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Tanzania 2001:

New Strategies for Poverty Reduction and Debt Relief

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1. Introduction*

Tanzania reached the Completion Point (CP) under the Enhanced HIPC Initiative in late 2001 and will now receive unconditional debt relief amounting to around US$ 3,000 million over a 20-year period – almost 50 percent of the existing external debt. This implies – at least in theory – large savings for the government, savings that will be used to fight poverty according to the strategy as laid down in the poverty reduction strategy paper (PRSP).

The documentation underlying the decision of the IDA and IMF to accept Tanzania as eligible for irreversible debt relief include a Completion Point document and a debt sustainability analysis (DSA). The latter projects how key variables in the macro economy will develop over the HIPC period (in the case of Tanzania: up to 2020/21), and how debt sustainability indicators will develop.

It is of considerable interest to analyze these projections in some detail. As several authors, including Danielson (2001), have noted, projections in the DSA preceding the Completion Point DSA were extremely optimistic and assumed, inter alia, that Tanzania's nontraditional export sector would grow, in volume terms, by around 25 percent per annum over two decades. We show in this report that the CP projections are substantially less optimistic, but there are still reasons for concern regarding the country's ability to meet them.

The purpose of this report is to analyze the Completion Point assumptions regarding Tanzania's macroeconomic growth in the future, and to compare those both with the historical record and with the projection in the Decision Point (DP) document – the set of projections preceding the CP's. The structure of the report is as follows. Chapter 2 provides a macroeconomic update by focussing on a small set of variables and events in recent years. Chapter 3 analyzes HIPC projections with particular emphasis on exports. Chapter 4 provides some calculations regarding the impact of growth on poverty and Chapter 5 offers a few concluding remarks.

2. Macroeconomic Update

2.1 Macroeconomic Trends

In the past years, most macroeconomic indicators in Tanzania have improved considerably;

and those that have deteriorated have done so mainly because of exogenous events, e.g., the "el Nino" rains in 1998 and the ensuing drought. Growth has picked up, foreign direct investment is increasing relatively rapidly, and export performance is improving. Some key selected macroeconomic data for Tanzania appear in Table 1.

Table 1

Selected Economic Indicators, 1996-2001

	1996	1997	1998	1999	2000[a]	2001[b]
GDP (nominal bn TSh)	3 767	4 703	5 631	6 433	7 226	7 292
Real GDP growth	4.5	3.5	4	4.7	4.9	5.1
Real GDP growth per capita	1.6	0.7	1.2	1.9	2.6	2.4
Inflation	15.5	15.4	11.3	7.9	5.9	5.2
Revenue (% of GDP)[c]	12.5	13.2	13.5	12.0	11.5	12.2
Public Expenditure (% of GDP)	18.3	17.6	15.1	14.8	14.9	18.8
Overall balance (% of GDP)	-3.8	-2.2	2.0	0.2	0.6	-1.2
Investment (% of GDP)	17	15.2	15	15.5	16.4	15.9
o/w: public	*3.1*	*3.3*	*3*	*3.5*	*4*	3.8.
o:w: private	*13.9*	*11.9*	*12.1*	*12*	*12.4*	12.2
Current account (% of GDP)[d]	-3.6	0.1	-4.4	-3.8	-0.7	1.6.
Int'l reserves (months of imports)	1.5	2.8	3.1	4.2	5.6	5.5

Sources: *HIPC Decision Point Document*, March, 2000; *Public Expenditure Review*, 1999, Vol. 1 & 2000, Vol. 1; *HIPC Completion Point Document*, November 2001; *Tanzania: Statistical Annex*, IMF Staff Country Report No. 00/122

[a] Preliminary

[b] Projection

[c] Excluding grants

[d] Including grants

Growth of GDP is higher than it has been for over two decades and has been increasing consistently for the past four years or so. However, since population growth is an estimated 2.8 percent per annum, increases in per capita incomes are still modest. Since poverty is widespread and possibly has increased in the 1990s (despite positive per capita growth), it has

been estimated that growth in the range 7-10 per cent in real terms is necessary to impact visibly on poverty levels (Danielson and Mjema, 2000).[2] As pointed out in Danielson and Mjema (2000) for growth to have a significant dent on the poverty stance it must take place in sectors, including agriculture, where the majority of the population is found.

