

Fighting fiscal corruption: The case of the Tanzania Revenue Authority

Odd-Helge Fjeldstad

WP 2002:3



Chr. Michelsen Institute *Development Studies and Human Rights*

CMI Working Papers

This series can be ordered from:

Chr. Michelsen Institute

P.O. Box 6033 Postterminalen,

N-5892 Bergen, Norway

Tel: + 47 55 57 40 00

Fax: + 47 55 57 41 66

E-mail: cmi@cmi.no

Web/URL: <http://www.cmi.no>

Price: NOK 50 + postage

ISSN 0804-3639

ISBN 82-8062-019-2

Indexing terms

Corruption

Tax evasion

Tax administration

Incentives

JEL Classification: H26, H30, J33, K42

Introduction*

Tax systems in most poor countries are characterised by widespread corruption and tax evasion. Substantial amounts never reach the treasury (Alm et al., 1991; Galtung, 1995; Ul-Hague & Sahay, 1996). This erosion of the tax base has several detrimental fiscal effects. The consequences of lost revenue to the funding of public services are of special concern (Tanzi, 2000a). In addition, corruption and tax evasion may have harmful effects on economic efficiency in general (Tanzi, 2000b), and income distribution in particular (Hindriks et al., 1999; Slemrod & Bakija, 1998).

In order to increase revenue and curb corruption, a number of African countries have implemented comprehensive reforms of their tax administrations over the past ten to fifteen years (Devas et al., 2001). Tanzania introduced a major reform in 1996 with the formation of a new revenue authority – Tanzania Revenue Authority (TRA). The choice of a revenue authority model, which originates in the so-called executive agency model, aimed partly to limit direct political interference by the Ministry of Finance, and partly to free the tax administration from the constraints of the civil service system.¹ This was considered to be essential for several reasons of which the most important were to pay rates above the civil service regulations to attract and retain quality staff, and to make dismissals easier. Moreover, the tax administration's senior management was replaced. It was assumed that these steps would provide incentives for greater commitment and less corruption.

How successful was this reform? It is naturally too early to pronounce a clear verdict, only six years after the Authority was put in place. Reforms need time and results will always depend on the criteria underlying the evaluation. The reform appeared to be a success in TRA's first years of existence. Reported revenue increased sharply – from 11% of GDP in 1995/96 to more than 12% in 1996/97. Corruption seemed to be declining too. But since then, TRA has failed to meet its targets and revenue has dropped in percentage of GDP (see table 1c). There are also clear indications that corruption is on the rise again.² The stylised facts of the development in Tanzania's tax administration are as follows:

- *Prior to the reform:* Widespread and systemic corruption. Low tax revenues in percentage of GDP (table 1c).
- *At the time of the reform:* Spotlight on wage incentives, control, recruitment and steps to reduce political interference.

* This article was prepared with financial support from the Research Council of Norway and Danida through the research programme "Taxation, aid and democracy". Useful comments on earlier drafts were received from Jens Andvig, Ivar Kolstad, Mohamed Othman, Ole Therkildsen, Bertil Tungodden and participants at the workshop on taxation and development, Nepru, Windhoek, 4-5 April 2002. Points of view and any remaining errors can be attributed to the author.

¹ The executive agency model is one institutional model of the new public management (NPM), which is inspired by the radical public sector reform programmes of the 1980s that began in the UK, USA, Australia and New Zealand. Executive agencies provide a way of separating certain governmental functions into arms-length units, giving the management the autonomy to operate the activity like a business, emphasising economic norms and values, rather than a civil service department. McCourt & Minogue (2001) examine the conceptual and practical problems connected with such policy transfers to developing countries.

² Credible information on corruption and tax evasion levels is hard to come by since the parties involved have an interest in keeping such information secret. This study is based on documents written by public employees, consultants, business people and researchers, and personal interviews and discussions that have taken place over the past six years with business people in Dar es Salaam, customs officials and other tax officers, customs clearing agents, staff at the Ministry of Finance, aid workers and researchers.

- *Post-reform phase 1*: Low(er) corruption levels. Sharp annual growth in tax revenue (tables 1b and 1c).
- *Post-reform phase 2*: Rising corruption levels. Declining revenue in percentage of GDP (table 1c).

Table 1a Tanzania tax revenue components (in TSh billions, nominal prices)							
	1994	1995	1996	1997	1998	1999	2000
Total tax revenues	220.4	299.9	385.8	514.6	566.1	616.5	685.1
Tax on imports	50.2	91.3	121.2	174.2	180.7	218.9	220.4
Tax on exports					4.7		
Sales and excise tax on domestic goods	70.4	72.6	104.7	141.7	140.5	161.3	180
Income taxes	58.5	86.7	112.3	134.2	149.8	162.9	209.7
Other taxes	41.20	49.4	45.6	64.5	90.4	73.4	75.1

Table 1b Annual changes in tax revenues (in %)							
	1994-95	1995-96	1996-97	1997-98	1998-99	1999-00	
Total tax revenues	36.07	28.64	33.39	10.01	8.90	11.13	
Tax on imports	81.87	32.75	43.73	3.73	21.14	0.69	
Tax on exports					-100.00		
Sales and excise tax on domestic goods	3.12	44.21	35.34	-0.85	14.80	11.59	
Income taxes	48.21	29.53	19.50	11.62	8.74	28.73	
Other taxes	19.90	-7.69	41.45	40.16	-18.81	2.32	

Table 1c Tax revenues in per cent of GDP							
	1994	1995	1996	1997	1998	1999	2000
Total tax revenues	11	11.3	11.4	12.1	10.9	10.1	10
Tax on imports	2.5	3.4	3.6	4.1	3.5	3.6	3.2
Tax on exports	0	0	0	0	0.1	0	0
Sales and excise tax on domestic goods	3.5	2.7	3.1	3.3	2.7	2.6	2.6
Income taxes	2.9	3.3	3.3	3.2	2.9	2.7	3.1
Other taxes	2	1.9	1.3	1.5	1.7	1.2	1.1

Source: Mokoro & Oxford Policy Management (2001) based on data from the Ministry of Finance, Dar es Salaam

The purpose of this article is to explore in greater detail factors that may explain this pattern of corruption within TRA and, to a lesser extent, to shed light on revenue trends.³ Rising levels of corruption may help explain why the growth in revenue has tailed off in recent years (see table 1b).⁴ There are clearly other explanatory factors also at work. First, tax revenue depends on external factors over which the tax administration has no control. For instance, general economic trends impact on tax bases such as income tax, VAT and import duties. Import

³ Similar developments appear to characterise other tax administrations in Africa, such as, for example, the Ghanaian and Ugandan administrations (see Chand & Moene, 1999; Hadler, 2000; Therkildsen, 2002).

