Creating Fiscal Space for Social Sectors Development in Tanzania

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Abstract

This paper discusses fiscal space creation and use in the context of development of social sectors in Tanzania. The paper observes that Tanzania is making good progress in creating and using her fiscal space. The priority being accorded to social sectors, especially in education and health is in the right direction. However, weaknesses in tax administration, imprudent tax exemptions, high debt service, excessive reliance on external funding, and high administrative expenditures dampen the robustness of the fiscal space. In this regard, the paper argues that there is a need for creating additional fiscal space through re-prioritization of spending, especially by reducing the size of government, scaling up mobilization of domestic revenue, including reducing or eliminating tax exemptions, broadening the tax base and reducing external debt to sustainable levels. In tandem, the available fiscal space has to be used more effectively and efficiently, and progressively increasing social sector's funding to meet internationally agreed commitments and targets.

Key words: Fiscal space, social sectors' development, education, and health

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1.0 Introduction

The well being of the Tanzanian population is affected by fiscal policy decisions that determine the level and progressivity in revenue generation and public spending, and external economic forces such as terms of trade or influence by donors. Effective revenue mobilization is crucial for creating fiscal space essential for a sustainable budgetary room, particularly to support efforts directed at achieving price stability, full employment and equitable economic growth. Equally important is how the revenue is obtained and spent. If a larger portion of the revenue is obtained through domestic resource mobilization, the fiscal space tends to be sustainable (and vice versa). If spending is effective, efficient and accountable, society tends to achieve greater value for money and the fiscal space tends to achieve faster growth, thus becoming more effective in efforts directed at reducing poverty.

Heller (2005) defines fiscal space as “the availability of budgetary room that allows a government to provide resources for a desired purpose without any prejudice to the sustainability of a government’s financial position.” Roy and Heuty (2005) on the other hand, define fiscal space as “concrete policy actions for enhancing domestic resource mobilization, and the reforms necessary to secure the enabling governance, institutional, and economic environments for these policy actions to be effective.” The emphasis on domestic resource mobilization in this definition shows that, ultimately, the sustainability and solvency of an economy depends on several things, including (i) the extent to which domestic financing mechanisms are able to support public expenditures, and (ii) the fact that the mobilization of fiscal space in a sustainable manner is a function of the political economy context within which fiscal space is secured.

According to Roy et al. (2006), governments can create fiscal space through the following types of fiscal instruments which are also illustrated by the fiscal space diamond in Figure 1:

- Oversees Development Assistance (ODA) through aid and debt relief.
- Domestic revenue mobilization through improved tax administration or tax policy reforms.
- Deficit financing through domestic and external borrowing, and
- Reprioritization and raising efficiency of expenditures.

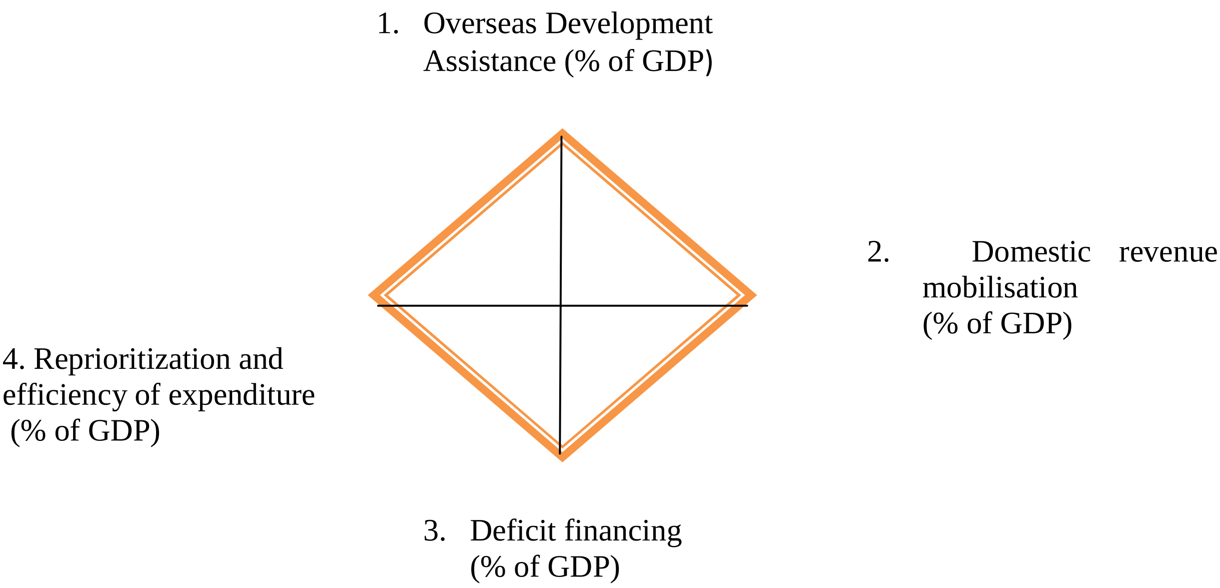


Figure 1: The fiscal space diamond

Source: Roy et al. (2006).

Roy et al. (2006) observe that a government can enhance fiscal space for human development through more effective tax and expenditure policies. Various options for increasing and using fiscal space are also provided in UNDESA (2007), including the need for Less Developed Countries such as Tanzania to increase the proportion of its domestic revenue to Gross Domestic Product (GDP) to sustain increasing expenditures.

