

Dependency on Foreign Aid: How the situation could be saved.

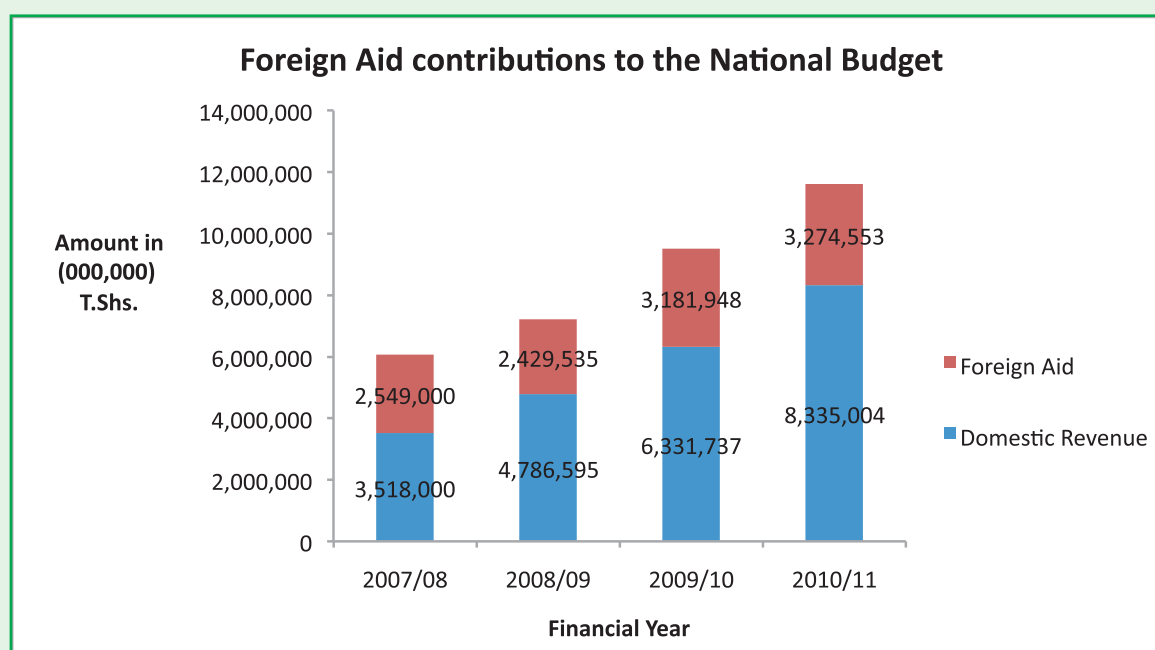
An analysis of Tanzania's Budget 2010/2011

Since independence, Tanzania has been heavily dependant on foreign aid to the extent of being regarded as the “darling” of the donor community .In recent years, however the government has proclaimed its intentions to reduce dependency of foreign aid . This brief examines whether this intention is being met by analyzing the composition of aid in the budget for this and previous financial years and makes recommendations on how to reduce aid dependence.

Foreign Aid contributions towards the National Budget

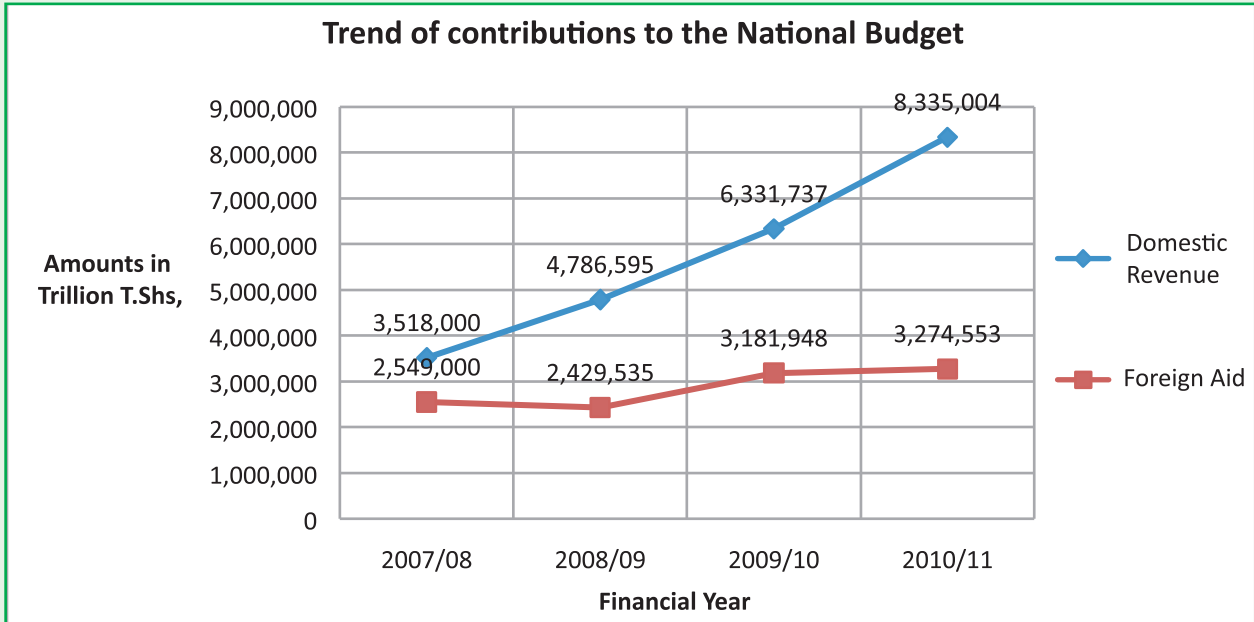
Tanzania's budget for financial year 2010/11 is 11.6 trillion Tanzania shillings. This amount comprises both revenue to be collected internally (8.33 trillion Tanzania shillings) and foreign aid (3.27 trillion Tanzania Shillings). On the whole foreign aid makes up a total of 28.2% of this years national budget. This is a significant contribution as it implies that close to one third of the governments priorities cannot be met without foreign aid contributions. This shows the extent to which our national budget is dependent on foreign aid. The chart below shows the extent the national budget has been dependent on foreign aid over the past four years.

