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THE PARALLEL ECONOMY IN TANZANIA: MAGNITUDE, CAUSES AND POLICY IMPLICATIONS

By ESRF & TBC

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TITLE: *The Parallel Economy in Tanzania: Magnitude, Causes and Policy Implications*

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EXECUTIVE SUMMARY:

This study attempts to assess the magnitude of the Parallel Economy in Tanzania, and to assess parallel activities in the following sectors: industry and trade, minerals, tourism and natural resources, transport and communications, and agriculture. It is found that substantial economic activities fall within the parallel economy. Factors that cause and sustian activities in the parallel economy in these sectors are identified as: high and multiple taxes; the presence of laws that are not sufficiently deterrant (or their total absence); and low remuneration/lack of incentives. On the basis of the analysis, recommendations on policy actions that would be desirable and feasible, and that would facilitate the shift towards a formal economy are made.

KEY WORDS:

The Parallel Economy, Tanzania

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LIST OF ABBREVIATIONS

ASYCUDA	-	Automated System for Customs Data and Management
AERC	-	African Economic Research Consortium
BIT	-	Board of Internal Trade
BET	-	Board of External Trade
BOT	-	Bank of Tanzania
CIF	-	Cost, Insurance and Freight
CRDB	-	Cooperative and Rural Development Bank
CTLA	-	Central Transport Licensing Authority
DUP	-	Dar es Salaam University Press
ECGS	-	Export Credit Guarantee Scheme
ERP	-	Economic Recovery Programme
ESRF	-	Economic and Social Research Foundation
EU	-	European Union
FEMATA	-	Federation of Miners Associations of Tanzania
FOB	-	Free On Board
GDP	-	Gross Domestic Product
IBRD	-	International Bank for Rural Development
IPC	-	Investment Promotion Centre
MDB	-	Marketing Development Bureau
MOA	-	Ministry of Agriculture
MT	-	Metric Ton
NAPB	-	National Agricultural Products Board
NASACO	-	National Shipping Agency Company
NBC	-	National Bank of Commerce
NIC	-	National Insurance Corporation
NMC	-	National Milling Corporation
OLS	-	Ordinary Least Squares
REMAs	-	Regional Miners Associations
RTC	-	Regional Trading Company
RTLA	-	Regional Transport Licensing Authority
SGS	-	Sociètè Generale de Surveillance
SAP	-	Structural Adjustment Programme
SCRS	-	Seed Capital Revolving Scheme
SIDA	-	Swedish International Development Agency
SMEs	-	Small and Medium Enterprises
STC	-	State Trading Company
STS	-	State Travel Service
TAMIDA	-	Tanzania Mineral Dealers Association
TAN	-	Tax Assessment Note
TANEXA	-	Tanzania Exporters Association

TATO	-	Tanzania Tour Operators
TBC	-	The Business Centre
TBS	-	Tanzania Bureau of Standards
TCCIA	-	Tanzania Chamber of Commerce, Industry and Agriculture
THA	-	Tanzania Harbours Authority
TISCO	-	Tanzania Industrial Studies and Consulting Organization
TLA	-	Tanzania Licensing Authority
TLB	-	Transport Licensing Board
TPTC	-	Tanzania Ports and Telecommunications Corporation
TRC	-	Tanzania Railway Corporation
TTC	-	Tanzania Tourist Corporation
TTCL	-	Tanzania Telecommunications Corporation Ltd
UFI	-	Ubungo Farm Implements
UK	-	United Kingdom
UN	-	United Nations
URT	-	United Republic of Tanzania
USA	-	United States of America
US $	-	United States Dollar
VAT	-	Value Added Tax
ZK	-	Zambian Kwacha

PREFACE

A study of the Parallel Economy in Tanzania is the result of collaborative efforts involving on one hand, the Parliamentary Finance and Economic Affairs Committee which initiated the idea to undertake the study, and the consultants on the other, namely, the Economic and Social Research Foundation (ESRF) and the Business Centre (TBC).

The study aims at deepening the understanding of the parallel economy by:

(i) assessing its magnitude;
(ii) examining its causes and mechanisms; and
(iii) making recommendations on how it could be brought in the mainstream economy.

The report draws from earlier studies on the parallel economy and utilizes primary data collected by interviewing a small sample group of officials from the Government, parastatals, business associations and institutions, as well as private business operators in Dar es Salaam.

The report covers parallel activities carried out in selected key sectors namely:

(i) industry and trade;
(ii) agriculture;
(iii) minerals;
(iv) natural resources;
(v) tourism; and
(vi) transport and communication.

The study team comprised of members from the Economic and Social Research Foundation (ESRF)[1] and the Business Centre (TBC).[2] The members of the study team from ESRF covered the industrial, trade and agricultural sectors while the study team from the Business Centre (TBC) covered the minerals, natural resources and tourism, and the transport and communications sectors.

1. The ESRF team: Prof. S. Wangwe, Dr. P. Tibandebage and Dr. A. Kilindo.

2. The TBC team: Mr. G. Mandara, Mr. A. Simba, Mr. Munisi, Dr. Zuberi and Mr. Mugeta.

EXECUTIVE SUMMARY

1. The Parallel Economy in the National Accounts: Largely Unrecorded

1.1. The size and structure of the Tanzanian economy is understood only to the extent that the official national accounts can reveal. It has come to light that the national accounts do not accurately reflect the country's economic activities either because coverage is incomplete or because of inaccurate estimates of its activities in the national accounts. Thus a significant part of the economy outside the formal economy remains unrecorded. The bulk of these activities are what constitute "the parallel economy".

1.2. In this study, the parallel economy is taken to include all the economic activities which involve the *illegal* production and trade of goods and services that are legal in themselves and therefore have alternative *legal* market channels. Such activities should be included in the national income but are presently not adequately captured by official national accounts and statistics. These activities tend to take place in markets that are not officially organized.

1.3. This study examines the magnitude and pattern of activities taking place in the parallel economy and identifies the factors and dynamics which cause and sustain the existence of such activities. The findings on the magnitude, pattern and causes of the parallel economy and the dynamics sustaining it form the basis for drawing policy implications from the study. The identification of the nature and structure of economic activities in the parallel economy is expected to throw light on areas where policy action is needed to facilitate the development of desirable activities in the parallel economy and on areas where policy action is desired to facilitate a shift towards the formal economy.

2. Size of the Parallel Economy: Size Uncertain; Operations Significant

2.1. According to studies carried out in the mid-1980s the size of the "second economy" amounts to some 30% of the GDP. According to other estimates using alternative methodologies, the size of the second economy is found to be large, with estimates ranging from 30%-70%. Furthermore, concern has been expressed over the possibility that national income estimates are considerably underestimated by about 30%-200%. The width of the underestimated range is itself an indication of the uncertainty of information on the actual size of the parallel economy in Tanzania. Given the time constraint in this (preliminary) study, it would not be realistic to generate new estimates of the parallel economy's size. Making comprehensive estimates of the parallel economy is the task of a special project which is currently in progress at the Bureau of Statistics. However, on the basis of existing studies, the size of the parallel economy is estimated to be in the region of 60%-70% of the official GDP. The large size of the parallel economy is also indicated by the fact that:-

(i) unrecorded exports are about twice the amount of recorded exports;

(ii) own funded imports are largely financed from unrecorded export earnings; and

(iii) actual revenue collection is about 30%-40% of the potential.

2.2. New estimates of national accounts have recently been made incorporating new data from recent surveys. These latter surveys were carried out by the Bureau of Statistics (e.g. the Household Survey of 1991/92, the Census of Industrial Production of 1989, and the Informal Sector Survey of 1991). The new estimates of national income for the period 1976-1990 have now been completed (revised estimates for the more recent period are not available as yet). The new estimates for 1990 reveal that previous national accounts underestimated the size of various sectors of the economy by a large margin. According to the Revised National Accounts of Tanzania (1976-1990), newly revised estimates of GDP are higher than the former official estimates by 46%-62% -- depending on whether the GDP is estimated at factor cost or at market prices.

3. The Nature of Activities in Selected Sectors

3.1. In this study, limited fieldwork was carried out (in selected sectors), through the identification of key indicators in the parallel economy. Where possible, an estimation of the size of these activities was made. The sectors covered (as previously mentioned) were the following: industry and trade; minerals; tourism; natural resources; agriculture; and transport and communication.

4. Factors that Cause and Sustain Activities in the Parallel Economy

4.1. Activities in the parallel economy usually develop in response to excessive Government interventions and restrictions. The motive is usually to avoid various forms of Government interventions such as taxes, price controls, quota restrictions, the requirement to sell through officially designated channels and other regulations.

4.2. In many cases, the persistence of such activities is a rational response to the environment in which those activities are taking place. Based on the literature on this subject, and from interviews, this study examined the main causes and factors sustaining the activities in the parallel economy.

4.3. Tax-related issues which have contributed to the existence of the parallel economy are associated with high taxes, the multiplicity of taxes, and cumbersome and inefficient tax administration.

4.3.1 Prohibitive tax rates have been identified as one of the main causes for the existence of the parallel economy in Tanzania. Commenting on the issue of tax evasion, some of the respondents interviewed pointed out that often tax payment is evaded as a necessity because payment of high tax rates could put the price of commodities beyond the reach of the majority of the population.

4.3.2. Information gathered also indicates that there are too many taxes, a factor which has also contributed to tax evasion. This multiplicity complicates the administration of the taxes and does not provide a conducive environment.

4.3.3. Another tax-related factor which contributes to tax evasion is the lack of transparency in the assessment and administration of taxes -- which leads to acts of corruption.

4.4. The management of a market economy and an economy which allows substantial private sector participation requires that the (Government) bureaucracy manages the economy in ways that are consistent with that kind of economy. However, findings of this study indicate that the bureaucracy is still perceived to be inclined towards a stiff approach to economic management. As a result registration, licensing and import procedures remain bureaucratic. It still takes too long to register a business in Tanzania (one requires many licences for a single business undertaking; has to renew licences; or register after a relatively short period). Customs control, for example, is very problematic. All these factors have been identified as contributing towards sustaining activities of the parallel economy.

4.5 The presence of laws that are lenient or not severe enough, and laxity in the enforcement of the existing laws are other factors which keep the parallel economy in existence.

There are weaknesses in the Customs Tariff Act, and the Customs and Excise Management Act. The section of the law that allows for tax exemption is most abused. There have been unmerited import exemptions. This abuse of privilege has increased during the trade liberalization period.

Laxity in customs procedures also occurs in the control of customs warehouse and the follow-up of transit goods. The transit goods loophole is also used; goods are declared as being destined for a neighbouring country but are later on sold within the country.

4.6. It appears that economic reforms resulting in a liberalized economy did not first ensure that an enabling environment for successful private sector participation in marketing activities was in place. This situation has also contributed to parallel market activities.

4.7. Low remuneration and lack of adequate incentives for Government employees has contributed to acts of bribery and corruption. Some Government officials collude with business operators to cheat the Government of its revenues. Because of low pay, some law enforcers are willing to collaborate with tax evaders. They thus end up sharing a substantial part of Government revenue.

5. Major Recommendations

5.1 Reducing and rationalizing taxes

The recommendations made with regard to reducing and rationalizing taxes were as follows:

5.1.1. Tax rates should be rationalized with a view to encouraging compliance. The tax base should also be widened. The extent of reduction should, however, consider revenue needs by Government.

5.1.2. Income tax for businesses should be rationalized, and payment should not be made before the inception of a business. Income tax should be levied on income actually earned (rather than on anticipated income).

5.1.3. Where there have to be more than one tax levied on a business, these should be minimized to not more than two. Currently, there are businesses which have to pay more than 10 different taxes.

5.1.4. Corruption is encouraged by the excessive discretion of the tax assessor, and the fact that negotiation possibilities exist between the tax assessor and the tax payer. The process of tax assessment should not involve face to face contacts between the assessor and the tax payer.

