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FISCAL REFORMS AND DEFICITS IN TANZANIA: AN EXPLORATORY REVIEW

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Abstract: This study provides an exploratory review of the trends, policy reforms, and determinants of fiscal deficits in Tanzania during the period 1980-2017. During this period, the country undertook various fiscal policy reforms intended to improve revenue mobilization and expenditure efficiency. The most significant of these reforms included the introduction of the semi-autonomous revenue authority and an extensive public financial management reform program. While the post-independence period was characterized by large fiscal deficits, recent trends show that fiscal deficits in Tanzania have been contained, even as some public investment management challenges exist. The review of trends and literature suggests that fiscal deficits are linked to the structure of the economy, low levels of development, donor aid and grants, as well as the overall macroeconomic environment. In particular, fiscal deficits are associated with growth cycles, inflationary episodes, and external sector developments.

Keywords: Fiscal deficits; revenue management; expenditure efficiency; policy reforms; Tanzania

JEL Codes: H1; H2; H5; H6; E62

1. Introduction

Tanzania's post-independence economy was characterized by administrative controls under a quasi-socialist system of Government from the late 1970's to the mid-1980s. However, the economy suffered from internal and external imbalances,

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that precipitated low or negative economic growth as production, exports and capacity utilization declined (van Arkadie, 1995). This period was characterized by high inflation averaging over 30 percent per year as the balance of payments registered large deficits, agricultural production and exports had been declining since the 1970's, and the country faced a shortage of foreign exchange reserves, leading to an accumulation of external payment arrears (Nord et al., 2009). Faced with financing challenges, the fiscal deficit excluding grants widened and averaged -9.14 percent of GDP during the five years between 1981-1985.

With the support of international multilateral financial institutions, the authorities in Tanzania instituted macroeconomic reforms that reduced government control over the economy, removing direct controls on prices, exchange and interest rates, and liberalizing the economic space to private sector involvement. Reforms intensified in the mid-1990s with public spending cuts, which helped the Government to control the fiscal crisis, turning fiscal deficits to surpluses. In addition, inflation was brought under control and exchange rate stability was restored as the reforms supported export performance (Ndulu, 1987). The economic situation improved remarkably during the period 1986-1990 as the country embarked on a reform process that focused on stabilization and reducing the macro-fiscal imbalances. Economic growth for the five years during that period averaged 5.5 percent. However, this period of growth was not sustained and the 10 years that followed were characterized by a slowdown during 1991-2000, with economic growth averaging 3 percent. During this time, the country faced various shocks and the government fiscal position deteriorated. Faced with growing budget deficits, inflation rose rapidly, and the current account deteriorated further.

During the period 2000-2010, the fiscal deficit continued to rise, despite the rapid increase in domestic revenue mobilization in the past decade. This has been made possible because public spending has increased faster than revenue mobilization, as tax revenue performance has often fallen short of budget targets (Bevan, 2010). The fiscal deficit increased from 4 percent in 2000 to 8 percent in 2010 but started to decline to start in 2011 and was estimated at 4.3 percent in 2015. The deficit was finance by central bank financing, concessional foreign borrowing, and reduced government expenditure (IMF, 2018).

More recently, the fiscal deficit started to decline, particularly in the two years during 2016-2017, even as government revenue fell short of budget estimates. In the fiscal year 2016/17, the fiscal deficit was much lower than what was envisaged in the budget on account of underspending which mirrored the un-realization of both external and domestic financing (IMF, 2018). While tax revenue has improved significantly over the past couple of years, budget execution faced challenges, mainly due to external financing shortfalls that led to low execution of capital spending. In addition, foreign aid loans and grants have remained a significant and steady share of GDP and a highly significant financing item in the budget. Specifically, foreign aid increased considerably as the government embraced the reform agenda, rising from 2 percent in 1991 to 5 percent in 2010. However, the government's access to external financing has declined recently, with grants component reducing to 0.5 percent of GDP in 2016.