⁴ It may be the case, however, that increased revenue accompanies a rise in corruption levels (see Mookherjee, 1997). We should also be careful in drawing too confident a conclusion about successes and failures on the basis of the tax/GDP ratio since it tends anyway to be a relatively imprecise measure of performance (see Stotsky & Wolde Mariam, 1997).

restrictions and politically allocated tax exemptions for different sectors and businesses also contribute to reducing the tax base.⁵ Furthermore, staff productivity may have changed, possibly due to falling motivation, - whether that is unrelated causing or caused by an increase in corruption is not given. However, there are many indications that an increase in fiscal corruption has contributed to reduce the growth in reported revenues. Thus, a closer look at the pattern of corruption may shed light on the development of tax revenues.

The remaining part of the article is divided into four sections. The first describes the state of affairs in the tax administration in Tanzania prior to the establishment of TRA. Factors identified as crucial in explaining the extent and types of corruption in the tax administration are reviewed in section two. The administrative reforms are discussed in section three, while their results are presented in section four. Finally, section five concludes and examines lessons learned from this case study which could benefit future reforms of tax administrations in poor countries.

Status prior to the 1996 reform

Corruption is not a new phenomenon in Tanzania. According to Mukandala (1983:261), the public sector in the early 1980s was “increasingly riddled by corruption and embezzlement of public funds”. The Auditor General’s reports from the 1980s show that this trend continued (Semboja & Therkildsen, 1992:1103). By the mid-1990s, corruption in Tanzania was rampant in all sectors of the economy and politics (URT, 1996). In tax administration these issues were particularly pressing, given the need to raise more tax revenues, partly to mitigate corruption in other parts of public services.

Extensive corruption and embezzlement of public funds are documented in a number of reports from both commercial and official sources. For instance, the *Confederation of Tanzanian Industries* (CTI) estimated that the value of lost revenues from customs and sales tax due to inefficient tax administration and mis-classification and undervaluation of imported goods amounted to more than TSh 250 billion for the period March 1993 to March 1994 (Osoro et al. 1999:5). According to ESRF (1996:6), official import statistics underreported the value of imports by as much as 70 per cent. One indication of the extent of this problem is that some types of textiles (including those used in the most popular type of clothing, the “khanga”) were sold in the early 1990s for 30 per cent less than the value of the customs duty per metre of the textile. Official statistics on reported revenue from customs duties also indicate substantial leakages. While the most prevalent official customs duties in the period 1993–96 were 20–30 per cent, the reported duties as a percentage of official import value were less than 7 per cent (see table 2). In the fiscal year 1993/94 this figure fell below 5 per cent.

⁵ There has been a considerable increase in the allocation of tax exemptions in Tanzania in recent years, which obviously erodes the tax base, at least in the short run. For instance, generous investment incentives in the form of tax exemptions have been granted foreign investors, especially in the mining and tourism sectors.

Table 2. Effective import duties in Tanzania (1993–2000)

	1993/94	1994/95	1995/96	1996/97	1997/98	1998/99	1999/00 ¹
(a) Revenue from import duties (in million TSh)	28,404.0	46,723.4	61,271.8	77,910.5	81,684.3	87,798.6	95,300.0
(b) Total import value, c.i.f. (in million TSh)	614,597.6	765,814.2	885,952.6	807,303.0	808,168.0	1,043,096.9	1,164,840.6
(c)=(a)/(b) Effective import duties (in %)	4.6	6.1	6.9	9.7	10.0	8.4	8.2

¹ Estimates

Sources: Based on data from the Tanzania Revenue Authority and Bank of Tanzania

Evasion of other types of taxes was also widespread. For sales tax and excises on domestic goods, underreporting of production volumes was a common form of evasion (Ososo et al., 1999:6). With regard to corporate taxes, underreporting of profits and falsified tax deduction claims were common (Mwinyimvua, 1996). In both cases, such underreporting could be achieved with or without the help of staff within the tax administration. For personal income taxes, including pay-as-you-earn (PAYE), one method of evading taxes was for employers to circumvent reporting collected PAYE to the tax authorities. Another was to pay wages and other cash emoluments to workers “under the table”. But the discrepancies between potential and reported tax revenue can also be due to plain and simple theft. In a study of the local government tax system in Tanzania, Fjeldstad & Semboja (2000) found that embezzlement of collected taxes – which did not implicate taxpayers – was widespread. It was caused by poor control routines in the tax administration. In some cases the tax inspectors and auditors were also involved in corruption. Table 3 provides a picture of some of the most common forms of fiscal corruption and tax evasion.⁶

Evidence of the amount of taxes and duties lost to the treasury was extensive. The donor community did not react, however, until autumn 1994. A report from two of the Pre-shipment Inspection (PSI) companies in charge of the pre-imports inspection and valuation of cargoes to Tanzania then revealed that lost tax revenues in the form of unpaid customs duties amounted to TSh 70 billion (then equivalent to US\$ 134.5 million) in the fiscal year 1993/94 (*The Indian Ocean Newsletter*, No. 647, 19 November 1994:1). In comparison, recorded customs revenues that same year were TSh 28.4 billion (Gandhi et al. 1995:10). In other words, lost customs revenues represented an amount 2.5 times higher than reported customs duties. This revelation led to an aid freeze to Tanzania in November 1994. Several major donors, including Norway and Sweden, decided to withhold aid while they awaited the results of investigations of what was assumed to be corruption involving senior officials. The Government promised a full-scale investigation into the matter.

