

ACCOUNTABILITY THROUGH TAX REFORM? REFLECTIONS FROM SUB-SAHARAN AFRICA¹

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INTRODUCTION

Taxation is important, even crucial, for development. First, taxation is a significant – and for many countries, the only – sustainable source of state revenue. Second, taxation is considered to provide for more democratically accountable governments, which in turn is held to be conducive to political as well as economic development. The first argument is apparent. The second is more contested. The notion that democratically accountable governments provide the foundation for development is not conclusively proven. However, there seems to be a broad consensus in the development and democratisation literature on the need for developing countries to strengthen government accountability (World Bank 1998, Bratton and van de Walle). It is the link between taxation and accountability that is most contested. Our concern here is not with processes of democratisation or the nature tax reform per se, but with the circumstances under which taxation provides for more democratically accountable governments. We focus on three interrelated issues affecting the relationship between taxation and accountability. First, we consider the *internal accountability* of the tax system and ask whether the reforms have resulted in a system of taxation with greater reach, higher level of efficiency and transparency. Second, we ask whether the tax reforms have created closer links between African governments and their citizens and thereby increased *democratic accountability*. Third, we discuss to what extent and in what ways *external accountability* relations between the governments and international donors affect domestic accountability relations.

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We discuss the relationship between taxation and accountability in the context of tax reforms currently undertaken in a number of sub-Saharan African countries, with particular reference to the reforms carried out in Uganda, Zambia and Tanzania in the 1990s as part of larger structural adjustment programmes. In the 1980s, Uganda, Zambia and Tanzania faced fiscal crises as the main revenue base – export taxes – declined or collapsed. Tax reforms were implemented as part of the economic restructuring agreements with the International Finance Institutions (IFIs). The creation of semi-autonomous revenue authorities was a central component of the reform process in all three countries. In all three countries, these reforms resulted – at least initially – in a substantial transformation of the tax base and increases in the ratios of tax revenue to GDP. However, the tax reforms appear only to a limited degree to have resulted in closer links between government and citizens and we do not find that they have provided the basis for more democratically accountable governments. One reason is that the tax reforms have not focussed on the forms of taxation most profoundly affecting the relationship between governments and citizens - direct taxes. Large sectors of the economy, most notably agriculture and the informal sector, remain outside the tax system. We argue that the tax authorities have focused on ‘easy taxes’, such as import taxes and the large formal businesses in order to satisfy donor demands for increased tax/GDP ratios. By contrast, the more sustainable, but administratively and politically complicated task of expanding the tax net has not taken place. As a result, a ‘tax culture’ appears to be lacking in all three countries. There is little reciprocity in the relationship between state and society and accountability mechanisms have not been strengthened to the degree predicted in the literature.

THE LINKS BETWEEN TAXATION AND ACCOUNTABILITY

The notion of accountability used here has three components: *transparency*, *answerability* and *controllability*. Office-holders are fully accountable when: they exercise their powers in a way that is *transparent*, in the sense that it enables others to see whether all is done in accordance with the relevant rules and mandates; they are *answerable* in the sense of being obliged to provide reasons for their decisions and actions; and *institutional checks or control mechanisms* are in place to prevent mismanagement and abuse of power and ensure that corrective measures are taken in cases where the rules are violated. *Democratic*

accountability requires in addition institutional mechanisms through which ‘the people’ can punish (remove) officials who do not meet the standards, and influence laws and policy decisions. In the following we attempt to measure controllability in relation to the institutional mechanisms in place to control corruption in the new tax authorities. Answerability will be understood as the ability of the new agencies to act independently of government, thus, the extent to which they are answerable for their own decisions (Table 2).

Taxation is believed to promote these qualities in public officials and institutions because this is necessary in order to make the population accept their tax obligations. If governments are perceived as accountable, more people will pay their taxes “voluntarily”, which lowers the need for coercion and generally reduces the costs of tax-collection (Levi 1988). Conversely, if people do not see their governments as accountable, there is an increased likelihood that state demands for (new or higher) taxes will be met with protest and violence that is costly and might even jeopardise the position of those in power. History provides numerous examples of democratic concessions granted in order to broaden the tax-base, and of tax-payment being used as an explicit condition for citizens to qualify as a voter or candidate for office. This illustrates both a demand from taxpayers that if they are to contribute they should also have a say in how the money is used, and an acknowledgement from governments of the validity of this claim - whether for pragmatic reasons or on grounds of reasonableness. The link between taxation and accountability is typically illustrated by the battle cry from the American colonies’ fight for independence from Britain - “no taxation without representation”.

