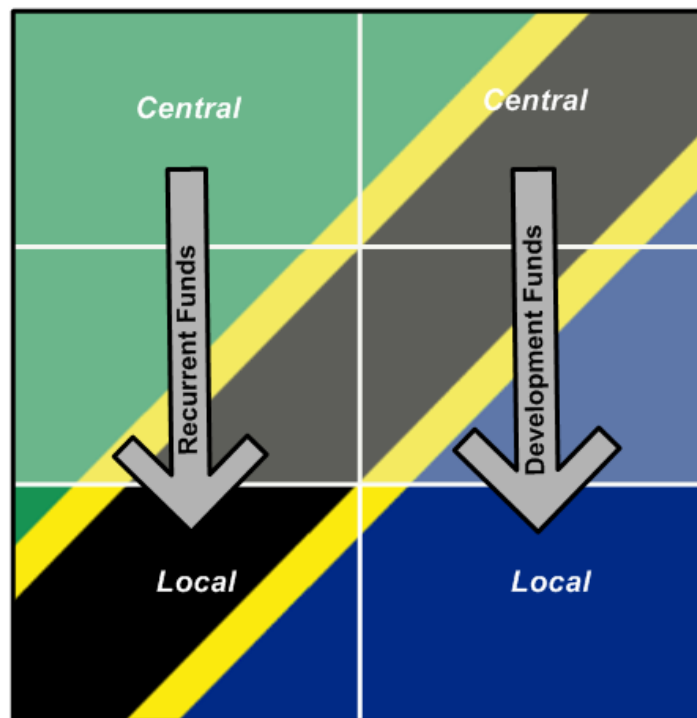




Local Government Fiscal Review 2007

Measuring Progress on Decentralization by Devolution



December 2007

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Decentralization by Devolution*

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Acronyms

CAG	Controller and Auditor General
CBG	Capacity Building Grant
CDG	Capital Development Grant
CWIQ	Core Welfare Indicators Questionnaire
D-by-D	Decentralization by Devolution
DADP	District Agriculture Development Programme
DMIS	Directorate of Management Information Systems
DLG	Directorate of Local Government
FY	Financial Year
HLG	Higher-level Local Government
LGA	Local Government Authority
LGCDG	Local Government Capital Development Grant
LGRP	Local Government Reform Programme
LGSP	Local Government Support Project
LLG	Lower-level Local Government
M&E	Monitoring and Evaluation
MDA	Ministries, Departments and Agencies
MKUKUTA	National Strategy for Economic Growth and Poverty Reduction
MOEVT	Ministry of Education and Vocational Training
MOHSW	Ministry of Health and Social Welfare
MTEF	Medium Term Expenditure Framework
O&OD	Opportunities and Obstacles to Development
OC	Other Charges
PE	Personal Emoluments
PMO-RALG	Prime Minister's Office, Regional Admin.and Local Government
PO-PSM	President's Office, Public Service Management
PST	Project Support Team
RALG	Regional Administration and Local Government
TRA	Tanzania Revenue Authority
TShs	Tanzania Shillings
UDEM	Urban Development and Environmental Management



Chapter 1 Progress on Tanzania's Intergovernmental Fiscal Reform Agenda

The year 2007 is a milestone for Tanzania's intergovernmental fiscal system, reflecting 25 years since the enactment of the Local Government Acts including the Local Government Finance Act, which signaled the re-introduction in 1984 of elected local authorities in Tanzania. As such, this year provides an opportune time to consider the role that local governments play in the country's public sector, and reflect on the progress that the country has made on its intergovernmental fiscal reform agenda.

This stock-taking exercise –determining where Tanzania is on the road to a sound, fiscally decentralized system- serves more than an academic purpose. Next year, it will have been ten years since the Government of Tanzania adopted the *Policy Paper on Local Government Reform* which initiated the current wave of local government reforms. In fact, the *Local Government Reform Programme* which was set up in 1999 to implement the Government's local government reform agenda is scheduled for completion in June 2008. As such, the current Review can help to inform the formulation of the next stage of support to Tanzania's local government reform agenda, as the Government continues to pursue the policy of decentralization by devolution (D-by-D).

1.1 Measuring Progress on Decentralization by Devolution

This is the fourth annual edition of the *Local Government Fiscal Review*. Since its inception in 2004, the Review has had three objectives. First, the *Local Government Fiscal Review* seeks to provide an accurate, comprehensive and up-to-date overview of local government finances and intergovernmental fiscal relations in Mainland Tanzania. Second, the Review seeks to assess the progress made on the Government's local government finance reform agenda. Third, the Review seeks to identify policy areas within the realm of local government reform that will require additional attention during the upcoming year.

The theme of this year's Review is "Measuring Progress on Decentralization by Devolution" and the document's content has been adjusted slightly to focus on this theme.

Like in previous years, the document's chapter structure continues to reflect the main dimensions of intergovernmental finance, notably, local expenditures, revenues, intergovernmental transfers, and local financial management. Likewise, each chapter

analyzes how each different dimension of fiscal decentralization is progressing in Tanzania. However, in previous years, these questions were answered by a combination of detailed descriptive review as well as quantitative analysis. In addition, a heavy emphasis was put in previous years on forward looking policy discussions.

From this *Review* forward, the document will be more compact in nature in reviewing progress in the realm of local government finance. While the opening section of each chapter will still provide a review of progress, the descriptive updates in each chapter will be shorter using bullet-points rather than a lengthy and detailed review.

In analyzing the progress in the four main areas of local government finance (in the four subsequent chapters), the report will focus on four primary quantitative benchmarks:

- **First**, with respect to subnational expenditures responsibilities, we consider the share of public spending that is undertaken at the local government level as a measure of the degree of expenditure decentralization.
- **Second**, with respect to subnational revenues, we identify the share of subnational expenditures that is funded by own source revenues as a measure of the degree of revenue decentralization.
- **Third**, with respect to intergovernmental transfers, we analyze the share of public resources that is provided to the local government level through formula-based transfers, which are provided directly to the local level (rather than going through a ministerial budget).
- **Fourth**, with respect to the management of subnational finances, we consider the share of total local government finances that are managed properly, as indicated by the National Audit Office.

In addition to each primary benchmark, a number of secondary benchmarks are presented and analyzed in order to more accurately assess the progress on each of the four different components of decentralized finance.

Finally, in previous years, each chapter of the *Local Government Fiscal Review* identified challenges in fiscal decentralisation reform. This final section in each chapter often took the shape of a policy reform ‘wish list’ rather than serving as a tool for prioritizing policy reforms within each area of local government finance. As such, in this year’s Review, the main challenges in the area of local government finance – along with the prioritization of issues to be addressed during the next financial year – are discussed in a separate chapter (Chapter 6).

1.2 Overall Status of Decentralised Finance: The Big Picture

Local government finances continue to play an important role in the public finances of Tanzania Mainland. Table 1.1 provides a summary of local government finances for Financial Year 2006/07. Local government expenditures and revenues account for a substantial share of the country's public finances, with local governments in total spending over 858 billion Tanzanian Shillings during last financial year.