5.1.5. It is also recommended that the process of identifying tax brackets should involve business associations, because the latter know their members' level of activity.

5.1.6. Arrangements should be made to impart knowledge to tax payers on the tax rates and procedures followed in tax assessment. This could easily be done through the publication of the tax brackets and what one is supposed to pay say, in newspapers or brochures.

5.1.7. Remove the harsh methods that have characterized the approach to tax payers. These should be replaced by more systematic and smooth tax collection methods with a view to encourage compliance and responsibility on the part of the tax payers.

5.1.8. After rationalizing and making taxes affordable, stiff sanctions (including imprisonment) should be imposed on tax evaders.

5.2. Streamlining registration and licensing procedures

On streamlining the registration and licensing procedures, the recommendations were:

5.2.1. The process of registration and acquisition of business/industrial licences should be made as simple as possible.

5.2.2. Small and medium scale activities which are currently operating outside the formal economy should be encouraged to register their activities by simplifying the registration procedures and by providing promotional and support services to registered activities.

5.2.3. The licences issued should allow flexibility and accommodate the standard activities expected to be carried out in an industry. This would obviate the need to have multiple licences required before a particular industry starts operations.

5.3. Removing bureaucracy and lengthy procedures in external trade

5.3.1. Currently, it is estimated that it takes on average, 37 days to clear imports from the port. There is need for the Government to speed up the introduction of "one-stop, one-day" arrangements.

5.3.2. The Government should then clearly define the role of Pre-Shipment Inspection (PSIs) companies and customs.

5.3.3. The Government should seriously consider whether the retention and "own funds" import schemes are still needed given that the foreign exchange market has been liberalized.

5.4. Strengthening the legal framework and law enforcement for business operations

On strengthening the legal framework and law enforcement for business operations, the following was recommended:

5.4.1. The review of the existing legal framework should be speeded-up to make it appropriate for a market-oriented economy and private sector led development.

5.4.2. In all sectors (or sub-sectors), institutional arrangements should be made to establish joint councils between actors in the public sector and those in the private sector. Such councils should co-operate in addressing various procedures and obstacles to smooth business operation. The councils should discuss the relevant public policies that impinge on the activities of the relevant sectors.

5.4.3. It was also recommended that business regulations be streamlined and obstacles to business operations removed. Once this has been done, the Government should then strengthen the mechanisms for monitoring the various business operations in accordance with the legal and regulatory framework in place.

5.4.4. The revenue collection arms of the Government should involve associations of respective operators in specific sectors in reviewing and monitoring performance in revenue collection.

5.5. Establishing and promoting proper marketing arrangements

5.5.1. A proper marketing system is necessary for successful business operations. This entails having policies and incentives which attract and motivate business in place such as an adequate infrastructure, both in terms of transport and communication, and easy access to credit.

5.5.2. It is recommended that the establishment of competitive joint venture operations in marketing and other activities between local operators and appropriate foreign counterparts be encouraged with a view to make capital and technology better available for domestic operations.

5.5.3. It is also recommended that indigenous small scale investments should be promoted and facilitated by the provision of incentives that are at the very least as favourable as those offered to foreign investors under the Investment Promotion Centre Act.

5.6. Removing bureaucratic barriers and enhancing efficiency of public services

On removing bureaucratic barriers and enhancing efficiency of the public services, the following is recommended:

5.6.1. Bureaucratic difficulties should be reduced by putting into place incentives that encourage public servants to step up their performance to cope with the requirements of a market economy and competitiveness. Civil Service Reforms currently being implemented are expected to address this problem. Among other important issues, however, there is need to establish a system under which the implementors and managers of regulatory functions can be held accountable to the public they serve. This could provide an institutionalized mechanism by which the performance of Government officials can be assessed/evaluated on a continuous basis by a performance audit or other institutional arrangements.

5.6.2. Regulations and procedures which guide the actions of the bureaucrats should, to the extent possible, be made available to the public that makes use of the service. Greater transparency would not only give strength to the public being served but would also show the public what their rights are -- and when they could launch complaints.

5.6.3. The bureaucracy should establish the system of evaluation. After a member of the public has received service it should be possible for him/her to express opinion on the quality of service rendered and show the difficulties encountered, if any. These suggestions/opinions should be made available to the superiors and/or to the performance audit unit.

5.6.4. Pay a living wage commensurate with qualifications, experience and performance and providing incentives for good performance.

CHAPTER ONE

INTRODUCTION

The size and structure of the Tanzanian economy can be partially understood only to the extent that the official national accounts can reveal. It has come to light that the national accounts do not accurately reflect the economic activities being conducted in the country either because its coverage is incomplete, or because of inaccurate estimates of the activities which are supposed to be covered in the national accounts. A substantial part of the economy (outside the formal economy), thus remains unrecorded.

Various World Bank Reports rank Tanzania as one of the world's poorest countries. The latest among the reports puts Tanzania's 1993 GDP per capita at US $90 (World Development Report, 1995), which is one of the lowest in the world and making a tie only with Mozambique.[3] However, these estimates should be interpreted with caution as alternative estimates vary considerably. For instance, in 1982 income per capita for Tanzania was US $280 (World Bank, 1984)[4] and increased to US $290 in 1985 (World Bank 1985). Following large devaluations of the Tanzanian shilling, the income per capita is shown to have declined to US $160 in 1988 (World Bank 1990) and further down to US $100 in 1991 (World Bank 1993). In 1993, it fell further down to US $90 (World Bank, 1995). The same document, however, indicates that Tanzania's income per capita has been growing at an annual rate of 0.1% during 1980-1993 (World Development Report, 1995), suggesting that data showing such large declines should be interpreted with great caution. According to the national accounts of Tanzania, the average GDP growth during 1986-94 was around four percent in real terms. Considering that population growth is about three percent per annum this implies an income per capita growth of about one percent in real terms over the period. This appears to contradict the

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[3]. Per capita income estimates by the World Bank and other multilateral institutions are arrived at on the basis of "cleaned" data obtained from the Government of Tanzania.

[4]. See IBRD/World Bank. 1984. World Development Report.

claim that income per capita has been declining over the same (1986-94) period. Estimates of the GDP in US dollars are likely to be problematic in the context of the large devaluations. Alternative estimates by the United Nations International Comparison Project registered Tanzania's 1990 per capita purchasing-power-parity (PPP) equivalent to GDP per capita as US $540. According to the Human Development Report (1995), the real GDP per capita for 1992 in terms of the PPP is given as US $620 for Tanzania. According to estimates of the Poverty Profile Study conducted in 1993, per capita GDP for Tanzania was put at US $280 (World Bank 1993a). Estimates of GDP per capita in US dollars indicate great care should be taken in their estimation. This is because of several reasons:

(i) First, the fact that there is wide variation between the different estimates suggests that the estimation is problematic.

(ii) Second, due to the large devaluations that Tanzania has gone through since the mid-1980s, the usefulness of estimates of the GDP in US dollars is greatly reduced. Thus the drastic decline in GDP figures for Tanzania reflects the changes in the standard of living that devaluation brings.

(iii) Third, the GDP per capita estimates for 1993 put Tanzania and Mozambique as the world's two poorest countries; however, impressionistic comparison with the economic situation in other countries in Africa does not suggest that Tanzania is the poorest in the world (although this should not be taken as a denial that Tanzania is poor).

These precautions suggest that the official GDP figures are suspect and incomplete in their coverage and understate the size and composition of the economy.

It is hypothesized that a large parallel economy exists within Tanzania. In this context, this study sets out to give an indication of the parallel economy's magnitude and nature, and identify its causes. This is important in the context that the existence of such a sizeable sector of unrecorded domestic and international economic transactions has several implications relevant to policy analysis and economic management. The four main implications are:

(i) That the condition of the real economy is only partially understood is implied. Incomplete information on the status and condition of the economy imposes considerable limitations on the formulation of pertinent policies and the determination of the desired direction of socio-economic change.

(ii) This is also an indication that the existing series of national accounts are not robust enough for meaningful policy analysis, or for policy and programme formulation. This could cast doubt on the reliability of the macroeconomic aggregates and projections on the basis of which existing policies have been formulated.

(iii) The co-existence of a parallel economy is likely to limit the efficacy of a blanket policy for the economy. The design of policies specifically aimed at promoting desirable economic activities in the parallel economy (e.g. policies that enhance access to markets and resources such as capital and technology) may be inhibited by the lack of information on activities and operations in that part of the economy.

(iv) The ability to design policies to facilitate the necessary shift of activities from the parallel economy to the official economy is limited by inadequate knowledge of the parallel economy's operations and its relationship and linkages to the rest of the economy. Success in inducing such a shift is likely to facilitate efforts towards a comprehensive policy analysis and economic management and to enhance the broadening of the economy's tax base.

This study examines the magnitude and pattern of activities taking place in the parallel economy and identifies the factors and dynamics which cause and sustain the existence of such activities. The findings on the magnitude, pattern and causes of the parallel economy and the dynamics sustaining it form the basis for drawing policy implications of the study. The identification of the nature and structure of economic activities in the parallel economy is expected to throw light on areas where policy action is needed to facilitate the development of desirable activities in the parallel economy and on areas where policy action is desired to facilitate a shift towards the formal economy.

This report is organized in five chapters. Following the first (introductory) chapter, the second chapter defines the parallel economy and describes the methodology adopted in the study. Chapter three addresses the magnitude and pattern of the activities in the parallel economy placing relatively greater emphasis on activities in the sectors sampled. The underlying factors that cause and sustain operations in the parallel economy are examined in chapter four. This chapter addresses the cross-cutting factors as well as factors which are more specific to the selected sectors. Chapter five is a presentation of the study's conclusions and recommendations.

CHAPTER TWO

CONCEPTUAL AND METHODOLOGICAL ISSUES

In this study, the parallel economy is taken to include all economic activities that involve the *illegal* production and trade of goods and services that are *legal* in themselves and therefore could be channeled through the *legal* market. Such activities should be included in the national income but presently are not adequately captured by the statistics of the official national accounts.[5] These activities tend to take place in markets that are not officially organized.

Activities in the parallel economy usually develop in response to excessive Government intervention and restriction. The motive is usually to avoid various forms of Government interventions such as:

(i) taxes;
(ii) price controls;
(iii) quota restrictions;
(iv) sale through officially designated channels; and
(v) other regulations.

For example, when the tax rate is perceived to be too high, there is a tendency for tax evasion; at the same time, if the risks for evading taxes are not prohibitive, supply and demand may clear at a price lower than that after the taxes are paid, a situation which makes tax evasion pass as a profitable option. Similarly, relatively higher duties on imports serve as an incentive for the under-reporting of imports, while subsidies may encourage exporters to over-invoice shipments. Price controls, import licensing and credit restrictions amidst shortages and inflation may create excessive demands which set up a queue of people willing to buy goods and services at higher and unofficial prices.

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5. This definition of the "parallel economy" is very close to that of the "underground"' economy used by Tanzi (1982) and similar to Schneider's (1986) "hidden" economy and similar to Bagachwa and Naho (1995).

Higher parallel market prices motivate producers and traders to divert part of their output to the parallel market. Such activities of the parallel economy may in most cases fall outside the purview of the Government's promotional, regulatory, control and monitoring mechanisms.

There are many perceptions of the parallel economy; and some of these are adverse. For the purposes of this study, all these perceptions can be summarized into two main contrasting views. One view stresses the dysfunctional role and negative aspects of the parallel economy, and regards it as being caused by clandestine activities that deny the state of its legitimate revenue needs, and serves as a breeding ground for theft and fraud. In addition, such activities are perceived to be inequitable and exploitative (Bagachwa and Naho, 1995). According to this view, the parallel economy is irrational and represents an undesirable departure from the established economic and social norms or equilibria.