Inflation has been reduced from almost 30 percent per annum in 1995 to an estimated 5 percent. Moreover, most of recent increases in prices are attributable to increases in food prices, something which is not under the control of the monetary authorities. The major reason for the success in bringing inflation down is undoubtedly the cash budget—the system by which the government is prohibited to spend, in any given month, more than it received in tax collections (plus budget support) the previous month. While the cash budget has had a negative impact on the workings of the public sector—in particular the quality of social sector output—it is rather clear that the reduction of inflation could not have been accomplished without this system. Moreover, the negative effects of the cash budget are likely to gradually shrink as the system is being made more flexible (with e.g., quarterly, rather than monthly, balance benchmarks and the possibility of short-term borrowing from the Central Bank).

The cash budget system removed the possibility of financing discrepancies between revenues and expenditures through borrowing from the central bank; in a sense, expenditures are the residual under a cash budget. Since the government has been unable to increase the revenue-to-GDP ratio in a consistent fashion, the cash budget implied that expenditures fell and reached an all-time low of 13.4 percent of GDP in 1999. An additional feature of the cash budget is a clear prioritization of expenditures, with debt servicing and clearance of arrears having first priority, followed by personal emoluments (Danielson and Mjema, 1999). This means that the residual in the system has been "other charges"—the post under which expenditures on maintenance, running costs other than wages and salaries and administration are recorded. As will become evident later on in the report, this has affected social sectors negatively and measures are currently being taken to correct for it.

Investments are picking up—both private and public. The increase in the latter is partly due to a renewed investment effort following the 1998 *"el Nino"* rains which ruined a sizeable part of the country's infrastructure. The increase in private investment is mainly due to increased inflows of foreign direct investments into three main areas: mining, tourism and purchases of privatized public entities. While the recent increase in private investments is to be welcomed, it is still very low and probably insufficient for the rates of growth that are envisaged for the near future (cf. below). There are still remaining constraints to increased foreign direct investments as indicated in a joint report produced in 2001 by the Bank of Tanzania, Tanzania Investment Center and the National Bureau of Statistics. These include: problems related to land ownership, cumbersome and time wasting tax collection methods, the lingering attitude in some circles that foreign direct investment is primarily for profit and not business associates.

A declining trend in merchandise exports was noted during the 1996-1999 period. However there are marked improvements in the overall performance of exports for 2000 and 2001 in the performance of the has been impeded mainly by the continued decrease in world commodity prices of the traditional exports. Non-traditional exports have shown an up-ward trend; increasing by 47.2 per cent between 1998 and 2000. Merchandise imports did not show any significant increase between 1998 and 2000: capital imports still dominated the import bill. The period has seen a decline in food imports mainly due to favorable weather conditions that have encouraged agricultural and food production in particular.

Finally, the current account does not appear to have improved very much—with the exception of 2001; cf. Table 3 below). However, as noted above, unfavorable weather conditions in the late 1990s decreased exports and increased imports. Even though this is a clear illustration of the fragility of Tanzania's success, it is not a consequence of bad policy; at the contrary, the government has been able to accumulate international reserves equivalent to five months of imports which should be sufficient to cushion most future shocks without jeopardizing the

stability of the current situation. Moreover, the BoP data in IDA/IMF (2000: Table 10) clearly shows that non-traditional exports account for an increasing share of total exports: from 46 percent in 1999 to 56 percent in 2000. While part of this is explained by a fall of traditional exports, revenue from exports of non-traditional goods increased by over 40 percent in nominal dollar terms.

It is notable in this regard that the Shilling has experienced a significant depreciation since late 2001. Although at first sight this may seem surprising in view of increased commitments of foreign aid and multilateral debt relief, some commentators (e.g., EIU, 2002) attribute this to inflows of foreign exchange being smaller than expected. In any case, the depreciation is welcome – even though it may make it more difficult to maintain inflation targets – mainly to balance the real appreciation of the currency that took place during the late 1990s.

As often noted, a major problem in Tanzania's stabilization efforts has been the public budget. This goes for unrestricted spending as well as slow improvements in revenue collection. While some of these problems have been addressed through the cash budget system, public affairs are still a major problem, both with regard to revenue collection and to perceived corruption among officials—the judiciary, the police, and the customs were singled out in the Warioba Report on corruption. In a recent ESRF study the list of corrupt institutions has included the health sector.