Tanzania is committed to support social sectors' development in order to advance human development. The commitment is manifested through ratification of various international conventions and development of sound domestic policies. Regional commitments that obligate African countries to invest in social sectors include:

- Education: Dakar Education for all Declaration of 2000 – 20% of government expenditure for education (World Education Forum, 2000).
- Health: Abuja Declaration on HIV and AIDS, Tuberculosis and other related infectious diseases of April 2001: signatory countries pledged to spend 15% of their national budgets on the health sector (Organization of African Union (OAU), 2001).
- The Abuja Commitment to Action of May 2006: signatory countries pledged to target universal access to HIV and AIDS, Tuberculosis, and malaria treatment, prevention and care by 2010 (Abuja Conference, 2006).
- Social protection: 4.5% of GDP for Social Protection (OAU, 2008a).
- Water and Sanitation: eThekwini Declaration (2008): 0.5% of GDP for Sanitation and Hygiene (OAU, 2008b).

Despite been a signatory to these international agreements, the government has not met its commitments supposedly due to tight budget constraints. In 2009, real GDP of Tanzania grew by 4.5% compared with 7.1% experienced in 2008 and 2007. However, the Household Budget Survey (HBS) indicates that between 2001 and 2007, poverty declined marginally across the country. In mainland Tanzania the poverty headcount ratio declined by only 2.2% from 35.6% in 2000/01 to 33.4% in 2007 (United Republic of Tanzania, 2008). The rate of decline in poverty was more in urban areas than in rural areas. Thus, members from relatively poor households (most in rural areas) are less likely to receive appropriate treatment for illness, to go to schools which give quality education and to access safe water. Hence they are more likely to have health problems, to be illiterate and voiceless and ultimately to remain poor.

In order to achieve the social sector targets stipulated in the agreements listed above, the government needs to mobilize and use resources effectively. This paper systematically analyzed the fiscal space and budgets in Tanzania in order to identify areas in which more resources could be created in supporting social sectors development. Specifically, the following questions are addressed by the analysis presented in this paper;

(i) How fiscal space has been created and used to support social sectors development?
(ii) What are the main constraints in creating and using fiscal space?
(iii) Is there room to manoeuvre in order to achieve more desirable outcomes from social sectors?

The methodology used includes an evaluation of the tax effort (Mondiale, 2004 for details of this method) and an analysis of the uses of the fiscal space. Data supporting our analysis are derived from the Bank of Tanzania (BoT), Ministry of Finance (MoF), World Bank, International Monetary Fund (IMF) and other publications particularly on how Tanzania's fiscal space is created and used. Purposeful interviews and focus group discussions with public and private stakeholders in the social sectors such as education, health and water were held in order to obtain some views on how the fiscal space can be reprioritized for better outcomes in social development.

2.0 Social budgeting

Social sectors development is the public domain for many countries. Supporting these sectors is enshrined in the concept of social budgeting which is a process by which society's goals and priorities, as well as the rights of all of the population, are better reflected in public policy making, notably in the government budget (UNICEF, 2010). It further advocates four key principles for attaining sound social budgeting, namely: equity, efficiency, accountability and stabilisation. These principles are briefly discussed below:

Equity: Equity refers to the quality of being fair and just. In this regard, budgets should emphasize non-discrimination, social inclusion, and an attention to power relations. This implies ensuring that people with disability, children, women, and poor households are not marginalized in both the actual public sector allocations as well as in the decision-making processes. In order to achieve this principle several researchers (Budlender, 2008; Cagatay, 2000) suggest democratizing the formulation of macroeconomic policy frameworks and ensuring Gender Responsive Budgeting process.

Efficiency: Efficiency requires that budgets raise revenues, allocate resources, and achieve outcomes with the least distortions and costs. The principle of efficiency has several considerations. Achieving technical efficiency implies producing the maximum level of output using available resources at minimum cost. In terms of debt management, efficiency means borrowing funds at the lowest possible cost (Shah, 2007). Efficiency in allocation refers to how resources are distributed among competing needs, such as by spending more on cost-effective interventions that have a greater chance of achieving desired objectives and goals.

***Stability/sustainability*:** An analysis of stability involves assessing whether budget decisions are supporting sustained and long-term objectives as well as reflecting pro-poor policies and outcomes. Stability also is reflected in having sufficient social protection safety nets during periods of economic volatility. Contributing to stability would therefore involve securing adequate resources to sustain investments in the social sectors and promote social protection, notably during times when they are most needed, for example, during crises and economic downturns.

***Participation and accountability*:** Participatory decision-making process is necessary so as to ensure everyone has a voice. Citizens voices and participation in the policy making process helps in the realization of the right to non-discrimination, the right to legal remedies if one‘s rights are violated, and the right to participation in the making of policies or laws that affect one's rights (UNICEF Canada, 2008; Shah 2007; Malena et al., 2004).

In order to achieve the preceding principles, sound social budgeting system demands that there should be fiscal discipline in the level and amount of resource use as well as efficiency in allocation and spending to achieve intended results. Generally, total spending must match the existing sustainable growth policies and strategies, while allocation of resources has to be linked to strategic priorities. How well the resources are used will critically affect results and outcomes of the spending, particularly the attainment of intended delivery of goods and services.

In this paper we also underscore the fact that effective social budgeting is contingent upon conducive macro environment that enables the sustainable fiscal space to be created and effectively used. Results from cross-country regressions (Easterly and Kraay, 1999) suggest that growth, investment, and productivity are positively correlated with macroeconomic stability. These observations are also elaborated in International Monetary Fund—IMF (2000) study which shows the poor and disadvantaged tend to benefit more from a sound macro environment. The IMF paper provides examples which include the relationship between infant mortality rates and per capita income, the ratio of female to male literacy and per capita income, and average consumption and the incidence of income poverty, which all show positive social development with an improved macro environment.

The aforementioned observations notwithstanding, there is no automatic link between economic growth and social well-being. The literature shows that in order for economic growth to translate into social well-being (Ranis et al., 2000):

- The growth has to be accompanied by an equitable distribution of income as the most effective means of sustained human development (e.g. The Republic of Korea).
- Countries can make significant improvements in human development over long periods - even in the absence of good growth or good distribution – through well-structured social expenditures by governments (Botswana, Malaysia, Sri Lanka, Chile and Costa Rica).
- Human development may not improve significantly if the distribution of income is bad and if social expenditures are low (Nigeria and Pakistan) or appropriated by those who are better off for example in Brazil.

