AgEcon SEARCH
RESEARCH IN AGRICULTURAL & APPLIED ECONOMICS

The World's Largest Open Access Agricultural & Applied Economics Digital Library

This document is discoverable and free to researchers across the globe due to the work of AgEcon Search.

Help ensure our sustainability.

Give to AgEcon Search

AgEcon Search
http://ageconsearch.umn.edu
aesearch@umn.edu

*Papers downloaded from **AgEcon Search** may be used for non-commercial purposes and personal study only. No other use, including posting to another Internet site, is permitted without permission from the copyright owner (not AgEcon Search), or as allowed under the provisions of Fair Use, U.S. Copyright Act, Title 17 U.S.C.*

Feed the Future Innovation Lab for Food Security Policy

Policy Research Brief 2 October 2014

Tanzania

Agricultural Produce Cess in Tanzania: Policy Options for Fiscal Reforms

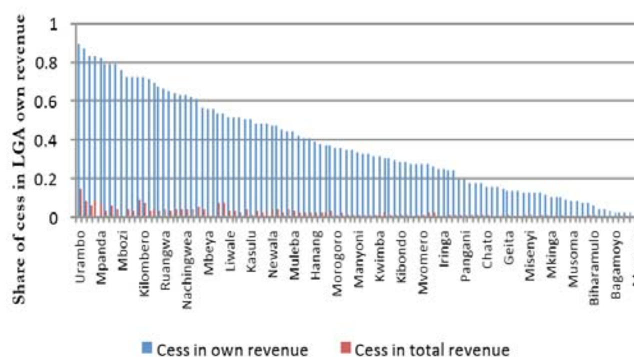
Rural taxation policy is a major issue in many countries of Africa as they pursue more decentralized forms of governing and at the same time work to enhance the effectiveness, efficiency, and fairness of their tax systems. Tanzania has struggled with this issue since at least 1962, when it expanded countrywide the limited decentralization that had occurred under the colonial regime, then abolished LGAs in 1972 in favor of "Madaraka Mikoani", only to then rein- state them and enshrine them in the constitution in 1984. With wide powers to set tax policy and practice at local level, made possible by the Local Government Finance Act (LGFA) of 1982, Tanzania soon experienced a dizzying array of taxes and fees, with dramatically differing rates across LGAs. The situation became so extreme that some claimed that Tanzania by the late 1990s had "about 110 local authorities … each with a different tax system" (Fjeldstad and Semoja 2000). A sustained effort at reform culminated in 2003, when the "head tax" and a series of "nuisance taxes" were abolished, and the produce cess was limited to a maximum of 5% (compared to rates as high as 20% in the past).

Though the resulting system of local taxation is substantially less complex, less variable across LGAs, and less onerous than it was prior to these reforms, important problems remain, and stakeholder demands for further reform have been growing. Since the produce cess became the most important source of local revenue after 2003, much of the demand for reform has focused on it. In response to these concerns, GoT included a commitment to "reduce or abolish" produce cess when it signed the G8's "New Alliance for Food Security and Nutrition" declaration.

The policy brief draws on a study that took advantage of a newly available database of LGA revenue and expenditure and complemented it with fieldwork in 27 LGAs with varying levels of reliance on the produce cess. Its overall purpose is to generate new empirical understanding that contributes to the on-going debate on produce cess and that informs the GoT on pros and cons of potential options for reform.

Key new findings include:

1. Dependence on the produce cess varies widely among rural LGAs, from 0% of total locally generated revenue in Ngorongoro to 90% in Urambo;
2. Relative to the value of their marketed production, traditional export crops generate more than three times as much cess revenue as do food crops;
3. Much potential cess revenue goes un- collected: nationally, LGAs collect not more than one-quarter of the revenue that is potentially available to them from produce cess charges. This low level of collection reflects both limited human and institutional capacity at local level and widespread tax evasion, some of it likely featuring the collaboration of some local officials;
4. Because it is charged on the gross value of production, current cess rates can result in very high tax (even confiscatory) on net revenue among farmers that use a large amount of inputs but experience small net margins;



Much potential cess revenue goes uncollected

FEED THE FUTURE The U.S. Government's Global Hunger & Food Security Initiative
USAID FROM THE AMERICAN PEOPLE
MICHIGAN STATE UNIVERSITY
INTERNATIONAL FOOD POLICY RESEARCH INSTITUTE IFPRI
UNIVERSITEIT VAN PRETORIA UNIVERSITY OF PRETORIA YUNIBESITHI YA PRETORIA

Confirmed previous findings include:

1. With the reforms of 2003, local revenue fell sharply as a share of total LGA revenue, from 20% to a current level of 7%. Central government transfers provide the rest. Such a low share of locally generated revenue makes meaningful decentralization quite challenging.
2. Nationally, cess contributes only 1.8% of total LGA revenue, with other local taxes accounting for 5%;
3. Yet cess is the largest source of rural LGA own revenue, at 43%. Because this revenue is very flexible (it does not come with the spending dictates that accompany central government transfers), it is highly valued by local authorities, and is largely used for Councilor allowances and other "costs of doing business";
4. Cess rates are highly variable across LGAs, varying by a factor of as much as four (Beans in Handeni at Tshs 1000/bag vs. Lushoto at Tshs 4000/bag);
5. Tax evasion is widespread and likely a more serious problem than tax avoidance;
6. But avoidance – farmers or traders or others changing their production and marketing be- havior due to the tax (and especially due to the variation over space in tax rates) – can be a serious problem in particular instances. For example, some sugarcane growers in Mvomero are considering shifting their farming activities to Kilombero due to lower cess rates in the latter; and farmers and traders report that traders favor some districts over others in their food trade due to differences in cess rates.

Reform options include:

1. Abolish cess in one step
2. Gradual phasing out of cess
3. Reduce the cess rate, broaden its base, and improve capacity for collection
4. Institute a differential cess for food- and non-food crops
5. Completely remove cess in food crops, leaving it only for traditional and other export crops

Based on the analysis in the paper, and in keeping with the view that improvement in tax systems is a long-term process featuring continuous, incremental improvement, the report suggests that option 3 – reducing the rate of the cess (thereby reducing its variability over space), broadening its base, and working continuously to improve the human and institutional capacity of LGAs to collect taxes in efficient and fair fashion, is likely to be the best option for Tanzania. This option might include differentials in stipulated cess rates between cash- and food crops. Piloting of technological and institutional innovations such as the use of mobile money for cess payment are proposed as one way to address both the inadequate local capacity and the scope for corruption in cess collection.

Funding for this project was provided by the Innovation Lab for Food Security Policy and the United Republic of Tanzania Ministry of Agriculture, Food Security and Cooperatives.

This research is made possible by the generous support of the American people through the United States Agency for International Development (USAID) under the Feed the Future initiative. The contents are the responsibility of study authors and do not necessarily reflect the views of USAID or the United States Government

Copyright © 2014, Michigan State University and Bill and Melinda Gates Foundation. All rights reserved. This material may be reproduced for personal and not-for-profit use without permission from but with acknowledgement to MSU and the United Republic of Tanzania Ministry of Agriculture, Food Security and Cooperatives.

Published by the Department of Agricultural, Food, and Resource Economics, Michigan State University, Justin S. Morrill Hall of Agriculture, 446 West Circle Dr., Room 202, East Lansing, Michigan 48824