Some aspects of government operations are in Table 2. Corruption, singled out by many as the major cause hampering faster development in Tanzania, is by its very nature difficult to capture and the information is limited to formal aspects. There are, nevertheless, interesting features to note. The government has, indeed created the National Anti- Corruption Strategy in a move that is aimed at putting in place the preventive and curative measures against corruption. What is more compelling is how this strategy will be implemented at all levels: national, regional and district.

Domestic revenue generation remains low at slightly above 11 percent of GDP. It has in addition been falling for the past four years. A more detailed analysis (based on the data in the PER 2000, Vol 1: Table 2.1) reveals that both tax and non-tax revenue have failed to keep pace with GDP. The tax ratio is in fiscal 2000 below 10 percent for the first time in many years. One contributing explanation for this is continuing liberalization of imports: harmonization of tariffs and the gradual lowering of the average tariff, but it is difficult to understand why, for instance, revenue from sales and excise taxes have declined consistently (as a share of GDP) at least since fiscal 1995. Although much has been done to remedy the situation—including the establishment of TRA, the introduction of VAT and the abolishment of discretionary exemptions—tax evasion and rampant corruption (particularly in Customs) prevent the tax ratio from increasing consistently. The other side of the coin is frequent complaints of tax harassment by complying businesses. The failure of the government to increase revenue collection substantially (to, say, 15-17 percent of GDP) is a major constraint on service delivery of adequate quality and quantity.

Table 2
Government Operations, percent of GDP (fiscal years)

	1996	1997	1998	1999	2000	2001
Total Revenue	**14.5**	**15.4**	**17.1**	**15.0**	**15.5**	**15.3**
Domestic	12.5	13.2	13.5	12.0	11.5	11.2
"Import support"	0.8	1.0	1.8	0.7	1.2	1.9
Project aid	1.2	1.2	1.8	2.3	2.8	2.2
Non-bank borrowing[a]	1.2	0.6	-0.3	0.5	-0.1	na
Bank borrowing[a]	2.1	2.7	-0.4	-0.9	0.0	na
Other[b]	1.7	-0.3	-1.1	0.3	-0.2	0.8
Rec Expenditure	**15.1**	**14.0**	**12.5**	**11.0**	**10.9**	**12.0**
Debt Service	3.4	3.3	2.6	2.3	1.6	1.6
Personal Emolument	4.2	4.6	4.7	4.2	3.7	4.2
Other	7.5	6.1	5.1	4.5	5.7	6.2
Dev Expenditure	**3.2**	**3.6**	**2.6**	**3.8**	**4.0**	**3.9**
Overall balance	**-3.8**	**-2.2**	**2.0**	**0.2**	**0.6**	**-0.6**

Source: PER, 2000, Vol. 1, tables 2.1, 2.2, 2.3, and 2.6.
Notes: Fiscal years run from July to June ending in the year given in the table heading. "Other" includes transfers and OC proper. "Import support" covers all program aid, including debt relief, budget support and resources released under the OGL scheme.
[a] Domestic
[b] Includes foreign borrowing, revenue from privatization fund, and change in arrears

Expenditures have been contained, mainly because of the cash budget coupled with an inability to raise more revenue. It deserves to be noted that development expenditures appear to be on an upward trend (partly a reflection of increasing foreign aid after 1996) while both components of recurrent expenditures net of debt service are relatively constant (again with the exception of fiscal 2001).

Consequently, the Tanzanian resource envelope is far from sufficient, mainly due to an inability to increase the tax ratio. While a more successful fight against corruption may do much to increase collections, the solution in the longer term is clearly a move towards a more streamlined and broad-based tax system. In this strategy, economic growth is the key to a

sustained increase of revenue.

The one area in which stabilization has failed to materialize is the external balance (Table 3). Although a slight improvement can be seen in 2000/01, the current account has worsened for some years, with declining exports and increasing imports. Although almost entirely attributable to unfavorable weather conditions, it still illustrates the country's vulnerability to exogenous shocks. Official transfers are still larger than total export receipts, which further add to exposure to exogenous shocks.