On 23 February 1995, the Office of the Controller and Auditor General submitted its report to the President. The report exposed negligence and dishonest practices by high-level civil servants (*The Indian Ocean Newsletter*, No. 661, 4 March 1995:1). Of the total amount of TSh 70 billion that could not be accounted for, TSh 20 billion could be put down to tax evasion by importers, while TSh 50 billion was due to tax exemptions. Of the latter, legal exemptions granted to public institutions and religious and humanitarian organisations made up a

⁶ In response to a question about tax evasion methods in use in Tanzania, one customs clearing agent said: “There are thousands of methods. When the Government plugs one loophole new ones arise immediately. We Tanzanians are very clever in this game!” (personal interview, June 1997).

substantial share, but a large number of cases were found to be illegitimate exemptions granted to various businesses.

According to Osoro et al. (1999:28), “the third schedule of the Customs Tariff Act and a number of Government notices which allow for exemptions [was] probably the most abused section of tax legislation”. Within the Ministry of Finance, the *Revenue Department* went under the nickname the “Tax Exemption Department”. In response to pressure from Western donors, the Minister of Finance Kighoma Malima was removed from his post in the spring of 1995 and installed in a new ministerial position. In June that year he was forced to resign from the Government altogether. The investigations also led to the dismissal of several senior civil servants in the Ministry of Finance, including the head of the revenue department.

Diagnosis

The corruption scandals in the tax administration were instrumental in President Benjamin Mkapa’s decision to appoint former Prime Minister Joseph Warioba to head a commission whose mandate was to map the extent of corruption in the country and identify steps to deal with it. The Anti-Corruption Commission has since been referred to as the Warioba Commission (URT, 1996). The crisis riding the tax administration was also the immediate cause behind the formation of the *Tanzania Revenue Authority* (TRA) in July 1996. *The Indian Ocean Newsletter* (No. 726, 6 July 1996:1) wrote on this occasion that “a beginning has been made in tackling the country’s two major ills: corruption and tax evasion”.

These measures were well perceived by international donors. They were also crucial because a new corruption scandal was threatening to derail negotiations between Tanzania and the IMF, the World Bank and the Paris Club on fresh loans and a restructuring of current debts. The new affair concerned the authorisation given by the Ministry of Finance to four companies to import 4,700 tons of cooking oil at old and much more favourable tariffs than the new rates that were introduced in the 1996/97 budget. Thus, the companies saved TSh 4.7 billion in tax. According to opposition politician Augustine Mrema, the Minister of Finance Professor Simon Mbilinyi and Principal Secretary at the President’s office Martin Lupanga received a bribe of TSh 900 million (US\$ 1.5 million) to authorise lowered rates. The Minister of Finance denied charges of corruption, but a parliamentary inquiry headed by Iddi Simba, then Minister of Industries and Trade, found that the Minister of Finance had authorised the rate reduction against the advice of his ministry’s senior civil servants. The parliamentary commission writes that it had no “tangible evidence” that confirmed the allegations of corruption involving the minister, but asks what sort of motive he may have had to act against the recommendations of his ministerial aides. Consequently, the commission recommended to charge the minister. On 3 November 1996, President Mkapa announced the resignation of the Finance Minister (*The Indian Ocean Newsletter*, 1996:6, No. 740, 9 November). Thus, Professor Mbilinyi became the second minister of finance forced to resign within a period of two years as a result of poor judgement in taxation matters.

Table 3. Tax evasion and corruption in Tanzania – typologies (mid-1990s)

Different types of tax evasion and corruption	Mechanisms and extent
1. 'Unadulterated' tax evasion (without the involvement of TRA employees)	
Smuggling	Smuggling of goods (beer, spirits, soap, sugar, cooking oil, etc.). Border police is involved in some cases. Extensive.
The Zanzibar loophole	Goods are imported via Zanzibar where tariffs are lower. They are then transported to the mainland. <i>Tanzania Harbour Authority</i> may be involved in some of the cases. Extensive.
Underreporting of the value of imports	A general problem in imports of goods.
Underreporting of turnover	Common within retail and wholesale sectors.
Misclassification of goods	Import goods with high tax and duty rates are classified as goods with lower rates. One example is the classification of alcoholic beverages as mineral water. Extensive.
Taxable income/transactions are not reported or are underreported in accounts	Several ledgers are often used, including one for taxation purposes that shows a deficit. Common within many businesses. Extensive.
Goods in transit are sold on the domestic market	Could involve many types of commodities. Extensive, especially for oil and petrol.
VAT fraud	Falsified claims for VAT refunds. Can occur with the help of collaborators within the tax administration.
Overreporting of expenditures	An accounting trick to reduce tax burden. Common.
2. External corruption (involves both tax officers and taxpayers directly)	
Goods in transit	Tanzania is a major transit country for the importation of goods to Burundi, Eastern DR Congo, Rwanda, Uganda and Zambia. One way of evading tax is to report import goods as transit goods. Customs officers and importers work together occasionally. Substantial taxation losses. A review in 1996 concluded that at least 50% of all transit imports were unable to provide final documents proving that goods had arrived at their final destination. Most likely they ended up on the domestic market. Extensive.
False classification of goods	Customs officers may be involved (see above).
Underreporting value of goods	To avoid pre-shipment inspection of goods before shipment from the export country, a common method is to split the goods into units which individually are worth less than the minimum required to trigger inspection. The goods are therefore exempted from pre-shipment inspection. Underreporting the value of goods is also common, in particular for used cars. Customs and excise officers may be involved.
Tax exemption	Involves the tax administration, the Ministry of Finance, and Tanzania Investment Centre (TIC). In some cases, the tax payer is not registered in the tax registers, but pays a lower tax "privately" to tax collectors. Goods imported to religious and non-governmental organisations are exempted from taxation by law, but this is misused by business people who, by bribing tax officers, register goods as if they were intended for these types of organisations. In some cases business people also collude with NGO officials. Extensive.
Extortion	Taking advantage of taxpayers incomplete knowledge of tax legislation, tax collectors threaten taxpayers to increase rates and/or assume that taxpayers will not be financially able to press charges. Difficult to quantify, but small businesses, e.g., hotels and restaurants, claim that this is a big problem.
3. Internal corruption within the tax administration (does not involve taxpayers directly)	
Embezzlement of collected revenue	Tax officers steal tax money, leaving little or nothing behind for the treasury. May take place with or without the collusion of bank employees and/or auditors within the tax administration. Extensive.
Fraud	Falsifying tax receipts is common.
Corrupt inspectors/auditors	Internal auditing within Customs is considered inefficient and corrupt. Exacerbates the problems of corruption since it undermines the credibility of the monitoring policy. Extensive.