Table 1.1 Summary of local government finances, FY 2006/07 (in TShs. Million)				
	Budget Plan	Actual Outcome	Actual (as % of Total)	Perform. ratio (%)
Own Source Revenues	63,385.2	61,411.3	6.7	96.9
Intergov. Transfers	1,100,870.6	859,467.9	93.3	78.1
<i>o/w Block Grants</i>	695,191.8	600,270.6	65.2	86.3
<i>o/w Subventions and Funds</i>	142,314.4	77,980.1	8.5	54.8
<i>o/w Development Grants</i>	263,364.4	181,217.2	19.7	68.8
Local Borrowing	126.1	100.0	0.0	79.3
Total Revenues	1,164,381.9	920,979.1	100.0	79.1
Recurrent Expenditures	765,067.8	673,726.2	78.5	88.1
<i>o/w Concurrent functions</i>	601,661.7	539,379.3	62.8	89.6
<i>o/w Exclusive local functions</i>	163,406.1	134,346.9	15.7	82.2
Development Expenditures	353,940.9	184,574.3	21.5	52.1
Total Expenditures	1,119,008.7	858,300.6	100.0	76.7
Surplus / (Deficit)	45,373.2	62,678.6	--	138.1
Expenditure Ratio (%)	96.1	93.2	--	---
Source: PMO-RALG, LGA Finance Statistics, FY 2006/07 (LOGIN).				

1.3 Changes to the local government structure

A number of new councils were created during 2007, increasing the number of LGAs in Tanzania Mainland from 122 to 133 (including Dar es Salaam City Council).

Arumeru District Council (703001) ceased to exist in 2007 as it was divided into two new councils: Meru DC (703098) and Arusha DC (703099). Likewise, Dodoma DC (723013) ceased to exist and was divided into Bahi DC (723101) and Chamwino DC (723102).

In addition, seven new District Councils were created, including Longido DC (703100) which was created from Monduli DC in Arusha Region; Siha DC (753103) which was created from Hai DC in Kilimanjaro Region; Rorya DC (773104) which was created from Tarime DC in Mara Region; Nanyumbu DC (803105) which was created from Masasi DC in Mtwara Region; Mkinga DC (863106) which was created from Muheza DC in Tanga Region; Chato DC (873107) which was created from Biharamulo DC in Kagera Region; and Misenyi DC (873108) which was created from Bukoba DC in Kagera Region

Furthermore, two new Town Councils were created: Njombe Town Council (732026) in Iringa Region and Mpanda Town Council (892027) in Rukwa Region.

1.4 Progress on Tanzania's intergovernmental fiscal reform agenda

Overall, the current state of fiscal decentralization in Tanzania reflects strengths and weaknesses. One area of strength is the gradual increase in the share of expenditures that take place at the local government level. At the same time, an area of weakness is that local governments continue to have limited control over local expenditure, reflected among others by centralized control over local public servants and a limited degree of revenue autonomy.

Likewise, progress has been mixed with respect to the intergovernmental transfer system. On one hand, the introduction of formula-based grant systems (both on the recurrent and development sides of the budget) has been a major positive achievement. On the other hand, however, the Government's commitment to the principle of formula-based allocations has been weak, both with respect to the recurrent grant system as well as in the context of the formula-based Local Government Capital Development Grant System. Whereas recurrent allocations deviate substantially from the formula-based pattern due to the continuation of the hold harmless clause, the Government's contribution to the LGCDG for FY 2007/08 was not allocated consistent with the LGCDG formula-basis.

Although progress in Tanzania's intergovernmental fiscal system has taken place in a gradual manner, one area where improvements have been made in recent years appears to be in the quality of local financial management and in the transparency of local government finances.



Chapter 2 Local Government Expenditures

The responsibility for delivering public services in Tanzania Mainland is divided between the central government and Local Government Authorities, where the regional level authority functions as an administrative and coordinating tier of the central government. In accordance with international best practices, the assignment of expenditure responsibilities between these levels of government is generally guided by the principle of subsidiarity, which suggests that functions and expenditure responsibilities should be assigned to the lowest government level that can perform each function efficiently. The Local Government Acts (1982) provides a detailed list of the specific functions and responsibilities assigned to the local government level.

2.1 An Update on Local Government Functions and Expenditure Responsibilities

No changes in expenditure assignments. Local governments' concurrent expenditure responsibilities include primary education, basic health services, agriculture extension and livestock services, local water supply, and local public works (e.g., road maintenance). For these services, LGAs are responsible for delivering the service, but the central government remains responsible for policy-setting and financing the local delivery of these public services through intergovernmental transfers. Local councils' exclusive expenditure responsibilities include local land use planning, sanitation, public markets, and other such local amenities. In addition, local governments are responsible for local administration. With respect to the assignment of expenditure responsibilities in Tanzania, no major changes have taken place during the last year.

No decentralization of secondary education. One area of public service provision that has expanded substantially over the past few years in Tanzania is secondary education. Although sound arguments could be made to support the decentralized provision of secondary education in the country (as discussed in last year's Review), the Government has chosen to centrally manage the provision of secondary education under the Ministry of Education and Vocational Training (MOEVT) in FY2006/2007 and FY 2007/2008/ The Government has made a decision to decentralize secondary education to local governments from FY 2008/2009.

D-by-D compliance of ministries is being scrutinized. Under the direction of the Chief Secretary, PMO-RALG has been leading a review of ministerial budgets to ensure that the functions carried out by line ministries do not encroach on the functions that are assigned to local government authorities. During FY 2006/07, the ministerial budgets of the ministries responsible for education, health, agriculture, works, and

water were reviewed by PMO-RALG, jointly with MOF and the respective sector ministries. In addition, the budget of PMO-RALG proper (Vote 56) was also reviewed to consider which functional activities and financial resources could be devolved directly to the local government level under the principle of subsidiarity. During the current financial year, the ministerial budgets of several additional ministries are being reviewed by PMO-RALG, jointly with MOF, MPEE, PO-PSM and the respective sector ministries to ensure compliance with the concept of decentralization by devolution (D-by-D). These ministries include Ministry of Energy and Minerals, Ministry of Livestock Development, Ministry of Natural Resources and Tourism, Ministry of Community Development, Gender and Children, Ministry of Lands, Housing and Human Settlements, and the President's Office-Public Service Management (PO-PSM).

Satisfaction with local service delivery seems to be improving. It is difficult to establish direct links between the degree of decentralization in a country and the quality of public services. However, a recent study by REPOA suggests that citizens' satisfaction with local government service delivery has improved in recent years, particularly in the areas of primary education and basic health services.¹ It should be noted that these are the sectors that received the greatest amount of funding through the recurrent sectoral block grants. A number of Core Welfare Indicators Questionnaire (CWIQ) surveys conducted in various parts of Tanzania also seem to indicate improved utilization of, and general satisfaction with, local public services over time.²

Despite the relatively high degree of citizens' satisfaction with regard to primary education and basic health services, there continues to be significant concern within sectoral line ministries with respect to the capacity of local governments to deliver sectoral services.

Local control over local expenditure functions is limited. Finally, it should be noted that despite the advances in fiscal decentralization made in Tanzania over time, local governments in reality have only limited expenditure autonomy. Most importantly, local governments continue to have only very limited control over local personnel decisions, as the approval of local government posts continues to be controlled centrally by PO-PSM. While this lack of decentralization in the realm of human resource management has important implications for the system of intergovernmental fiscal relations (for instance, in terms of an unequal allocation of resources among local authorities), the centralization of human resource decisions is fundamentally a policy choice made by Tanzania's political leadership that will need to be resolved at the highest policy levels.

¹ See: Einar Braathen and Geoffrey Mwambe. 2007. *Service Delivery in Tanzania: Findings from Six Councils, 2000-2003*. REPOA.

² See: Economic Development Initiatives. 2005. *Comparison of Baseline Surveys on Poverty, Welfare and Services in Selected Districts in Kagera, Shinyanga and Northern Highlands*.

2.2 Trends in Local Government Functions and Expenditure Responsibilities

To what degree do subnational expenditures in Tanzania reflect progress on the country's policy of 'Decentralization by Devolution' (D-by-D)? Four benchmarks are used in order to answer this question.