The other view regards the parallel economy's activities as being productive and creative adaptations to social market forces working towards socio-economic harmony/equilibrium. Such behaviour is conceived as having developed in response to an economic crisis and formal official system's failure to deliver the goods and services required in time; and/or as a revolt against excessive state intervention. According to this view, the parallel economy is not to be regarded as a pathological fact but as nature's revolt; a somewhat healthy reaction to the pathology of the state (Del Boca and Fortes, 1982). This view further assents that the activities in the parallel economy can best be understood by addressing the nature of Government interventions, restrictions and other policies which possibly provide motivation and sustenance to parallel market operations.

This study is open to both interpretations of activities in the parallel economy depending on the nature of specific activities and operations found in the parallel economy. Some activities may be found to conform more closely to the first view, while other activities and operations may be found to be more akin to the second view. The relative importance of the two categories of activities can only be established by a closer examination of particular activities in the parallel economy.

This study has approached these issues by first making reference to research that has been undertaken on the subject in Tanzania and other countries. Given the time constraint, the bulk of the information on the parallel economy has been collected from existing studies on the subject. Previous studies have mostly focused on the period before or soon after the introduction of economic reforms in the mid-1980s. In order to capture some elements of the nature and pattern of the parallel economy in more recent years, a survey of a sample of sectors and sub-sectors was conducted. Information collected from field work on selected sectors was used to supplement the existing information (from secondary sources). On the basis of that sample, and based on guesses of knowledgeable actors involved in the respective activities, the study provides some indication of the magnitude, pattern and causes of parallel market activities. The sectors selected were:

(i) agriculture;
(ii) industry and trade;
(iii) minerals;
(iv) natural resources;
(v) tourism; and
(vi) transport and communications.

CHAPTER THREE
MAGNITUDE OF THE PARALLEL ECONOMY

3.1. General Overview

The most comprehensive study of the parallel economy to-date shows that the size of the parallel economy had grown as the official economy entered distress in the early 1980s.[6] In their study Maliyamkono and Bagachwa (1990) estimated the size of the second economy at some 30% of the GDP. Using the demand-for currency approach it has been suggested that the size of the second economy is still large with estimates ranging from 30%-66% (Bagachwa and Naho, 1995).[7] Using the missing income methodology Sarris and Brink (1993), have arrived at estimates of the parallel economy ranging between 60%-68% of the official GDP for the period between 1985-1988. Further concern has been expressed about the possibility that the underestimation of the national income estimates could be in the range of 30%-200% (Komba, 1996).[8] The width of the range of underestimation itself indicates the uncertainty of information on the actual size of Tanzania's parallel economy. However, all the studies agree that the size of the parallel economy is substantial. Most studies indicate that the share of the parallel economy has been increasing over time. In the Maliyamkono and Bagachwa (1990) study, the size of the parallel economy in terms of the GDP is shown to have increased from about 10% (1978) to about 30% (1986).

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6. This refers to the book by Maliyamkono and Bagachwa (1990) which was based on a major study conducted in the mid-1980s in which both micro and macro approaches were used.

7. Bagachwa , M. S. D. and A. Naho. 1994. A Review of Recent Developments in the Second Economy in Tanzania. *AERC Special Paper No. 16*, Nairobi, Kenya.

8. This information is based on a background paper prepared for the ESRF by Mr. John Komba (retired Assistant Government Statistician) who for many years was in-charge of the National Accounts Section of the Central Statistical Bureau. The estimates from various studies are summarized in Appendix A.1 and A.2.

The level of underestimation of the national income originates mainly from the fact that the methodology used in estimating the national income has not been adjusted to cope with the changing structure of the economy and to the changing nature of activities in a more liberalized market economy. In addition, it is admitted that the results of recent surveys such as the Household Survey of 1991/92 and the Informal Sector Survey of 1991 have not been incorporated into the estimates of national accounts. The way the surveys were designed captures a substantial part of activities within the parallel economy.

In the time allowed for this study it would not be realistic to generate new estimates for the size of the parallel economy. That task needs more time[9] and resources. In any case, before anybody embarks on such an ambitious research project it would be advisable to take into account the on-going efforts in the direction of improving national income estimates.

Recently, the estimates of national accounts have been revised with the technical support of Eurostat and the Swedish International Development Agency (SIDA). The new estimates have incorporated information from recent surveys carried out by the Bureau of Statistics such as the Household Survey of 1991/92, the Census of Industrial Production of 1989 and the Informal Sector Survey of 1991. The new estimates of national income have been completed only for the 1976-90 period. Revised estimates for the more recent period are not available as yet. New estimates for 1990 reveal that the national accounts grossly underestimated the size of various areas of the economy. According to the Revised National Accounts of Tanzania 1976-90, the newly revised estimates of GDP are higher than the former official estimates by a range 46%-62% (URT, 1995b). The new GDP (at market prices) is found to be higher than the former GDP by 45.7% while new GDP estimates at factor cost exceed the former official estimates by 61.7%. Final consumption expenditure at household level is found to have been underestimated by 35.7% while the gross fixed capital formation had been underestimated by 29.8%. The revisions have improved the accuracy of national accounts estimates but several areas remain in which the national accounts estimates are fragile and less accurate. The

[9]. About 6-12 months.

new and revised national accounts estimates have a better coverage and greater accuracy than the old estimates. However, the extent to which they still leave out some economic activities is not known as there are no new estimates of the parallel economy. A recent World Bank two-year project (which started in July 1995), has been designed to strengthen the national accounts of Tanzania with a focus on developing new data sources for activities in three sectors for which the national accounts data is known to be weakest. These sectors are construction, trade and transport.

In addition, the World Bank project on Strengthening of National Accounts aims at improving the quality of the national accounts by improving the overall methodology and by providing training. The results of that project should substantially improve the accuracy of the national income estimates.

In recognition that efforts to improve estimates of national income are in progress, and that new attempts to estimate the parallel economy would require more time and resources, this study proceeds to identify the nature of activities currently falling in the parallel economy category in selected sectors. Where possible, the size and activities within the parallel economy in those sectors is estimated based on the guesses of knowledgeable actors in the respective sectors.

3.2. Parallel Market Activities in Selected Sectors

As mentioned in chapter two, key indicators of parallel economy activities in selected sectors are identified and where possible estimation of the size of these activities is made. The sectors covered are: industry and trade, minerals, tourism, natural resources, agriculture and transport and communication.

3.2.1. Industry, internal and external trade

- **An overview**

The manufacturing sector's contribution to the GDP rose rather steadily from 1961 and reached a 13% peak in 1976. After that, there was a steady decline to 7.9% in 1987. Between 1987 and 1992 manufacturing GDP averaged over eight percent per annum (URT, 1994).

There has been an increase in the share of foreign trade in GDP -- with imports having the larger share. External trade contributed an average of 30% to GDP for the 1983-90 period. The share of exports in the GDP was 5.9% in 1983, and rose to 6.8% in 1986 reaching 16.4% in 1990. Imports contributed 12.8%, 18.7% and 40.3% in 1983, 1986 and 1990 respectively.[10] Since imports have contributed a larger share to the GDP, the merchandise trade gap has been growing from 6.8% of the GDP in 1983 to 23.9% of the GDP in 1990.

Parallel activities form a significant proportion of the economic activities in industry and trade. These are:

(i) unlicensed activities;
(ii) under-declaration of production level to avoid taxes; and
(iii) mis-classification of imports into categories which are subjected to lower duties.

While parallel activities consisted of parallel commodity outlets and parallel prices during the confinement period, with the coming of liberalization, these activities have manifested themselves differently. In industry, for example, the number of unlicensed industries has increased indicating that actors within this sector choose to operate underground due to cumbersome licensing procedures and high taxation that businesses have to face before embarking on the venture.

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10. Mbogoro. 1994.

Parallel activities are also undertaken by some registered private and corporate companies. The sales tax legislation stipulates that manufacturers are supposed to fill a form showing their level of production for sales tax assessment. Customs officials showed that there are incidences in which production figures have been under-declared. Sometimes, the required forms are not filled. There are also instances where the producer colludes with the customs official and part of what was supposed to go to the Government as tax revenue is appropriated by the official.

- **Over and under-invoicing of imports and exports**

Another manifestation of the parallel market in external trade is over and under-invoicing of exports and imports. Maliyamkono and Bagachwa (1990) showed that Tanzanian imports data were under-recorded by Tshs.430.5 million in 1985 and over recorded by Tshs.297.7 million in 1986. This suggests that Tanzania's imports from Britain were under-invoiced by 18.7% in 1985 and over-invoiced by 8.1% in 1986. In 1986 the extent of under-invoicing was estimated at 8% of the total recorded imports which is equivalent to Tshs.2,471 million (about US $65 million). Apparently, those requesting for forex from the Treasury (for their imports) chose to over-invoice as a way of obtaining forex from the Government; while those who imported using their own funds under-invoiced as a tax evasion strategy.

The country's under invoicing to the total recorded imports between 1985 and 1990 was estimated at Tshs.3,884 million, while exports were over-invoiced to the tune of Tshs.593 million (Nyagetera, 1995; also see Tables 3.1 and 3.2).

Table 3.1 **Imports Over/Under-Invoicing: Tanzania and the UK**

Year	Recorded Imports Value - Million Tshs.	Data Discrepancy %	Value Discrepancy - Million Tshs.
1987	8,518	-34.70	-2,955.00
1988	1,468	-20.30	- 298.0
1989	23,912	-9.30	-2,234.00
1990	34,104	+4.7	1,603
1991	68,002	-62.60	3,884

Source: (1) Nyagetera. 1995. (For Data Discrepancy).
(2) BOT. 1995. (For Recorded Imports).

Table 3.2. Exports Over/Under-Invoicing: Tanzania and the UK

Year	Recorded Exports Million Tshs.	Data Discrepancy %	Value Discrepancy Million Tshs.
1987	1,978.00	-29.20	-577.60
1988	3,421.00	-14.10	-482.40
1989	6,267.00	+23.5	1,472
1990	8,578.00	+ 2.1	180
1991	20,244.00	-17.70	+ 593

Source: (1) Nyagetera. 1995.
(2) BOT. 1995.

An examination of imports data discrepancies by sector, reveals that food and live animals, crude materials, inedible fuels, mineral fuels and lubricants, animal and vegetable oils, fats and waxes, chemicals and related products and manufactured goods have tendencies towards over-invoicing (see Appendix Table 1).

- **Unrecorded imports and exports**

Another parallel activity in external trade is to evade normal channels and export or import without entering official records for the purpose of avoiding payment of duties.

There is lack of official records of estimates on unregistered exports and imports. The occurrence of widespread unregistered border sales and purchases, and open trade deals represents a substantial under-estimation of the external trade. However, data on trends of this type is not readily available.

Maliyamkono and Bagachwa (1990) used the value of goods seized by custom authorities to provide some indications of the volume of unrecorded trade. Table 3.3 portrays the level of unrecorded exports and imports. Impounded goods, however, are likely to represent a small proportion of unrecorded trade volumes. The trend suggested by these data is towards an increase in unrecorded imports in the post-liberalization period (from 0.25% in 1985 to 1.5% in 1994). This is to be expected because liberalization measures (such as the encouragement of own funded imports) and the lack of efficient control mechanisms by authorities, increase the loopholes for such practices. It has been suggested that unrecorded exports accounted for about 30% of the import bill (ESRF 1996a). The prevalence of illegal activities in the export sector is shown in Appendix Table 2.

Table 3.3: Export/Import Goods Seized by Tanzania Customs (in Million Tshs.)

	1985	1986	1994
Total Imports	16,930.00	39,881.00	18,050
Goods Seized	42.9	18.9	276.3
Goods Seized % of Total Imports	0.25	0.06	1.5
Total Exports	6,030	10,963.00	n.a.
Goods Seized	5.4	1.7	n.a.
Goods Seized % of Total Exports	0.09	0.02	n.a.

Source: (1) Maliyamkono and Bagachwa (for 1985 and 1986).
(2) Customs (for 1994).