Sources: Compiled from various sources including Cunningham (1996), Osoro et al. (1999), TCCIA (1995), and personal communications with tax officers, clearing agents and business people in Dar es Salaam.

Four factors were identified as keys to explaining the extent and types of corruption pervasive in the Tanzanian tax administration:

- *Political intervention.* This generally took place in the form of discretionary tax exemptions granted to business people who were willing to pay and/or had the “right connections”.
- *High tax rates and complicated regulations.* The potential gain from involvement in corruption could be considerable both for officials and taxpayers. Relatively high rates and a complex and partly incoherent set of rules, especially for customs and corporate taxes, resulted in large potential rewards for taxpayers willing to bribe to cut their own tax burden and/or speed up customs clearance of their goods.⁷ For customs officials, the bribes taken for clearing specific containers in Dar es Salaam harbour could be as much as a whole year’s salary. In general, the system gave tax officials considerable discretionary powers.
- *Poor pay and working conditions.* The low wage levels at the tax administration compared to the private sector invited corruption. The average public employee’s salary including allowances in the early 1990s was sufficient to cover only about 40 per cent of normal household expenditures (Mans, 1994:378). Moreover, working conditions were characterised generally by a lack of technical equipment and poor office facilities, as well as unclear criteria for recruitment, promotion and rewards.
- *Low probability of detection and punishment for corruption.* Internal auditing and monitoring functions had become for the most part non-operative and ineffective (Cunningham, 1996). For instance, the internal operational auditing unit in the Customs Department at the head office in Dar es Salaam had only four staff members in early 1996, and five persons for the whole Dar es Salaam region where about 80 per cent of the total customs revenues in Tanzania are collected. Responsibility for internal auditing was therefore outsourced to external auditors from the Office of the Controller and Auditor General which stationed on a permanent basis six–seven people at the customs administration. But this compromised, of course, their independence and opened up for collusion between auditors and tax officers. According to Cunningham (1996:66), these auditors were “part of the system and the peer network to be inspected”. Audits were further handicapped by low skills. The auditing staff lacked training in auditing and inspection methods, and the required equipment and basic facilities to perform controls. In practice, the probability of being detected and punished for corruption was virtually non-existent.

Reform: The founding of TRA in 1996

A key element of the reform was to move the existing revenue departments out of the Ministry of Finance into a semi-autonomous Revenue Authority, the Tanzania Revenue Authority. TRA started operating 1 July 1996. Its objective was to reach a given revenue target, expressed as a given ratio of tax revenue to GDP. This target would be revised annually in the Finance Minister’s budget speech.

⁷ One example of the complexity of the regulations can be found in “The Harmonised Customs, Sales and Excise Tax Handbook”, which sets out in detail specific rates for imported goods. This “Handbook” was revised in 1996 with the aim of simplifying a complex system. The earlier edition numbered 350 pages; the revised edition ended up with 921 pages – excluding appendices – with smaller characters than the previous one. Some business people in Dar es Salaam argued that this was a deliberate strategy by the civil servants in charge of the “revisions” to facilitate corruption by making the system even more complicated and incomprehensible, since they had the most to lose from depersonalisation and simplification of customs.

The philosophy behind this move was twofold: first to eliminate the direct political influence of the Ministry of Finance on the day-to-day operations of the tax administration. And second, to raise the salary of tax officials without parallel increases for the rest of the public sector. A revenue authority, established outside the civil service system, is not, in principle, bound by wage rates and employment regulations that apply to other sectors of government (see Devas et al., 2001:214). This means that the institution can pay rates which enables it to attract and retain highly qualified staff. In TRA, this involved dramatic increases in pay rates – for some categories of staff up to ten times higher than corresponding positions in the civil service. Further emphasis was laid on strengthening accounting and internal monitoring systems and curtailing the opportunity of tax officers to deal with cases on the basis of their own discretion. The general scarcity of qualified accountants, lawyers and IT-experts in Tanzania meant, however, that these groups at TRA would be equally sparse. Finally, steps were taken to improve working conditions for employees by improving offices, expanding computer services, purchasing service vehicles etc..

To ensure a sense of “local ownership” to the reforms, efforts were made to fill board and executive management positions with Tanzanians. This in contrast, for instance, to the Uganda Revenue Authority which, for the first seven years of its existence, was led by a Ghanaian. Persons recognised for their integrity and past good performance were appointed as Chairman of the Board and Commissioner General. The rest of the executive management was generally recruited from outside the system, most from jobs in government-owned enterprises. Exceptions were the Commissioner for Internal Investigation and the Commissioner for Customs, both of whom were already employed in the tax administration.

Drastic measures were put in place to break the “culture of corruption” in the administration. All former staff members were dismissed and had to re-apply for a position at the new TRA. More than a third (35 per cent) were rejected on evidence or suspicion of misconduct (see table 4). Almost 1200 previous staff members, of whom 500 were former Customs officers, were not re-employed. All new employees were given a one-year probation period before being accepted on a permanent basis. Staff had to report their private financial circumstances, including wealth, on starting. Furthermore, a new unit was set up for internal investigation and monitoring. The first board of TRA, chaired by Professor Benno Ndulo (1996–98), played an essential role here by virtue of their *de facto* autonomy, integrity and expertise.

Table 4. TRA staff dismissed for misdemeanours

Year	1995/96	1996/97	1997/98	1998/99	2000/01
Staff at start of fiscal year	3365	2201	1962	1927	1897
Dismissed	1164	239	35	30	24
Percentage dismissed	35	11	1.8	1.6	1.3

Source: Tanzania Revenue Authority

How did the reforms work?

Developments after the founding of TRA can be divided into two periods. The first was characterised by decreasing corruption and a sharp increase in tax revenue. As already indicated, the trend turned, corruption seemed to increase and growth in revenue declined. In what follows these changes in corruption levels over the two periods are explained.

Phase 1 (1996–97)

In the first year of TRA's operations tax revenues grew by more than 30 per cent compared to previous fiscal years (see table 1b). Since there were few changes in the tax structure (rates and bases) and external conditions in this period, the growth in revenue must have been mainly due to the efforts of the tax collectors and other officials at TRA.