To sum up, a stable macroeconomic environment is essential for fostering economic growth, which in turn can have positive effect on reducing poverty. However, for this to happen, the growth must be pro-poor and equitable.

3.0 Analysis of the fiscal space

3.1Sources and uses of fiscal space

The government of Tanzania has been making commendable progress in creating and using fiscal space over the past decade or so. Table 1 shows the sources and uses of fiscal space for the last six financial years. Overall, the main source of fiscal space which is domestic revenue mobilization has improved. For example, during FY2002/03-FY2008/09 sources of fiscal space resulted in an increase of fiscal resources by 9.1% of GDP, of which 56% was generated by higher domestic revenues, 18% from domestic borrowing and the remaining 26% through a combination of foreign grants and foreign credits. This favourable trend is due to an increase in number of large tax payers and improved tax administration. Similarly, during FY2009/10-FY2011/12 sources of fiscal space resulted into an increase of fiscal resources by 2.5% of GDP, of which 68% was generated by higher domestic revenues, 2% from domestic borrowing and the remaining 30% through a combination of foreign grants and foreign credits. Domestic revenue performed well during this period partly because of closer monitoring of monthly collections by Tanzania Revenue Authority (TRA), higher recovery of tax arrears and strengthened tax audits to improve compliance.

Table 1: Sources and uses of fiscal space

Description	2002/03-2008/09	2002/03-2008/09	2005/06-2008/09	2005/06-2008/09	2009/10-2011/12	2009/10-2011/12
	As % of GDP	As % of Total	As % of GDP	As % of GDP	% of GDP	As % of GDP
Sources of fiscal space	9.1	100	1.9	100	2.5	100
Domestic revenue	5.1	56	3.5	189	1.7	68
Domestic borrowing	1.6	18	-0.5	-29	0	2
Grants	0.3	3	-1.3	-70	0.6	24
External financing	2.1	23	0.2	10	0.1	6
Uses of fiscal space	9.1	100	1.9	100	2.5	100
Recurrent expenditure	4.1	45	-2.4	-128	0.7	27
of which: - wages	2.4	27	2.1	114	-0.3	-11
- other current spending	1.7	18	-4.5	-243	1	38
Development expenditure	5	55	3.8	206	1.6	65
Interest payments	0	0	0.4	22	0.2	8

Source: World Bank, (2011).

Evaluation of the uses of fiscal space (Table 1) shows that 45% of the additional resources were used for recurrent expenditures and 55% for development expenditures. A large part of the recurrent spending was allocated to wages and salaries during the period FY2002/03-FY2008/09. During the three year period ending FY2008/09, recurrent expenditures were suppressed, except for wages and salaries in order to provide room for increasing capital spending. This enabled development expenditures to be increased by 3.8%. In FY2009/10-FY2011/12, the use of fiscal space contained wage growth and increased further development and other recurrent expenditures such as maintenance for the road sector and agricultural spending, while improving the quality of services in the social sectors. Focus group discussions and interviews conducted as part of this study applauded the priority being accorded to improve the quality of social services, especially in health and education and the road infrastructure.

International experience from various countries shows that in order to create sustainable fiscal space, the tax system should have the following key elements (Tanzi and Howell, 2000);

- A broad-based consumption tax, such as a Value Added Tax (VAT), preferably with a single rate, minimal exemptions and a threshold to exclude smaller enterprises from taxation.
- Excise taxes should apply to petroleum products, alcohol and tobacco, should be collected at the point of production or import, and should apply equally to domestic production and imports.
- Taxes on international trade should play a minimal role. Import tariffs should have a low average rate and a limited dispersion of rates, to reduce arbitrary and excessive rates of protection. Exemptions should be kept at a minimum and nontariff barriers should be avoided altogether.

- The personal income tax should be characterized by only a few brackets and a moderate top marginal rate, by limited personal exemptions and deductions, by a standard exemption that excludes persons with low incomes, and by extensive use of final withholding.
- The corporate income tax should be levied at one moderate rate. Depreciation allowances should be uniform across sectors, and there should be minimal use of tax incentives other than permitting net operating losses to be carried forward for some reasonable period of time.

In Tanzania, the main components of the sources of fiscal space are shown in Tables 2 and 3. Overall, VAT has been the main revenue source averaging 34.3%, followed by income tax (about 29.3%). As can be seen from Table 2, the increase in domestic tax revenue has come in particular from better tax administration in the areas of income tax, and import and excise duties. Income tax revenue increased from 3% of GDP in FY2004/05 to 5% in FY2008/09. Over the same period import and excise duties doubled from 0.7% and 1.6% to 1.4% and 3.1% of GDP, respectively. This reduced the heavy dependence on VAT taxes and henceforth led to a greater diversification of Tanzania's tax revenues. However, the full benefits of VAT as outlined above have not been realized in Tanzania due to large tax exemptions and other fiscal weaknesses as detailed in Section 3.5 below.

Table 2: Main sources of fiscal space

	2004/05	**2005/06**	**2006/07**	**2007/08**	**2008/09**	**2009/10**	**2004/10**
Percent of total				**Average**			
Total	100	100	100	100	100	100	100
Import duty	6.4	9.8	9.6	8.6	8.8	9.2	8.7
Excise duty	14.7	13.4	20.6	19.7	19.7	20.5	18.1
VAT	42.2	41.3	32.9	31	29.7	28.8	34.3
Income tax	27.7	28.5	28.3	29.3	31.3	30.9	29.3
Other	9	7	8.6	11.4	10.4	10.6	9.5
As % of GDP							
Total	10.8	11.5	13	15	15.9	15.6	13.6
Import duty	0.7	1.1	1.2	1.3	1.4	1.4	1.2
Excise duty	1.6	1.5	2.7	2.9	3.1	3.2	2.5
VAT	4.5	4.7	4.3	4.6	4.7	4.5	4.6
Income tax	3	3.3	3.7	4.4	5	4.8	4.0
Other	1	0.8	1.1	1.7	1.7	1.7	1.3

Source: Based on data from MoF, IMF and World Bank, and authors' estimates.