Against this background, this study provides an exploratory review of the trends, policy reforms, and determinants of fiscal deficits in Tanzania during the period 1980-2017. In the years following independence, Tanzania instituted a wide-ranging reform agenda that was expected to usher in a period of recovery and growth. During that time, the tax base was eroded as easy-to-tax public enterprises disappeared and customs tariffs were lowered (Nord et al., 2009). Subsequent reforms that included the creation of the Tanzania Revenue Authority (TRA) in 1995 allowed the introduction of a more modern tax system that has led to improved tax revenue performance. Meanwhile, on the spending side, public financial management reforms created more fiscal space and made public spending more effective. Tanzania is now considered to have one of the best fiscal policy systems in sub-Saharan Africa and fiscal policy is expected to play a critical role in sustaining the recent good economic performance and propel the country to middle-income status as envisaged.

The study findings show that fiscal deficits are linked to the structure of the economy, low levels of development, donor aid and grants dependency, as well as the overall macroeconomic environment. Fiscal deficits are associated with growth cycles, inflationary episodes, and external sector developments. To the best of the authors' knowledge, this is the first paper to provide a systematic review of the fiscal policy trends and reforms in Tanzania. The rest of the paper is structured as follows: section two presents the literature review. Section three presents the methods and data sources. Section four discusses the findings. Section five concludes.

2. Literature review

During the period following independence, Tanzania pursued a quasi-planned socialist economic model (*Ujamaa*) which placed emphasis on an egalitarian system with rural development at its center. However, the economy suffered from multiple external and domestic shocks in the 1970's and early 1980's. The causes of the crisis were the following: drought resulting in harvest failure and the sharp deterioration in the terms of trade following the 1973 global oil crisis (Hartmann, 1983). Weakness in domestic policy in response to the shocks exacerbated the situation. First, public spending had accelerated in response to the ambitions of the socialist economic policies. At the same time, development aid broke the link between domestic savings and investment and funded development spending with too little regard for efforts to improve domestic revenue mobilization to sustain the expanded activities. Second, public service expanded. Third, there was an expansion of military expenditure as Tanzania went to war with Uganda during 1978-1979 (Gabagambi, 2013). The crisis also reflected the effects of a deterioration in the terms of trade; the collapse of the East African Community in 1977 which increased the burden on public spending; the second oil price shock in 1979; and the general decline in world prices for agricultural commodities which eroded the value of export earnings (Gabagambi, 2013; Morrissey, 1995).

Faced with a growing economic crisis, with low economic growth, high fiscal deficits, and inflation, the country embarked on a reform agenda intended to improve the macroeconomic situation and return the economy on a growth path. The first-generation economic reforms in Tanzania date back to 1981 and covered four major programs: The national economic survival program (NESP) during 1981-1982; the structural adjustment program (SAP) during 1982-1985; the economic recovery program (ERP) during 1986-1989; and the economic and social action program (ESAP) during 1989-1992. The reform process initially focused on restoring stability in the wake of the multiple shocks that the economy suffered in the post-independence period. More recently, reforms have focused on improving domestic tax revenue mobilization and improving public financial management, intended to improve the efficiency and economic return on public investment.

2.1. The National Economic Survival Program

The government's first attempt at reforming the economic system was enshrined in the national economic survival program (NESP) that was implemented during 1981-1982. This was intended to improve the government fiscal and macroeconomic position by streamlining production incentives, with the removal of export taxes on coffee and other commodities (Potts, 1995). However, this program was short-lived as it failed to deliver its intended objectives because its articulation of policy reforms was limited and based on exhortations, the wish for self-reliance, and unsustainable short-term measures that precipitated even bigger imbalances (Morrisey, 1995).

2.2. Structural Adjustment Program

Tanzania implemented a structural adjustment program (SAP) during 1982-1985. At the time, the country was in a deep economic crisis and prior reforms under the National Economic Survival Program had proved unsuccessful. At the same time, Tanzania was experiencing international isolation with a dispute involving the major international financial institutions. The major objective of the SAP was to address the fiscal deficit in the absence of external financial support. The SAP was more elaborate than the NESP and included plans to improve the fiscal deficit by reforming the tax system and address the foreign exchange constraint (Morrissey, 1995). However, this program too was largely unsuccessful as Government was not bold enough to address the root causes of the crisis, including price distortions and in particular the exchange rate (Wangwe, 1996).