Table 3
Balance of Payments (US$ mn unless indicated)

	1995/96	1996/97	1997/98	1998/99	1999/00	2000/01
Exports	695.9	794.0	612.6	540.5	541.0	663.1
Imports	1 370.3	1 387.8	1 444.5	1 592.5	1 630.6	1 534.4
Trade balance	**-674.4**	**-593.8**	**-831.9**	**-1.052.0**	**-1.089.6**	**-871.3**
Service receipts	472.0	519.7	564.8	569.6	671.9	726.7
Service payments	759.3	793.2	918.0	877.2	911.3	716.9
Service balance	**-287.3**	**-273.5**	**-353.2**	**-307.6**	**-239.4**	**9.8**
Private transfers	19.9	25.7	30.0	32.0	33.9	34.6
Current account (excl OT)	**-941.8**	**-841.6**	**-1.155.1**	**-1.327.6**	**-1.295.1**	**-826.9**
Project financing	523.8	567.1	580.1	595.4	606.2	587.1
Program financing	57.6	122.8	88.6	126.4	130.4	175.6
Official transfers	**581.4**	**689.9**	**668.7**	**721.8**	**736.6**	**762.7**
Current account (incl OT)	**-360.4**	**-151.7**	**-486.4**	**-605.8**	**-558.5**	**-64.2**
Capital account	**191.2**	**171.1**	**353.7**	**574.3**	**588.3**	**239.1**
Amortization	*354.4*	*317.0*	*274.7*	*274.2*	*223.1*	*273.0*
Direct investment	*134.1*	*150.0*	*165.0*	*178.8*	*183.0*	*192.8*
Overall balance	**-169.2**	**19.4**	**-132.7**	**-31.5**	**29.8**	**111.7**
Memo:						
Gross official reserves[a]	1.5	2.8	2.9	3.3	4.1	5.6

Source: IDA/IMF (2000), table 10

[a] In months of imports

However, on the trade account there are several trends that indicate that Tanzania may eventually manage to get out of the current situation. First, export receipts increased by 22 percent between fiscal 2000 and fiscal 2001. Second, imports declined between the same years despite a continuing increase in transfers. Third, and perhaps most important, export growth appears to be driven by non-traditional exports. If this trend continues, one might expect a decreased vulnerability to exogenous shocks. We shall have more to say about exports in the subsequent chapter.

In addition, the government has managed to improve her debt servicing record and accumulate a healthy level of reserves. This is partly due to rapidly growing (albeit from low levels) inflows of foreign direct investments. To make these continue is probably both necessary for sustaining the current development path and the major challenge for the government.

2.2 The Process to the HIPC Completion Point

Tanzania reached the Decision Point (DP) under the Enhanced HIPC Initiative in April 2000 and started immediately to receive interim debt relief (i.e., relief of interest payments, but no stock reductions). To reach the Completion Point (CP), the country would have to perform adequately with respect to the agreement under the Poverty Reduction Growth Facility (PRGF) and to adopt a number of structural measures, including privatization of DAWASA (the water and sanitation utility in Dar es Salaam), preparation for privatization ("unbundling") of TANESCO (the electricity utility), implementation of an action plan to combat corruption, conclusion of the ongoing tax reform, and submission to Parliament of amendments to the Tanzania Investment Center Act to improve business and investment climate. The PRSP – a condition for the Decision Point – should be drafted in dialogue with all stakeholders (notably "civil society" through NGOs), subjected to a first annual progress report, and approved by the Boards of the IDA and the IMF.

Given the shaky data on poverty in many low-income countries, the drafting of a realistic plan to fight poverty is no easy task. Fortunately for Tanzania, however, it was possible to build on the existing poverty strategy from 1997—the National Poverty Eradication Strategy—but it was felt that existing knowledge was too weak to facilitate a realistic Poverty Reduction Strategy Paper (PRSP). Consequently, the government initiated a household budget survey (HBS), designed so as to facilitate comparison with the results from the 1990/91 HBS. In addition the government was required to adopt a medium-term expenditure framework to determine allocations to priority sectors. Again this was made easier in Tanzania, both because of the well-developed routines for the annual Public Expenditure Review (PER), and because close monitoring of allocations to priority sectors had been routine since the implementation of the multilateral debt relief fund (MDF) in 1998 (cf. Danielson and Mjema, 2001 for a discussion of the MDF).