- **Own-funded imports**

A glimpse of the size of parallel exports can also be given by examining the volume of own-funded imports. Own foreign exchange of the importer is used to finance imports under this category. This scheme started in 1984 and it was intended to first exhaust the stock of foreign exchange that had presumably been accumulated outside by residents. On the contrary, import licences issued under own funds doubled within a span of four years from US $252 million (19% of total import licences) in 1984 to US $638 million (35.1% of total import licences) in 1988. According to Bagachwa and Naho (1995), figures for 1991 remained high at US $494 million (29% of total import licences). The persistence of own funded imports suggests that they are funded from a flow rather than from a stock of foreign exchange. Such a flow must be funded by exports most likely through parallel trade. It has been indicated that about 90% of own-funded imports are financed by unofficial foreign exchange earnings (Mbelle and Karamagi, 1991).

3.2.2. The mineral sector

The contribution of the mineral sector to the Gross Domestic Product (GDP) fell from three percent to four percent in the early 1960s to less than 0.4% in 1980[11]. The value of mineral export earnings[12] fell from US $35.13 million in 1967 to US $16.75 million in 1989. The level of mineral exploration and development expenditures fell from US $11.3 million in 1980 to US $4.0 million in 1985.[13]

Subsequent to the measures of macro-economic restructuring and coupled with trade liberalization, mining GDP grew by 46% between 1990 and 1992. The value of mineral export earnings rose from US $16.75 million in 1989 to US $53.23 million in 1992. On average, the mineral export earnings represent 8.5% of the total recorded export earnings. According to the records, there has been a substantial slump in mineral export earnings from 1993.

In this sector, parallel economy activities are found mainly in the gold and gemstone sub-sectors. With regard to gold, the trend of official purchases shows that between 1990 and 1995 (mostly between 1991 and 1994), a total of over 16 metric tons of gold were purchased. The largest purchases of 4.5 tons occurred in 1994 (whose current worth is about US $64 million),[14] while 1995 saw a very sharp drop in purchases down to a mere 131 kgs. whose current worth is about US $1.8 million.

Estimates of current actual production of gold in Tanzania range from a low estimate of 13 metric tons per annum whose current worth is US $177 million (Vethouse, 1995), to a likely case estimate

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11. URT. 1990. Economic Survey. June.

12. Non-indexed dollar.

13. These funds were provided by the Government and bilateral institutions/donor governments.

14. In April 1996, the world market price for gold, from a private interview with M. Maembe, was US $400 per oz, equivalent to US $14.08 per gram.

of 30 metric tons per annum currently worth US $423 million.[15] A low estimate of 100,000 artisanal gold miners by the Ministry of Minerals and Energy implies that to produce 30 tons of gold per year, each miner on average would need to produce 300 grams of gold during the year, with a local buying price of about US$ 1.3 million. If the actual numbers of artisanal miners is larger, then the actual gold production figures could well be much higher than 30 tons per year, especially if the more significant production of some of the few mechanized mining operations is taken into account. There are four major gold occurrence areas with heavy mining activity.[16]

A total of about 10 mainland regions of Tanzania have significant and on-going gold mining activity. These are Mwanza, Musoma, Mbeya, Rukwa, Ruvuma, Shinyanga, Kagera, Tabora, Singida, and Dodoma.[17]

Compared to the 0.13135 tons of gold obtained by public commercial banks during the whole of 1995, parallel market channels produced and marketed a conservative estimate of 13 tons of gold which represents 100% of all the gold produced.

In brief, even though it has proven difficult to establish exactly how much gold is produced and marketed through the parallel market in Tanzania, it is estimated from reliable official sources, and from informed private opinion, that it is a substantial amount. It is possible that it could be in the same order of magnitude as the value of the total officially recorded exports from Tanzania in 1994, i.e. US $519 million.

In the gemstones sub-sector, a variety of gemstones are found in several regions of Tanzania. The most important gemstones are Tanzanite (Merelani, Arusha); rubies, red garnets and sapphires

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15. *Obtained from the interviews conducted.*

16. The Mineral Sector in Tanzania: Vethouse Associates, Inc. Report for USAID/Tanzania, December 1995.

17. From the interviews.

(Matombo, Morogoro; Tunduru, Songea; Longido, Arusha; Umba River, Tanga); emerald (Manyara, Arusha); spinel (Handeni and Umba in Tanga); zircon (Usambara Mountains and Singida); tourmaline (Uluguru Mountains and Handeni) and gem garnets from Umba River in Tanga, Tunduru and Ruvuma (Vethouse, 1995).

Until the Government order of 24 January 1996, almost all saleable gemstones were being bought from artisanal and/or small scale miners by legal and illegal dealers, most of whom were foreigners. It is estimated that nearly 90% of the production was not officially declared, and most of it was exported illegally. According to the official statistics, gemstone production between June 1994 and June 1995 increased from 32,973 kgs. to 48,507 kgs. Official export proceeds from gemstones for the years 1993, 1994 and 1995 amounted to US $3.6 million, US $6.0 million and US $6.2 million respectively (Ngonyani, 1996). Assuming that this represents only 10% of the value of actual production, then the proceeds should have actually been in the order of US $32.4 million, US $54 million, and US $55.8 million.

However, it is reported that the best gem quality material, fetching premium prices on the world market, escapes official attention.[18] This means that even at their best, official statistics totally fail to provide a good estimate of the true value of the wealth that leaves the country in the form of gemstones. For example, in Tunduru, a conservative estimate based on the reported number of international dealers arriving on charter flights to the area during 1995, and the money carried by them for the trade, it is estimated that gemstone sales worth US $300-US $400 million could have been made in one year (Vethouse, 1995).

It has also been revealed that an average of 1,200 kgs. of Tanzanite are produced by small scale miners in Arusha per year.[19] Starting with a minimum international price of US $160 per gram for

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18. Obtained from interviews.

19. From an interview with the Chairman of the Federation of Miners Associations of Tanzania.

Tanzanite (going up to US $540 per gram for high grade gem material), this works out to be anywhere between US $190 and US $650 million worth of Tanzanites per year.

Judging from the kind of figures estimated from Tunduru and Arusha alone (not to mention the famous Matombo rubies of Morogoro, Umba sapphires from Tanga, and the Shinyanga diamonds), it can therefore be safely concluded that an unknown but very substantial amount of gemstones are produced and marketed through parallel market channels .

3.2.3. Tourism

In 1995, gross foreign exchange earnings from international tourism to Tanzania amounted to about US $205 million spent by an estimated 280,000 visitors to the country. This figure is low by international standards and in relation to the potential for tourism in Tanzania.

In the hotel industry, in order to evade tax, many hoteliers do not record the actual rooms they sell on their monthly returns. It is estimated that the Government loses 20% of the revenue in the hotel industry annually. This is also the case with tour operators whereby the majority of them also do not reveal their actual tour package prices. It is estimated that the Government is losing 30% of the total revenue in this way.

There is also parallel economy activities in the air charter business. There are about 26 licensed charter operators with approximately 168 registered aircraft. The majority of these air charter companies do not reveal the true number of their tourist passengers in their monthly returns so as to avoid high tax rates. Here, it is also estimated that 30% of Government revenue is lost this way.

3.2.4. Natural resources

Tanzania is recognized globally for its natural heritage, and is classified as a 'mega diversity' nation along with Zaire, Brazil and Indonesia. The Government of Tanzania has recognized the importance of its natural resources base and has set aside, as protected area, 25% of mainland Tanzania in the form of national parks, game, forestry and marine reserves.
In this sector, activities categorized as belonging to the parallel economy are found in all the sub-sectors, nameiy fisheries, wildlife and forestry and bees. Parallel activities in the fisheries arena occur in the form of underpricing and the under-declaration of exports, and also when trans-shipments or unregistered fishing takes place in the high seas. As a result, the country loses its taxes and foreign exchange.

With regard to wildlife, activities of the parallel economy are related to the allocation of hunting blocks as a result of collusion between Government officials and hunting companies in the allocation of these hunting blocks.

In forestry and beekeeping, a reported significant volume of trade in forest and bee products, both local as well as (non-traditional) exports takes place outside the formal economy.

3.2.5. Agriculture

Agriculture is the country's major economic activity underpinning employment, food production and export. The agricultural sector employs about 80% of the population, accounts for over 40% of GDP, and 75% of the foreign exchange earnings. The sector usually includes crops and animal husbandry, forestry, fishery and hunting. In this study, the agricultural sector covers crops and animal husbandry while fishery and hunting are discussed under the natural resources sector. Food crop production dominates the agricultural sector, totalling 55% of the agricultural GDP. Livestock accounts for 30% of the agricultural GDP and traditional cash crops (coffee, cotton, cashewnut, sugar, pyrethrum, tea, tobacco and sisal) account for about eight percent.[20] Parallel activities in this sector are found mainly in the marketing of crops and livestock.

While higher producer prices as the result of a complete liberalization and deconfinement of food crop marketing might have reduced the temptation for illegal cross border trade in food crops, parallel market activities are still taking place.

Apart from the official exportation of food crops (recorded by the Customs Department), there is also unofficial trade operating between Tanzania and its neighbouring countries. Evidence of this was shown in studies conducted by MDB between 1993 and 1994 to assess the extent of trade in food crops along the borders of Tanzania mainland.

In conducting the studies, MDB visited a total of nine regions namely Mbeya, Rukwa, Kigoma, Kagera, Mwanza, Mara, Arusha, Kilimanjaro and Tanga. It was found that, in all regions visited, extensive border trade existed both in food crops and other items. The volume of cross border trade indicated that a large proportion of all food crops exported did not pass through the official channels. Table 3.4 shows the major crops traded along the borders and their destinations.

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20. Msambichaka, L. A and H. P. B. Moshi. 1994. *Development Challenges and Strategies for Tanzania: An Agenda for the 21st Century.* DUP. Dar es Salaam. Tanzania.

Table 3.4: Unofficial Cross Border Trade in Food Crops

Type of Food Crop	Region of Origin	Destination
Beans, Rice, Maize	Mbeya Rukwa Kigoma Kagera	Zambia, Malawi Zambia, Zaire, Burundi Zaire, Burundi Burundi
Maize, Rice	Mwanza Mara	Uganda, Kenya Kenya
Maize, Beans	Arusha Kilimanjaro Tanga	Kenya Kenya Kenya
Fruits	Tanga	Kenya

Source: MDB, 1995.

A study on border trade in food and agricultural products in Eastern and Southern Africa commissioned by the Common Market for Eastern and Southern Africa (COMESA) between December, 1993 and March, 1994 had some findings on the Tanzanian borders which include the following:

(i) Most of the unofficial trade between Zambia and Tanzania was one way, moving from Tanzania to Zambia. Commodities traded included rice, fish, Irish potatoes, beans, sugar, and vegetables (mostly onions and tomatoes).

(ii) Daily quantities of various commodities crossing from Tunduma (Tanzania) to Makonde (Zambia) were estimated to be worth about Zambian Kwacha ZK12.665 million which amounts to about ZK4,623 million per year (approximately US $8.7 million). The movement of commodities between the two points is summarized in Table 3.5.

(iii) The study further reports that on the Tanzania/Kenya border, the value of unofficial exports of food crops from Tanzania to Kenya was estimated at about US $1.2 million per annum. Table 3.6 shows the quantity and total value of daily unofficial exports of maize and beans to Kenya.

Table 3.5. Daily Movement of Commodities from Tunduma (Tanzania) to Makonde (Zambia)

Commodity	Quantity	Price (in Zambian Kwacha/ZK)	Total Value (in Zambian Kwacha/ZK)
Rice	400 bags	28,000	11,200,000
Potatoes	100 bags	8,000	800,000
Fish	300 kgs.	300	90,000
Beans	500 kgs.	250	125,000
Sugar	1,000 kgs.	300	300,000
Vegetables	100 kgs.	200	20,000
Bread	500 loaves	200	100,000
Soft Drinks	50 crates	4,800	240,000

Source: MDB, 1995.

Notes: A bag weighs 90 kgs.