Development Partners' foreign aid in the form of grants or foreign credits continues to finance a significant portion of government expenditures and as such amount to a considerable percentage of GDP (Table 3). Total aid in the last six years has averaged about 10% of GDP. With total expenditures averaging around 25% for the period, aid has therefore financed on average 40% of total outlays by the government of Tanzania. The composition of aid (project versus General Budget Support—GBS), has hardly changed over the last five to six years. Even though there is clearly some variance from year to year in the composition of aid, on average GBS amounts to about 60% of the total aid with the remaining 40% entering Tanzania as project financing.

Table 3: Development Partners' support to Tanzania's fiscal space

	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10	2004/10
Percent of total				Average			
Total	**100**	**100**	**100**	**100**	**100**	**100**	**100.0**
Project aid	46.5	41.6	39.7	35.9	43.2	40.4	41.2
Budget aid	53.5	58.4	60.3	64.1	56.8	59.6	58.8
Percent total expenditure							
Total	**48.2**	**39.1**	**36.5**	**42.2**	**32.2**	**36**	**39.0**
Project aid	22.4	16.3	14.5	15.1	16.1	14.5	16.5
Budget aid	25.8	22.8	22	27.1	21.1	21.5	23.4
As % of GDP							
Total	**10.2**	**9.3**	**8.7**	**10.3**	**9.4**	**10.2**	**9.7**
Project aid	4.7	3.9	3.5	3.7	4.1	4.1	4.0
Budget aid	5.4	5.4	5.3	6.6	5.3	6.1	5.7

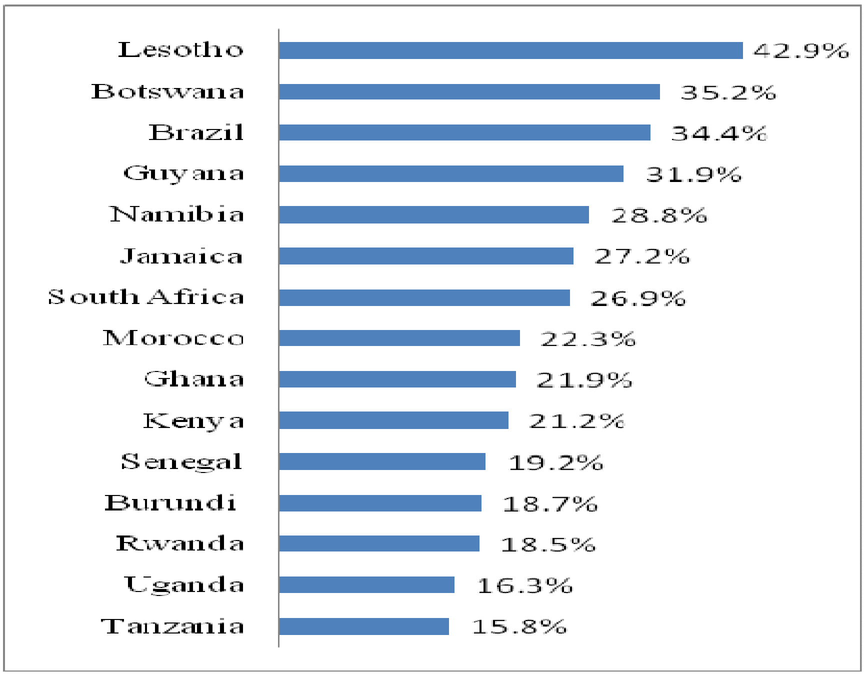
Source: Based on data from MOF, IMF and World Bank, and authors' estimates.

3.2 Adequacy and predictability of the sources of fiscal space

Domestic revenue

Is the fiscal space created from domestic revenue adequate to foster economic growth and long term human development? A simple answer is no. Despite much Government effort to put in place a conducive environment for enhancing domestic revenue, including tax system reforms by: (i) replacing sales tax by a value added tax in 1998, (ii) eliminating nuisance taxes, (iii) removing some tax exemptions (although some of these exemptions continue under the Tanzania Investment Centre incentive packages), (iv) adopting new Income Tax Act in 2004, (v) rationalizing local government taxes, and (vi) strengthening tax administration; much more efforts are needed. The tax reforms have resulted in a gradual increase in domestic revenues from 11.3% of GDP in 1999/2000 to 15.8% in 2009/10. This revenue outturn is low compared with other developing countries (Figure 2). Therefore, revenue authorities have to scale up tax collection to reach comparable countries' performance.