Primary benchmark for expenditure decentralization

With respect to subnational expenditures responsibilities, the share of public spending that takes place at the local government level is used as the primary measure of the degree of expenditure decentralization in Tanzania.

Table 2.1 shows the relative levels of spending that are budgeted to take place at the different government levels in Tanzania for FY 2006/07. The table shows that overall, 21.4 percent of public spending is budgeted to take place at the local government level. On one hand, this is not an insignificant portion of public spending and is well above the share of public spending that takes place at the local government level in other countries in Sub-Saharan Africa. On the other hand, this share might be considered relatively low when considering the fact that local governments are responsible for delivering some of the most important pro-poor public services in Tanzania, including primary education, basic health services, agricultural extension, local road access and rural water supply.

Table 2.1						
Expenditure decentralisation in Tanzania:						
Recurrent and development budgets by central and local governments						
FY 2006/07						
	Tshs. Billion			Percent of total		
	Recurr. Budget	Dev. Budget	Total	Recurr. Budget	Dev. Budget	Total
Central (MDAs)	2,316.75	1,685.67	4,002.42	73.73	80.72	76.52
Regions	60.51	48.80	109.31	1.93	2.34	2.09
Local Governm.	765.07	353.94	1,119.01	24.35	16.95	21.39
Total	3,142.33	2,088.41	5,230.74	100.00	100.00	100.00
Source: Computed based on Ministry of Finance and PMO-RALG data.						
Note: To the extent local spending is funded from ministerial subventions and other central government transfers (other than local government grants); some public spending may be double-counted.						

Another feature that should be noted in Table 2.1 is that recurrent spending in Tanzania is considerably more decentralized than the development budget (24.35% for recurrent and 16.95% for development). While it is not unusual for development

spending to be determined in a more centralized manner, the lower share of expenditure decentralization in the development budget may reveal a hesitance on the part of the central government to provide local government with substantial expenditure discretion.

Secondary benchmarks for expenditure decentralization

In addition to the primary benchmark to assess progress on the degree of expenditure decentralization, we specify three additional secondary benchmarks. These secondary benchmarks include:

- Is (the share of) local government budgeted spending increasing over time?
- Do local expenditures reflect a well-balanced mix to provide quality local public services?
- Are local expenditure budgets executed as planned?

The first of these three secondary benchmarks is addressed in Table 2.2. The table presents the share of recurrent public spending that has been budgeted at the central government level (including the regions) versus local government spending over the period from FY 2001/02 until 2006/07.

Table 2.2						
Expenditure decentralisation in Tanzania:						
Recurrent public expenditures by central and local governments,						
FY 2001/02 – FY 2006/07						
	Central	Local	Total	Central	Local	Total
	TShs. Billion			Percent of total		
2001/02	1,018.5	234.5	1,253.1	81.3%	18.7%	100.0%
2002/03	1,237.8	290.0	1,527.8	81.0%	19.0%	100.0%
2003/04	1,509.8	324.3	1,834.1	82.3%	17.7%	100.0%
2004/05	1,869.2	383.1	2,252.3	83.0%	17.0%	100.0%
2005/06	2,341.1	534.4	2,875.6	81.4%	18.6%	100.0%
2006/07	2,377.3	765.1	3,142.3	75.7%	24.3%	100.0%

Source: Computed based on Ministry of Finance and PMO-RALG data.
 Note: Central expenditures include spending by regional level. Prior to 2005/06, the local expenditure budget is approximated by budgeted transfers plus actual own source revenues (and thus excludes local spending from ministerial subventions).

The table shows a steady increase over the last three years in the local governments' share of recurrent spending from 17 percent in FY 2004/05 to over 24 percent in FY 2006/07. In part the increase in the local share of recurrent spending has been driven by the relatively high public sector wage increases in recent years, which disproportionately drove up local spending (as two-thirds of public servants work at

the local level in Tanzania). However, whereas many MDAs faced reduction in Other Charges (OC) in recent years, local governments have largely been spared cut-backs in their OC budgets.

Another secondary benchmark with respect to expenditure decentralization considers whether the mix of local expenditures is adequately balanced in order to provide quality local public services. This issue is addressed in Table 2.3, which provides a detailed breakdown of aggregate actual local spending by sector and spending type, as reported by LGAs themselves.

Table 2.3					
Summary of local government expenditures, FY 2006/07					
	PE	OC	Recurrent Expend.	Development Expend.	Total
TShs. Million					
Education	329,276.4	72,952.5	402,228.9	51,966.4	454,195.2
Health	70,605.0	28,780.8	99,385.8	17,399.2	116,785.0
Agriculture	10,401.4	4,277.6	14,679.0	19,340.4	34,019.5
Roads	4,965.7	4,301.5	9,267.1	9,307.8	18,574.9
Water	4,095.4	9,723.1	13,818.5	15,206.7	29,025.2
Concurrent functions	419,343.9	120,035.4	539,379.3	113,220.5	652,599.9
Local Admin	46,870.9	47,869.3	94,740.2	14,335.9	109,076.1
Other Spending	19,962.9	19,643.8	39,606.7	57,017.9	96,624.6
Exclusive local func.	66,833.8	67,513.1	134,346.9	71,353.8	205,700.7
Total	486,177.7	187,548.5	673,726.2	184,574.3	858,300.6
Percent of local government expenditures					
Education	38.36	8.50	46.86	6.05	52.92
Health	8.23	3.35	11.58	2.03	13.61
Agriculture	1.21	0.50	1.71	2.25	3.96
Roads	0.58	0.50	1.08	1.08	2.16
Water	0.48	1.13	1.61	1.77	3.38
Concurrent functions	48.86	13.99	62.84	13.19	76.03
Local Admin	5.46	5.58	11.04	1.67	12.71
Other Spending	2.33	2.29	4.61	6.64	11.26
Exclusive local func.	7.79	7.87	15.65	8.31	23.97
Total	56.64	21.85	78.50	21.50	100.00
Source: PMO-RALG, LGA Finance Statistics, FY 2006/07 (LOGIN).					

The table reveals several clear tendencies in local government spending. First, almost four-fifths (78.5 percent) of local spending is recurrent spending, with the remaining 21.5 percent for development expenditures. Second, most of recurrent spending (56.6

percent of all local spending, or almost three-quarters of local recurrent spending) is spent on personal emoluments. Third, spending is heavily concentrated within just two sectors: three-quarters (74.4%) of recurrent spending and two-thirds (67%) of all local spending is spent on primary education and basic health services.

Rather than being driven primarily by local priorities and choices, it appears that these local expenditure trends also reflect national sector priorities and are driven to a large extent by the nature of the intergovernmental fiscal transfer system, which limits the spending discretion of local government authorities between sectors and between spending type (PE, OC or development).

The final benchmark with respect to subnational expenditures in Tanzania is whether local expenditures are executed as planned. This issue is considered in Table 2.4, which compares local government spending plans with local budget execution for FY 2006/07, as reported by the councils themselves. The performance ratio in the table is defined as actual spending expressed as a percent of budgeted spending.

Table 2.4			
LGA Expenditures for Mainland Tanzania, FY 2006/07			
(Tshs. million)			
Budget item	Annual budget plan	Actual Outcome	Performance ratio (%)
Total (Recurrent plus Development) Spending			
Recurrent Spending	765,067.8	673,726.2	88.1
o/w PE Spending	544,759.1	486,177.7	89.2
o/w OC Spending	220,308.7	187,548.5	85.1
Develop. Spending	353,940.9	184,574.3	52.1
Total Spending	1,119,008.7	858,300.6	76.7
Source: PMO-RALG, LGA Finance Statistics, FY 2006/07 (LOGIN).			