Financial Year	Domestic Revenue (000,000)	Foreign Aid	Overall Budget
2007/08	3,518,000	2,549,000	6,067,000
2008/09	4,786,595	2,429,535	7,216,130
2009/10	6,331,737	3,181,948	9,513,685
2010/11	8,335,004	3,274,553	11,609,557



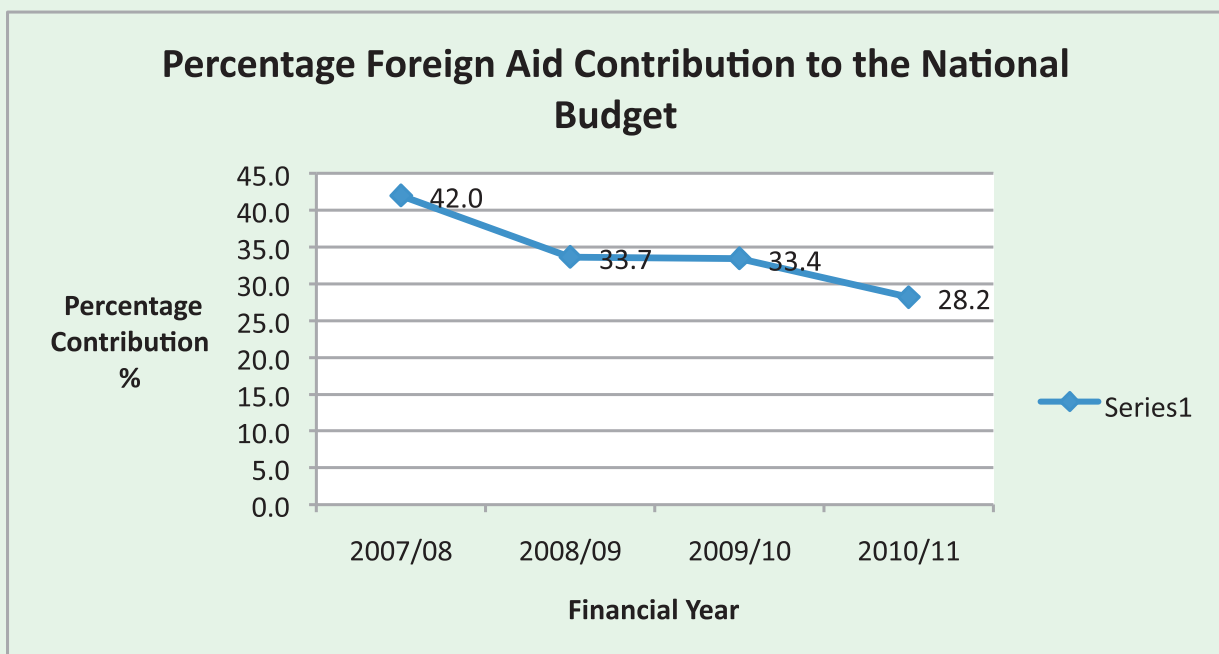
The trend of Domestic *versus* Foreign Aid Contributions to the overall budget

A quick glance at the graph will portray an almost constant trend of foreign aid contributions to the national budget. However, a critical comparison of the rate of increase of the overall budget compared to foreign aid contributions will reveal that there is a gradual tendency in the direction of depending more on domestic revenue than on foreign aid. This is portrayed in the graph below:



This also means that the percentage contribution of foreign aid to the overall national budget has been decreasing by the year as is portrayed in the table and graph below.