2.3. The Economic Reform Program

With two unsuccessful reform attempts, Tanzania embarked on an economic recovery program (ERP) in 1986 with the support of the International Monetary Fund and the World Bank. The reform initially focused on addressing the substantial overvaluation of the Tanzanian shilling by implementing a series of discrete devaluations. In addition, the ERP prioritized fiscal reforms aimed at broadening the revenue base and reducing the overall budget deficit and reforming the public service. The overarching objective of the reform was to restore internal and external balance by pursuing prudent fiscal, monetary, trade, and market-oriented policies. This was intended to be achieved through a series of reforms that focused on improving agricultural productivity by providing appropriate incentives, marketing structures, and resources; rehabilitating physical infrastructure; and increasing industrial capacity utilization (Agrawal et al., 1993).
Unlike the previous reforms, the ERP was successful in meeting its intended objectives. The overall budget deficit (after grants) reduced from an average of 10.1 percent in 1981-85 to 3.5 percent by 1991 as revenue to GDP ratio increased substantially, from an average of 18.3 percent in 1981-85 to 22.1 percent by 1991 and government embraced expenditure restraint. At the same time, the Government reduced its reliance on domestic bank financing of the deficit, and in 1990 and 1991 the Government in fact made net repayments to the banking system. In addition, the structure of the tax system was progressively reformed, improving tax administration, and lowering the maximum tax rates and reducing the dispersion of the rates, contributing to a more efficient tax system (Agrawal et al., 1993).

2.4. Economic and social action program

Given the remarkable success of the ERP, the Economic and Social Action Program (ESAP) was launched in 1989 and was implemented until 1992 as its direct successor. The major objective of the ESAP was to continue and build on the momentum generated by the ERP. Specifically, the ESAP had the objective of further improving the domestic fiscal conditions and reducing dependence on external support. In addition, the ESAP had the objectives of improving trade and the financial sector. A major objective was to pursue a privatization drive that would limit governments' involvement in the provision of an enabling environment for private enterprise through the provision of social and physical infrastructure (Morrissey, 1995).

2.5 Tax Policy Reforms in Tanzania

Building upon the structural adjustment reforms, Tanzania undertook reforms to improve tax revenue performance. While piecemeal reforms had been part of the wider adjustment programs, the government instituted a "Commission of Enquiry into Public Revenues, Taxation and Expenditure" in October 1989 to study and review the central and local government tax systems and its administration and make recommendations (Fjeldstad, 1995a). The first attempt to reform the tax system was mooted in December 1991 when the tax commission recommended reducing the marginal tax rates on personal and company income. In addition, the reform would include measures intended to broaden the tax base by eliminating exemptions, and to introduce more efficient enforcement mechanisms, to introduce measures to simplify the tax system (Fjeldstad, 1995b).

The Tanzania Revenue Authority (TRA) was established by an act of Parliament in 1995 and started full operations in 1996. Since inception, the TRA has undertaken reforms intended to improve efficiency in tax administration and this have included the following: the introduction of the Value Added Tax (VAT) in 1998 to replace the sales tax, the promulgation of a new Income Tax Act in 2004, and revisions to customs policies and administration in line with the requirements of the East African Community Customs Management Act of 2004 (AfDB, 2010). In addition, a large taxpayer office (LTO) was instituted in 2001 and the domestic revenue department was formed in 2005 by merging the VAT and income tax departments. Subsequent reforms in tax administration included the review of the PAYE structure, and the introduction of the Tanzania Interbank Settlement System, allowing payment of taxes through banks, the introduction of modern ICT systems for tax operations, unification of the tax appeals system, and promulgation of the enterprise-wide risk management system (Kitillya, 2011).

The tax reform initiatives in Tanzania may partly be considered as a response to the threat of a major fiscal crisis. This is reflected in the fact that most of the proposed and implemented tax reforms in Tanzania were guided by the need to increase revenues. The reform process was largely successful. Revenue to GDP ratio has increased from 10.8% in 2004/05 to 14.6% in 2009/10 and 15.4 by 2017 (IMF, 2018).

2.6. Budgeting and public expenditure reforms in Tanzania

Although Tanzania is considered to have some of the strongest budgeting and public expenditure systems in Africa today, systematic steps towards a reform agenda were not taken until the mid-1990s. By this time weakness in public financial management had led to large budget deficits and accumulation of arrears. Systems and procedures for cash management were nonexistent, expenditure allocations were based on unrealistic assumptions, and accounting reporting and audits were inadequate (Nord et al., 2009). The reform process started with the launch of the Public Financial Management Reform Program (PFMRP) in 1998. The major aim of the program was to improve the country's fiscal position, restore macroeconomic stability, grow the economy, and improve the delivery of public services.