However, the interim PRSP was not endorsed by the IDA and IMF Boards, mainly because the results from the HBS were not available, and costings and time-frames were considered unrealistic. In addition, the process through which the interim PRSP had been drafted was criticized by Tanzanian NGOs (such as the TNGP), mainly on the ground that consultations with civil society and NGOs were forced and superficial. A final PRSP that addressed some of the weaknesses was completed in October 2000 and was followed the next month by a joint staff assessment by IDA and the IMF that recommended endorsement of the document. The first annual progress report was completed in August of 2001, and in November of 2001, the Boards of the IDA and the IMF agreed that Tanzania had reached the completion point. From then on, the multilateral debt relief as calculated in the completion point document (IDA/IMF, 2000) became irreversible.

Table 4
Indicators of Total External Debt, 2001/02-2020/21.

	2001	2002	2005	2010	2020
After Paris Club relief					
NPV of total debt (US$ mn)	3 739.9	3 852.2	4 217.1	4 959.2	7 011.6

NPV of debt-to-exports (%)	271.7	267.7	238.6	185.6	130.6
NPV of debt-to-revenue (%)	325.0	297.5	245.6	172.9	94.9
After multilateral relief					
NPV of total debt (US$ mn)	1 800.3	1 946.4	2 347.6	3 269.3	6 300.8
NPV of debt-to-exports (%)	130.8	135.2	132.8	122.3	117.4
NPV of debt-to-revenue (%)	156.5	150.3	136.7	114.0	85.3
After additional bilateral relief[a]					
NPV of total debt (US$ mn)	1 437.3	1 589.8	2 241.6	3 054.6	6 118.3
NPV of debt-to-exports (%)	104.4	110.5	116.0	114.3	114.0
NPV of debt-to-revenue (%)	124.9	122.8	119.4	106.5	82.8
NPV of new loans (US$ mn)	152.7	313.5	817.3	1 896.3	5 136.9

Source: IDA/IMF (2000), Tables 11 & 13

Note: Years refer to fiscal years (July-June) that start in the year given in the table heading.

[a] Some bilateral creditors—Paris Club as well as non-Paris Club—have offered to give additional debt relief.

It was found that in addition to a revision of the PRSP, that Tanzania had managed to fulfill most of the conditions stipulated in the DP document. The only areas in which progress had been slower than envisaged was the privatization of DAWASA – the process for the concessioning of the company was underway but had been delayed for technical reasons – and a delay of the analysis from the 2000 HBS. Table 4 sets out the projected impact of the debt relief given under the HIPC Initiative.

Approximately half of the existing external debt will be forgiven over a 20-year period. Bilateral creditors (in the Paris Club) have agreed to reduce their claims by approximately 90 percent; the remainder comes from multilateral creditors, particularly the IDA. This will imply that Tanzania's debt service ratio will decrease by more than half, and that the share of government revenue that is earmarked for debt service decreases substantially; current estimates suggest that the savings correspond to an increase of revenue of some 7-8 percent.

However, the last row of Table 4 suggest that while debt relief is substantial, the need to borrow does not disappear with the HIPC Initiative. Consequently, the HIPC strategy will lead to a sustainable debt stock in Tanzania only if particular indicators develop as projected. An analysis of the projections in the Decision Point document is contained in Danielson

(2001), where it was concluded that these were very optimistic and very sensitive to small changes in the macroeconomic assumptions. The next chapter contains a comparison between the projections in the DP and the CP documents.

2.3 Concluding Remarks

Tanzania has come a long was since BWI-sponsored reforms were initiated in 1986, and particularly since Benjamin Mkapa became President of the Union in 1995. However, reforms have not been implemented painlessly and results have not been immediate. Only in recent years has the economy reached something which can be called macro economic stability; traditional agriculture is still the mainstay for most of the population; change of the economic structure is slow; the external situation is characterized by unsustainability and imbalance between inflows and outflows of foreign exchange; and poverty appears to respond only slowly to the increasing rates of economic growth.

The possibility of enjoying HIPC debt relief increased the government's focus on poverty issues. The national poverty eradication strategy has been expanded into a fully-fledged PRSP, more resources have been devoted to the construction, collection and analysis of poverty indicators and attempts to make the formulation of development strategies a more participatory process have been strengthened.

It remains, however, to be seen whether the HIPC debt relief will be sufficient for alleviating poverty at a rate consistent with the international development targets and the national targets formulated in the *Vision 2025* document. In a sense, the HIPC process has turned tables completely. While standard arguments in favor of debt relief emphasize the growth-hampering role of a large debt, this mechanism is virtually absent in the HIPC analyses. Instead, growth is a necessary input to reach debt sustainability: without high growth, sustainability will not be reached. And since growth is an exogenous input into the debt calculations, the official HIPC documents are not very precise when they motivate their choice of future growth rates. The next chapter takes a look at the projections in the CP

document, compares them to Tanzania's historical performance and to the projections in the DP document. The chapter also takes a closer look at export performance and fluctuations, mainly because a relatively rapid growth of exports is a vital component in the development strategy underlying the HIPC process.