Table 2.4 indicates that local recurrent spending is executed substantially better (at 88 percent of the budget plan) than development spending (52 percent of the plan). While the lower performance ratio for development spending may reflect greater difficulties in implementing and managing development projects versus recurrent spending, the difference may also be explained by variations in the transfer system. In fact, the analysis in Chapter 4 indicates that LGAs only report receiving 86 percent of their recurrent transfers, whereas they only report receiving 55 and 69 percent of ministerial subventions and development funds, respectively.



Chapter 3 Local Government Revenues

The local government revenue system in Tanzania is arguably the weakest component of Tanzania's local government finance system. The previous relatively "permissive" (open-list) approach to local taxation in Tanzania resulted in a local revenue system that virtually lacked any sense of uniformity. Concerned with the efficiency and equity effects of local government revenues, the Government rationalized the local revenue system in 2003 and 2004 by abolishing a number of local revenues while restricting local rate-setting discretion over the remaining local revenue sources. As a result, local government revenues in Tanzania have witnessed a relative decline in recent years.

Concerned by the decline in local government revenues, the Government commissioned a study to inform a strategic framework for the financing of local governments in Tanzania (LGRP/GSU, June 2005). This study suggested formalizing the more restrictive "closed list" approach to local government revenues and improving local revenue administration by adopting a standardized approach to local revenue administration across LGAs.³

3.1 An Update on Local Government Revenues

Strengthening of the local revenue framework has not progressed as anticipated. Although consideration was given to grant LGAs with additional revenue sources (including vehicle registration fees and a surcharge on public utilities), the Government made the decision to encourage LGAs to first improve revenue mobilization from existing sources. It is expected that reforms will be initiated on improving local revenue administrative capacity and on simplifying, standardizing and harmonizing revenue administrative systems and procedures.

There is an institutional vacuum. In almost all countries, central government plays an important supervisory role in the realm of local taxation. Whereas this role is legally assigned to PMO-RALG in the Local Government Finance Act, this function is not specified as part of the organizational responsibilities of PMO-RALG's LGA Finance Section within the Directorate for Local Government. In the absence of any institutional ownership over local government revenues by PMO-RALG, the Government's policy stance towards local revenues is informed more by the limited revenue potential of local government revenues (compared to central government

³ LGRP (2006) "Background Paper on Local Government Finance: The Framework for the Financing of Local Government Authorities in Tanzania" and LGRP (2006) "Transforming the Local Government Revenue System in Tanzania: A Roadmap for Reform"

revenue sources), while not adequately taking on board the interests of local governments and considering the importance of (some) local revenue autonomy and accountability for local governance in Tanzania.

TRA to assist in property rates collection. The local collection rate for property taxes ranges roughly from 20-60 percent of the tax liabilities, depending on the local government and the type of property involved. In order to strengthen local revenue collections, the Prime Minister announced Government's decision in June 2007 to have the Tanzanian Revenue Authority (TRA) assist LGAs in the collection of local property rates. While the exact role that the TRA will play is still unclear, it is expected that TRA's involvement in local revenue administration will be structured to build local capacity and to provide support to local authorities in the actual collection and enforcement of local property rates. Although expected to provide a 'window of opportunity' to strengthen local revenue administration and standardize local revenue administration practices across Tanzania Mainland, the TRA involvement must be carefully structured to avoid weakening local revenue mobilization accountability and autonomy which are necessary for successful D-by-D reforms.

Unclear way forward. Although a roadmap for reform was prepared for PMO-RALG which details the gradual transformation of the local government revenue system in Tanzania, it is unclear how the local government revenue system will develop as part of the evolving local government financing framework. The way forward will depend in part on the speed and degree to which PMO-RALG will establish a more conducive environment for sound local government revenue administration. Another determining factor on the way forward will be the exact role that will be assigned to TRA in supporting local revenue collection efforts.

3.2 Trends in Local Revenues

Some degree of revenue autonomy is necessary to strengthen accountable local governance and for the benefits from fiscal decentralization to arise, under conditions in which local residents can make an informed, rational assessment of various proposals for local public expenditure while being informed about the tax bill sufficient in order to pay for the selected public expenditures.

Primary benchmark for local revenue autonomy

How much progress has Tanzania made since the re-introduction of local governments in 1984 in achieving local revenue autonomy in a manner that devolves an adequate amount of revenues to the local government level? Table 1.1 (in Chapter 1) addresses this question by indicating that local governments in Tanzania collected TShs. 61.4 billion in own source revenues during FY 2006/07, compared to planned revenue collections of TShs. 63.3 billion. In practice, this means that less than 7 percent of total local recurrent and development expenditures is funded from own source revenues. The low degree of local revenue autonomy in Tanzania reveals a weak link between the benefits from local expenditures and the costs of these to local residents.

Secondary benchmarks for local revenue autonomy

A secondary benchmark for local revenue autonomy is whether local revenues are growing over time, both in nominal as well as in relative terms. In this regard, Table 3.1 indicates that local own source revenues has shown remarkable resilience since 2004/05, subsequent to the local revenue reforms in 2003 and 2004 when major local revenue sources were abolished. Local revenues have grown in nominal terms and have stabilized around 9 percent of local recurrent financial resources when expressed as a percentage of total recurrent local resources.

Table 3.1					
Local government recurrent financial resources					
FY 2002/03 - 2006/07					
	2002/03	2003/04	2004/05	2005/06	2006/07
TShs. Million					
Local Grants (incl. GPG)	247,027.3	313,872.7	386,767.8	452,831.2	600,270.6
Own Source Revenues	57,740.2	48,343.6	42,871.4	49,291.0	61,411.3
Local Borrowing	225.0	442.5	549.3	1,495.9	100.0
Total	304,992.5	362,658.8	430,188.5	503,618.1	661,781.8
Percent of local government resources					
Local Grants (incl. GPG)	81.0	86.5	89.9	90.4	90.7
Own Source Revenues	18.9	13.3	10.0	9.3	9.3
Local Borrowing	0.1	0.1	0.1	0.3	0.0
Total	100.0	100.0	100.0	100.0	100.0
Notes: Starting 2005/06, data reflect actual amounts as reported by LGAs. See LGFR 2006 (Table 1.1) for data sources for earlier years.					
Source: PMO-RALG, LGA Finance Statistics, FY 2006/07 (LOGIN).					

A final secondary consideration is whether local governments have access to a proper mix of local revenue sources, and whether local governments properly utilize the revenue sources available to them. Table 3.2 shows that local governments rely on two broad sources of revenue: tax revenues (accounting for almost 60 percent of local revenues) and non-tax revenues (accounting for the remaining 40 percent). On one hand, this revenue mix provides LGAs with a potentially solid stream of user fees for locally provided services that are funded on a fee basis, while on the other hand a substantial share of local revenues is untied, thereby providing local authorities with a sizeable revenue pool to fund local expenditure priorities.

Whereas taxes on local business activity produce almost half of all local revenues, a particular concern is the fact that revenues from property rates and land rent accounts for less than 12 percent of all local revenues.