The reform process progressed with the introduction of the Treasury Single Account (TSA) that was to centralize the government's payments system and improve public expenditure management by reducing leakages by closing the accounts of a multitude of ministries, departments, and agencies (Tommasi, 2009). Treasury single accounts help governments with fragmented banking arrangements to manage cash resources better and minimize borrowing costs (Pattanayak & Fainboim, 2010). The TSA was soon followed by the introduction of the Integrated Financial Management System (IFMS) in 1999 to support TSA operations. With these reforms, it was necessary to put in place an enabling legal structure to provide a solid institutional foundation that, among other things would allow for a commitment control system (supported by IFMS) and better control of the budget. Consequently, the Public Finance Act (PFA) of 2001 was passed, and associated regulations were formulated. These reforms were largely successful and resulted in a major reduction in domestic arrears and better control over funds.

At the same time, the government has introduced a medium-term expenditure framework (MTEF) to guide its planning through better revenue and expenditure projections, based on realist assumptions. The budget formulation was also enhanced by the introduction in 2000/01 of Government Finance Statistics as the basis for budget classification. In addition, a Strategic Budget Allocation System (SBAS) was created to better link the budget with national priorities as identified by Poverty Reduction Strategy Papers and National Development Plans also known as *Mpango wa Pili wa Kukuza Uchumi na Kuondoa Umaskini Tanzania* (MKUKUTA). Starting in 2004, spending plans identified in the MTEF must be reviewed against the MKUKUTA and the expected outcomes identified. This is intended to improve transparency and accountability.

Table 1 Summary of key fiscal policy reforms in Tanzania

Year	Reform
1981	Launch of the National Economic Survival Program
1982	Structural adjustment program
1986	The Economic Reform Program
1989	Economic and social action program
1995	Tanzania Revenue Authority (TRA) established
1998	Treasury Single Account (TSA)

1998	Public Financial Management Reform Program (PFMRP)
1998	Value Added Tax (VAT) introduced
1999	Integrated Financial Management System (IFMS)
2000	Vision 2025 launched
2000	Strategic Budget Allocation System (SBAS)
2001	Public Finance Act (PFA
2001	Medium-term expenditure framework (MTEF)
2004	New Income Tax Act promulgated
2005	First five-year National Strategy for Growth and Reduction of Poverty
2005	Spending plans identified in the MTEF must be reviewed against national development plans
2010	Second five-year National Strategy for Growth and Reduction of Poverty
2015	Third five-year National Strategy for Growth and Reduction of Poverty

Source: Author compilation from the literature

Tanzania launched the vision 2025 in the year 2000 whose preparation had started five years earlier in 1995. The major objective of the vision 2015 was to propel Tanzania to middle-income status by the year 2015. The principal objectives of the vision 2015 were to realign fiscal policy to deliver sustainable development of the country through three pillars that included: achieving quality and good life for all; good governance and the rule of law; and building a strong and resilient economy that can effectively withstand global competition. These were not only meant to correct previous failures and deal with economic issues that prevailed but also include social issues such as education, health, the environment and increasing involvement of the people in working for their development (IMF, 2011).

Authorities in Tanzania started a series of strategies through which the vision 2015 would be achieved by formulating rolling five-year plans. Consequently, the first National Strategy for Growth and Reduction of Poverty (NSGRP) in 2005, informed by the aspirations of Tanzania's vision 2025. Since then there have been two five-year follow-on National strategies for growth and reduction of poverty, the second covering the period 2010-2015, and the third covering the period 2015-2020.

Tanzania's macroeconomic management during the first NGRSP was intended to improve the efficiency of fiscal policy, by improving the productivity of public expenditure through resource constraints, keeping spending in line with the national development priorities and instituting a supportive monetary policy to ensure macroeconomic stability. These reforms were successful. Economic growth has accelerated to an average of 6.7 percent during the period 2010-2017 from 6.2 percent during 2000-2009, tax collections as a percentage of GDP have increased to 12.5 by 2015 from less than 8 percent 10 years earlier, and fiscal deficits declined from 7.14 percent during 2000-2009 to 5.30 during 2010-2017 (Ngowi, 2005; IMF, 2018). A summary of key fiscal policy reforms carried out in Tanzania is provided in table 1.