3. The HIPC Vision and the Historical Record

3.1. Projections in the Completion Point Document

All DP and CP document for HIPC-eligible countries contain a set of assumptions regarding the economy's growth path for the period covered by HIPC debt relief. While these differ somewhat from country to country (and between DP and CP documents for the same country), they typically include assumptions regarding the rate of growth of GDP, exports and imports; changes in terms of trade; inflow of external resources, including foreign direct investments and foreign aid; and inflation. These assumptions form the basis for a debt sustainability analysis (DSA) that is said to determine the amount of debt relief necessary for the country to be debt sustainable at the end of the HIPC period.[3]

As Johansson (2001) has showed, most of the Decision Point documents contain projections in the DSA that assumes much better development of key variables than the historical performance would lead us to believe. Danielson (2001) calculates for instance that the assumptions in Tanzania's Decision Point document imply that the country's non-traditional export revenue would have to grow by 25 per cent per annum for 20 years in order for Tanzania to reach a sustainable level of debt-to-exports by 2020. Other commentators, including the U.S.' General Accounting Office (GAO, 2000) and several NGOs, have noted similar trends.[4]

However, when we compare the macroeconomic assumptions underlying the DSA in the CP with those in the DP for Tanzania, it emerges that the optimism that characterized the projections in the DP has been substantially reduced in the CP. It should however be noted that the assumptions explicitly stated differ between the documents, so it is not possible to compare all details. Table 5 provides the information.

The projections have been moderated in several respects. First, and perhaps most importantly, the projection that the export ratio should increase to 18 percent of GDP has been cut down to

15 percent. This means that while the DP document implicitly assumes that nontraditional exports in volume terms will increase by 25 percent per annum between 1999 and 2018, the CP document make the less unrealistic assumption that the volume growth of nontraditional exports will average 8.7 percent over the period. This is still a high number, but not necessarily unrealistic in view of recent history: data from IMF (2000) show that the average rate of growth of nontraditional exports in the years following the 1997 "el Niño" disaster was 11 percent per annum.

Second, the projected rate of growth of imports has been lowered – at least if one believes that the average rate of inflation in the US will be higher than 0.6 percent per annum. It is much higher than the average for 1995-99 – and it should be kept in mind that the bad harvest in 1997 increased import needs for that year and thus biases the 1995-99 average upwards. Average import growth in 1998 and 1999 – using IMF (2000) data – was slightly over one percent per annum. The rationale for the high import projection is that higher GDP growth will require high imports of investment goods; the CP DSA analysis even suggests a constant imports-to-GDP ratio over the period. It should be noted, however, that this assumption – if it is excessive – serves to paint a gloomier picture of the prospects of debt sustainability for Tanzania.

Third, the implied annual rate of growth of direct investment in the DP is 12.5 percent for the first half of the period, and 5 percent thereafter. In the CP, the average rate is 7.5 percent, which is slightly lower. Given the rapid growth of foreign investment during the last half of the 1990s, these assumptions make sense.

Finally, the CP makes a radical departure from the DP projections when it comes to the forms of foreign assistance. For some undisclosed reason the DP document assumes that all official transfers take the form of project grants from 2002/03 and that the level of project grants in real terms remain unchanged at the 1999/2000 level. The CP document on the other hand assumes that grants will remain virtually unchanged (they increase at an average rate of 0.8

percent over the period), but that program grants will assume an increasingly larger share of this: these are assumed to increase at over 5 percent per annum, mainly at the expense of project aid, which is projected to decrease at an average annual rate of 0.5 percent per annum.