Table 3.2
Total Local Government Revenue Collections, FY 2006/07
(in Tshs. million)

	Annual budget plan	Actual outcome	Actual (as % of total)	Perform. Ratio (%)
I. Local Rates				
<i>A. Local rates on immovable property and land</i>				
i. Local property rates	8,195.2	5,476.3	8.9	66.8
ii. Land rent	2,062.4	1,332.7	2.2	64.6
<i>B. Local rates on income, business, or activity</i>				
i. Service Levy	13,180.8	15,138.8	24.7	114.9
ii. Produce Cess	12,154.3	13,118.5	21.4	107.9
iii. Guest House Levy	1,323.7	1,127.9	1.8	85.2
<i>Subtotal</i>	36,916.4	36,194.3	58.9	98.0
II. Local Licenses/ Permits	1,817.4	1,470.5	2.4	80.9
III. Local Fees and Charges	15,901.1	14,631.3	23.8	92.0
IV. Other Revenue Sources	8,750.2	9,115.2	14.8	104.2
Total Own Revenues	63,385.2	61,411.3	100.0	96.9

Source: PMO-RALG, LGA Finance Statistics, FY 2006/07 (LOGIN).



Chapter 4 Intergovernmental Fiscal Transfers

Intergovernmental fiscal transfers form the backbone of Tanzania's system of local government finance. If we consider all types of intergovernmental transfers that local governments receive from the central government (including recurrent block grants, ministerial subventions as well as development grants), then intergovernmental transfers account for almost 93 percent of local government finances.

Given the importance of the intergovernmental transfer system, this chapter provides a separate update on the recurrent grant system in Section 4.1 and the development grant system in Section 4.2.

4.1 An Update on Intergovernmental Fiscal Transfers: The Recurrent Grant System

Back-sliding on the application of the formula-based recurrent grant system. In principle, virtually all recurrent transfers provided to the local government level are provided through five formula-based sectoral block grants plus the formula-based General-Purpose Grant (GPG). These funds are transferred directly to the local level through the so-called Regional Votes in the national budget.

However, in practice, adherence to the formula-based system has largely failed to materialize. While the first year after the full-fledged implementation of the formula-based system (FY 2005/06) saw an improvement in the formula-based allocation of resources, the adherence to the formula-based allocations has declined substantially since then.

The decline in adherence to the formula-based allocations is driven in large part by the allocation of resources for personal emoluments. Whereas the formula-based system was designed to cover both personal emoluments (PE) as well as Other Charges (OC), PE resources have continued to be allocated in a manner that is inconsistent with the formula-based approach.⁴ For FY 2007/08, this has meant that not a single LGA in Tanzania receives its formula-based amount, as all local governments are currently being 'held harmless'.

As such, the failure to apply the allocation formulas to the allocation of wage resources has led to a wider break-down of the formula-based grant system that

⁴ See: LGRP. *Adherence to The Formula-Based Recurrent Block Grant System and The Allocation of Personal Emoluments in Tanzania*. September 2007.

should be urgently addressed. The current allocation approach is detrimental not only to the objectivity of the formula-based approach and the sense of equity across councils, but also has a negative impact on sectoral service delivery objectives and the achievement of poverty reduction goals under MKUKUTA.

D-by-D compliance. As noted in Chapter 2, during the budget formulation process for FY 2006/07, at the instruction of the Chief Secretary, PMO-RALG, jointly with MOF and the relevant sector ministries, reviewed the budgets of various line ministries in order to assure that all resources for devolved recurrent functions were allocated to the local level through the recurrent block grant system. Although some of the results of this exercise materialized too late in order to be fully taken on board as part of the current budget, certain resources were shifted out of ministerial votes and into the regional votes. For instance, primary education capitation resources are now exclusively provided through the primary education block grant mechanism, rather than relying on a duplicative funding flow through the Ministry of Education and Vocational Training (MOEVT).

Incorporating intergovernmental transfers into the central government budget in a 'D-by-D consistent' manner. As a result of practices that were in place preceding the government's policy of Decentralization-by-Devolution, the formula-based, recurrent sector grants are currently incorporated into the central government budget as part of a series of so-called "regional votes" (Budget Votes 70-89 and 95). These 21 regional budget votes group all LGAs by the administrative region in which they are located. The five sectoral block grant schemes as well as the GPG are thus spread out in the central government budget across 21 separate budget votes.

There are numerous problems with the current approach. Not only does the current approach mix local resources for different sectors within the same budget votes, but these votes also mix regional and local resources. Thus, it is difficult to separate out the share of the central government budget that is transferred to the local government level. Furthermore, the budget voted on by Parliament only includes transfer amounts that are aggregated across all LGAs within each region. Therefore, Parliament never actually votes on the exact formula-based allocations for each council, which eliminates any legal backing for the formula-based allocation of resources.

PMO-RALG and the Ministry of Finance are considering ways to consolidate the progress that has been made in transforming the previous discretionary system of allocation budgetary resources to the local government level into an objective, transparent, efficient and equitable formula-based transfer system. Part of this effort will be to incorporate the intergovernmental transfer system into the central government budget in a more transparent and 'D-by-D consistent' manner. One of the several options that has been under discussion is the establishment of one or more 'local government grant votes', which would allow all local government grants to be transferred to the local government level in a much more transparent and effective manner, and with the aim of enhancing financial accountability.

4.2 An Update on Intergovernmental Fiscal Transfers: The Development Grant System

Efforts to mainstream the LGCDG cautiously moving forward. Whereas the basic structure of the recurrent grant system has been well-established, until recently, the provision of development grants to the local government level has been much more haphazard. The design and implementation of the Local Government Capital Development Grant (LGCDG) system in 2004/05 sought to address this concern. The Letter of Sector Policy envisioned that “the LGCDG system will be established as the main modality through which funds for capital investment are transferred from central government and donors to LGAs. Ultimately the LGCDG system procedures and modalities will be the vehicle for the transfer of all development funds to LGAs, including sectoral programmes.”

Despite the Government’s intentions for LGCDG to become ‘the’ government’s system for providing capital development funding to the local government level, LGCDG is perceived by many as “a project”. Furthermore, the system retains many project features. For instance, LGCDG funding is not deposited into the regular local development account at the local government level. Instead, LGCDG (CDG and CB) resources are deposited in a separate project account.

Efforts are gradually picking up speed to ensure that the LGCDG system truly evolves into the government’s Development Grant System, in which the current LGCDG (including the CDG and CB grant components) would form one of the windows under the wider Development Grant System. One option under preliminary discussion is the establishment of a Local Government Development Fund (LGDF) which would be capitalized on an annual basis as a fixed percentage of total domestic revenue.

LGCDG’s management shifted to PMO-RALG. Until mid-2007, the day-to-day operations and management of LGCDG were supported by a Project Support Team (PST) financed under LGSP. This PST was placed in charge of the LGCDG assessment system; computing the formula-based allocations; and supervising and supporting LGCDG planning and fund utilization. While some of these functions were performed ‘in-house’, many other functions (such as the annual assessments) were consultancy-based.

The responsibility for the day-to-day operation and management of LGCDG was shifted to PMO-RALG during 2007, and the LGSP PST for Component 1 was abolished. Within PMO-RALG, the lead for the LGCDG is assigned to the LGA Finance Section within the Directorate of Local Government (DLG). Other sections, such as the Inspectorate Section, Service Delivery Section and the Human Resource Section also have a role in monitoring. Furthermore, four of LGSP-supported M&E-related staff are located within PMO-RALG Directorate for Management Information Systems (DMIS). Even when the PST for Component 1 was in place, these sections contributed staff support for the management and administration of LGSP.

Given that the LGA Finances Section was created only less than two years ago (as part of a re-organization of PMO-RALG that coincided with the beginning of LGSP), the functional mainstreaming of LGSP's management into PMO-RALG with the LGA Finance Section at the helm should be considered a major achievement for both PMO-RALG and LGSP.