It may also suggest that the internal control mechanisms worked. During the probation period (1996/97) 239 staff members were dismissed (see table 4). A survey of taxpayers in Dar es Salaam also concludes that corruption shrank during the first year (PriceWaterhouseCoopers, 1998). But, according to the respondents, at the same time as the *number* of corrupt acts fell, the *price* per bribe rose (ibid. p. 3). Since there is no evidence that the demand for corrupt services grew during the period, the most plausible explanation is that tax officers who were willing to take bribes considered it more risky than before, and, thus, incorporated a "risk premium" in the bribes. According to the PriceWaterhouseCoopers study, the most corrupt staff members during this period were junior officers. Interviews with business people in Dar es Salaam confirmed this observation. This may imply that younger staff members were more inclined to accept a higher risk, or that they acted as agents for players higher up in the tax administration and then shared the "proceeds" with them (see Rose-Ackerman, 1999:49).

Phase 2 (1997–2001)

After the initial success, TRA failed to reach its revenue target and a new increase in corruption and tax evasion set in (Osoro et al., 1999:36). How can this relapse be explained?

One explanation could be that the first year's success was due to the fact that most employees were working on a probation basis and, additionally, had yet to learn how the new system worked. So although their attitudes to corruption may not have changed, it was perceived to be more risky to get involved at that stage in corrupt dealings. Tax officers did not know how the internal control mechanisms worked or how the top management would execute the rules and whether they stood in danger of losing prospects of a permanent job. These points were also confirmed in interviews with present and former TRA staff. It was stressed that many employees in the operational departments used their probation period to "study" how the system worked: "sitting on the fence waiting for better times". Later it was shown that some staff at TRA's Internal Investigation and Monitoring Unit (IIMU) were willing to take bribes to turn a blind eye to corruption. Rumours of corruption in IIMU were circulating as early as 1997, but it was not until December 2000 that the TRA management and board took action, resulting in 24 IIMU officers, including the head of the unit, being "retired in the public interest" (see table 4).

The assumption that higher salaries would boost productivity over time was most likely also exaggerated.⁸ It is a well-known fact in sociological management theory that when changes are introduced in an organisation, output increases – for a period. This is the so-called Hawthorne effect, which shows that short-term, individual incentives have few palpable effects on

⁸ Another aspect of wage incentives that has received little attention in connection with institutional reforms in Africa is associated with the role of family networks and obligations. Increased pay rates may also imply more extensive social obligations, resulting actually in a net loss to the individual. This state of affairs can develop into a vicious circle with higher wages leading to more corruption because the tax officer has to make up for the loss caused by such obligations. See Rose-Ackerman (1998:317–323) for a discussion of the role of traditional networks in reform processes.

productivity (Gillespie, 1993).⁹ The Hawthorne experiments showed that given certain conditions, both positive and negative changes in the employee's working conditions could lead to increased output. It was the social setting and peer group dynamics linked to the actual environmental change that affected productivity. An important conclusion from these studies is that workplaces are social environments and that people in them are motivated by much more than pure economic self-interest. Recent research also indicates that reformers and economists have an inclination to exaggerate the impact of economic incentives because of a too narrow understanding of group dynamics (see Frey, 1997; World Bank, 1995). James Wilson (1998:47) argues therefore that "[t]he principal challenge facing public managers is to understand the importance of carefully defining the core tasks of the organization and to find both pecuniary and nonpecuniary incentives that will induce operators to perform those tasks as defined".

Despite a dramatic increase in pay rates compared with normal rates in the public sector, it was not enough to compensate for the potential gains from corruption (URT 1996:285): "For a 'Long-Room' employee who is used to get bribes of TSh 20–30,000 daily, a ten fold increase of his salary from the present level will not make him desist from demanding and accepting bribes." The situation worsened even more due to the erosion by inflation of the initial pay rates for TRA staff, since nominal wages between 1996–2000 remained unchanged. It is therefore no surprise that the wage reforms seem to have had limited impact on restraining the extent of corruption in the tax administration.¹⁰

Another factor is linked to the impact of corruption networks. Research shows that corruption in public institutions has often been conducted by reasonably well-organised networks, where trust and reciprocity is found between network members (Rose-Ackerman, 1999). Such relationships are likely to reduce transaction costs, as well as any moral costs that may arise from allowing oneself to be involved in corruption. Furthermore, the peer networks often function as "repositories of knowledge" for members, e.g., on the attitudes of the top management to corruption, how the internal monitoring unit works, who is potentially bribable among staff members and management, etc..

The reforms probably managed to break a few existing networks, but not to hinder new networks – within and outside TRA – from emerging. The following anecdote may illuminate this process within TRA.¹¹ The TRA board is responsible for appointing people to high-ranking positions, while vacancies at lower levels are the responsibility of middle-level managers. Already in TRA's first year, board members were made aware of a practice in some units in TRA where applicants had to pay "speed money" just to have their applications processed. The board suspected this to be a method of sifting applicants which ensured that only those who signalled their readiness to pay bribes – and therefore probably also a readiness to get involved with the internal corruption networks – were recruited. This indicates the emergence of an informal market for jobs in TRA.¹²

⁹ The Hawthorne studies were carried out from 1927 to 1932 at the Western Electric Hawthorne Works in Chicago. The experiments focused on productivity and working conditions.

¹⁰ Irrespective of wage rates, the tax administration remains a very attractive workplace. According to the Commissioner for Personnel, TRA receives hundreds of applications for every advertised vacancy. The tax collection departments are particularly attractive. There is also considerable internal competition within TRA for vacancies in the operational departments (personal interview, March 2001).

¹¹ Personal interview with former board member of TRA, December 1998.

¹² From other countries it is known that a market for lucrative positions can emerge in public institutions that pay wages considerably over the market rate, where those with the capacity to pay the most get the jobs (see Andvig, 1999).

Just as intriguing is to see how new, external networks gradually formed connections between TRA and former employees in the tax administration. As already mentioned, about a third of former employees in the tax administration were not given new jobs in TRA. They were persons considered by the new management and board to have compromised themselves through involvement in corrupt dealings. Many of the dismissed people were, however, attractive as “tax experts” in the private sector due to their inside knowledge of the workings of the system. For example, many former customs officers were recruited by clearing agencies or they set up their own agencies.¹³ These persons had intimate knowledge of the tax administration, of loopholes, etc.. Since many of their former colleagues remained in the tax administration, good connections to the inside were assured.¹⁴ It is therefore not surprising that this type of corruption network eventually managed to reverse the positive process that characterised TRA’s first period.