Table 5

Macroeconomic Assumptions in the DP and the CP: Tanzania. Annual averages

	Decision Point	Completion Point	Average 1995-99
GDP growth	5 percent pa in 1999 and 2000 and 6 percent thereafter.	About 6 percent, 2001-20	3.96
Exports	*Growth of traditional exports*: 5-7 percent *Exports-to GDP*: from 14 % in 1999 to 18 % in 2018	*Growth of traditional exports*: 6.1 percent *Exports-to-GDP*: will stabilize at 15 %	*Traditional exports*: -4.32 % *Exports-to-GDP* 18.2%
Imports	6.3 percent in real terms	6.8 percent in nominal terms	1.6% in nominal terms
Direct investment	US$ 352 mn in 1999-2008 to US$ 913 mn in 2009-2018	Growth of 7.4 percent	US$ 183 mn (15.2 % growth)
Loans and grants	*Project loans*: US$ 448 mn to 2009 and US $ 802 mn to 2009-18. *Program loans*: US$ 100 mn throughout the period *Grants*: Project grants unchanged at the 99/00 level; *Share of program grants*: no new program grants	*Project loans*: 6 % in nominal terms *Program loans*: 7.5 % in nominal terms *Grants*: US$ 760 mn in 2000 to US$ 891 mn in 2020. *Share of program grants*: from 23 % in 2000 to over 40 % in 2020.	*Project loans*: 18.8% *Program loans*: 11.8% *Grants*: US$ 784.7 mn *Share of program grants*: 14.7%
International reserves	4 months to 2008 and 3.7 months 2009-18.	5.6 months in 2000 to 4.3 months in 2010 at which level they remain.	3.24 months

Sources: IDA/IMF (2000); IDA/IMF (2001); IMF (2000).

At the end of the period, program grants are assumed to cover over 40 percent of total official transfers. The argument made for this assumption is that "the donor community becomes more confident of improved fiscal management in Tanzania, and the authorities are consistently implementing the PRSP." Given the experience with the MDF/PRBS, the progress on implementation of the system for financial management, the improved strategy for combating corruption, this is not an unreasonable assumption.

In sum, then, the Completion Point document represents a considerable improvement over the Decision Point document, which seems to have been put together without very much regard to Tanzania's potential. While the projections in the CP are on the high side, they no longer border on the ludicrous as did some of those in the DP document.

However, while the CP document represents an improvement, there are still a number of inconsistencies that make it difficult to see exactly how the data compiled in the CP document's tables square with the assumptions made in the DSA. We here list some of the more glaring inconsistencies.

First, according to Table 13, GDP in US$ terms grows at 8 percent per annum up to 2009/10. For this to be consistent with the DSA assumption of an annual growth rate of 6 percent, the Shilling would have to appreciate against the dollar over the period. Specifically, assuming a 2001 exchange rate of 900 to the dollar, the corresponding rate in 2010 would have to be 750 to the dollar. While we have not been able to find any exchange rate projection in the CP DSA, it is difficult to envisage that a nominal appreciation of almost two percent per annum would be consistent with nontraditional export growth of almost 9 percent per annum.

Second, terms of trade are assume to improve every year up to 2010 (Table 9), despite the fact that import prices are assumed to increase and the price of gold assumed to remain constant. To make this consistent, export prices would have to increase by over 2 percent per annum.

Third, the import-to-GDP ratio is assumed to decline from almost 26 percent in 2000 to 24

percent in 2010. If this is the case then the assumption of GDP growth of 6 percent per annum is not consistent with the data (in Table 9) projecting imports to grow at over 7 percent per annum. To put it another way: if we calculate the GDP growth that is implied in the import projections, we arrive at an average GDP growth of 7.1 percent – not the 8 percent in dollar terms noted above, and not the 6 percent envisaged in the DSA.

3.2 Export: Performance, Structure and Fluctuations

Since one of the assumption in both the DP and CP is on the export performance it is reasonable to look at this variable closely with a view to analyze Tanzania's prospects in this (export) sector. The examination entails two basic things. First, the trends of growth in the traditional and non-traditional sectors and second, existing policies to promote exports.

Tanzania's economic structure is heavily dominated by the agricultural sector. However there is also limited manufacturing activities, both of which have not shown promising export prospects. Only recently do the mining and tourism sectors appear to be making a significant show. The structures of exports and imports have not changed significantly in terms of composition and direction of trade.

When addressing Tanzania's export sector it is important to highlight some of its central elements like its traditional and non-traditional export base, the influence of weather and production characteristics, the price (in) stability, commodity concentration and policy characteristics and its formal and informal characteristics.