Figure 2: Comparative selected countries' domestic revenue as % of GDP, 2009/10

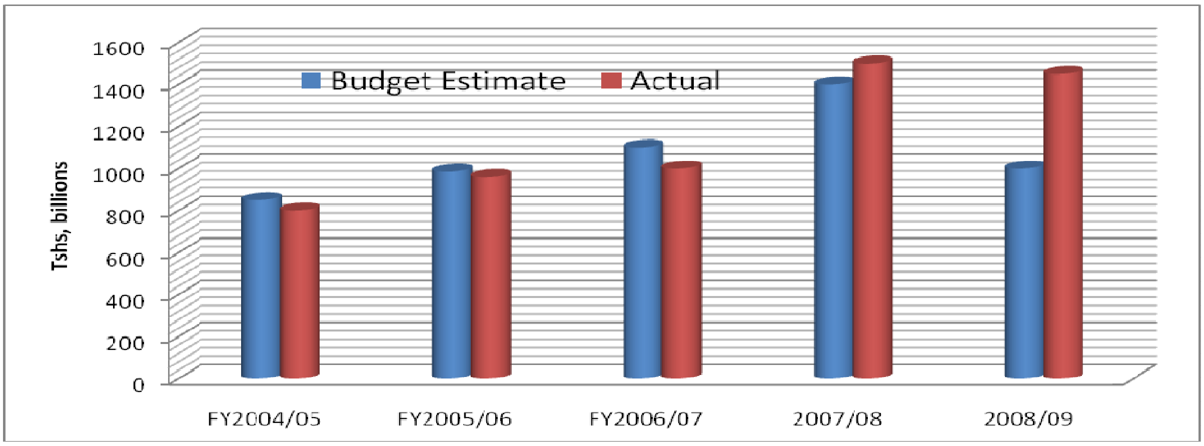


Source: Authors based on World Bank (2011) and Wikipedia (2011)

Official Development Assistance

Development Partners supporting Tanzania's efforts have a well established mechanism for channelling their Official Development Assistance (ODA), either through the GBS or project financing. As Figure 3 shows, the support that has been channelled through GBS is fairly more predictable, although during FY 2008/09 actual disbursements were nearly 40% higher than original budget estimates, due to more donors joining the GBS.

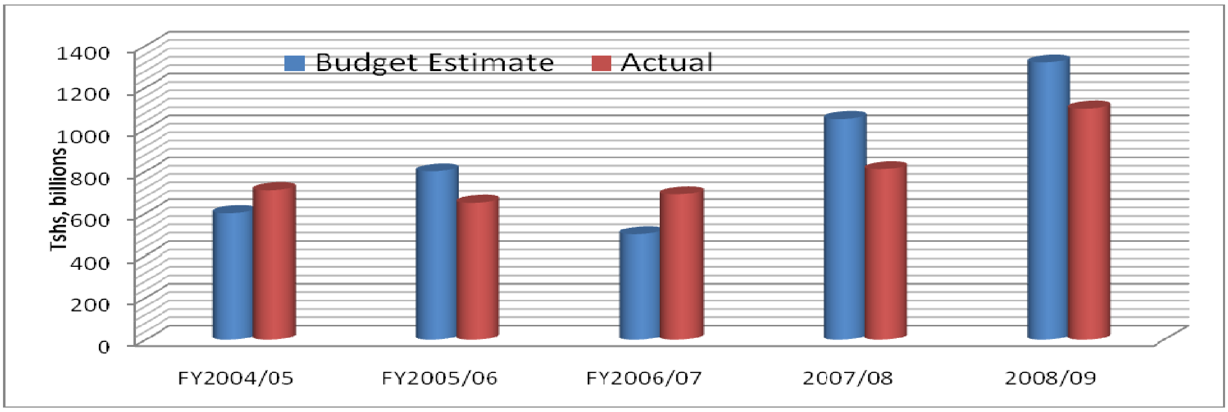
Figure 3: Predictability of ODA's General Budget Support



Source: World Bank, (2011).

As shown in Figure 4, project aid shows clearly a higher degree of variance and actual disbursements have been well below expected levels of disbursements during the last two fiscal years. The delays in project disbursements are associated with weaknesses in implementation capacity of spending units, some of whom fail to submit required reports to trigger further disbursements, as well as the impact of the on-going global economic crisis.

Figure 4: Predictability of ODA for project financing



Source: World Bank, (2011).

3.3 Component analysis of the use of fiscal space

In this section we answer the crucial question on whether the fiscal space is used for interventions necessary to speed up development process. We also examine whether there is room in the fiscal space to manoeuvre or reprioritise in order to increase the fiscal space available for enhancing social sector spending.

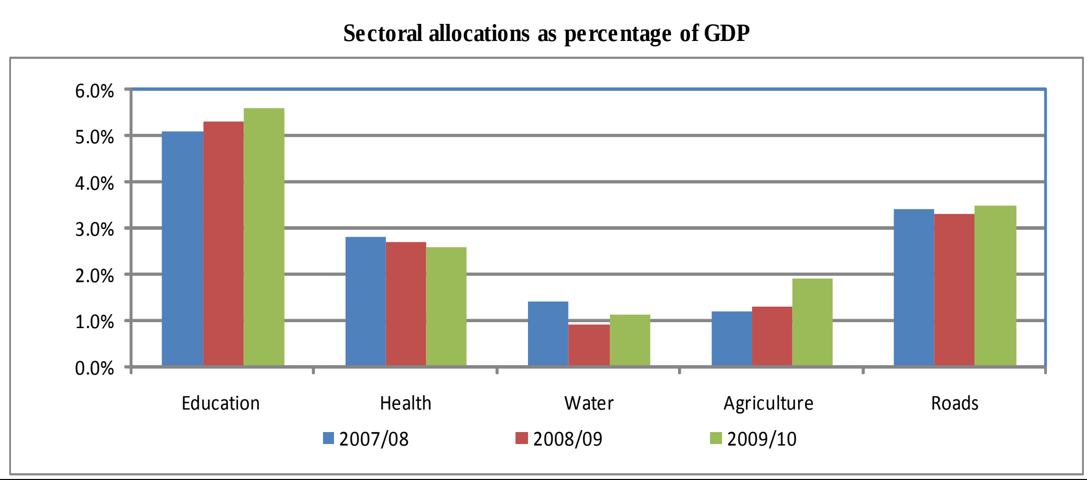
Macro-level use of fiscal space in relation to social sectors budgets

Since independence in 1961, the Government of Tanzania has continued to use available fiscal space to foster human development and economic growth, although much remains to be done to ensure a high standard of living for all – men, women and children. Recent use of fiscal space shows that expenditure priority in resource use is accorded to education, health, roads, agriculture and water (Figure 5). These sectors have been identified in the poverty reduction strategy as essential for improving welfare and development.

