ICTD Research in Brief
Issue 49 • December 2019

Democratisation in Tanzania: No Elections Without Tax Exemptions

Summary of Working Paper 98 by Ole Therkildsen and Ane Karoline Bak

In this paper, we contribute to a better understanding of the political economy of tax exemptions in African countries. Based on a simple demand-supply framework, we explore how, in the context of increasingly competitive elections and economic liberalisation in these countries, fluctuations over time in the volume of tax exemptions for companies and individuals are linked to the election cycle.

Some of these fluctuations are driven, at least in part, by the demand for campaign financing and a corresponding willingness of companies and individuals to supply it. Ruling elites need political funding to stay in power. Businesspeople need tax exemptions and other state-provided rents to be successful. Thus, mutual interests between major capitalists and the ruling political elite are central to the supply in the face of an increasing demand for political funding.

The importance of tax exemptions

Tax exemptions are usually defined as deviations from a benchmark tax system that give rise to tax revenue losses rather than direct expenditure. They occur in many forms, including reduced tax and customs rates, and they may be bound to certain geographic locations (tax free zones) or time spans (e.g. tax holidays).

The use of tax exemptions has spread to an increasing number of countries in sub-Saharan Africa. The money involved is substantial according to the latest available comparable data: Tanzania spent 2.5 per cent of GDP in 2010/11 on tax exemptions compared to 7.1 per cent in Burundi, 2.6 per cent in Kenya, 3.2 per cent in Rwanda and 1.2 per cent in Uganda. Similar levels of tax exemptions are found in West Africa. This indicates that the use of tax exemptions in Tanzania is fairly typical. Its annually revenue losses due to tax exemptions are substantial. They amounted to approximately USD 1.16 billion at their peak in 2011 but have since declined to USD 0.47 billion in 2016.

For Tanzania, this information is taken from official sources – especially time series data on tax exemptions from the Controller and Auditor General's (CAG's) annual reports and (limited) microdata on tax exemptions by beneficiaries. Also, academic articles, newspapers, major recent reports by consultants and NGOs, plus interviews with various key informants during the period

> “The regulatory framework for political financing is not enforced and public access to information about tax exemption beneficiaries is unreliable, thereby providing ample opportunities to exchange exemptions for political funding for the ruling party.”

2009 to 2018 are used. Other uses of the tax system to influence election results – and of the government apparatus and budgets in general – are not analysed in this paper.

The link between tax exemptions and political funding

The exploratory analyses of the link between tax exemptions and political funding in Tanzania mainly focus on Chama Cha Mapinduzi (CCM) – the ruling party since independence in 1961, and the largest recipient of political funding from the private sector.

Exemption data from 2002 to 2016, covering three general elections, establishes the link between tax exemptions and political funding. They show that peak volumes of tax exemptions to private companies and individuals co-vary with election years. The supply of donations from companies and individuals helps to meet the demand for campaign financing by the ruling party. Moreover, although the total volume of tax exemptions has fallen significantly since 2011, the peak volume of this type of exemption has increased from the 2005 to the 2015 elections.

Five main findings underpin this argument: (a) the cost of election campaigns has risen due to increased competition for political power since the 2000s – both within the ruling party and vis-à-vis the opposition. (b) The regulatory framework for political financing is not enforced and public access to information about tax exemption beneficiaries is unreliable, thereby providing ample opportunities to exchange exemptions for political funding for the ruling party. (c) The tax/GDP ratio has decreased around each of the three recent election years. (d) The volume of tax exemptions (in constant shillings) to 'private companies and individuals' has increased around each of these three election years – even though the total volume of tax exemptions has actually declined since 2011/12. And (e), although some of the donations given in exchange for tax exemptions may end up in private pockets, a significant share must go to the ruling party, otherwise it would be difficult for it to finance the continued rise in election campaign costs.

Governance implications

The Tanzanian case illustrates that democratisation since the 1990s has not undermined its clientelistic politics. Instead, it has amplified it: money has become increasingly important in Tanzanian politics. Consequently, this has driven the old self-proclaimed socialist party of workers and peasants into close engagement with a small segment of the business community, as well as people with money. If states that rely on broad taxation have better incentives to practice better governance, then the short-term prospects for governance improvements are not good in such contexts.

Democratic or not, in a country where the government depends on a very limited number of rich companies and individuals for its revenues and where the ruling party depends on such sources of income to run election campaigns, there cannot be a meaningful inclusive fiscal contract in place.

Further reading

Citation: Therkildsen, O. and Bak, A.K. (2019) *Democratisation in Tanzania: No Elections Without Tax Exemptions*, ICTD Working Paper 98, Brighton, IDS

Credits

Ole Therkildsen is a Senior Researcher, Emeritus, at the Danish Institute for International Studies, DIIS.

Ane Karoline Bak is a Postdoctoral Researcher at the Department of Political Science from Aarhus University. She holds an MSc in Africa and International Studies from the University of Edinburgh and an MSc in Political Science from Aarhus University. She is affiliated with the Political Settlement and Revenue Bargains in Africa research programme.

The ICTD is funded with UK aid from the UK Government and by the Bill & Melinda Gates Foundation; however, the views expressed herein do not necessarily reflect the UK Government's official policies, nor those of the Bill & Melinda Gates Foundation.

IDS Institute of Development Studies

ICTD is based at the Institute of Development Studies, Brighton BN1 9RE UK.