Finally, the reforms also increased the distance between the executive management and the staff. Few in the top management of TRA had any previous experience with tax administration, in contrast to other staff members who were largely recruited from the former tax administration. The commissioners lack, in the view of a broad section of the staff, knowledge of how the organisation actually works on the ground. This may of course change in the future, and it is obviously positive that the present TRA leadership is considered to be “clean”.¹⁵ But it is not obvious that the current *esprit de corps* among the top managers will permeate the rest of the organisation. The reforms may also to some extent have hindered this by allowing huge differences in pay levels between the top and bottom grades.¹⁶

Conclusions

One lesson to be learned from TRA’s first six years is that even with relatively respectable salaries and working conditions, corruption may still thrive. The study shows that pay level is only one of several factors affecting the behaviour of tax officers. In an environment where the demand for corrupt services is extensive and monitoring ineffective, wage increases may end up functioning as an extra bonus on the top of the bribes taken by corrupt officers. The situation requires strong internal control mechanisms and effective sanctions that make it easier to dismiss staff.

Moreover, the study shows that partial reforms may soon run into difficulties. Despite quite comprehensive changes in the tax structure (rates and bases) after 1998, the tax system in Tanzania is still complicated and relatively non-transparent (Osoro et al., 1999:54). The lack of co-ordination between central and local government taxes exacerbates these difficulties (Fjeldstad & Semboja, 2000). Furthermore, tax legislation is unclear and causes random and partly *ad hoc* collection procedures (Luoga, 2002). Reforms of tax legislation and procedures should therefore take place concurrently to reduce opportunities for corruption and the demand

¹³ Since the founding of TRA, a total of 1,492 employees have been dismissed (see table 4). Of these, 656 came from the Customs Department (*Business Times*, 21–26 September 2001).

¹⁴ An employee in the Research Department of TRA referred to these former tax collectors as “ticking bombs” loaded with potentially dangerous information and knowledge about TRA.

¹⁵ These opinions emerged from personal interviews with business people in Dar es Salaam, and surveys conducted by the University of Dar es Salaam.

¹⁶ A similar situation prevails in the Uganda Revenue Authority (URA), where the internal wage compression rate is 34, i.e., equivalent to a wage gap of 3,300 per cent between the top and bottom grades (personal interview, Commissioner for Personnel at URA, June 2000).

for corrupt services. If not, one faces the risk that the administrative reforms will leave behind them highly paid, but also highly corrupt civil servants.

A major challenge facing reformers of tax administrations is to crack corruption networks and the inherent trust that appears to prevail between members of such networks. One suggestion is to introduce rotation systems for staff in tax administrations, where tax collectors remain only for shorter periods in the same post (Das-Gupta & Mookherjee, 1998). But one of the risks of this system is that the uncertainty that is thereby created for employees may result in increased corruption as collectors may use the opportunity to try enriching themselves while they are stationed in the most “lucrative” posts. Moreover, the rotation of officials may give corrupt superiors undue power. For instance, they might “sell” assignments to attractive positions or reassign officials to remote stations as a punishment for honesty (Rose-Ackerman, 1999:84). The scarcity of qualified personnel like auditors and accountants also reduces the potential of rotation schemes in the poorest countries.

Another suggestion is that staff should be compelled to give details of their economic situation and wealth to their employer, the purpose being that any jumps in assets that can not be put down to official earnings, will spark a reaction. TRA has introduced this system. But according to staff members, it is easy to get round the rules by registering unlawful gains in the names of other family members. The system is further undermined because even when staff members are discovered with more assets than their wages might lead one to expect, the assets are rarely confiscated. The reason for this is that the judicial system in Tanzania, as in many other poor countries, is highly corrupt and can easily be bribed. The threat of confiscation is therefore not credible.

Is privatisation of tax collection a possible solution? Currently, international Pre-shipment Inspection companies assess the value of imports to Tanzania. The collection of customs duties, however, is carried out by TRA. In Mozambique, however, both the assessment and collection of duties is managed by a private contractor (i.e., the British company *Crown Agents*). The contractor retains a percentage of the collected revenue. This management contract of customs was introduced in 1997, and, already in the first year, customs revenues jumped by 40 per cent. In 2000, the contract was extended for a new three-year period. According to Hubbard et al. (1999:155), the reform in Mozambique was less a decision to hand over the management of customs to a private organisation than to engage a private organisation temporarily in order to reorganise customs to reduce corruption and clearing times, and to increase customs revenues. Such contracts for reforming public institutions may, however, be fairly complex in poor countries, due to their multiple objectives and uncertainties (ibid., 162). In particular, they risk steering the contractor’s incentives towards quantifiable objectives, at the expense of issues such as transparency, accountability and taxpayers’ rights. In spite of these weaknesses, the experiences from Mozambique, “gives reason for guarded optimism” for this type of quasi-privatisation (Hubbard et al., 1999:163). But, whether this is a feasible option for Tanzania is another question. Given the vast resources invested in TRA and the political prestige involved, it is unlikely that the Mozambican approach represents a realistic alternative to TRA in the short run.

A necessary condition for successful reforms is the presence of political will to back them up (Riley, 1998; Tanzi & Pellechio, 1997; Rose-Ackerman, 1999). Without this determination, administrative and legal reforms will lack credibility. And if existing legislation is ignored, there is little chance that a new body of laws and regulations will bring about meaningful change. When the level of corruption is high and nothing is done to punish corrupt leaders, public confidence in the political and administrative leadership is undermined. Corruption at

high levels may also contribute to reduce the stigma costs of corruption and “legitimise” lower level corruption. Consequently, the Warioba Report (URT, 1996) argues that “it is obvious that if we want to rid ourselves of corruption, we must begin by cleaning the top leadership ranks”.