Sector windows emerging under LGCDG. Another component of the mainstreaming of the LGCDG that is picking up speed is the emergence of sector windows under the LGCDG system. For FY 2006/07, the funding of the District Agriculture Development Plans (DADPs) was included into the LGCDG system as a sector window. For FY 2007/08, the Rural Water Programme and the Urban Development and Environmental Management (UDEM) grants were also included into LGCDG. Yet, while the disbursement of these sectoral windows takes place under LGCDG, each window continues to have a somewhat separate management structure. Furthermore, the main local government sectors (primary education and health) have not yet bought into the broader LGCDG system.

D-by-D compliance: shifting all local development grants into the regional votes. Similar to the D-by-D compliance exercise on the recurrent side of the budget, substantial effort has been made to harmonize and consolidate all development grants in the central government budget. As a result, numerous transfer programs have been shifted from ministerial budget votes as well as Vote 56 (the budget vote for PMO-RALG proper) into the regional budget votes. The programs that were shifted to the regional budget votes include the LGCDG (along with its sector windows); primary education development grants; the Health Sector Basket Fund; the Village Transportation and Roads Programme; HIV/AIDS transfers; and several minor local government grants. These resources are thus now distributed to the LGAs through the RALG Section within the Budget Department of the Ministry of Finance, rather than through the ministerial budgets.

4.3 Trends in Intergovernmental Fiscal Transfers

Primary benchmark for a sound intergovernmental fiscal transfer system

The primary benchmark that we draw on to consider progress in Tanzania with respect to a sound formula-based intergovernmental transfer system is the amount of transfer resources that is provided to the local government level. In particular, we are interested to identify those resources that are provided on a formula basis, and those that are provided directly to the local level (rather than going through a ministerial budget). As such, this benchmark is consistent with the performance indicator set forth in the GBS Performance Assessment Framework for fiscal decentralization.

Table 1.1 (in Chapter 1) already addressed this question in part by indicating that LGAs budgeted to receive TShs. 1,101 billion in intergovernmental transfers during FY 2006/07, whereas TShs. 859.5 billion was actually provided to the local government level during the financial year (as reported by the LGAs themselves). Table 4.1 (on the next page) provides a more detailed break-down of the intergovernmental fiscal transfers received by LGAs.

Table 4.1
Intergovernmental fiscal transfers in Tanzania, FY 2006/07
(Tshs. million)

Budget item	Annual budget plan	Actual Outcome	Performance ratio (%)
Recurrent Block Grants			
Education Grant	418,016.6	386,705.4	92.5
Health Grant	114,778.5	96,811.2	84.3
Agriculture Grant	22,172.4	12,455.0	56.2
Roads Grant	8,063.2	6,889.7	85.4
Water Grant	14,482.6	14,485.7	100.0
GPG (incl. local admin)	117,678.4	82,923.6	70.5
Total Grants	695,191.8	600,270.6	86.3
Sector Basket Funds and Subventions			
Education Subventions	73,124.4	20,881.9	28.6
Health Subventions	22,737.6	24,980.9	109.9
Roads Subventions	13,273.6	14,223.6	107.2
HIV/AIDS Subventions	12,915.2	7,251.6	56.1
Other Subventions	20,263.6	10,642.0	52.5
Total Subventions	142,314.4	77,980.1	54.8
Development Grants and Funds			
LG CDG	59,937.9	50,363.6	84.0
Education	74,642.8	22,820.9	30.6
Health	6,021.2	5,915.3	98.2
Roads	12,054.0	10,797.9	89.6
Water	15,662.0	12,835.4	82.0
Agriculture	11,935.8	17,920.2	150.1
Local Admin.	5,768.8	6,578.8	114
TASAF	36,165.5	24,748.4	68.4
Other Capital Funds	41,176.5	29,236.6	71.0
Total Capital Funds	263,364.4	181,217.2	68.8
Total (Recurrent plus Development) Transfers			
Recurrent Transfers	837,506.2	678,250.7	81.0
Capital Transfers	263,364.4	181,217.2	68.8
Total Transfers	1,100,870.6	859,467.9	78.1
Source: PMO-RALG, Consolidated LGA Finance Statistics, FY 2005/06 (LOGIN).			

As shown previously in Table 2.1, central and regional expenditures for recurrent and development purposes were budgeted to total TShs. 4,112 billion for FY 2006/07. Thus, when expressed as a share of the total central government budget (i.e., TShs. 4,112 billion plus TShs. 1,101 billion), intergovernmental transfers to the local government level account for 21 percent of the central government budget.

On one hand, we should note that this methodology somewhat overstates the central government's budget, as this amount also includes ministerial subventions and development programmes that were captured under ministerial budget votes. As such, the share of public resources that are transferred to the local government level are in fact marginally higher than the figure of 21 percent suggests.

On the other hand, we should note that not all intergovernmental transfers listed in Table 4.1 are either (i) provided to the local government level on a formula basis, or (ii) provided directly from the Treasury to the LGA. We already noted above that the allocation of recurrent block grants often deviates significantly from the formula-based allocation pattern. During FY 2006/07, many development grants were still provided through ministerial votes and/or in the absence of a sound allocation formula. For instance, during FY 2006/07, primary education development resources were allocated to the local level through the Ministry of Education and Vocational Training, which determined each council's allocation in a discretionary manner.

Secondary benchmarks for a sound intergovernmental fiscal transfer system

A secondary benchmark to measure progress on the implementation of a sound intergovernmental fiscal transfer system is whether transfer resources are indeed allocated in accordance with formula. It was already noted in Section 4.1 that recurrent block grants have not strictly been allocated to the local government level in accordance with the sectoral allocation formula due to the "hold harmless" provisions.

Table 4.2 quantifies the adherence to the formula-based allocation approach by analyzing variations in budgeted per capita local government block grants to LGAs over the period from 2000/01 to 2007/08.

Since the recurrent block grant formulas are predominantly capitation-based (in other words: they allocate resources largely in proportion to the population of each district), the implementation of the formula-based transfer system should have reduced the variation of per capita allocations between local governments. However, Table 4.2 shows that the variation in allocation improved initially from 2001 though 2005/06 but has gotten worse since 2006/07.

While the period from 2001 through 2005/06 generally saw improvements (reductions) in the variation of per capita transfers, starting in 2006/07, there was a substantial increase (worsening) of the variations in per capita transfers. For example, the Coefficient of Variation reduces systematically from 0.38 in 2001/02 to 0.28 in 2005/06 but then increases to 0.34 and 0.31 in 2006/07 and 07/08, respectively. Another indication of worsening is in the ratio max/min which started at 6.05 in

2001/02 systematically reducing to 3.54 in 2005/06 only to worsen to 4.16 and 11.71 in 2006/07 and 2007/08, respectively.

Table 4.2							
Variations in budgeted per capita local government block grants to LGAs							
FY 2000/01- 2007/08							
	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08
Average	7,210	8,479	10,394	12,344	14,686	21,777	23,454
Std. Deviation	2,739	3,094	3,486	3,821	4,125	7,459	7,265
Coeff. of Var.	0.380	0.365	0.335	0.310	0.281	0.343	0.310
Minimum	2,604	3,526	4,838	6,339	9,263	12,698	4,807
Maximum	15,745	18,882	23,578	26,661	32,759	52,776	56,298
Ratio Max/Min	6.05	5.36	4.87	4.21	3.54	4.16	11.71
Ratio Min/Avg.	0.36	0.42	0.47	0.51	0.63	0.58	0.20

A final hallmark of a sound intergovernmental transfer system is that transfers are disbursed from the central government Treasury to the local government level as planned. Treasury disbursement data (as presented by the Treasury) suggests that recurrent grant disbursements closely follow their planned amounts (Table 4.3).