Based on Western experiences, one might expect that the recent processes of democratisation taking place in sub-Saharan Africa, coupled with economic reforms (hereunder tax reforms), would have a positive effect on revenue extraction. So far, however, there is little empirical evidence to support such expectations. Why is this so? One reason might be that the rationale for tax-collection is different in these countries. It may seem self-evident that the purpose of increasing revenue is to finance government expenditure and thus facilitate the provision of public services. But with donors playing a critical role in financing external debt service and development projects, the rationale for

increasing domestic revenue is not self evident. In sub-Saharan Africa, the primary objective of tax reform might rather be to fulfil criteria (conditionalities) set by the donors. The structural adjustment processes, of which these tax reforms are a part, have generally limited the ability of the state to provide social services to their citizens. This may be an obstacle to the establishment a new culture of tax-paying. As argued by Luoga (2001: 15): “Citizens feel the burdens imposed by taxes more heavily in the current environment where government has withdrawn from providing social services”. While this paper focuses on the *revenue* side of the taxation-accountability relationship, it should be kept in mind that the *expenditure* side also plays a crucial role. Taxation can only be a reciprocal relationship between governments and taxpayers if the latter feel that they get a return in the form of services, infrastructure or security.

Furthermore, the expected relationship between taxation and accountability is mainly relevant for certain forms of taxation: the revenue sources that are highly ‘visible’ or ‘felt’ and thus directly link citizens to the state. These are primarily direct taxes (corporate and personal taxes). Indirect taxes in the form of the Value Added Tax (VAT) tend to be broad in reach. While they may have a similar effect to direct taxes, it is likely to be much weaker. Particularly where they are relatively visible and ‘felt’ by large sections of the populations, indirect taxes may give rise to demands for something in return and a say in how the money is spent. The replacement of general sales taxes with VAT, which has taken place in many sub-Saharan countries as part of the economic restructuring, was intended to bring larger groups into the tax net. As we shall see, this has not really happened.

Historically, direct forms of taxation have been limited in sub-Saharan Africa due to problems of information, taxable incomes, infrastructure and political sensitivity. Most African governments relied instead on ‘easy taxes’ such as commodity exports and excise duties. But, in the late 1980s, after a series of external shocks, most African countries faced a deep fiscal crisis due to, among other factors, adverse terms of trade. The cases of Uganda and Zambia are illustrative. In Uganda the main revenue source basically collapsed with the demise of the International Coffee Agreement in the 1980s and the subsequent fall in coffee prices. In Zambia, the dramatic decline in world market prices on copper reduced

government revenue by half between 1975 and 1980. Increasingly, it was realised that the fiscal crisis was also a crisis of *governance* as the central state apparatuses in most countries of the region were plagued by political and institutional weaknesses that undermined their abilities to promote economic development, and collect revenue to sustain state activities. Thus, from the late 1980s, Uganda, Tanzania and Zambia, like most sub-Saharan countries, have received substantial amounts of aid aimed at stimulating economic policy reform. In most cases, the structural adjustment agreements entered into with the IFIs have included tax reforms.

For the purposes of the present analysis the primary aims of the tax reforms are, firstly, to increase the *internal accountability* and efficiency of the tax system. Strengthening this mechanism is seen as an important means to help achieve the broader goal of increasing *democratic accountability* between the government and the taxpaying voters. Unless potential taxpayers know that the tax system is reasonably efficient and trustworthy - that their neighbours are also likely to pay, and that the money will reach the relevant authorities - they are unlikely to pay up voluntarily, or to engage in political activity to influence the ways in which the money is used, thus institutionalising democratic practices and accountability relations.

A factor that differentiates Africa's political development from Europe's is the role of the international donor community in shaping Africa's development trajectories. A prominent feature in most African countries is that what initiates and keeps up momentum for the reforms is external pressure from donors and international lending institutions. *External accountability* between governments and donors (multilateral and bilateral) therefore plays a crucial role in initiating and driving the reforms by creating incentives structures and placing conditions on the recipient governments. Donors set standards regarding the internal operation of the tax system as well as the spending of tax and other revenue. *External accountability* relations between the governments and international donors may therefore affect domestic accountability relations. The relationship between these three forms of accountability is illustrated in figure 1.