In December 1993, ZK100 was equivalent to Tshs.700 and one US dollar was equivalent to ZK530 or Tshs.450.

Table 3.6. Daily Movement of Commodities from Tanzania to Kenya

Item	Quantity	Price/Value	Total [illegible]
Maize	50 bags	Tshs.8,900	Tshs.400,000
Beans	30 bags	Tshs.35,000	Tshs.1,050,000

Source: COMESA, 1994.

Notes: One US dollar was equivalent to Tshs.450.

Activities categorized under the parallel economy are also likely to be taking place in the export and import of agricultural crops and the importation of agricultural inputs through methods such as over-invoicing and under-invoicing.

In the livestock sub-sector, the unofficial export of live animals, hides and skins is known to have taken or to be taking place. Export figures of goods seized by Tanzania Customs as reported by Bagachwa (1991), show that livestock worth Tshs.4,510,000 and hides, skins and leather worth T.shs.27,320 were seized in 1985. It is likely that a number of heads of cattle, hides and skins could have been exported illegally without being detected.

The point made by these figures is that parallel activities exist. However, the exact magnitude may be difficult to establish at this stage and may require further research in the respective areas.

While removal of price controls and deconfinement might have reduced the parallel exportation of livestock and livestock products, the high taxes imposed on imported livestock pharmaceuticals could be a factor leading to tax evasion by importers. The tax rate for livestock pharmaceuticals is 50% compared to a 10% tax rate for human beings pharmaceuticals (URT, 1995).

3.2.6. Transport and communications

Transport and communication services are very important in ensuring satisfactory performance in other sectors of the economy. The transport sector grew at a rate of 4.1%, from Tshs.2,100 million in 1993 to Tshs.2,186 million in 1994 (in 1976 prices). However, in 1994, the contribution of the transport sector to the GDP (in 1976 prices) remained at 6.2%, as in 1993.[21]

- **Parallel activities in transport**

An example of parallel activities in the transport sector is that of evading the payment of fees by heavy duty vehicle operators. Depending on capacity, insurance cover for the transit vehicles has risen from Tshs.7,000 to Tshs.168,000. Operators have now resorted to under-estimating the capacity of vehicles and thus avoiding the high rates demanded by the authorities. The order by Treasury that transit vehicles must show up at the weight bridges within two hours after departure from the port is causing long queues and as a result, vehicle operators have tended to "negotiate" with control staff, resulting in losses of Government revenue.

The activities of many operators of *daladalas* (mini buses) and taxis including taxi ***"bubu"*** (unregistered/illegal taxis) are not recorded. In general, the transport sector is one of the sectors which have been identified as one in which estimates of national accounts are weakest.

- **Parallel activities in communications**

A parallel telephone service is being offered, mostly by TTCL technicians using the existing TTCL networks facilities. A whole range of services from obtaining a telephone line, maintaining and keeping it in order and even making unregistered (overseas) calls can be obtained in the parallel market. Despite the fact that payment is no guarantee for trouble-free communication, this is the kind of service that many telephone users have had to resort to at some point.

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21. URT, 1995. *Economic Survey* for 1994.

TTCL's audited accounts for 1994 indicate that the company has inherited from TPTC a claim from Teleglobe Canada in respect of international telecommunications traffic accounts for the years 1987 to 1990 of US $8,429,834. This amount, which averages out to approximately US $2,810,000 per annum, is disputed by the company and represents calls made directly by the international operator fraudulently to Europe and North America alone.

In the past, it has been possible to collude with officials of telephone companies in order to "rent" lines for varying periods of time in order to place high value calls for small illegal payments as TTCL's audited accounts for 1994 indicate. Sometimes, a telephone line that has already been subscribed by one customer is diverted to another "renter" for unlimited use.

The callback service offered by Telegroup Inc. of the US and available in Tanzania is used by customers to cheat the Government of its revenues. It is estimated that for anyone making a minimum of 10 minutes worth of overseas calls per month on the callback system can realize savings of up to 75% of the official cost.

The recent agreement in Parliament to amend the Tanzania Communications Act 1993 indicates a conflict between Telegroup and TTCL. According to the Tanzania communications Act (1993), the aim of the amendment is:

> *" ... to stop a person from denying revenue to the Tanzania Telecommunications Company Limited by pretending, through (the use of) technological devices that a telephone call he makes from Tanzania to a person abroad has originated from outside Tanzania."*

Although such a move will render the callback system illegal, it will be very difficult for TTCL to effectively monitor such calls and bring culprits to task. It will also deprive TTCL of up to $0.75 per minute on incoming calls from the USA that callback guarantees under international carrier agreements. Such reactions to callback, particularly in countries where the state has a monopoly have been common, and yet, the system continues to find more users in more markets. A less hostile approach needs to be adopted by TTCL who must accept that it is very difficult, and indeed a disservice to the customer, to curb technological progress and competition.

It would be wrong to claim that all is wrong at TTCL. Indeed, in some areas (such as working Direct Exchange Lines and lines connected to subscribers), some positive results have been recorded. Nevertheless, the overall picture remains bleak. The inadequate provision of materials, spare parts and tools has constrained performance. Telex communications have been affected by high costs. Falling demand and international calls remain problematic.

- **Parallel activities in computers for communication**

The proliferation of computer technology has been hampered by various constraints that have led to many consumers by-passing various laws, rules and regulations and operating outside the officially set parameters. The fact that the high sales taxes and import duties imposed on both software and hardware (20% and 30% respectively), provokes many users of this technology to collude with officials during the importation process in order to cut down on costs and deny the Government of its revenues. However, unlike certain other high technology products such as televisions and video sets, the prices of computers changes radically and sporadically over short periods of time due to the nature of the technology. With consumers willing to pay handsome sums for the latest products, and with innovations within the industry advancing so rapidly, it is difficult for the authorities to be able to gauge the true value of certain items in order to collect the right amount of revenue.

CHAPTER FOUR

CAUSES OF THE PARALLEL ECONOMY

The parallel activities identified in chapter three are caused and maintained by various factors in the economy. In many cases the persistence of such activities is a rational response to the environment in which those activities are taking place. The main causes and factors sustaining the activities in the parallel economy are examined in this chapter based on the literature on this subject and from the interviews conducted.

4.1. Tax-Related Issues

Tax related issues which have contributed to the existence of the parallel economy are associated with high taxes, the multiplicity of taxes and tax administration.

4.1.1. High taxes

Prohibitive tax rates have been identified as one of the main causes for the existence of the parallel economy in Tanzania. Commenting on the issue of tax evasion, some of the respondents interviewed pointed out that tax payment is often evaded out of necessity because paying the high tax rates would put the price of commodities beyond the reach of the majority of the population. This would mean the collapse of the business.

As an example, the tax rates for *khangas*[22] are very high. The cumulative tax levied on *khangas* is 107% of its CIF value. In the fisheries sub-sector, tax rates of 45% of the net profit have also been identified as being the reason why commercial and large-scale registered operators tend to under-declare their exports. In the communications sector, it has been noted that due to the high sales taxes

22. Soft colourful apparel made from cotton that Tanzanian women use to cover themselves or their heads/shoulders.

and import duties (20% and 30% respectively) imposed on both software and hardware, many users of this technology tend to collude with officials during the importation process as a way of cutting costs.

Over-taxation of the tourist industry has created a parallel economy in all its sub-sectors. In May 1995, the Tanzania Association of Tour Operators (TATO) prepared a fairly accurate assessment of the tax situation in the industry.[23] The European Union (EU) report on the tourism masterplan also covers this issue well.[24]

Revenue earnings are based on the benchmark prices given by the Ministry of Natural Resources instead of the actual prices realised in the market. This leads to an underestatement of the actual profit realised, which therefore means that inappropriate taxes are computed from it. This is because the high tax rate prevailing is at least 45% of net profit in comparison to the more internationally competitive rate of 35%. In Mauritius, instead of giving tax holidays, a flat tax of 15% is imposed instead.

High tariffs have also contributed to the sustenance of activities of the parallel economy in the importation business. It is apparent that when setting tariffs, the Government considered protection of industry and revenue collection as the primary objectives. Very high duties were set for luxuries before 1984 (between 200%-500%). It was later discovered that tariff rates of 100% and above had very low collection rates (Osoro, 1993; and 1994). As a result, under-reporting and/or tax evasion has been high. Osoro, 1993, suggests that the country lost a total of Tshs.94 billion during the 1986-90 period.

Despite the revision of tariffs, they are still considered to be high resulting in a low tax compliance rate of 10% as Osoro (1993) and Mpango, (1995) indicate. Indeeed, some actors are of the view that

23. The name of the report is *Review of Taxation of Tourism Industry*.

24. The EU report was on an Integrated Tourism Master Plan.

while the Government seems to have taken steps to reduce the tax rates, these reductions have not been substantial (see Table 4.1).

Table 4.1. General Tariff Structure between 1980/81 and 1992/93

Tariff Year	Capital Goods (%)	Intermediate Goods (%)	Consumer Goods (%)	Luxury Goods (%)
1980-81	10-15	10-15	30-40	30-150
1982-83	15-20	15-20	30-40	30-120
1983-84	15-20	15-20	30-60	60-300
1984-85	15-20	15-20	30-60	100-120
1985-86	15-20	15-25	30-75	100-120
1986-87	15-20	15-25	30-75	100-150
1987-88	15-20	15-25	30-75	100-150
1988-89	15-20	20-25	30-60	60-150
1989-90	15-20	20-25	40-60	60-150
1990-91	20	20-25	40	60
1991-92	20	20-25	40	60
1992-93	20	20-25	40	60

Source: (1) Semboja, H. *et al.* 1995.[25]

(2) Semboja, J. and Ndulu. 1995.

25. Semboja, H. H. 1995. "Changes in Protection over the Decade". ESRF. Mimeo.

4.1.2. Multiplicity of taxes

The information gathered also indicates that there are too many taxes, a factor which has also contributed to tax evasion. The number of taxes levied on the hotel industry and tour operators outlined below shows an example of how one type of business is liable to pay so many taxes. In the hotel industry, there are at least 17 taxes as indicated in Appendix 4 and Appendix 5. It has been estimated that, excluding corporation tax, indirect tax paid on hotel supplies, administration supplies, the importation costs on goods and equipment, the taxation costs of beer, soft drinks and cigarettes, the hotels in Tanzania pay as much as 21% of the turnover in taxes and this accounts for as much as 30%-35% of the hoteliers' total costs.

Tour operators have a total of 18 taxes to pay on a monthly basis. It has been estimated that, excluding the Corporation tax, indirect taxes paid on administrative supplies, importation costs for goods and equipment, and fuel tax costs, tour operators in Tanzania pay as much as 33% of their turnover and as much as 50% of all their costs in taxes.

Such multiplicity of taxes complicates the administration of taxes and does not provide a conducive environment for tax compliance.

4.1.3. Lack of transparency in tax assessment and administration

Another tax-related factor which contributes to tax evasion is the lack of transparency in the assessment and administration of taxes which all lead to acts of corruption. In the import business for example, the valuation and classification of import for duty is done by classifying imported goods under tariff headings which carry lower rates of duty or are totally exempted from duty. Among the practices that deprive the Government of import duty revenue are the:

(i) application of incorrect tariff rates;

(ii) use of lower exchange rates;

(iii) the partial imposition of duty on a consignment;

(iv) and the granting of a greater depreciation allowance (particularly on motor vehicle imports).

This is usually encouraged by corrupt customs officials who get bribes from importers.

In the wildlife sector, for instance, the allocation of hunting blocks is not transparent -- it is not advertised (for the public's knowledge), and therefore encourages clandestine activities. In addition, licensing procedures are extremely cumbersome.