3. Methodology and data

The study uses two separate but complementary approaches. First, the paper uses a review of fiscal deficits trends in Tanzania and juxtaposes these upon fiscal policy reforms in Tanzania. The trends are analyzed concurrently with developments in other macroeconomic variables. Second, the paper uses a systematic review of literature on the evolution of fiscal policy and determinants in Tanzania and other comparable emergent countries from Sub Saharan Africa. This study relies on data derived from three sources: the IMF, World Bank, and International Centre for Tax and Development (ICTD) databases. The descriptive statistics for data specific to Tanzania are provided in table 2.

Table 2 Tanzania's Macro-Fiscal indicators 1980-2017

Indicators	1980-1989	1990-1999	2000-2009	2010-2017
GDP Growth, % annual	3.55	3.27	6.19	6.69
GDP per capita growth, % annual	0.61	0.23	3.29	3.22
GDP per capita (Constant 2010 US$)	490.84	489.39	605.96	799.96
Fiscal deficits excluding grants, % GDP	-8.58	-5.35	-7.14	-5.30
Current account, % GDP	-5.31	-14.03	-4.97	-8.31
Debt Service, % GNI	2.94	3.90	0.83	0.67
Inflation, CPI annual % change	30.06	23.09	6.53	8.25
Military Expenditure, % GDP	4.54	1.68	1.02	1.03
Lending rates	18.04	30.74	16.37	15.67
Population growth, % annual	3.06	3.00	2.94	3.12
Grants, %GDP	-	2.94	4.15	2.91

Source: Author computations from IMF, World Bank, and ICTD databases

4. Findings

4.1. Fiscal deficit trends in Tanzania

Fiscal deficits have varied widely during the period of study, corresponding to different political and policy environments, but the trends provided in figure 2 suggest four distinct periods of note. The first period corresponds to the six years during 1980-1985. The second period corresponds to the ten years during 1986-1995. The third period corresponds to the 10 years from 1996-2005. The fourth period corresponds to the period during 2006-2017.

Tanzania's post-independence economy was characterized by administrative controls under a quasi-socialist system of Government from the late 1970's to the mid-1980s. However, the economy suffered from internal and external imbalances, that precipitated low or negative economic growth as production, exports and capacity utilization declined (van Arkadie, 1995). This period was characterized by high inflation, averaging over 30 percent per year, the balance of payments registered large deficits, agricultural production and exports had been declining since the 1970's, and the country faced a shortage of foreign exchange reserves, leading to an accumulation of external payment arrears (Nord et al., 2009). Faced with financing challenges, the fiscal deficit excluding grants widened and averaged -9.14 percent of GDP during the five years between 1981-1985.

The period from 1980-1985 represents Tanzania's worst performance. During this period, the state had control of the economy under socialist systems of government. This was a period of low growth and expansionary fiscal and monetary policies. While the country suffered from multiple external and internal shocks, the policy responses were inadequate. In addition, the exchange rate and pricing policies were not based on market mechanisms (Ndulu, 1987). Tax revenues were declining, and fiscal deficits widened to an average of 9.14 percent. At the same time, gross fixed investment declined to 18.1 percent of GDP, down from 28.0 percent in the period 1976-1980 on account of a sharp decline in domestic savings as well as a contraction of inflows of external financing. The overall fiscal deficit was financed by printing money, exacerbating macroeconomic imbalances (Kombe, 2015).