This is particularly true for the Other Charges component of transfers, which is executed 99-100 percent in accordance with the budget plan. Although PE disbursements are frequently less than 100%, the deviations are relatively modest for most sector grants. Since PE grants are supposed to flow automatically when local government posts are filled, the lower performance ratio suggests that certain sectors are having a harder time filling local government posts than others.⁵

Although Treasury does not report on disbursements of development grants or ministerial subventions to the local government level, reports by LGAs suggest that the execution of many of these intergovernmental transfer programs is substantially worse than the recurrent grant system.

⁵ The absence of agriculture PE reported in the table is a data anomaly. PO-PSM is yet to report local agriculture staff separately from local administration staff.

Table 4.3
Treasury Disbursements of Block Grants, FY 2006/07
(Tshs. million)

Budget item	Annual budget plan	Actual outcome	Performance ratio (%)
Education PE	362,514.5	378,451.5	104.4
Education OC	68,215.8	67,618.3	99.1
Education Total	430,730.3	446,069.8	103.6
<i>Receipts reported by LGAs</i>	<i>418,016.6</i>	<i>386,705.4</i>	<i>92.5</i>
Health PE	89,937.8	78,710.5	87.5
Health OC	27,320.2	27,228.9	99.7
Health Total	117,258.1	105,939.4	90.3
<i>Receipts reported by LGAs</i>	<i>114,778.5</i>	<i>96,811.2</i>	<i>84.3</i>
Agriculture PE	22,419.9	0.0	0.0
Agriculture OC	3,996.0	3,995.5	100.0
Agriculture Total	26,415.9	3,995.5	15.1
<i>Receipts reported by LGAs</i>	<i>22,172.4</i>	<i>12,455.0</i>	<i>56.2</i>
Water PE	5,360.7	4,134.2	77.1
Water OC	9,600.0	9,624.3	100.3
Water Total	14,960.7	13,758.5	92.0
<i>Receipts reported by LGAs</i>	<i>14,482.6</i>	<i>14,485.7</i>	<i>100.0</i>
Roads PE	5,777.2	4,659.2	80.6
Roads OC	2,442.0	2,441.7	100.0
Roads Total	8,219.2	7,101.0	86.4
<i>Receipts reported by LGAs</i>	<i>8,063.2</i>	<i>6,889.7</i>	<i>85.4</i>
Local Admin & GPG PE	89,638.4	49,896.1	55.7
Local Admin & GPG OC	43,062.7	42,480.0	98.6
Local Admin & GPG	132,701.1	92,376.1	69.6
<i>Receipts reported by LGAs</i>	<i>117,678.4</i>	<i>82,923.6</i>	<i>70.5</i>
Total PE	575,648.6	515,851.5	89.6
Total OC	154,636.7	153,388.9	99.2
Total Disbursements	730,285.3	669,240.4	91.6
<i>Receipts reported by LGAs</i>	<i>695,191.8</i>	<i>600,270.6</i>	<i>86.3</i>

Note: The treasury system erroneously reports disbursements for Agriculture PE together with Local Admin/GPG PE.

Source: Ministry of Finance and PMO-RALG, LGA Finance Statistics, FY 2005/06 (LOGIN).



Chapter 5

The Management of LGA Finances

A critical assumption in assuring a sound fiscal decentralization approach is that once financial resources reach the local government level is that the funds are indeed used for their intended purpose. This requires sound management of LGA finances at the local government level.

5.1 An Update on Local Financial Management

Local Integrated Financial Management System (Epicor). PMO-RALG continues to promote Epicor as the main computerized financial management system for LGAs. Since the inception of LGRP in 1999, Epicor has been rolled out to 85 LGAs (out of a total of 133 LGAs) in Tanzania Mainland.

A recent field survey by PMO-RALG's DMIS reported that out of over thirty sample councils visited, not a single council reported that their Epicor system is fully operational. Inadequate support from the zonal-based systems support unit and SoftTech was generally observed. This resulted in most LGAs maintaining a manual accounting system in parallel to Epicor, thus largely defeating the purpose of the integrated financial management system.

PlanRep2. Local governments are required to use PlanRep2 to prepare their annual budget plans and submit their budgets to the Ministry of Finance. As needed, support is provided by the University Computing Center (UCC) to LGAs in preparing their budgets for submission in PlanRep2. The field survey recently conducted by DMIS reported that PlanRep2 is widely used in housing the LGA plan and budget, and that many LGAs managed to enter the plan and budget themselves.

However, the reporting module of PlanRep2 is generally not used by LGAs. Furthermore, it appears that some councils actually do not develop their budget plans in PlanRep. Instead, there are indications that many councils develop their budget plans on paper and then enter their budget plan into PlanRep for submission to PMO-RALG and the Ministry of Finance.

Continued reporting of Quarterly LGA Financial Reports. A quarterly financial reporting system for local governments was initiated by PMO-RALG in 2005. All local governments in Tanzania continue to provide quarterly LGA Financial Reports to PMO-RALG. Delays continue to be encountered in the production of financial reports by some councils, despite the development of an improved Excel reporting form and more detailed instruction guidelines. The reports for all LGAs in Tanzania

Mainland are subsequently reviewed and consolidated by PMO-RALG on a quarterly basis, and are made publicly available on LOGIN Tanzania (www.logintanzania.net).

Difficulty in reporting on LGCDG. In contrast to the progress made in producing quarterly LGA financial reports, PMO-RALG is experiencing considerable more difficulty in producing quarterly physical and financial progress reports for LGCDG projects. Steps are being taken to improve the reporting on local development projects by incorporating the development progress reports in the existing quarterly reporting process.

5.2 Trends in Local Financial Management

The primary benchmark selected here to indicate successful local financial management at the local government level is the share of local government authorities that receive a “clean” or “unqualified” audit opinion.

Table 5.1				
Auditor-General Opinions, 2002/03 – 2005/06				
	FY 2002/03	FY 2003/04	FY 2004/05	FY 2005/06
Clean	37	47	61	53
Qualified	50	48	50	67
Adverse	28	20	4	4
Total	115	115	115	122
As percent of total				
Clean	32.2	40.9	53.0	43.4
Qualified	43.5	41.7	43.5	54.9
Adverse	24.3	17.4	3.5	3.3
Total	100.0	100.0	100.0	100.0
Source: CAG Reports (various years).				

The trend revealed in Table 5.1 suggests a steady improvement in local audit results. In particular, a steady decline in adverse audit opinions is observed. This general trend notwithstanding, the share of qualified opinions increased in FY 2005/06. This outcome may be the result of a stricter application of audit standards, rather than by a factual worsening of local financial management practices.

Finally, a secondary benchmark which indicates successful local financial management at the local government level is the share of local government authorities that meet the eligibility criteria for the LGCDG’s Capital Development Grant. Consistent with the trend shown in Table 5.1, Table 5.2 shows a steady increase over time in the number of councils that qualify for the LGCDG.

Table 5.2
LGCDG Assessment Outcomes, FY 2004/05 – 2007/08

	2004/05			2005/06			2006/07			2007/08
	LGSP	Donor Basket	Total	LGSP	Donor Basket	Total	LGSP	Donor Basket	Total	Total
LGAs	41	6	47	41	72	113	41	80	121	121
Qualifying										
LGAs	22	3	25	25	41	66	28	56	84	109
Qualifying										
Percentage	53.7	50.0	53.2	61.0	56.9	58.4	68.3	70.0	69.4	90.1

Source: LGCDG Assessment reports (PMO-RALG, various years); LGSP Midterm Review (December 2007).



Chapter 6 Priorities for Tanzania's Intergovernmental Fiscal Reform Agenda

Fiscal decentralization is never a one-time event. In fact, we should recognize that intergovernmental fiscal systems are always in transition and should plan accordingly. Thus, given the current state of fiscal decentralization in Tanzania, what are the main issues and priorities that should be taken forward in order to ensure continued progress the country's local government finance reform agenda?

