Local Government Taxes in Tanzania: Weaknesses of the Current System of Local Government Revenues

It is clear that there are problems with the current system of local government revenues in Tanzania. A common critique of local government revenues in Tanzania is that local government revenue sources are low yielding, inequitable, form an obstacle to local economic growth, are inefficiently administered, and impose high compliance costs on taxpayers. Based on such a negative assessment of local revenues, some central government politicians and stakeholders have arrived at the conclusion that own local government revenue sources are not a necessary ingredient for a sound system of local government finance. In fact, a “rationalization” of the local government revenue system announced in June 2003 (which included the elimination of the Development Levy as well as the abolition of a number of other minor local revenues) suggests that it proved politically expedient to accept the argument that it is easier to just eliminate local taxes and introduce compensatory grants to provide resources to the local government level, as opposed to attempting to fix the problems with the current local government revenue system.

However, most fiscal decentralization experts would argue that a well-designed local government revenue system forms an indispensable component of any local government finance system. Although the primary function of local government taxes and local non-tax revenues is obviously to provide financial resources to cover the cost of delivering local government services, there are other important reasons to provide local governments with a certain degree of revenue autonomy. For instance, unlike intergovernmental transfers, local government revenues encourage the efficient use of public resources by establishing a direct link between the benefits of a public service on one hand and the cost of providing that service on the other hand. Furthermore, local government revenues can form an important mechanism for ensuring the accountability of local government officials toward their local constituents. Other advantages of increased local revenue autonomy include the development of creditworthiness and an
An effective way to address vertical imbalances against local governments in the intergovernmental finance system.

This chapter considers the shortcomings of the current system of local government revenues in Tanzania. For this purpose, the chapter is divided into five sections. First, Section 4.1 explores the characteristics of a sound revenue assignment, recognizing that public finance theory and international practices suggest that some taxes are best collected at the national level, whereas other revenue sources are good candidates to be administered at the subnational level. Subsequently, we turn our attention to revenue assignments in Tanzania. Sections 4.2 and 4.3 respectively provide an overview and an assessment of the current local government revenue system in Tanzania. Section 4.4 considers the relationship between local tax administration and the efficiency of the local government revenue system. Section 4.5 highlights the need to transform the system of local taxation and provides some concluding remarks. Subsequently, Chapter 5 presents the main outlines of a proposed transformation of the local government revenue system in Tanzania.

4.1 Principles of a sound revenue assignment

In order for local governments to exercise a degree of fiscal autonomy consistent with a fiscally decentralized government structure, local governments must control some own sources of revenue. In this regard, the key policy question is: which taxes should local governments levy and how? This question is commonly referred to in the decentralization literature as the “revenue assignment question” (McLure, 2000).

Objectives of revenue decentralization and local taxation

The assignment of taxes in a decentralized system of finance must decide three types of issues. First, what level of government will be granted legal powers to introduce new taxes or change their structure in terms of the definition of tax bases and the determination of tax rates? Second, how will the revenues from different taxes be shared, if at all, among the different levels of government? Third, what level of government will be responsible for the administration and enforcement of the different taxes? This section mostly focuses on empowering local governments with the discretion to introduce own source taxes and other revenue instruments, including setting their rates and bases. Of course, revenue assignments are not a stand-alone issue; it should be seen as an element that must interact and be compatible with the rest of the design of a decentralized system of finance and more generally with the design of the entire fiscal system of a country.

Criteria that should guide the assignment of revenue sources across different government levels in a country reflect a dual role of taxes. First,