Financial Year	2007/08	2008/09	2009/10	2010/11
Percentage Contributions	42.0	33.7	33.4	28.2



Among the factors that have contributed to this trend of increased domestic revenue collection are:

- Reform of the tax structure including amending laws that have reviewed the rates for various taxes, fees, levies and charges under different revenue laws,
- Simplifying tax administration and the revenue collection systems both at national and local levels,
- Selling of matured government bonds and increased domestic borrowing,
- Expanding the tax base and identification of new sources of revenue,
- Strengthening the administration of tax exemptions with a view to reducing them and enhance administration tools. (*Budget speeches 2007/08 – 2010/11*)

Extent to which revenue lost could be reversed to cut-down the dependency syndrome

1. **Curb tax exemptions:** Tanzania is proliferating with tax exemptions to corporations. Over the past four years, the increasing levels of tax exemptions have contributed to low revenue collection and thus weakened government ability to finance social economic infrastructure thus reducing the pace of improving the lives and wellbeing of citizens. Tax exemptions have been increasing each year reaching an average of 30% of total tax revenues. Tax exemptions have been seen to create loopholes for tax evasion and revenue leakage – which revenue would otherwise have been used to reduce the Government’s dependence on foreign aid.¹
2. **Mobilising domestic revenues through tax reform:** growth of domestic revenue should be a key element of reducing dependence on aid. While in industrialised countries the total tax revenue as a percentage of Gross Domestic Product (GDP) is at around 40-45%, the figure is at 16% of GDP for Tanzania in 2010 according to the Finance Minister’s speech in June 2010 (other sources put it at 13%).² To increase this ratio and tax revenues in general, reform of the tax system including building the capacity of the tax administration is necessary. For instance, as Ghana illustrates, increasing the direct income tax, reducing the indirect tax (such as the value-added tax), and decreasing dependence on import and export duties, has helped boost total tax revenues and made taxes more comfortable to the poor.³
3. **Increasing revenue streams at local level:** Having a mechanism for incentivising local authorities to improve on own-source taxation can help raise more revenues for the government. For example, a local council’s share of the disbursement from the central government can increase as a result of increased own-source revenues. Another way of incentivising local authorities to collect more tax, as done in Asian countries such as Indonesia, is by disbursing funds based on the variation between financial needs of the authority and its collection performance. This gives the local authority incentives to collect more revenue so as to close the gap.⁴

¹ TWaweza (2010) Tanzania Tax exemptions: are they too high and making us too dependent on foreign aid?

² Heritage Foundation (2010), Index of Economic Freedom. <http://www.heritage.org/Index/Country/Tanzania#fiscal-freedom>

³ Shenggen Fan, Anuja Saurkar, and Ghada Shields (2009) , How to Mobilize Public Resources to Support Poverty Reduction in 2020 Focus briefs on the world’s poor and hungry people

⁴ Taliercio, Robert, “Subnational Own-Source Revenue: Getting Policy and Administration Right” in East Asian Decentralizes. Washington, DC: World Bank, 2005.

- 4. Reducing the tax burden:** Domestic tax policy should be geared towards improving the tax burden. In Tanzania, there is consensus that the government is raising revenue from a limited number of sources such as Value Added Tax and Pay as You Earn (PAYE) and that these sectors are already overtaxed and that no further taxes can be imposed in these areas without worsening the rising costs of living and degenerate living conditions.⁵ One way of addressing this is by increasing the formalisation of the workforce currently existing outside recognized structures. If we are to continue to greatly rely upon PAYE, then the pool of people to be taxed has to increase. This in the long run will help raise revenues and reduce the burden on the few.

Conclusion

In view of the above, it can be concluded here that a lot of revenue that would otherwise have been used to contribute towards domestic revenue is lost in tax exemptions in the various ways they are applied. Although the trend of budget contributions is such that domestic revenue contributions are rising at a higher rate compared to foreign aid contributions over the last four years, there is still need to gradually cut down foreign aid dependence through, among others, the collection of revenues lost in tax exemptions.

Recommendation

Dependence on aid can have negative effects on country's planning Aid is much more unpredictable than revenues and the volatility of it increases with the degree of aid dependence.⁶(Bulir and Hanman, 2010) Also development programmes can be affected should aid inflows decline and growing dependence on aid reduces incentives for government to adopt appropriate policies (Azam, devarajan, and O'connal, 1999). Besides tax exemptions have a risk of benefiting a few well connected and powerful interest groups rather than small enterprises.

Hence, it would suffice to recommend here that a thorough review of the Government's policy on tax exemptions coupled with good administration of the same would ensure more domestic revenue collected to contribute towards the national budget. Ultimately, this will lead to a reduction in foreign aid contributions towards the national budget over time. This way the Government would make strides towards becoming self reliant.

⁵ Policy Forum (2009) How much revenue are we loosing? Source: <http://www.policyforum-tz.org/files/Howmuchrevenuearewlosing.pdf>

⁶ Bulir and Hanman, 2010 – Volatility of Development Aid: From the frying pan into the fire, IMF – Washigto DC, USA



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