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In this paper, we focus on each of these three accountability structures and the relations between them:

1. With regard to the *internal accountability* of the tax system, we ask to what extent the reforms have succeeded in creating more efficient and trustworthy tax systems - transparent systems capable of ensuring that tax-money is not embezzled, and that those who should pay tax do in fact pay.
2. We also ask whether the conditions are in place for taxation to have a positive effect on *democratic accountability*. Have reforms changed the nature of the tax system to the extent that taxes are being 'felt' by a majority of the population? And, if so, has this triggered a response in the form of demands for greater accountability by the citizens? Do we find evidence of governments more willing to be transparent, to justify their decisions in public, and be constrained by institutions representing the public will?
3. We discuss whether *external accountability* aimed at strengthening domestic accountability structures through tax reforms have succeeded, or whether external accountability relations in fact hamper development of domestic structures for democratic accountability.

THE INTERNAL ACCOUNTABILITY OF REFORMED TAX AUTHORITIES

If the tax collection apparatus is inefficient, incompetent and corrupt, this is a strong disincentive for potential taxpayers. As part of the economic restructuring process, the international donor community has emphasised the virtue of independent revenue authorities. By placing the responsibility for revenue collection outside the civil service, the aim has been to bypass deficiencies in existing state institutions through higher salaries and more flexible procedures for hiring and firing employees. In Uganda, Tanzania and Zambia the new revenue authorities provided incentives, such as high quality training and higher salaries. The challenge facing the revenue authorities in all three cases was to raise the contribution of locally-raised revenue to the domestic budget from the very low levels prevailing in the

1980s. It was also necessary to restructure taxes away from export taxes to a tax system that could facilitate private sector growth. In all countries export taxes acted as a major disincentive for the agricultural sector and they were abolished in the early stages of reform.

In terms of increased levels of efficiency in revenue collection, evaluations of the tax reforms in the three countries are generally positive, pointing to increased levels of administrative efficiency, greater compliance from formal sector tax payers, and a decreased levels of smuggling (Table 1)². However, measured by the amount of revenue collected in relation to total GDP, the effectiveness of the tax reforms in all three countries presents a mixed picture. Uganda initially provided a striking success case. Total revenue rose from 7 per cent of GDP in the early 1990s to 12 per cent by 1999, a success coinciding with the establishment of Uganda Revenue Authority (URA) in 1991. However, the ratio has remained stagnant since 1995, suggesting that overall revenue performance has reached a plateau below the level needed to achieve fiscal sustainability. In Zambia the ratio of tax to GDP improved from 17.5 per cent to 18.5 after the creation of Zambia Revenue Authority (ZRA)³. In Tanzania tax income increased from 11 per cent of GDP in 1995/96 to 12 per cent the year after, but the ratio has later dropped to 10 per cent, suggesting perhaps that the effects of the 'agency model' may be short-lived (Fjeldstad and Tungodden 2001).

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The tax base was narrow in all three countries prior to the reforms. Success in widening it would be an important indicator of their success from an accountability perspective. The record in all three countries is strikingly similar: the reforms so far have focused on increasing

² For Zambia, see Harvey et al. (1996) and Gray, Shera and Condy (2001). For Tanzania, see Fjeldstad and Tungodden (2001), Rakner (2001), and Temu and Due (2000). For Uganda, see Obwona (2001) and Gray, Karuga and Ssemegere (2001).

³ However, due to a 2 per cent contraction of the Zambian economy between 1997-1999, the GDP/tax ratio is probably not an adequate reflection of the efficiency of the Zambian Revenue Authority (Gray, Shera and Condy 2001).

collection through improving the compliance of existing and known taxpayers. As a result, the tax bases remain narrow. In the case of Uganda, the growth in the number of taxpayers does not reflect the rather broad and rapid economic growth recorded in recent years. Similarly, the accounts from Tanzania Revenue Authority (TRA) indicate that more than 70 per cent of taxes collected are consumption taxes. The regional distribution also points to a relatively limited tax net: close to 80 per cent of revenues come from the region of Dar es Salaam (Temu and Due 2000, Luoga 2001). In Zambia both the agricultural sector and the non-agricultural informal sector, which account for almost all the labour force, remain outside the tax net. As the Minister of Finance has continued to grant significant exemptions to corporations, the tax base in Zambia has remained exceedingly narrow.