4.2. Bureaucracy in Registration, Licensing, and Export and Import Procedures

Management of a market economy and an economy which allows substantial private sector participation requires that the bureaucracy manages the economy in ways that are consistent with that kind of economy. However, findings by Ringo *et. al.* (1995), indicate that the bureaucracy is still perceived as being inclined towards an unmodified approach to economic management. As a result registration, licensing and import procedures remain bureaucratic and this tends to encourage parallel economy activities. For the case of industrial undertakings for example, an industrial licence is required. However, the process of getting a business licence in Tanzania (as summarized in Appendix Table 3.12), is complex and costly. An entrepreneur in Tanzania requires 306 days to register his business on average. A similar exercise takes 3.5 hours in Tampa, Florida and four hours in New York (Levitsky, 1989). The Tanzania entrepreneur has to work almost 700 times harder than an entrepreneur in the USA just to get started. As a consequence, many small and medium size enterprises (SMEs) opt to operate without a licence. Where a licence has been obtained, the rights of the licence are sometimes not respected and possession of a licence does not appear to facilitate access to resources such as finance and technology. As Ringo *et al.* (1995) further observe, to register SMEs, registration under the Companies Ordinance involves filing of six copies of the "companies memoranda" and "Articles of Association" together with particulars of directors, initial capital, stamp duty and other requirements. Despite filing procedures being simple on paper, SMEs have to face bureaucracy and red tape. Once the Registrar is satisfied that the provisions of Cap 212 have been fulfilled, a certificate of incorporation is issued. The registration of unincorporated businesses (such as partnerships or sole traders) is covered under the Business Names Registration Ordinance Cap. 215 which still operates in Tanzania as enforced by the relevant authority -- the "Registrar of Companies and Business Names". The Registrar's office is located in Dar es Salaam, making registration an expensive exercise for up country SMEs, given the need for their personal presence so that the application is pushed through. This requirement has been an obstacle to SMEs, making them undertake illegal activities i.e. operate in the parallel economy.

Multiple licence requirements (for the same activity), or having the frequent need to renew licences or register after relatively short periods have also been identified as factors that contribute to the sustaining of activities within the parallel economy. For example, in the area of crop marketing, traders are required to register annually; they register at one place and get their licences at another. The issue of many licences (for one operator) is well captured in the hotel industry and tour operators' case. In the hotel business, one can have up to nine different licences while in the tour operator business, one needs to have four different licences (see Tables 4 and 5 in the Appendix).

Problems related to bureaucracy in customs control have been among the factors that have encouraged parallel activities in the import-export trade. Interviews showed that regardless of their volume or value, it takes importers three to four weeks to clear imported goods on average. The time also depends on whether the importer will have received the relevant shipping information from the National Shipping Agencies Company Limited (NASACO).

Box 1: Procedures, Documentation and Taxes for Imported Goods

1. Importers or agents begin the import procedure by producing Bills of Lading and Invoices stating the CIF value of imports. 2. They then: (a) obtain from the BOT six copies of the Import Declaration Form (IDF). IDF forms cost Tsh 1000. (b) obtain from Tanzania Central Freight Bureau a certificate of carriage costing Tshs 1000 (c) submit to the National Bank of Commerce (NBC) IDF forms and proforma invoice and pay 1.2 % of FOB value of imports **Note**: at this stage the following is happening: (i) NBC processes IDF and sends a copy to the SGS with the proforma invoice for later inspection. (ii) NBC also prepares a Tax Assessment Note (TAN) based on a Clean Report of Findings (CRF). The CRF verifies the value given in the proforma invoice. TAN documents provide importer s with estimates of the import duty, sales tax and the excise duty. 3. After collecting TAN documents from the SGS, an importer submits TAN documents to the NBC, completes a Pay-in Slip and pays the import duties and sales taxes as shown on the TAN documents. 4. NBC certifies the TAN and Pay-in Slip documents and distributes copies to the importer, NBC and SGS. 5. The importer submits certified and original TAN copies, Pay-in Slips and IDF documents to the customs officials for the inspection of goods. 6. Customs processes TAN and other documents and verifies the Pay-in Slips against NBC statements. 7. If procedure (6) is complete, the importer is ready to start port procedures. 8. The importer goes to port officials to pay port charges as follows: (a) handling charge i.e. four US dollars per cubic metre of imports (paid in local currency in equivalence to the day's exchange rate). (b) wharfage of 1.5 % the CIF value of imports. (c) a storage charge of one US dollar per cubic metre times the number of extra days the goods remain uncleared from the port. 9. If procedure (8) is complete, the goods are finally released from port.

Source: Mjema and Shitundu. 1996.

Currently, an importer spends, about 37 days on average to clear imported goods either from the port of Dar es Salaam (for sea-freighted cargo) or from Dar es Salaam Airport (in the case of air-freighted cargo). That means on average, importers have to pay storage fees for 30 days because port officials allow a grace period of only seven days to clear goods. In both cases, customs officials work out the storage charges for the 30 days of delay in clearing goods.[26] An importer importing one cubic metre of imports will, by this method, pay a total of US $30 as storage charges. Table 4.2 shows how reforms in clearing goods will save both time and storage charges.

Table 4.2. Imported Goods Clearing Procedures: Current vs Improved Situations

Current Procedure	Estimated Time to Complete Current Procedure (in Days)	Estimated Time to Complete Procedure if Improvements Occurred (in Days)
1. Bill of Lading and Invoice Processing	3	1
2. Process IDF Forms and CFB Certificate	4	1
3. Process TAN Forms	4	1
4. Process Pay-in-Slip Documents	4	1
5. Goods Inspection Procedure	5	1
6. Verification of TAN Forms	5	1
7. Port Procedures	7	1
8. Wharfage/Storage/Handling Payments	3	1
9. Final Clearing Procedures	2	1
Total	37	9

Source: Mjema and Shitundu. 1996.

26. Calculations are done as follows: one US dollar x volume of imports (in cubic metres) x 30 days (i.e. one US dollar x *"b"* cu.m x 30); where b is the volume in cu.metres (see Mjema and Shitundu, 1996).

There are many institutions that prescribe and practice export procedures and documentation that suit their needs. These include the ministries responsible for Minerals and Natural Resources; Industry and Trade; and Finance. Other institutions are: BOT, BET, Customs and Sales Tax Department, CRDB, NBC, NASACO, TBS, Tanzania Central Freight Bureau, TCCIA and other forwarding companies. Ngogo (1993) shows that 16 export documents are needed to ease the movement of goods due for export (to the proccessing institutions involved). The delays and payments involved are the source of additional costs to exporters.

In the natural resources sector, it has been noted that because of discretionary powers, the over involvement of wildlife staff in the allocation of hunting blocks has created an opportunity for clandestine deals and parallel market activities. In the wildlife and forestry sectors, licensing procedures are reported to be extremely cumbersome.

4.3. Weaknesses in the Legal Framework and Laxity in Law Enforcement

The absence of laws, and the existence of laws which are not deterrent enough as well as laxity in the enforcement of the existing laws are among the factors that keep the parallel economy in existence.

Mpango (1995) identified weaknesses in the Customs Tariff Act and the Customs and Excise Management Act and points out the section of the law that allows for tax exemption as being the most abused. Exemptions have been granted for imports which simply do not deserve duty exemptions. He further notes that the abuse has increased over the trade liberalization period. In 1986, for example, exemptions amounted to 88% more than the actual import duty and sales tax collected compared to the 1982/83 period when exemptions were 22% less than the actual collections (Mpango 1995). The actual duty collected may itself be small because of tax evasion. For instance, an ESRF (1995) study found that the importation of goods which attracted high tariffs was scant, presumably because of false classifications induced by the intention to evade tax (whisky could, for example, come in as chemicals).[27] While 30% of the exemptions are given to the Government, UN agencies, diplomatic missions and charitable organizations, 70% consists of exemptions from duty granted to other importers. The size of import duty revenue forgone by way of exemptions is shown in Table 4.3.

Table 4.3. Import Duty Exemptions (Million Tshs.)

Year	Exemptions	Collection	Exemption/Collection
1982	1014.7	724	140.15
1983	909.5	959	84.84
1984	1200.1	1532	73.84
1985	1393.5	1550	89.90
1986	2843.7	4042	70.35
1987	7533.8	5573	135.18
1988	n.a.	8449	n.a.
1989	12289.1	11673	105.28
1990	27185.3	17467	155.64
1991	26075.7	20573	126.75
1994	63100	n.a.	n.a.

Source: (1) Mpango. 1995. (Up to 1991).
(2) The Treasury. 1994.

27. ESRF. 1996. Budget Proposals for 1996/97: A Synthesis of Views from the Business Community. (Forthcoming).

Loopholes in the legislation also allows for the payment of duty in installments. Importers often pay the first installment when they clear goods from Customs and hardly bother paying the outstanding amount after that. In 1993, it was revealed that individuals, firms and institutions owe the Government import duties and sales tax that amount to Tshs.3.7 billion; this being the accumulation for the 1988-92 period (Mpango, 1995).

The same study reveals that another area prone to deviate from customs procedures is the customs warehouse where control and laxity occurs in the follow-up of transit goods. The transit goods method is used by simply declaring that the goods are destined to a neighbouring country but selling them (later on) within the country. Appendix Table 3 gives a sample of tax evasion cases through transit goods.

4.4. Inadequacies in the Marketing System

It appears that reforms that have liberalized the economy did not first ensure an enabling environment (for a successful private sector participation in marketing) was in place. This situation has also contributed to parallel market activities.

In the minerals sector, the absence of a viable, competitive and transparent formal financing as well as a marketing system probably are the most significant cause for 100% of the parallel market activities with regard to gold and gemstones.

In 1990, the Government issued a decree imposing the gold buying scheme on the banking system. This was the consequence of an outcry by the public on gold smuggling which by then was rampant. It was the Government's thinking even then, that if gold was given a formal buying arrangement through the banking system, it would curb capital outflows through illicit trading and spearhead the implementation of the Economic Recovery Programme.

Both the gold and the gemstone trade require a lot of cash. According to a 1994 appraisal of the experience of the National Bank of Commerce in the trade, about Tshs. one billion was tied up in gold purchases at that time (Mwamukonda, 1994). Only the commercial banking system could possibly mobilize the scale of finances required to provide a competitive alternative to a parallel gold buying 'cartel'. Fortunately, there is a previous -- even if it initially failed -- experience which the country can draw upon to develop an entrepreneurial, competitive, gold marketing system.

Although the policy objectives were good, the scheme worked rather well for a while but could not be sustained. This is because the scheme was hurriedly launched without proper preparations being made by the Bank of Tanzania, the NBC and CRDB, which were the key players in the implementation of the Scheme. The operation of the gold buying scheme was not supported by any legal documentation outlining the responsibilities and obligations of the parties involved in the scheme. Major problems therefore quickly arose; these compounded and led to the eventual collapse of the scheme.

Due to the problems the NBC experienced with the Gold Buying Scheme, they conducted a preliminary survey with their correspondent banks to try to gauge their experience in the gold financing business. These included the Union Bank of Switzerland; Standard Bank of South Africa, London; Loita Capital Partners, through Warburg, London; First National Bank of South Africa; and the Swiss Banking Corporation. The NBC received positive responses from these financial institutions stating that the gold business was very profitable for Commercial Banks -- if a proper mechanism was put in place. In addition to confirming the profitability, there were possibilities for financial arrangements for the purchase of equipment which could be used in the analysis of gold. Technical support for gold buying centres could be obtained from several commercial banks. Proposals for smelting, and refining facilities for gold were available, with a number of the correspondent banks, which could even undertake the marketing of the refined gold.

Apart from the lack of competitive formal market channels for gold and gem sales, other reasons why operators in the marketing of these materials remain in the parallel market include:

(i) long-winded, bureaucratic and 'harassing' licensing procedures,
(ii) the maximization of benefits through tax evasion; and
(iii) the lack of a transparent and pragmatic tax system (which leads to the active avoidance of Government tax officials, a situation linked to key operators having no

fear of many Government regulators and law enforcers, who are often perceived as being easily pliable or corruptible if need be; that is, an ineffective tax enforcement system (Vethouse, 1966).[28]

In the agricultural sector, accessible roads are very important in easing crop procurement and marketing. Yet in many rural areas, feeder roads are still inadequate and often inaccessible. Such a situation, apart from creating artificial food shortages in deficit regions, also encourages parallel market activities in surplus border regions.