Education is allocated the largest share of the total government spending. Educations' share in 2009/10 was 18.3% of the total development spending, 33.0% of the total priority spending and 5.6% of GDP. The overall trend as percent of GDP is upward (Figure 5), reflecting higher spending necessitated by the establishment of community (ward) schools and new tertiary learning institutions (Dodoma, Arusha, etc). Interviews and focus group discussions applaud this priority, but overwhelmingly recommend the need to shift priority towards improving the quality of education. Overall, Tanzania is making good progress towards meeting her international commitments (Education for All Declaration) to spend 20% of total budgeted resources to the education sector.

The shares for health sector in the same period were 8.4%, 15.2% and 2.6%, respectively. Health spending as percent of GDP declined slightly during the period, partly because of shift in priority to infrastructure in fiscal years 2008/9 and 2009/10. This has drawn negative reactions, with some commentators imploring the government to reverse this trend. Tanzania is 6.6 percentage points off in meeting the Abuja commitment to spend 15% of the total budget on the health sector, necessitating higher spending to this sector. Also, the international commitments for spending in social protection and water have not been realized. The priority spending accorded to agriculture is important because over 80% of Tanzanians depend on agriculture for their livelihood. Studies by Leipziger et al. (2003), Estache, (2006), Sachs and McArthur (2004) and Wiloughby, (2004), also show that investments in infrastructure such as roads, improved utilities and the like yield substantial benefits in fostering human development and economic growth.

Figure 5: Priority use of Tanzania's fiscal space



Fiscal Years	Education	Health	Water	Agriculture	Roads
		(Sector Share of Total Spending)			
2007/08	19.4%	10.6%	5.4%	4.6%	12.8%
2008/09	18.5%	10.2%	3.3%	5.0%	12.4%
2009/10	18.3%	8.4%	3.7%	6.1%	11.5%
		(Sector Share of Total Priority Spending)			
2007/08	36.3%	19.9%	10.1%	9.7%	24.0%
2008/09	33.5%	17.2%	5.5%	8.2%	21.0%
2009/10	33.0%	15.2%	6.6%	10.6%	20.8%
		(Sector Share of Total Spending excl interest)			
2007/08	22.4%	11.2%	5.7%	5.1%	13.5%
2008/09	21.9%	11.2%	3.6%	5.8%	13.7%
2009/10	21.8%	10.0%	4.3%	7.2%	13.7%
		(Sector Percent of GDP)			
2007/08	5.1%	2.8%	1.4%	1.2%	3.4%
2008/09	5.3%	2.7%	0.9%	1.3%	3.3%
2009/10	5.6%	2.6%	1.1%	1.9%	3.5%

Source: World Bank, (2011).

Is there a room to reprioritize expenditures from non-priority spending categories?

The current use of fiscal space is in the “right” direction and there appears to be little room to manoeuvre or reprioritise expenditures. Public debt service is unavoidable and continues to remain the largest single item among the non-prioritised allocations in the 2009/10 budget. Further, overall share of non-prioritised votes in the budget have also remained somehow stable. The share of public debt and general service (Vote 22) in the budget remain significantly high at around 10% of the total budget over the past three years (Table 4). About 50% of the allocations in Vote 22 are for debt services while the other 50% is for general services. Reducing arrears should release extra fiscal space to the economy.

Table 4: Non-priority spending as percent of the total budget

Vote Code	Vote Name	2007/08	2008/09	2009/10	Diff. (FY10 &FY09)
22	Public debt	10.0%	9.4%	10.2%	0.8%
28	Police force	2.4%	2.1%	2.3%	0.2%
29	Prison service	1.2%	1.1%	1.2%	0.1%
30	President's office	3.1%	2.8%	2.2%	-0.6%
34	Foreign affairs	1.0%	1.0%	0.9%	-0.1%
38	Defence	3.3%	3.3%	3.5%	0.2%
39	National service	0.8%	0.8%	0.9%	0.1%
42	National Assembly Fund	0.7%	0.8%	0.7%	-0.1%
57	Ministry of Defence	1.0%	1.2%	0.4%	-80.0%
21, 50	Treasury & MoF	4.7%	8.7%	10.1%	1.4%
Sub-total		**28.3%**	**31.0%**	**32.2%**	**1.2%**

Source: Based on MoF Budget Book, FY2007/08 –FY2009/10

Reallocation of defence-related budget is not feasible at this stage because expenditures in this sub-sector has remained almost stagnant over the past decade and the 3.5% of the total budget allocation in FY2009/10 is considered the minimum level necessary to achieve adequate maintenance and preparedness. However, the budget for the Ministry of Defence was substantially reduced (by 80%) in FY2009/10 partly to continue increasing funding to the social sectors and the agricultural drive the “Kilimo Kwanza.” Based on the current resource allocation and use for the non-prioritised expenditures as shown in Table 4 above, Tanzania’s fiscal space has little room to manoeuvre or undertake scaled up resource reallocation in those sub-activities to increase further allocation to the social sectors.

3.4 Creating additional fiscal space

In the context of Tanzania, there is scope to create additional fiscal space through further prioritisation of expenditures. It is possible to create additional fiscal space by shifting resources from government administrative activities other than those funding social, economic and production services. Table 5 shows broad resource allocations for the past three fiscal years.

