francis, Matt Glasser and Sabine Beddies (World Bank). Additional copies can also be requested via e-mail: socialdevelopment@worldbank.org.