Weaknesses in marketing of telecommunications services at non-competitive prices has encouraged parallel activities. Excessive rates (even by international standards) for overseas calls set by TTCL has led to many customers with large overseas communication needs to consider alternative and cheaper methods, the most popular of which is the callback service offered by *Telegroup Inc.* of the US and available in Tanzania.

4.5. Salary and Incentive Inadequacies in Public Services

Low remuneration and the lack of incentives for Government employees has contributed to acts of bribery and corruption in which Government officials collude with business operators to cheat the Government of its revenues. Law enforcers collaborate with tax evaders to share a substantial part of Government revenue between them. Thus the two either collaborate with would-be tax payers to avoid paying taxes in the first place, or are not willing to enforce punishment on the tax evaders caught.

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[28]. Also obtained from the interviews.

CHAPTER FIVE
CONCLUSIONS AND POLICY IMPLICATIONS

This study has found that most activities falling within the parallel economy usually develop in response to the nature and pattern of the Government system of interventions and restrictions. Studies undertaken during the period before economic reforms were adopted, reveal that the existence of activities in the parallel economy was a response to excessive administrative controls in the markets for goods and services and in the allocation of important resources such as credit and foreign exchange. During the period of economic reforms, and as the management of the economy has been shifting towards the market and private sector development, many administrative controls as well as the administrative allocation of resources have been removed. The parallel economy, however, has sometimes persisted in different forms. This is explained by the fact that the shift towards a market economy and private sector led development has not been accompanied by change of the institutional, legal and regulatory framework to make it more appropriate for and consistent with private sector development and economic management in a predominantly market economy.

Based on the findings of this study, it is proposed that the Government do the following in order to seriously embark on policies that will bring the parallel economy into the mainstream:

5.1. Tax-Related Recommendations

5.1.1. Reducing the tax rates

(a) Rationalize the current levels of both import duties and sales tax with a view to encourage compliance and widen the tax base. The extent of reduction should however, consider the Government's revenue needs.

(b) Income tax for business should be rationalized, and payment should not be made at the inception of business (i.e. in advance). Income tax should be levied on the income actually earned rather than on anticipated income.

(c) Within the tourist industry, specified building tax should be abolished with respect to hotel buildings, tour operators' workshops/garages and National Park buildings, as occurs in the case of factories. The threshold value should be indexed, and linked to the official inflation rate.

5.1.2. Reducing the number of taxes

Where there has to be more than one tax levied upon a business, these should be minimized to not more than two. Currently, there are businesses which have to pay over 10 different taxes. An example is the hotel business, where the following is recommended:

- Withholding tax and stamp duty should be abolished as they are difficult to administer and costly to supervise. It will also free the human resources to concentrate on the administration of the Value-Added Tax (VAT) which is to be introduced in the near future.

- Payroll and training levies should be repealed as they have outlived their usefulness and failed to fulfill their purpose and have instead been used as another means of raising funds for the Treasury. The VETA tax is a more appropriate tax.

- Land rent & property tax should be rationalized into one with the proceeds going towards local Government support for infrastructural costs (roads, street lighting, water drainage, garbage collection and other city/town administration costs).

- In the case of the hotel industry, the VAT on food sales should be pegged to the accommodation rate. This will simplify the administration of VAT at hotels and also solve the problem of what rate to charge for room only as compared to full board.

5.1.3. Streamlining the taxation process

In business and industrial activities the following action is required:

- Corruption is encouraged by excessive discretion on the part of the tax assessor and the possibility of room for negotiations between the tax assessor and the tax payer. The process of tax assessment should not involve face-to-face contacts between the assessor and the tax payer. This will reduce unnecessary delays and corruption tendencies, practiced by officials with discretionary powers in the determination of appropriate tax levels.

- It is also recommended that the process of identifying the tax bracket should involve business associations, because they are the ones who know their members' level of activity. This again, will remove the present discretionary powers vested upon the tax assessor that possibly contribute to corruption and unnecessary delays.

- Arrangements should be made to impart knowledge on the tax rates and the procedures followed in tax assessment to tax payers. This can easily be done through publication of the brackets and what one is supposed to pay in say, newspapers or brochures.

- The Government should ensure that the taxation in the various sectors conforms with the soon-to-be-adopted sectoral policies.

- Replace the harsh methods that have characterized the approach to tax payers. These should be replaced by more systematic and smooth ways of collecting tax with a view to encourage compliance and responsibility on the part of the tax payer.

- After rationalizing and making taxes affordable, stiff sanctions (including imprisonment), should be imposed against any tax evader.

5.2. Removing Bureaucracy in Registration, Licensing and Import/Export Procedures

5.2.1. Streamlining registration and licensing procedures

Registration and licensing procedures can be streamlined as follows:

(a) The process of registering and acquiring business/industrial licences should be made as simple as possible. The Government should handle the individual/business applications for the registration or acquisition of a licence as one would view a customer bringing in revenues. The procedure should be as transparent as possible and involve, for example, the filling in of a single form. The location of the offices issuing licences should be as close to the actors as possible.

(b) Small and medium scale activities currently operating outside the formal economy should be encouraged to register their activities by simplifying the registration procedures and by providing promotional and support services to those activities which are registered. This would act as an incentive for operators within the informal sector to come out and operate in the open. For instance, in the mining sector, the Government should legalise the status of artisanal miners, and give first priority to the promotion, development (upgrading) and formalization of artisanal and small scale gold production in the 1996-2000 period, working closely with the Regional Miners Associations, FEMATA, the proposed Tanzania Miners Corporation, TCCIA, TANEXA, and other appropriate institutions.

(c) The licence issued should allow flexibility and accommodate the standard activities expected to be carried out by an industry. This would obviate the need to have multiple licences in order to operate in a particular industry. For example, as listed below, within the tourist industry, there are a number of operational licences (see Tables 4 and 5 of the Appendix) that could be replaced by one or two licences:

- **The hotel board licence**

This licence is important for conducting normal hotel activities according to the classification of a hotel.

- **The city council health licence**

This licence, which covers the entire premises should be issued before the Hotel Board issues its licence.

In addition, licences should not be viewed as a way of raising revenues but rather for regulating the tourist industry and safeguarding the quality of the tourist product and safety of our guests in Tanzania. Therefore, the rates for such licences should be reasonable enough to cover the administrative costs of the Licensing Boards.

(d) Regulatory procedures that discourage operators from operating in the formal economy should be removed. For example, the regulation that requires *"all the coffee produced and cured domestically to be disposed of in export markets through auctions that are currently being held in Moshi"* makes it difficult to secure financing of crop purchases. This should be amended to enable licensed coffee buyers to directly contract coffee purchasers abroad.

5.2.2. Removing bureaucratic and lengthy procedures in external trade

- **Streamlining import/export procedures**

(a) Current estimates indicate that it takes 37 days, on average, to clear imports. There is need for the Government to speed up the introduction of a "one stop, one day" arrangement. The study has learnt that the Automated System for Customs Data and Management (ASYCUDA) project is a step in the right direction towards that arrangement. The Government should quickly take action to purchase the equipment required, to do away with bureaucratic delays in funding/tendering arrangements for the refurbishment of the long room.

It seems the Government sees ASYCUDA as simply being a move to computerize. The system is far more than a computerization project. It will cut down the customs procedures, increase Government revenue, and provide more precise external trade statistics.

(b) The Government should then clearly define the role of Pre-Shipment Inspection companies (PSIs), and Customs. At present, importers have to undergo similar processes in the two institutions, which increases delays.

(c) The Government should seriously consider whether the retention and 'own funds' import schemes are still needed, given that the foreign exchange market has been liberalized.

5.3. Strengthening the Legal Framework and Enforcing the Law

This will require Government action along the following lines:

(a) Speed up the review of the existing legal framework to make it appropriate for a market-oriented economy and private sector led development.

(b) In all sectors (or sub-sectors) institutional arrangements should be made to establish joint councils between actors in the public sector and those in the private sector. Such councils should cooperate in addressing various procedures and obstacles to smooth business operations. The councils should discuss the relevant public policies that impinge on the activities of the relevant sectors. For instance, in the case of the minerals sector, the Government should immediately establish a "Gold and Gemstones Task Force". One of the particular interests of the Task Force will be to reduce Government bureaucracy and other obstacles as a way to improve the flow of materials from production to the market, along with the attendant tapping of revenues to the national Treasury in the form of registration and licence fees, royalties, income and corporate taxes etc. This Task Force should:

(i) Carefully study the full implications of the national Mineral Sector Policy, especially with regard to the promotion of the gold and gemstone sub-sectors as priorities, and make any necessary policy adjustments to:

- improve demand;
- improve supply, and
- improve the Government's revenue collection.

(ii) Supervise the revision of mining laws to conform to the objectives and vision established by the Mineral Sector Policy document;

(iii) Monitor and guide the implementation of priority programmes and projects directed at the achievement of the set policy objectives. This will include defining the roles and relationships of key players and stakeholders in the accelerated production, processing, and marketing of gold and gemstones.

(iv) Identify the reported 100 or so individuals around the country (especially the goldsmiths -- most of whom reside in Dar es Salaam), who are involved in the traditional gold marketing network in Tanzania, and invite them to work as Master Gold Dealers, hand-in-hand with the government, in legalizing the gold trade.

(v) Only banks and master gold dealers who can prove that they have the necessary equipment and expertise to conduct the gold business successfully should be licensed. In the case of gemstones, licences should only be given to local and international gem dealers and lapidaries who can prove that they have the necessary expertise and equipment to conduct the business successfully.

(e) The Government should streamline the regulations and remove obstacles to business operations. Once this has been done, then the Government should strengthen the mechanisms for monitoring the various business operations in accordance with the legal and regulatory framework that is in place. In the minerals sector, for instance, the Government should put an efficient and effective system for the marketing of gold and gemstones in place; either on its own or by promoting other agents. This should be followed by putting effective monitoring systems (including the mobilization of the state security system) in place to track the actual business performance of the licensed gold and gemstone dealers and lapidaries. Businesses found to be operating dishonestly should be de-registered, and proprietors should face stiff penalties, for example, imprisonment without the option of a fine. In the fisheries sub-sector, the monitoring and supervision of commercial fishing operations in the high seas should be improved to ensure compliance. Costs could be met by allocating a percentage of the taxes collected for that purpose.

(f) The Government's revenue collection arms of should involve associations of respective operators in specific sectors in reviewing and monitoring revenue collection performance. For instance, in the case of the minerals sector, working closely under the guidance of the "Gold and Gemstones Task Force", the relevant revenue collecting arms of the Government should comprehensively review revenue performance at various key collection points in the gold and gemstones production-processing-marketing chain, starting with collections obtained from the issuing of, for example, prospecting licences, prospecting rights, claims and royalties.

5.4. Establishing Proper Marketing Systems/Channels

A proper marketing system is necessary for successful business operations. This entails having in place adequate infrastructure both in terms of transport and communication having easy access to credit and having in place, policies and incentives which attract and motivate business.

Lack of a proper marketing system was identified as the main cause of parallel activity in several sectors. This calls for an urgent need to:

(a) Establish a training facility (or facilities) for operations that are typical in specific sectors. For instance, in the case of mining, training would be encouraged in gold identification, purification, assaying, and marketing, in order to develop local human resources for the business.

(b) Encourage the establishment of competitive joint venture operations in marketing, and other activities between local operators and appropriate foreign counterparts, with a view to make capital and technology better available for domestic operations. For instance, in the mineral sector, cooperation in gold buying and marketing between locally registered commercial banks and foreign correspondent banks, as well as local and foreign master gold dealers should be encouraged.