Table 5: Broad functional allocation of the budget, FY2007/08 -2009/10

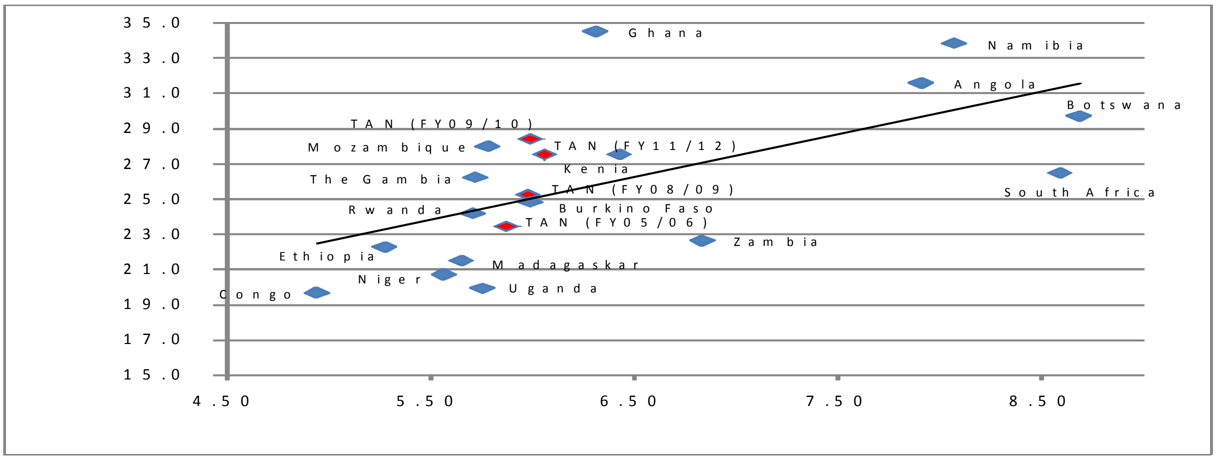
	2007/08					2008/09					2009/10				
	Rec	Dev			Total	Rec	Dev			Total	Rec	Dev			Total
		Local	Foreign	Total			Local	Foreign	Total			Local	Foreign	Total	
Broad Functions															
Administration	23.1	15.9	15.3	15.5	20.3	30.7	23	15.8	18.5	26.5	23.0	14.1	25.4	21.5	22.6
CFS	15.9	0	0	0	10.1	14.4	0	0	0	9.4	22.8	0.0	0.0	0.0	16.0
Defense and Security	11.8	1.1	0.2	0.5	7.7	10.7	2.4	0.3	1.1	7.4	10.1	6.9	0.3	2.6	7.9
Economic Services	6.8	57.7	24.9	36	17.4	5.7	48.4	30.2	37	16.5	5.2	45.4	16.9	26.7	11.6
Production Services	3.4	1.4	6.3	4.6	3.9	3.6	3.3	4.8	4.2	3.8	3.7	3.4	7.8	6.3	4.4
Social Services	39	23.9	53.3	43.4	40.6	34.9	22.9	48.9	39.1	36.4	35.2	30.3	49.5	42.9	37.5
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

Source: World Bank, (2011).

As discussed in the preceding section, social sectors continue to be accorded priority, being allocated 37.5% of all budgetary resources (recurrent and development) in FY2009/10. Economic and productive services combined were allocated 16.0% of all the budget resources in FY2009/10. In our opinion, administrative services are the area where resources can be trimmed down. Table 5 shows that administrative services are taking up over one fifth of the total budget. Looking at the last three fiscal years, the size of government as measured by total expenditures over GDP has risen noticeably from 22.8% of GDP in FY2005/06 to 24.9% in FY2008/09 to 28.5% in FY2009/10. A study by Gwartney et al. (1998) shows that economic growth slows down once government spending exceeds a certain proportion of the economy – estimated at between 15-25% of GDP. The main reasons are (i) the disincentive effects of higher taxes and crowding-out effect of public investment in relation to private investment, (ii) diminishing returns as governments undertake activities for which they are ill-suited, and (iii) an interference with the wealth creation process, because governments are not as good as markets in adjusting to changing circumstances and finding innovative new ways of increasing the value of resources.

Comparison of Tanzania to a group of comparable countries in Africa (Figure 6) shows that the growth of Government has outpaced with a significant margin the growth of GDP per capita. Therefore, there is potential for ***rationalizing and prioritizing expenditure allocations*** to achieve greater impact on growth. Larger government's are associated with less stellar growth performance given that it reduces simultaneously the resources available and allocated to the private sector as well as those needed to support social sectors development.

Figure 6: Tanzania: size of government development in contrast to other countries



Sources: Gordon and Wang (2004); World Bank, (2011).
Note: Measured by total expenditure as % of GDP (Y-axis) and natural log of GDP per capita (Y-axis)); TAN=Tanzania

Reducing the size of government is important both as a way to increase the fiscal space available to the private sector and achieving greater budgetary spending to development-related investments. One option in this regard may be to use the savings from the reduced size of government to increase resources destined for social sectors development. Other cost savings from smaller government may be achieved through ***efficiency gains in expenditure*** associated with reducing wasteful administrative spending as well as those associated with frequent government staff travel oversees and cutting back on too many seminars and workshops while streamlining and reducing overlapping government functions.

The final element in efforts to expand the fiscal space is the performance of the economy. High economic growth rewards a government with incremental revenues which (due to tax elasticities) generally rise faster than GDP. Of course the reverse holds when the economy weakens, leaving a government with a shortfall in revenue. Expenditures also fluctuate with shifts in economic conditions, though not to the same extent as revenues. With revenues and expenditures moving in opposite directions, the budget has automatic stabilisers which enlarge fiscal space in good times and shrink it in bad times. We anticipate good times ahead as government efforts bare fruits in soliciting greater mining revenues from foreign mining investors as well as anticipated oil and gas discoveries along the coast regions of the country.

3.5 Fiscal space sustainability

Fiscal space sustainability refers to the capacity of the government, at least in the future, to finance its desired expenditure programmes as well as service any debt obligations from expected future revenue stream (Buiter, 1985; Chalk and Hemming, 2000). This definition has a number of implications. First, the use of fiscal space requires a judgment that higher expenditure in the short term, and any associated future expenditures, can be financed from current and future revenues. If an expenditure programme or project is financed by debt, it should be assessed in terms of its impact on the underlying growth rate or by its effect on the country's capacity to generate the revenue needed to service that debt.