Local government expenditures. With respect to expenditure assignments, no major reforms should be expected during the coming year. However, continued vigilance is needed to ensure that policy makers and line ministries continue to adhere to the Government's policy of decentralization by devolution. While the D-by-D compliance exercise may not have resulted in a major reallocation of resources or activities in favour of the local level, the review has been a more or less effective way to engage line ministries in considering the limits of their functions and responsibilities in the context of a decentralized public sector.

One area where expenditure assignments may be usefully clarified –without triggering major institutional disputes - is in regard to the respective roles and responsibilities of so-called lower local government (such as Village Councils and *Mitaa* Committees) versus higher local governments (district and urban authorities). Clarifying the respective responsibilities will be particularly helpful to determine the respective roles of *Mitaa*/villages, wards and district and urban authorities in the participatory planning processes that are currently used for the LGCDG system.

The most fundamental challenge for local government expenditures is the limited degree of local expenditure autonomy in Tanzania. In order for the benefits from decentralization to arise, local government officials should have a real role in prioritizing recurrent resources within (and increasingly across) local government sectors, rather than being bound by personnel decisions made in Dar es Salaam and Dodoma. Likewise, local participatory processes are redundant if local capital development priorities are ultimately shaped by the instructions of the central government's leadership rather than by true community needs. However, enhancing local expenditure autonomy comes with the simultaneous challenge of strengthening effective local planning and budget processes and procedures to ensure that local resources (and particularly, local own source revenues) are indeed spent in accordance with the needs and priorities of their local communities.

Local government revenues. The Ministry of Finance took the lead on local revenue harmonization and rationalization reforms in 2003. It is important that PMO-RALG re-establish credible policy leadership in the area of local government revenues. This

is not an institutionally popular task. While in the short run virtually all local government officials would prefer to receive an unconditional grant rather than to collect own source revenues (particularly in light of the easy access at all government levels of external finances), maintaining a degree of local revenue autonomy will be a critical element to ensure the long-term accountability and sustainability of local government reforms in Tanzania. Yet, given the ongoing attrition of local revenue autonomy and the high policy profile accorded to local government revenues following the insertion of the TRA into local revenue administration, PMO-RALG will have to engage quickly in order to maintain even a minimal degree of local revenue autonomy.

The roadmap which was prepared in 2006 to guide the transformation of the local government revenue system in Tanzania focuses on improving the effectiveness and efficiency of local revenue administration. In particular, the roadmap suggests the need to harmonize and streamline local revenue administration procedures across LGAs, rather than each local government pursuing its own unique revenue administration system. In particular, the area of property tax administration offers substantial space for improvement through the development of standardized revenue administration processes, procedures and tools. For instance, the adaptation of the TRA's Integrated Tax (I-TAX) software to the local level could provide an effective platform for improved local tax administration, which would at the same time allow LGAs to benefit from the institutional capacity and expertise that resides within the TRA. Building on existing modifications made to the I-TAX system, the development and testing of the LGA I-TAX platform could be pursued during 2008.

Recurrent grant system. The introduction of a formula-based grant system in 2004/05 has been touted as one of the success stories of local government reforms in Tanzania. However, additional steps are needed to ensure that the formula-based system is implemented as intended and that the progress in this area is consolidated in a sustainable manner.

Most importantly, there is a need for PMO-RALG, PO-PSM, MPEE, MOF and the relevant line ministries to resolve how to bring about convergence between actual PE disbursements and the formula-based pattern. In the long run, enforcing a hard budget constraint for local governments will require giving local authorities the discretion to determine the balance between PE and OC within the context of each formula-based sectoral transfer ceiling. In the shorter run, transitional measures will need to be taken in order to ensure that posting of new staff is approached in a pro-poor manner in councils which –according to the formula- have the largest staff deficits, whereas procedures should be put in place to prevent over-staffed councils from receiving any further staff postings.

The consideration of the inequitable allocation of PE resources could take place in the context of an overall review of the recurrent grant system. Effectively as a “mid-term review” of the recurrent grant system, this exercise could comprehensively evaluate the adequacy of resources provided through the recurrent grant system; analyze the impact of the current allocation formulas on service delivery; evaluate adherence to

the formulas by PMO-RALG, Ministry of Finance and PO-PSM; and propose changes as needed to ensure that the formula-based recurrent grant system is implemented as intended and that the progress that has been made since 2004 is consolidated in a sustainable manner.

Development grant system. Likewise, the introduction of a formula-based capital development grant system has been a major step forward in the decentralization process in Tanzania. Steps should be taken to mainstream and integrate the current LGCDG into the regular (central and local) budgetary and financial processes in order to arrive at an integrated Development Grant System.

Developing and implementing a vision for a comprehensive intergovernmental fiscal transfer system that includes an integrated Development Grant System will involve:

- Defining what is meant by ‘integration’ of sector windows into the LGCDG / Development Grant System;
- Defining a roadmap that ensures that all local development grants (including sectoral funds) share a common management structure through PMO-RALG, DLG’s LGA Finance Section;
- Integrating all local development grants (and all recurrent grants) into the central government budget structure in a harmonized, transparent and effective manner;
- Harmonizing (and whenever possible, simplifying) the minimum conditions and performance criteria based on the annual assessment of LGAs;
- Ensuring that all development grant formulas adhere to sound formula practices and that the LGA Budget Guidelines properly includes all development grants;
- Providing for a common local planning and budgeting process for capital development, including a clear division of responsibilities in the involvement of HLGs and LLG;
- Establishing a common accounting process for all development grants through Account No. 2 (Development);
- Establishing a common reporting, monitoring, and audit mechanism for all development grants; and
- Formulating options for donor funding of the system.

Local financial management. Improved local financial management has been an important focus of local government reform under LGRP. Indeed, the quality of local financial management seems to have improved steadily over the past several years. However, it is unclear to what degree the various interventions and newly introduced financial management tools have contributed to the improved financial management performance. Several activities should be initiated from 2008 as part of the ongoing efforts to improve local planning, budgeting, reporting, and financial management.

One urgent activity in the realm of local financial management is to improve the quarterly reporting and monitoring of LGA finances, including the quarterly (financial and physical) progress reports on local development spending. These reports could be linked to LOGIN Tanzania to further enhance the transparency of local government finance.

In addition, there is a need to continue building the capacity of LGAs to manage their finances in a sound manner. These capacity building efforts should include strengthening of the internal audit function as well as other targeted institutional capacity building efforts. Such centrally-coordinated capacity building efforts ought to be supplemented by the demand-driven capacity building funded from the CBG.

Finally, there is a need to take a more comprehensive look at the entire local planning, budgeting and financial management system in Tanzania to evaluate how well the system functions as a whole. Different methodologies and tools have been imposed on the existing legal and regulatory framework over time that –when put together- may or may not contribute to an effective, integrated financial management system. Among others, the functionality, effectiveness and complementarity of the Local Government Finance Act, the Local Authorities Accounting Manual (LAAM), the Local Authorities Financial Memorandum (LAFM), procurement laws and regulations, O&OD planning, Epicor, PlanRep2, the Quarterly LGA Finance Reports, as well as any manual local financial management systems should be evaluated. In addition, the required (MTEF) format of the local budget plan and other local budget documents should be reviewed and evaluated.

As needed, the various elements of the local planning, budgeting and financial management process should be modified to constitute a comprehensive, consistent and complementary system. However, due to the scope of this activity, this comprehensive review process will likely need to be carried out in different stages over a multi-year period.