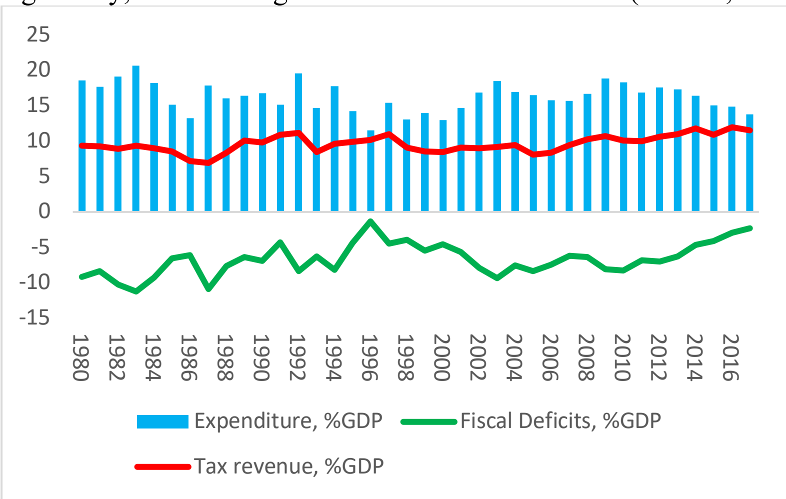

Figure 2: Trends in Tanzania's tax revenue, expenditure, and fiscal deficits

Source of data: IMF, World Bank, and ICTD databases

During the period 1986-1995, the country embarked on an ambitious reform journey with the economic recovery program, with liberalization, exchange rate, and trade reforms at the center of the macroeconomic agenda. Owing to the reform process, economic growth recovered reaching 7 percent in 1990. Despite challenges in budget management, the fiscal deficit was contained and averaged 6.93 percent during this time. Tax revenue performance improved, as the macroeconomic environment improved. At the same time, government expenditure reduced as the government started a privatization process that reduced expenditure on state-owned enterprises.

The period 1996 – 2006 fiscal deficits widened considerably as the government embarked on an investment drive in line with the public investment reform that focused on reviving the economy and reducing poverty in line with vision 2025. However, tax revenue flatted out during this time, averaging 9.02 percent. Consequently, the fiscal deficit widened from 4 percent in 1999 to 8 in 2005. However, this was a high growth period and the economy benefited from sizeable financial assistance that financed the large expenditure outlays. During this time grants to Tanzania as a percentage of GDP rose from 1.96 percent in 1996 to 5.43 in 2004, helping the country to sustain high expenditures even as tax revenue efforts faltered.

During the period 2007-2017, the country was well established on a growth trajectory. GDP growth averaged 6.6 percent and tax revenues as a percent of GDP increased from 9.5 percent in 2010 to 12 percent in 2017. At the same time expenditures had declined from a high of 19 percent of GDP in 2009 to 14 percent in 2017, although the decline was due to under execution of the development investment program. With these developments, the fiscal deficit narrowed significantly and rapidly, reaching 2 percent in 2017 from 8 percent in 2010. The decline in the fiscal deficit followed a similar trend where grants declined from 5 percent in 2010 to 0.4 percent in 2017. Therefore, fiscal deficits have been reducing not because of domestic fiscal consolidation measures, but because of limited access to external financing that has constrained the public investment program. At the same time, this period was associated with the global economic crisis that started in 2007. Whereas the crisis precipitated large fiscal imbalances in the advanced economies (see for example Mara et al., 2009; Hemmelgarn & Nicodème, 2010), the effects on Tanzania were minimal and short-lived (Bevan, 2010) and were transmitted majorly through reduced donor aid flows, remittances, and tourism receipts (Lunogelo et al. 2009). In addition, Tanzania was equipped with adequate fiscal space (low public debt levels and adequate reserves) which allowed accommodating policies (Kasekende et al., 2010).

4.2. The Determinants of fiscal deficits in Tanzania

The determinants of fiscal deficits in Tanzania are broadly linked with the social, economic, and political environment. First Tanzania experienced economic volatility, especially in the two decades following independence, with terms of trade shocks and socialist political systems constraining growth and leading to large macro-fiscal imbalances. Second, fiscal deficits in Tanzania are associated with the low levels of development with a high incidence of poverty, inequality, and low per capita income providing a narrow tax base. Third, fiscal deficits in Tanzania are associated with the structure of the economy, with the large informal and agricultural sectors exerting constraints on revenue mobilization efforts. Fourth, Tanzania has been an important recipient of donor aid and grants, and these have tended to be associated with large deficits due to their negative effects on tax revenue collections and a positive impact on expenditures. Fifth, Fiscal deficits are associated with growth and the general macroeconomic environment.

In the two decades following independence, Tanzania pursued a socialist system of government in which the state-dominated economy crowding out private sector participation. This was a period of low growth and the economy was not equipped with sufficient buffers to mount an adequate policy response. Consequently, the country suffered a near macroeconomic collapse with slow growth, inflation spiraling and fiscal deficit widening. A study by Osoro (1997) concluded that spending was often determined on political grounds and tax revenue adjusted accordingly. Consequently, the observed growth and persistence of deficits in the public sector of Tanzania were due to an increase in public spending that was intended to counter the effects of the economic crisis.

