

REVENUE ANALYSIS IN A DECENTRALISED CONTEXT

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1.0 **INTRODUCTION:**

- 1.1 Fiscal decentralization is often implemented as part of a much wider devolution of political powers to lower (local) levels of Government. Such devolution of powers arises out of recognition that political and administration systems operating closest to the beneficiaries are more likely to respond effectively to their needs and preferences. This therefore increases the overall welfare of the community, which has political and economic benefits.
- 1.2 However, decentralization taken to the extreme would generate negative effects, arising from loss of economies of scale in the provision of some services like defence and macroeconomic management. It could also have adverse effects on national unity! Decentralisation is therefore a matter of relativity, which each country exercising some degree of it, depending on the economic and political realities and preferences.
- 1.3 The term "Fiscal Decentralisation", (or Fiscal Federalism) refers to the manner in which rights to revenues and expenditure obligations are shared amongst different levels of government. Since revenue and expenditure are two sides of the same coin, they are closely related. However, we will only discuss revenue sharing in this session.

2.0 **PRINCIPLES FOR REVENUE SHARING:**

2.1 Through practice over years, there have emerged a number of principles for sharing revenue for different levels of government, or assigning revenue raising responsibilities.

(a) **Taxes for Central Government:**

- (i) Taxes on mobile bases e.g. Motor-vehicle taxes;
- (ii) Taxes on income, or sensitive to changes in income;
- (iii) Taxes on unevenly distributed bases (eg natural endowments)

(b) **Taxes for Local Governments:**

- (i) Taxes on fixed (non-mobile) bases eg. Property Tax;
- (ii) Taxes with low income elasticity;
- (iii) User charges and fees for services provided by the local government.

2.2 In Tanzania, there has been considerable overlapping of taxes i.e. taxes have been imposed on the same base by more than one level of government. Until recently, for example, both the Central Government and some Local Government Authorities (LGAs) levied a tax on the income of employees and the self-employed. Also, different LGAs could impose a levy on a product (natural or manufactured) as it moves through the distribution chain. Tanzania also has a system whereby different levels of government share the proceeds from a single base, e.g. Land Rent.

3.0 **CENTRAL GOVERNMENT TRANSFERS:**

- 3.1 As seen above, the decision for assigning revenue sources is generally based on the assessment of the extent to which the tax has localised or macro effects, and which level is better placed to formulate appropriate policies in relation to the base and effect those policies. On the other hand, expenditure responsibilities are generally assigned on the basis of capacity to assess beneficiary preferences and respond effectively. This leads, almost always, to a mismatch of resources and expenditure requirements at the local government level, calling for fiscal transfers from the centre to local levels.
- 3.2 Fiscal transfers are also necessary to equalise, or at least approximate, the level of social services across regions, given that different regions are differently endowed and have different capacities for generating own-revenues.
- 3.3 There are two broad categories of transfers – revenue sharing and grants. Revenue sharing refers to a situation where tax is imposed on a base and collected by one level of government (usually the Central Government), and the proceeds shared by the different levels on the basis of a pre-determined formula. Examples in Tanzania include the Land Rent and Service Charge, which is shared 20% and 80% for the Central and Local Governments respectively. Until recently it also applied to licence fees.
- 3.4 Grants come from the resource base of the central government, and are paid to the local government levels to enable the later

bridge the deficit in their expenditure budget. Grants may be conditional (i.e. funds can only be used for the specified purpose), or general (i.e. unconditional), availed for the recipient authority to spend as it wishes.

- 3.5 Revenue sharing and grant systems are usually used together, with wide variations in their dominance from one country to another. Revenue sharing provides an incentive for all levels of government to increase revenue collection, as it has a direct bearing on their resource base. On the other hand, it has a higher potential for variations across regions. Except where complex formulas are used, grants have almost the opposite effect.
- 3.6 Three important issues arise in considering the formula to apply in effecting inter-governmental transfers: predictability, accountability, and equity. For lower level authorities, planning may be hampered by the lack of sufficient certainty as regards resource availability in the medium term. In this case, revenue sharing may be better for them. Also, local communities will play a more active role in holding local government officials accountable for their expenditure programmes if resources are raised at that level. However localised resource mobilisation and expenditure practices could lead to huge developmental differences among deferent parts of the country, and to social tensions as a result.
- 4.0 **OWN SOURCES:**
- 4.1 In addition to resources transferred from the Central Government, local governments generate revenue from own sources. Own sources reflect local decisions on the exercise of taxing powers. In Tanzania, these are generally a small percentage of the District

Councils' annual expenditure, indicating the level of dependence on Central Government transfers. In a survey of a sample of local Authorities covering the period 1995 to 1999, own sources were found to account for an average 25% of their total budgets.

- 4.2 A major issue in Tanzania is the capacity of local Governments to formulate and implement revenue policies. The multiplicity of levies and fees, and the use of uneconomical rates, point to the likelihood that the economic and social impacts of the taxation regimes are not thought through. On the other hand, revenues almost always fall far below projections in almost all Councils. In the survey referred to above average performance for five Municipal Council¹, and eleven District and Town Councils was 67% of targets. There are also wide spread complaints about malpractices by revenue collectors in administering local government taxes.

5.0 **CONCLUSION:**

- 5.1 Fiscal decentralisation is both a political and economic management issue. The different dimensions need be carefully balanced and implemented if it is to be welfare enhancing for the affected communities.
- 5.2 Several studies undertaken in Tanzania suggest low capacity for revenue policy formulation and implementation at the local governments level. This explains, at least in part, the recent tendency for centralizing taxing powers and resorting to fiscal transfers.

¹ Mwanza (Municipal), Mbeya (Municipal), Tarime, Mpwapwa, Kilosa, Geita, Musoma (D), Morogoro (Municipal), Moshi (D), and Mbinga

- 5.3 Given that Tanzania has a Poverty Reduction Strategy (PRS) based on very wide consultations and containing the basis for national standards for service provision, and that expenditure responsibilities for different levels have been clearly assigned, there is an opportunity for a less controversial formula for determining grants to lower levels. The debate should be on how the PRS could be used for this purpose.
- 5.4 Finally, the question remains: Considering all the factors – political and technical – what is the appropriate level of fiscal decentralization for Tanzania? May be we'll have the answer after this programme.