The way in which VAT has been introduced illustrates and helps explain the failure to widen the population base of the tax system. A uniform VAT (with major exemptions) has replaced business turnover taxes and sales tax in all three countries. However, as food commodities are zero rated for VAT and most agricultural inputs are exempted, VAT has not included many new groups into the tax system. The tax reforms have so far only to a limited extent involved the forms of revenue considered to affect state-citizen relations.

An important aspect of internal accountability is the degree of transparency in the tax collection. Despite the creation of the semi-autonomous revenue authorities, with salary incentives and employment flexibility, evidence from Uganda, Zambia and Tanzania suggest that corruption remains a major problem. The close connection between the political elites and the executive directorship of the revenue authority is believed to be a major problem in Zambia (Gray, Shera and Condy 2001). In both Uganda and Tanzania, studies suggest a tendency of the fight against corruption to be undermined over time (Fjeldstad and Tungodden 2001; Gray, Karuga and Ssemogerere 2001; Obwona 2001). Based on survey data from their membership, the Uganda Manufacturing Association (UMA) claims that smuggling is increasing in Uganda and that up to 10 per cent of revenue is lost to smuggling (Obwona 2001). The government's decision to employ the military to curb smuggling is hardly a sign of increased transparency in tax collection efforts.

The internal accountability dimension has only to a limited extent has been strengthened by the reform processes. While compliance from known taxpayers has been increased, the tax base remains narrow. Furthermore, studies and reports from all three countries suggest that the level of transparency and independence from the central government remain low (Table 2). Have the tax reforms at all affected democratic accountability to the extent that the tax reforms have been 'felt' by any major groups in society?

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ASSESSING THE DEMOCRATIC ACCOUNTABILITY EFFECT

For taxation to provide the basis for democratic accountability several conditions must be in place. Firstly, a substantial part of the population must 'feel' the tax-burden. The inclusiveness of the tax-net and the visibility of the taxes are here of major importance. Next, structures and practices must be in place to provide for a reciprocal relationship between state and society, to allow articulation of demands for returns on the money, and changes in policy or leadership.

The discussion above has revealed that so far the authorities in Uganda, Tanzania and Zambia have not succeeded in widening the tax base to any great extent. The attempts to do so – as part of the conditions set by the international donors – reveal that these reforms are administratively complex and politically sensitive. Since 1998 the Uganda Revenue Authority has been instructed to implement a Presumptive Income Tax on informal sector enterprises with low turnover. However, the process has been met with little enthusiasm in the Authority as the collection is not regarded as cost-effective and is politically sensitive (Gray, Karuga and Ssemogerere 2001; Anene and Garyio 2000). Similarly, the Zambian government has been pressurised by the donors to widen the tax base to include the informal sector. However, so far the measures undertaken have not been successful. As the large scale traders with political connections remain outside the tax net, the taxing of the small scale vendors is widely perceived as unfair (Gray, Shera and Condy 2001). The vendors also represent a political force the government wishes to placate and taxing them became an issue in the December 2001 electoral campaign.

But taxation is 'felt' by business

According to available evidence the only group visibly affected by the central government tax reforms are the formal business corporations. In all three cases the revenue authorities have tended to target more effectively large taxpayers already in the net, rather than to widen the tax base. There is a widespread perception in the business community in all three countries that the revenue authorities have concentrated unduly on known corporate taxpayers. The effectiveness of the new institutions like Tanzania Revenue Authority with regard to this group is illustrated by studies conducted on the Tanzanian manufacturing sector. Until 1995, taxation was not an issue raised by manufacturers. Since 1996 it has become the main issue of concern because of the activities of the Revenue Authority.⁴ Formal sector business is also the group most affected by the overlapping central and local government taxes in Tanzania (Luoga 2001). Similar studies conducted in Uganda and Zambia indicate that taxation is the primary complaint by the business community. The private sector in Zambia perceives Zambia Revenue Authority to focus its efforts on a small segment of the economy, which may have serious implications for sustainable revenue collection⁵. Surveys of Ugandan firms reveal that high taxes, excessive levels of tax bureaucracy, ad hoc assessments, and audits are their major complaints (Obwona 2001: 74).