(c) The Government should promote and facilitate indigenous small scale investment by offering them incentives which are at the very least, as favourable as those offered to foreign investors under the Investment Promotion Centre Act. For example, the provision of tax holidays for the first five years in operation, and the charging of moderate duties and sales taxes on small scale equipment and inputs should be encouraged.

(d) In the tourist industry, tourists could be encouraged to use formal channels by:

(i) providing them with tools such as maps, hotel directories, and special discounts; and

(ii) ensuring that visa costs for tourists visiting Tanzania are competitive with other comparable countries.

(e) In activities that involve the rural communities (such as the agricultural sector), the provision of adequate and accessible feeder roads should be given priority. Costs could be minimized by using the community-participation approach under which local communities are mobilized to participate in manual work to improve or construct feeder roads.

(f) As a medium and long term measure, capacity building initiatives should be targeted at the indigenous peoples to enhance their ability to become effective joint venture partners or go it alone. The indigenous population issue is also critical to the tax equation because of its undivided loyalty to the country.

5.5. Providing Smooth Official Channels, Adequate Salaries and Incentives

(a) Bureaucratic difficulties should be reduced by putting in place incentives to encourage public servants to step up their performance to cope with the requirements of a market economy and competitiveness. The Civil Service Reform currently being implemented is expected to address this problem. Among other things, however, there is need for the establishment of a system under which the implementors and managers of regulatory functions can be held accountable to the public they serve. This could provide an institutionalized mechanism by which the performance of Government officials could be assessed/evaluated on a continuous basis by a institutional arrangement to audit performance. Under this arrangement, complaints from the public which is served by the Government officials would be heard.

(b) The regulations and procedures which guide the actions of the bureaucrats should, to the extent possible, be made available to the public that makes use of the service. Greater transparency would not only give strength to the public being served, but would also inform the public of its rights and when complaints could be launched.

(c) The bureaucracy should establish the system of evaluation. After a member of the public has received service it should be possible for him/her to express opinion on the quality of service received and show the difficulties encountered (if any). These suggestions/opinions should be made available to the superiors and/or the performance audit unit.

(d) Paying a living wage commensurate with qualifications, experience and performance, and providing incentives for good performance.

(e) The entrusting of too many discretionary powers to one individual should be abolished in favour of committees whose operations are guided by clear and transparent criteria and procedures. In addition, individuals whose applications are being processed should have the right to be given reasons which may have led to the rejection of the application. In the tourist industry for example, the Director of Wildlife should have no influence on the allocation of blocks. The allocation should be handled by an entirely independent committee, whose task should be to collect and compile information to enable the committee arrive to a decision based on reliable information and well-understood rules and procedures.

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(iv) the legal problems that were existing[32]; and

(v) being predictable due to the conditional nature of the country offers submitted.

In textiles and clothing, the mandate, and hence the negotiations were focused on bringing this ector under the rules and principles of the General Agreement. The discussions still concerned ssues left outstanding in the text proposed in Brussels in December 1990 for the re-integration f textiles and clothing into GATT rules and principles. These related to, *inter alia,* transitional afeguard measures and the length of the transitional period (of which the seventeen-month rolongation of the MFA from July 1991 was part); the pace, extent and timing of restriction limination, and the growth rates of the allocated quotas that should be applied during the uccessive stages in the transition period prior to the full integration of the sector into GATT ules and disciplines. Concerning agriculture, by early December 1991, considerable technical rogress had been made in clarifying certain technical concepts such as the tariffication of border rotection measures, and the definition of the "green" category (measures that were to be xcluded from the reduction in internal support). In spite of this, agricultural negotiations still aced a major problem due to the lack of political will underlying all the technical points being iscussed.

Under trade-related intellectual property rights, negotiations in this area continued on the basis f the Brussels text. By December 1991, no new formal texts had been agreed upon, and a umber of fundamental questions still had not been resolved. These included such issues as:-

(i) dispute settlement;

(ii) the scope and duration of patent protection (particularly of pharmaceutical products);

(iii) the confidentiality of information;

APPENDIX A.1: SELECTED ESTIMATES OF THE SIZE OF THE PARALLEL ECONOMY (I)

	Maliyamkono & Bagachwa (1990)	Bagachwa & Naho (1995)		Komba (1996)
Period to which the Study Refers	1978-1986	1967-1988	1985-1988	
Methodology Used	1. currency-to-demand deposit ratio 2. The Household Survey	OLS of demand-for-currency equation	The missing income methodology assuming $Y_u=C_u+E_u-M_u$	
Findings	1. According to demand deposit ratio PE_{1978} = 9.8% $PE_{1980\text{-}86}$ = 22-29% PE_{1986}=31.4% 2. According to the HH Survey PE_{1986} = 30%	PE_{1967} = 21.4-27.7% PE_{1970}=40.3-40.5 PE_{1975}=40.9-45.9% PE_{1980}=41.4-45.39% PE_{1986}=51-74.8% PE_{1986}=39.9-61.3% PE_{1988}=41.8-61.4	1985 1986 1987 1988 MIA_1= 16.3 21.7 33.5 45.2 MIA_2 = 93.8 109.3 93.9 95.6 MIA_3 = 60.7 67.6 58.9 59.6	30-200%

PE = The Share of the Parallel Economy to the Official GDP (in Percentages).
Y_u = Unofficial GDP.
C_u = Unofficial Unrecorded Consumption of the Product Generated by the Second Economy.
E_u = Unofficial, Unrecorded Exports.
M_u = Unofficial, Unrecorded Imports.
MIA_1 = Implied Second Economy GDP (from own funded imports at official rates as a share of official GDP at market prices).
MIA_2 = Implied Second Economy GDP (from own-funded imports at parallel rates as a share of official GDP at market prices).
MIA_3 = Applied Second Economy GDP (from own-funded imports at parallel rates as a share of the adjusted GDP, using the ratio of the NCPI to the implied GDP deflator -- to augment the reported GDP).

APPENDIX A.2: ESTIMATES OF THE SIZE OF THE PARALLEL ECONOMY (II)

	P^O_E	P^O_R
1967	21.4	27.7
1970	40.3	40..5
1975	45.9	40.9
1980	45.8	41.4
1983	46.7	35.3
1985	74.8	51.0
1987	62.4	41.3
1988	61.4	41.8

Source: Bagachwa and Naho. 1995.
Note: P^O_E = The second economy as a share of the final nominal GDP.
P^O_R = The second economy as a share of the real official GDP.

APPENDIX TABLE 1: IMPORTS OVER-INVOICING BY SECTOR

Sector	Data Differences as % of UK Data (1985-1990)
Food and Live Animals	+133.3
All Inedible Crude Materials, (Except Fuels)	+75.1
Mineral Fuels, Lubricants etc.	+180.3
Animal and Vegetable Oils, Fats and Waxes	+681.7
Chemical and Related Products n.e.s.	0.4
Manufactured Goods (classified chiefly by type of material)	20.8

Source: Nyagetera. 1995.

APPENDIX TABLE 2: DETECTED CASES AND RECOVERY OF TAXES (1994/95)

ZONE	ENQUIRIES	PRINC. TAX COLLECTED (Million Tshs.)	FINES & PENALTIES (Million Tshs.)	TOTAL (Million Tshs.)
Headquarters	163	234,211	7,941	242,153
Dar es Salaam	196	361,537	43,100	404,637
Lake		137,503	11,386	148,889
Tanga	132	187,813	21,387	209,201
Western	19	3,035	3,320	6,357
Zanzibar				
Northern		166,258	41,265	207,523
Mbeya		40,407	10,882	51,290
Total	510	1,130,766	139,284	1,270,051

Source: Customs.

APPENDIX TABLE 3: IMPORT DUTY EVASION THROUGH TRANSIT GOODS, 1991

Importer	Offence	Import Duty Due (Tshs. Million)	Source
Unspecified	Sold safety matches earlier declared destined to Zambia. All documents were duly stamped at Tunduma customs posts.	11.4	Daily News, April
Private Trader	Sold 67 containers of second hand clothes earlier declared were going to Zambia. All documents were stamped at the Tunduma customs post.	145.2	Daily News, May
Private Firm	Sold 1406 bases of *khanga* and spare parts purported to be in transit to Burundi	42.9	Daily News, July
Private Company	Diverted 1,079 bales of second hand clothes destined for Burundi, Rwanda and Zaire and 40,100 litres of fuel on transit to Burundi.	4.2	Daily News, July
Private Company	Sold 187 cartons of fabrics in transit to Burundi. Documentation of the cargo was cleared at the relevant exit points.	2.4	Daily News, July
Dar-Based Transporters	Sold consignments of *khanga*, second hand clothes, printed fabrics and textiles worth US $103,505 earlier declared were consigned for Zambia.	30.1	Daily News Nov.
Total		236.2	

Source: TCCIA. 1995.

APPENDIX TABLE 4: TAXES PAYABLE BY HOTELS ON A MONTHLY BASIS AND LICENCES FOR HOTEL OPERATIONS

Taxes:

1.	Hotel Levy	20% on accommodation
2.	Sales Tax	15% on food
3.	Sales Tax	30% on fresh juices & cakes
4.	Stamp Duty	one percent of turnover
5.	Withholding Tax	two percent on goods and services
6.	Training Levy	10% on expatriate employees taxable income
7.	Payroll Levy	four percent on gross taxable income of all employees
8.	VETA Tax	two percent on gross taxable income of all employees
9.	Specified Building Tax	one percent on the value of the hotel building
10.	Car Benefit Tax	Tshs.80,000 per saloon car provided to employees
11.	NPF Contribution	10% on the gross taxable income of all employees
12.	Corporation Tax	35% on profits as calculated by Tax Authorities
13.	Land Rent	on hotel or lodge sites
14.	Property Tax	has not started yet
15.	Pre-Shipment Inspection Fees	1.2% on FOB value of imports
16.	Import Duty and Sales Tax	on vehicles and spare parts
17.	Import Duty and Sales Tax	on imported capital goods and equipment

Licences:

1.	Common Lodging House Licence	Tshs.10,000
2.	Lodging Housekeeping Licence	Tshs.10,000
3.	Restaurant Licence	Tshs.10,000
4.	Retailer of Spirits Licence for each Outlet	Tshs.15,000 for six months
5.	TLA Licence Class A or C	Tshs.30,000 per annum; also depends on nationality of owner and type of hotel
6.	Entertainment Licence	
7.	TV & Radio Licence	
8.	TLB Licence	Tshs.10,000 for 1-5 ton trucks

For Tented Camps in National Parks:

1.	Bed Night Fees	One US dollar per night
2.	Concession Fees	10% of bed and meals of turn over

APPENDIX TABLE 5: BUSINESS AND OTHER TAXES PAYABLE BY TOUR OPERATORS

Taxes:

1.	Sales Tax	on spare parts
2.	Sales Tax	on tyres
3.	Stamp Duty	one percent of turnover
4.	Withholding Tax	two percent on goods and services
5.	Training Levy 10%	on expatriate employees' taxable income
6.	Payroll Levy 4%	on gross taxable income of all employees
7.	VETA Tax	two percent on gross taxable income of all employees
8.	Specified Building Tax	one percent on value of buildings valued over 20 million
9.	Car Benefit Tax	Tshs.80,000 per saloon car provided to employees
10.	NPF Contribution	10% on gross taxable income of all employees
11.	Corporation Tax	35% on profits as calculated by Tax Authorities
12.	Import Duty and Sales Tax	on vehicles and spare parts
13.	Motor Car Registration and Transfer Tax	
14.	Pre-Shipment Inspection Fees	1.2% on FOB value of imports
15.	Land Rent	on hotel or lodge sites
16.	Property Tax	has not started yet
17.	Import Duty and Sales Tax	on imported capital goods and equipment
18.	Road Toll	through the purchase of fuel

Licences:

1.	Business Licence	Tshs.95,000 per annum
2.	TLA Licence Class A or C	depends on nationality of owner and of hotel
3.	Radio Licence	
4.	TLB Licence	Tshs.10,000 1-5 ton trucks