Some analysts such as Reinhart and Rogoff (2010) estimated a threshold for the public-debt-to-GDP ratio that an economy cannot exceed without negatively affecting growth rates, which in turn would undermine fiscal solvency. According to these estimates, the critical level is 90% of GDP for developed economies and 60% for developing economies. Tanzania's debt ratio is 30% of GDP. However, the government must continue to exert caution and follow the debt sustainability plan by incurring largely concessionary debt that does not exceed the preceding threshold.

Secondly, fiscal managers (largely Ministry of Finance, Bank of Tanzania, Ministries, Departments and Agencies (MDAs) have to carefully evaluate the implications of the spending programs for which fiscal space is created in a given year. Are the expenditures for which fiscal space is created likely to be concentrated in the immediate term? Or are the desired expenditures likely to require future expenditures, in which case some fiscal space will be needed in the future as well? For example, decisions to build one community secondary school in each ward (Kata schools) has implications for current use of fiscal space as well as future needs to sustain the school investments – increased number of classrooms, teachers, laboratories, libraries, teaching aids such as textbooks, etc. In health, for example, the desire is for higher expenditures that can be sustained over a long period of time, e.g. antiretroviral treatment programs for AIDS patients or child immunization programs. In either case, it would be insufficient to create fiscal space in the first year without ensuring the creation of similar fiscal space in future years to cover these requirements.

Thirdly, the use of fiscal space must be made in the context of at least a medium-term expenditure framework that has a comprehensive perspective on the government's expenditure priorities as articulated in Vision 2025, five-year plans and the growth strategy (MKUKUTA). If there is a possibility that the fiscal space that allows for today's additional expenditure will not be replicated in the future, the government may find that it is forced to either underfund the new initiative or cut back on other expenditure programs in the future. Thus, fiscal space should not be seen strictly as an issue associated with a specific sector. It is necessary to assess the scope for higher spending within the context of a comprehensive and forward-looking fiscal and budgetary framework (see World Bank, 2005). Thus, the government has an obligation to weigh the relative merits of spending across different sectors, since initiatives in one sector may ultimately have crowding-out effects on others.

Fourthly, the best strategy for fiscal sustainability is to promote growth-enhancing fiscal policies. In particular, targeting spending on infrastructure (roads, electricity, water, etc) and social transfers – especially education and health noting that a more educated and healthier population is clearly associated with faster economic growth (Plan UK, 2009; Mustard, 2006). Thus, fiscal expansion, by increasing the level of activity and income, raises the revenue stream and reduces the debt-to-GDP ratio, in particular if interest rates are relatively low compared with GDP growth. In tandem, the growth should be pro-poor and foster more equitable sharing of the fruits of growth which should be expected to enhance poverty reduction objectives.

Lastly, fiscal sustainability will require undertaking measures to improve domestic resource mobilization and the quality of governance. Enhancing domestic revenue will entail reducing tax exemptions which involve very large sums of money. In 2009/10 alone, 2.3% of GDP or TShs 695 billion was granted in tax exemptions (TWAWEZA, 2010) compared with less than 1% and 0.4% of GDP in Kenya and Uganda, respectively (a list of tax exemptions can be found at Ministry of Finance website for Tanzania). A recent detailed study by the IMF Fiscal Affairs Department indicates that Tanzania has room for further improvements in domestic tax collection (Kitillya, 2011). In particular, the study estimates that the aggregate tax gap (the shortfall in tax revenues due to policy and administrative shortcomings compared to what the tax authorities could collect), is 5.8% of GDP for FY2008/09. This would imply domestic revenue can be scaled up to 21.8% of GDP merely by making further improvements in tax administration, plugging tax loopholes, and removing tax exemptions. The main elements of good governance that are important for fiscal sustainability and enhancing the country's growth prospects, include: accountability, transparency, efficiency and effectiveness, responsiveness, forward vision and rule of law.

4.0 Conclusion

The paper discusses fiscal space creation and use in the context of development of social sectors in Tanzania. Four ways in which the governments can create fiscal space (the fiscal space diamond) have been scrutinized. These include Oversees Development Assistance (ODA) through aid and debt relief; domestic revenue mobilization through improved tax administration or tax policy reforms; deficit financing through domestic and external borrowing; and reprioritization and raising efficiency of expenditures. Social budgeting principles such as efficiency and sustainability in spending have also been examined.

Overall, aggregate spending has not been in line with sustainable growth, partly because of large external component in the fiscal space, inadequate domestic resource mobilization and increasing debt service. Spending continues to reflect priorities of the growth strategy (MKUKUTA), but operational efficiency is weak, partly because of weak fiscal discipline as well as existence of large imprudent tax exemptions.

The paper argues that prioritizing and improving the efficiency of expenditures is an option because it appears that priority being accorded to social sectors, especially in education and health as well as in infrastructure is in the right direction but there are structural expenditure wastes that can be avoided and administrative expenditures are too high making reallocation necessary to improve the use of the available fiscal space.

The paper argues for prioritizing expenditures that will create additional fiscal space to sustainably and sufficiently fund interventions in the social sectors, especially in education, health, and water. This means; (a) shifting resources from government administrative activities other than those targeted for funding social, economic and production services, and (b) through expenditure efficiency gains associated with reduction of waste especially in non-productive expenditures. Scaling up mobilization of domestic revenue, including reducing or eliminating tax exemptions, broadening the tax base and reducing external debt to sustainable levels is also imperative. However, scaling-up aid in the form of grants to social sectors in the medium term, but with an eye to an exit strategy as domestic revenues improve is also an option, while improving economy-wide governance structures.

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