Corporate taxes in Tanzania, Uganda and Zambia are not high by international standards. The complaints raised may stem from the fact that, as in most of sub-Saharan Africa, a tax paying culture is lacking. As argued by the former Director of the Board of Tanzania Revenue Authority "The problem is the transition of mindsets of people who are not used to

⁴ Personal communications, Hajih Semboja, member of Taxation Task Force, Dar es Salaam, 22/3 2001.

⁵ Business confidence surveys carried out in Lusaka and on the Copperbelt confirm these perspectives. See M. Taylor and D. Aarnes (2002).

paying taxes, because 100 per cent profit is considered normal profit”⁶. Nevertheless, the *perception* by corporate business of the tax system as unfair is a major hindrance to the development of voluntary compliance and a level of trust between the tax authorities and the taxed. The frequent audits conducted by the Ugandan tax administration illustrate the lack of voluntary compliance and low level of mutual trust (Obwona 2001: 62). In extreme cases, as suggested by the *Zambian case*, differences in the actual treatment of formal and informal sector enterprises by tax authorities may create incentives for businesses to deregister to avoid taxation.

While the tax reforms so far have drawn few new groups and individuals into the tax net, a voice and an organised response to the new revenue policies appear to be developing within the business community. In Uganda the implementation of VAT was initially met with strong resistance. Organised through Uganda Imports and Exports and Traders Association (UGIETA), the Ugandan traders launched a one-week strike in July 1996 to protest its implementation (Garyio 2000; Ssewakiryanga 2000). The immediate response of the authorities was to arrest traders, but eventually the matter was solved through a decrease in the number of firms eligible for VAT. In Tanzania, the tax grievances of large taxpayers are increasingly being taken to the legal system (Luoga 2001). Organisations like the Tanzania Chamber of Commerce, Industry and Agriculture (TCCIA) and Confederation of Tanzanian Industries (CTI), which represent large business, have also on a few occasions employed economic consultants and presented their grievances to the authorities. Twice the demands from the business community have resulted in changes of the existing tax laws (Rakner 2001). The Tanzania Taxpayers Association (TATA) was recently established as a result of the growing awareness of the impact of taxation on business. In Uganda, the Uganda Manufacturing Association (UMA) is increasingly handling taxpayers' problems. The complaints from, among others, the business sector resulted in the creation of a Tax Appeals Tribunal within the Uganda Revenue Authority in 1998. While no similar agency has been

⁶ Interview, Benno Ndulu 28/3 2001, World Bank, Dar es Salaam, first Chairman of the Board of the Tanzanian Revenue Authority .

established in Zambia and Tanzania, the business sector has been invited as members of the Task Forces on Taxation.

Formal business constitutes a small segment of society in these countries. These developments, nevertheless, indicate that the tax reforms have resulted in some new demands on these governments, potentially creating new accountability structures. But how are the governments responding? In all three countries business complains that, so far, the consultation taking place is neither transparent nor effective. Furthermore, studies from both Tanzania (Luoga 2001) and Uganda (Anene and Gariyo 2001) point to the limited trust between the tax administration and the public, to the excessive imbalance in the taxpayer tax authority relations, and to the lack of efficient safeguards against misuse and abuse of power. Despite efforts to increase customer care and services, the tax system in all three countries still appears adversely affected by lack of trust that again manifests itself in low levels of voluntary compliance. In part, this is due to the external accountability dimension of tax reforms in sub-Saharan Africa. So far, the need to satisfy donor conditionality for increased tax/GDP ratios appear to have weighed more heavily on the Ugandan, Tanzanian and Zambian authorities than any concern about building a voluntary tax relationship with its own citizens.