Little has been done, however, to discipline corrupt leaders after the Warioba Commission submitted its report in 1996. This has probably contributed to undermining peoples’ belief that the authorities are taking the fight against corruption seriously, which may in turn increase frustration and cynicism among the general public. According to the Warioba report (URT, 1996:70), “the greatest source of corruption in the country is not the poor economy and low salaries, although these too have played some part. The greatest source is the laxity of leadership in overseeing the implementation of established norms. The absence of clear guidelines on accountability of leaders in their respective positions – be it political leadership or senior administrative or management positions is part of the weakness”. The reluctance to implement measures against smuggling from Zanzibar is a clear indication of the continued validity of this opinion voiced by the Warioba Commission.

A further indication of the absence of credibility surrounding the political leadership is the increasing extent of tax exemptions granted in recent years. While exemptions accounted for 15.2 per cent of total tax revenues (actually collected tax plus exemptions) in 1996/97, this percentage grew to 37 per cent in 1998/99 (Mokoro et al., 2001). It includes both legal and discretionary exemptions given to individual firms. The extent of tax exemptions results in a narrower tax base and legitimises tax evasion. In the 2000/01-budget, however, the Government discontinued tax exemptions for public sector procurement of goods and services. This is a step in the right direction. But, many openings remain to abuse the system, for instance by business people who use bribes to register purchases and imports as intended for non-profit organisations or for development aid projects that are legally tax exempted. The removal of tax exemptions, including those granted to aid organisations and their employees, would help boost the credibility of both the authorities and the donors in relation to anti-corruptions measures, and, at the same time, contribute to widening the tax base and simplifying the tax system.

References

- Alm, J., Bahl, R. & Murray, M.N. 1991. "Tax base erosion in developing countries." *Economic Development and Cultural Change*, Vol. 39, No. 4, pp. 849-872.
- Andvig, J. 1999. "Corruption in the former USSR countries and international oil business in Azerbaijan." Oslo: *NUPI Report R:253* (December).
- Chand, S.K. & Moene, K.O. 1999. "Controlling fiscal corruption." *World Development*, Vol. 27, No. 7, pp. 1129-40.
- Cunningham, B. 1996. *Tanzania: Strategy and action plan to reform customs administration*. Dar es Salaam: Tanzania Revenue Authority.
- Das-Gupta, A. & Mookherjee, D. 1998. *Incentive and institutional reform in tax enforcement: An analysis of developing country experience*. New York/Oxford: Oxford University Press
- Devas, N., Delay, S. & Hubbard, M. 2001. "Revenue Authorities: Are they the right vehicle for improved tax administration?" *Public Administration and Development*, Vol. 21, pp. 211-222.
- Economic and Social Research Foundation [ESRF]. 1996. "Budget proposal for 1996/97: A synthesis of views from the business community." Report submitted to the Government of Tanzania (May 14). Dar es Salaam.
- Fjeldstad, O-H. & Semboja, J. 2000. "Dilemmas of fiscal decentralisation. A study of local government taxation in Tanzania", *Forum for Development Studies*, Vol. 27, No. 1, pp. 7-41.
- Frey, B. 1997. *Not just for the money. An economic theory of personal motivation*. Cheltenham: Edward Elgar.
- Galtung, F. 1995. "Current strategies for combating corruption: A study of corruption in the tax administration." Berlin: *Transparency International Occasional Working Paper* No. 8:1995.
- Gandhi, P., Selassie, A.A., WoldeMariam, A., & Schenone, O. 1995. "Tanzania: Proposals for tax reform in 1995/96 and beyond." *Fiscal Affairs Department*. Washington D.C.: International Monetary Fund.
- Gillespie, R. 1993. *Manufacturing knowledge. A history of the Hawthorne experiments*. Cambridge: Cambridge University Press.
- Hadler, S.C. 2000. *Best practice in tax administration in Sub-Saharan Africa: A handbook for officials* (June). Boston: International Tax Program, Harvard Law School.
- Hindriks, J., Keen, M. & Muthoo, A. 1999. "Corruption, extortion and evasion." *Journal of Public Economics*, Vol. 74, pp. 395-430.
- Hubbard, M., Delay, S. & Devas, N. 1999. "Complex management contracts: the case of customs administration in Mozambique", *Public Administration and Development*, Vol. 19, pp. 153-163.
- Luoga, F. 2002. "Taxpayers' rights and obligations: a survey of the legal situation in Tanzania." Dar es Salaam REPOA (mimeo).
- Mans, D. 1994. "Tanzania: resolute action", in I. Hussain and R. Faruquee (eds.) *Adjustment in Africa*. Washington D.C.: World Bank, pp. 352-426.
- McCourt, W. & Minogue, M. (eds.), 2001. *The Internationalization of Public Management. Reinventing the Third World State*. Cheltenham: Edward Elgar.
- Mokoro Ltd. & Oxford Policy Management Ltd., 2001. *Sustainability of government revenue policy in Tanzania*. Report to DFID East Africa.
- Mookherjee, D. 1997. "Incentive reforms in developing country bureaucracies. Lessons from tax administration." Paper prepared for the *Annual Bank Conference on Development Economics*. Washington D.C.: World Bank.
- Mukandala, R. 1983. "Trends in civil service size and income in Tanzania, 1967-1982." *Canadian Journal of African Studies*, Vol. 17, No. 2, pp. 253-263.
- Mwinyimvua, H.H. 1996. *The impact of macroeconomic policies on the level of taxation in developing countries: The case of Tanzania*. PhD Thesis, University of Dar es Salaam.