Another determinant of fiscal deficits in Tanzania related to the narrow tax base, occasioned by the low levels of development with low per capita income, high incidence of poverty, and inequality. Despite the recent economic growth and progress with poverty reduction, Tanzania remains a low-income country. Real GDP per capita was estimated at US$937 in 2016 and remains below the threshold for middle-income status (IMF, 2018). Poverty was estimated at 28 percent in 2012 and is still high despite the recent sustained downward trend (World Bank, 2017). With these challenges, the tax base in Tanzania is still narrow, exerting constraints on tax revenue mobilization. These challenges are consistent with research that shows that countries that have low levels of development, with low per capita incomes and high inequality tend to have lower tax effort (see for example Fenochietto & Pessino, 2013; Mawejje & Sebudde, 2019).

Several studies have examined the fiscal effects of the underground economy across the world (see for example Buehn et al., 2019; Omodero, 2019; Radu et al., 2017). In Tanzania, the structure of the economy, dominated by informal and agricultural sectors, constrain revenue mobilization efforts and is a major determinant of fiscal deficits. The agriculture sector in Tanzania is large, accounting for about 31percent of value-added in the economy and 80 percent of total employment (World Bank, 2014). Available research shows that the dominance of the primary sectors is associated with informality, low productivity, and low incomes, presenting peculiar challenges for taxation (Gupta, 2007; Mawejje & Munyambonera, 2016). At the same time, revenue mobilization efforts have been affected by widespread tax evasion, which reflects citizens' dissatisfaction with the provision of public services (Ali et al. 2014) and is consistent with findings elsewhere in the region (see for example Mawejje & Okumu, 2016).

With the recent economic growth and progress with poverty reduction, Tanzania's real GDP per capita has risen from US$510 in 1990 to US$937 in 2016, placing Tanzania at the cusp of lower-middle-income status (IMF, 2018). In addition, the structure of the economy is changing, with signs of progress in the non-agricultural sectors. The manufacturing and construction sectors' contribution to real GDP growth is steadily rising, while that of agriculture is shrinking. Even with this structural transformation taking place, the economy is expected to remain largely agricultural-based in the foreseeable future. Although agriculture contribution to GDP is about 30 percent, it provides employment to about 73 percent of households (World Bank, 2014). The country is also burdened by a large informal sector, which is estimated to account for more than half of economic activity (Medina and Schneider, 2018). With these challenges, Tanzania continues to rely on a comparatively narrow tax base and therefore suffers from fiscal vulnerabilities (AfDB, 2010).

While the Tanzanian economy has embarked on a diversification path, non-agricultural activity is concentrated in low productivity service sectors. The country's private sector remains significantly small in terms of annual accumulated capital investment and employment capacity. Tanzania's Private Sector is largely informal and dominated by Small enterprises (Diao et al., 2016; Ellis et al., 2017). Consequently, the informal sector is large and was estimated to have averaged 52 percent of GDP between 1991 and 2015 and is the largest among East African countries (Medina & Schneider, 2018). In addition, available evidence suggests that countries with a large size of the informal sector are more likely to experience have a procyclical fiscal policy (Çiçek and Elgin, 2011) due to distortions that government face owing to large fluctuations in the tax base (Talvi and Vegh, 2005).

Official development assistance played an important role in the development processes particularly in the wake of the devastating economic crisis of the 1970's and early 1980's, even as authorities pursued policies that emphasized self-reliance. Throughout the reform period, the international community used aid as a tool to induce change and guide policy (Edwards, 2016). While aid seems to have given Tanzania space to run large budget deficits, recent research on the macroeconomic impacts of aid is not conclusive and has not directly addressed this issue (see for example Nyonyi, 1998; Rotarou & Ueta, 2009).