EXTERNAL DONOR ACCOUNTABILITY

From the development literature there are many well-known cases to support the claim that governments that do not depend on tax revenue as a significant part of their income, tend not to develop strong structures of democratic accountability. The low propensity of *rentier states* – deriving the bulk of state revenue from natural resource extraction (oil, minerals) – to democratise and consolidate their democracies is well documented (Moore 1998)⁷. And the main reason seems to be that the easily extracted rent eliminates (or substantially lowers) the need to trade democratic representation and accountability for tax revenue. It is increasingly acknowledged that similar dynamics tend to operate in states where the

⁷ Note also the contributions of Therkildsen, Fjeldstad, and Hlope and Friedman to this Bulletin.

government depends on foreign aid and loans for the bulk of their budgets. And when donor-funding increases this seems to have an adverse affect on tax collection.

There is, however a difference between donor dependent and rentier states (Therkildsen, in this volume). As the discussion above has revealed, for aid dependent countries *external* agencies – donors and international lending institutions – have increasingly demanded accountability from the government, by imposing direct and indirect conditionalities. From a donor perspective, where good (accountable) government is high on the agenda, to strengthen the domestic tax-base has become a major issue in order to weaken the dependence on foreign aid and to make governments more accountable. With aid increasingly being conditional and with tax reform part of the conditionality agenda, aid and taxation *may* be positively related. But is this so? There are as we have seen indications that it might not be so easy to introduce democratic accountability through externally imposed tax reforms.

The tax reforms carried out in Tanzania, Uganda and Zambia have to a large extent been formulated and imposed by the international donor community. In all three countries, the IMF has maintained a lead role in advising government on major issues of design of tax policies. To meet the targets set by the IMF and Ministry of Finance, the revenue authorities have focussed on increasing collection and compliance from existing taxpayers rather than attempting the more complicated task of widening the tax base. The long-term process of building wide tax nets and cultures of voluntary compliance requires different and more time-consuming practises. These processes are also politically more sensitive, as the resistance to taxing agriculture in Uganda and Zambia indicates.

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Table 1. Nature of tax reform in the 1990s

Form of taxation	Expected accountability effect	Tanzania	Uganda	Zambia
Direct taxes (Personal income tax, Corporation tax)	Visible, 'felt' taxes – positive accountability effect	Little change. Collection targeted on business corporations	New Income Tax act; increased compliance; but little emphasis on informal sector; business targeted	Little change. Limited to formal sector; major exemptions granted large corporations
Indirect taxes	Less visible, narrow reach - less clear accountability effect	57% total revenue*	82.5 total revenue**	61% total revenue***
Export taxes		Eliminated	Eliminated	Eliminated
Import taxes		Replaced export taxes	Replaced export taxes	Replaced export taxes
Excise duties		Little change	Increases	Little change
VAT	Visible, 'felt' taxes with broad reach – positive accountability effect	VAT introduced in 1998, but most basic goods exempted; narrow reach	VAT introduced in 1996 at 17%. Initial strikes and riots by business. Agriculture and basic goods exempted	VAT introduced in 1995 at 17.5%. Agriculture and basic goods exempted; narrow reach
Local taxes	Visible, 'felt' taxes with broad reach – positive accountability effect	Local 'development levy' 'felt' by majority. Little voluntary compliance. Duplication of central and local taxes	Local 'graduated tax' 'felt by majority'. No voluntary compliance	Hardly any local taxes; local govt. weak

*1997/98 Financial year, source: TRA Annual Report ** 1998/99 Financial year, Annual Background to Budget. Republic of Uganda *** 1997/98 Financial year, Ministry of Finance, Republic of Zambia

Table 2. Reform of tax administration in the 1990s

Reform of tax administration	Expected effect on accountability	Tanzania	Uganda	Zambia
New Revenue Authority	Positive - depending on internal accountability	TRA 1995, initial increase in tax/GDP from 11.5 to 12.5 % but now reduced to 10	URA 1991, increase tax/GDP from 7 to 12 between 1991-95, has remained stable at 12 % of GDP	ZRA 1994, tax/GDP increase from 17.5 to 18.5 per cent later reduced 17.5%
Independence (answerability)	Positive	More, but not financial independence	No financial independence	No financial independence, MOF grants exemptions
Transparency	Positive	Limited	Limited	Limited
Corruption (controllability)	Negative	Less, but increasing	Remains major concern	Reduced
Responsiveness (complaint office)	Positive	Task Force on Taxation	Tax Appeals Tribunal (1998)	Task Force on Taxation

Figure 1: Three dimensions of accountability