- Osoro, N.E., Mpango, P.I., & Mwinyimvua, H.H. 1999. "Enhancing transparency in tax administration in Tanzania." *EAGER/PSG Research Report* (March). Dar es Salaam: Department of Economics, University of Dar es Salaam.
- PriceWaterhouseCoopers, 1998. *Tanzania Revenue Authority. Corporate plan 1998/9 to 2002/3* (Appendix B: Taxpayer survey). Dar es Salaam (restricted distribution).
- Riley, S.R. 1998. "The political-economy of anti-corruption strategies in Africa." *The European Journal of Development Research*, 10 (June): pp. 129-159.
- Rose-Ackerman, S. 1999. *Corruption and Government. Causes, Consequences and Reform*. Cambridge: Cambridge University Press.
- Rose-Ackerman, S. 1998. "Bribes and gifts." Chapter 11 (pp. 296-328) in Ben-Ner & Putterman (ed.) *Economics, values, and organization*. Cambridge: Cambridge University Press.
- Semboja, J. & Therkildsen, O. 1992. "Short-term mobilization for recurrent financing of rural local governments in Tanzania", *World Development*, Vol. 20, No. 8, pp. 1101-1113.
- Slemrod, J. & Bakija, J. 1998. *Taxing ourselves. A citizen's guide to the great debate over tax reform*. Cambridge, MA: The MIT Press.
- Stotsky, J.G. & WoldeMariam, A. 1997. "Tax effort in sub-Saharan Africa." *IMF Working Paper*, WP 97/107 (September). Washington DC.: International Monetary Fund.
- Tanzania Chambers of Commerce, Industry and Agriculture [TCCIA], 1995. *Corruption and drug trafficking in Tanzania. A social-economic analysis*. Dar es Salaam.
- Tanzi, V. 2000a. "A primer on tax evasion." Chapter 10 (pp. 171-185) in V. Tanzi *Policies, institutions and the dark side of economics*. Cheltenham: Edward Elgar.
- Tanzi, V. 2000b. "Corruption, governmental activities, and markets." Chapter 6 (pp. 88-106) in V. Tanzi *Policies, institutions and the dark side of economics*. Cheltenham: Edward Elgar.
- Tanzi, V. & Pellechio, A. 1997. "The reform of tax administration" in Clague, C. (ed.) *Institutions and Economic Development*, Baltimore/London: The Johns Hopkins University Press, pp. 273-292.
- Therkildsen, O. 2002. "Uganda Revenue Authority: the limits of autonomy", Copenhagen: Centre for Development Research (unpublished mimeo).
- Ul Hage, N. & Sahay, R. 1996. "Do government wage cuts close budget deficits? Costs for corruption." *IMF Staff Papers*, Vol. 43, pp. 754-778.
- United Republic of Tanzania [URT], 1996: *Report on the commission on corruption* (The Warioba Report). Dar es Salaam.
- Wilson, J. 1989. *Bureaucracy. What government agencies do and why they do it*. New York: Basic Books.
- World Bank, 1995. "Bureaucrats in business. The economics and politics of government ownership." A *World Bank Policy Research Report*. Washington DC.

Summary

Over the last decade several African countries have undertaken comprehensive reforms of their tax administrations, with the aims of increasing revenue and curbing corruption. This paper examines recent experiences in the fight against corruption in the Tanzania Revenue Authority. Two lessons of broader relevance are highlighted. Firstly, even with relatively high wages and good working conditions, corruption may continue to thrive. In a situation where there is high demand for corrupt services, it is unrealistic to provide tax officers with pay rates that can compensate for the amount gained through bribery. Without extensive and effective monitoring wage increases may produce a highly paid but also highly corrupt tax administration. Secondly, hiring and firing procedures may lead to more corruption. Corrupt tax officers often operate in networks, which also include external actors. The manner in which the administrative reform was implemented in Tanzania, where many of those fired were recruited to the private sector as 'tax experts', seems to have strengthened the corruption networks. This partly explains why the positive process experienced in the initial phase of the new revenue authority was later reversed.

Recent Working Papers

- WP 2001: 2 OVERÅ, Ragnhild
Institutions, mobility and resilience in the Fante migratory fisheries of West Africa. Bergen, 2001, 38 pp.
- WP 2001: 3 SØREIDE, Tina
FDI and industrialisation. Why technology transfer and new industrial structures may accelerate economic development. Bergen, 2001, 17 pp.
- WP 2001: 4 ISMAIL, Mohd Nazari
Foreign direct investments and development: The Malaysian electronics sector. Bergen, 2001, 15 pp.
- WP 2001: 5 SISSENER, Tone Kristin
Anthropological perspectives on corruption. BERGEN, 2001, 21 pp.
- WP 2001: 6 WIIG, Arne
Supply chain management in the oil industry. The Angolan case. Bergen, 2001.
- WP 2001: 7 RIO, Narve
The status of the East Timor agricultural sector 1999. Bergen, 2001, 32 pp.
- WP 2001: 8 BERHANU, Gutema Balcha
Environmental, social and economic problems in the Borkena plain, Ethiopia. Bergen, 2001, 17 pp.
- WP 2001: 9 TØNDEL, Line
Foreign direct investment during transition. Determinants and patterns in Central and Eastern Europe and the former Soviet Union. Bergen, 2001, 41 pp.
- WP 2001: 10 FJELDSTAD, Odd-Helge
Fiscal decentralisation in Tanzania: For better or for worse? Bergen, 2001.
- WP 2001: 11 FJELDSTAD, Odd-Helge
Intergovernmental fiscal relations in developing countries. A review of issues. Bergen, 2001.
- WP 2001: 12 SUMAILA, Ussif Rashid and Samuel A. Laryea
Determinants of inflation in Tanzania. Bergen, 2001, 17 pp.
- WP 2001: 13 FJELDSTAD, Odd-Helge and Bertil Tungodden
Fiscal corruption: A vice or a virtue? Bergen, 2001.
- WP 2001: 14 TUNGODDEN, Bertil
A balanced view of development as freedom. Bergen, 2001, 21 pp.
- WP 2001: 15 SKAAR, Elin
Judicial independence and human rights policies in Chile and Argentina. Bergen, 2001, 24 pp.
- WP 2001: 16 TJØNNELAND, Elling N. *Rainbow justice and peace building. South Africa 1994-2001.* Bergen, 2001, 11 pp.
- WP 2001: 17 ANDVIG, Jens Chr., Odd-Helge Fjeldstad and Amit Shrivastava
Corruption: Critical assessments of contemporary research. Report from a multidisciplinary workshop. Bergen, 2001, 29 pp.
- WP 2001: 18 ANDVIG, Jens Chr. and Odd-Helge Fjeldstad (eds.)
Research on corruption in Bangladesh, Nepal, Sri Lanka, Tanzania and Uganda. What who and where? Bergen, 2001, 19 pp.
- WP 2002: 1 GRANBERG, Per
Updating the IO based Macmod functions. Bergen, 2002.
- WP 2002: 2 GRANBERG, Per
An analysis of Tanzania's 1998 imports. A sector of origin and end use analysis of Tanzania's goods imports, undertaken for the Macmod model. Bergen, 2002.