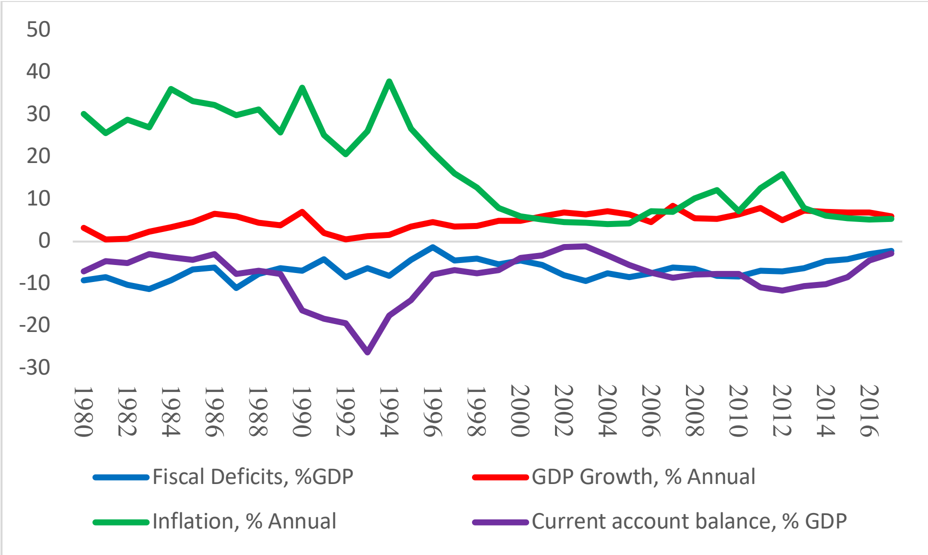

Figure 2 Fiscal deficits, inflation, growth, and current account balance in Tanzania
Source of data: Author construction using IMF, World Bank, and ICTD online databases

Lastly, fiscal deficits in Tanzania are associated with the general macroeconomic environment, including real GDP growth, inflation, and current account balances. Figure 2 suggests that there is a co-movement between fiscal deficits and GDP growth. The evidence shows that deficits tend to widen during years of high growth and tighten during periods of low growth. This suggests that fiscal deficits in Tanzania are procyclical. In addition, fiscal deficits tend to increase during high inflationary periods. Lastly, the evidence shows that there is a co-movement between fiscal deficits and the current account balance. This observation is consistent with Malindretos and Arize (2008) who investigated 10 African countries from 1973-2005 and showed that there is a positive long-run relationship between the trade deficit and the budget deficit. Overall, the findings in this paper are consistent with a recent scholarship which shows that fiscal deficits in low-income agrarian economies are associated with military and peace operations, and the overall macroeconomic economic environment, the dominance of the primary sectors, and dependency on aid (see for example Mawejje & Odhiambo, 2019).

5. Conclusions

Tanzania's economy was characterized by extensive administrative controls under quasi-socialist systems of Government from the late 1970's to the mid-1980s. At the same time, the economy suffered from persistent internal and external imbalances, largely because of inappropriate macroeconomic policy choices, expansionary fiscal policies, and structural challenges. These shocks led the authorities to institute macroeconomic reforms that reduced government control over the economy, removing direct controls on prices, exchange and interest rates, and liberalizing the economic space to private sector involvement.

The country embarked on a reform process, starting with the structural adjustment program in 1982 and the comprehensive economic recovery program in 1986. These reforms were meant to improve fiscal and macroeconomic stability and return the country on a sustainable growth path. Subsequent reforms have focused on improving revenue mobilization and improving the efficiency of budgets. These reforms have been successful. Tanzania has sustained a period of high growth over the past two decades, poverty has reduced, and the country is on the cusp of middle-income status. At the same time, the country received large aid inflows proportion of GDP. However, revenue growth has not kept pace with expenditure and fiscal deficits continue to be large, and the recent improvement reflects under-execution of the capital budget and not necessarily improves fiscal policy productivity.

This study set out to provide an exploratory review of the trends and determinants of fiscal deficits in Tanzania. Results show that fiscal deficits are linked to the structure of the economy, low levels of development, donor aid and grants dependency, as well as the overall macroeconomic environment. In particular, fiscal deficits are associated with growth cycles, inflationary episodes, and external sector developments. The authorities in Tanzania should put in place policies that are consistent with sustainable fiscal balances and maintenance of sustainable levels of public debt in line with the East African Monetary Union convergence criteria. In addition, authorities should improve public investment management to improve the execution of the development budget.

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Author Contributions

JM and NMO jointly conceived the study and were responsible for the design, development of the data analysis, and data interpretation. JM was responsible for data collection and literature review.

Disclosure Statement

The authors have not any competing financial, professional, or personal interests from other parties.

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