3.2.1 Composition and performance of merchandise exports

Tanzania exports are dominated mainly by primary agricultural and mineral based products. Her imports are largely manufactures from developed economies. The pattern has not changed much for more than three decades now, even though a sizeable manufacturing sector was put in place during 1970s. In the aftermath of the reforms undertaken since the mid-1980s, industrial restructuring has attracted considerable privatization while some of the manufacturing establishments remain moribund and not attractive to domestic or foreign

investors. The prospects for manufactured exports and thus changing the structure of production to one dominated by manufactured and processed agricultural exports does not look promising due to various reasons. First, it is usual for manufacturing firms to seek protection from the government. Second, the infrastructure is still inadequate and inefficient. Thirdly, the cost of doing business in Tanzania is relatively higher compared to what obtained in the neighboring countries (Tanzania Investment Centre, 2001).

The performance of major agricultural exports and non-agricultural exports as shares in total exports in selected years between 1991 and 2000 shown in Table 6. The table shows that the commodity composition of exports is concentrated around a few agricultural crops—cotton, coffee, tea, sisal, tobacco and cashew nuts. Other agricultural exports include pyrethrum, cocoa beans, cardamom, sesame, castor seeds, kapok, copra, palm nuts, sunflower and groundnuts. When all agricultural exports are considered, the proportion of total agricultural exports in total exports ranges between 70 and 90 percent since the mid-1980s.

Table 6
Structure of Export (*percent of total*)

	1991	1994	1995	1996	1997	1998	1999	2000
	TRADITIONAL							
Coffee	21.5	22.2	20.9	17.8	15.9	18.5	14.2	15.8
Cotton	17.7	20.2	17.6	16.4	17.3	8.1	5.2	3.3
Sisal	0.6	1.0	0.9	0.7	1.2	1.2	1.3	1.0
Tea	6.0	7.6	3.4	3.0	4.2	5.2	4.5	6.2
Tobacco	4.7	4.0	4.0	6.5	7.1	9.4	8.0	7.7
Cashew nuts	4.7	9.9	9.4	12.8	12.1	18.2	18.3	9.7
Traditional	*55.2*	*64.9*	*56.2*	*57.1*	*57.8*	*60.5*	*51.5*	*43.7*
	NON-TRADITIONAL							
Petroleum products	2.0	1.1	1.6	2.1	0.9	0.0	0.1	0.01
Minerals	11.6	5.8	6.6	7.3	6.8	4.5	13.2	26.5
Manufactured products	19.6	14.8	16.0	16.1	14.8	6.1	6.0	5.5
Other	11.6	13.5	19.7	17.4	19.6	28.9	29.2	24.3
Non-Traditional	*44.8*	*35.1*	*43.8*	*42.9*	*42.2*	*39.5*	*48.5*	*56.3*
GRAND TOTAL	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**

Sources: *Tanzania Economic Trends* (1990) and (1992), *Bank of Tanzania*,1999 and 2000

Non-traditional exports include minerals, manufactured products (from processed primary products) and petroleum products.

Mining has recently emerged as having significant export potential. Tanzania has large reserves of base metals and gemstones including gold, diamonds, iron, coal, cobalt, ruby, emerald, *alexandrite,* sapphire and *tanzanite* to name just a few of the known minerals. It also has large deposits of natural gas and exploration of hydrocarbons continues. The potential is signified by an increase in international mining interests in exploration following liberalization policies. The problem with mining sector in Tanzania is that there appears to be an over-emphasis on gold mining. Relatively less or no effort at all is directed to the exploration of minerals like iron ore, copper and coal. However, studies by Tandiscovery (1999) and ESRF (2000) show that private participants in the mining sector claim that an excessive number of taxes and high rates of taxes on trade in minerals are responsible for the clandestine shipment of mineral exports to neighboring countries. Also the "weight of historical market connections" was in favor of Nairobi which has for decades been a center for gem and gold trade in the region. Other constraints include bureaucratic marketing procedures, low skills, poor infrastructure, inadequate capacity, poor technology, lack of capital and the relatively high costs of production.

Manufactured products are broadly defined to include processed primary products such as textiles, cigarettes, sisal twine, cashew kernels, and processed coffee, made tea, canned beef, leather products, cotton seed cake, and pyrethrum extract. Others are cement and radio batteries, wood products and other products. It should be borne in mind that most of these industries were of the ISI-production structure, heavily reliant on imported inputs. Preliminary estimates for 1999 show a slow down in the annual real growth rate to 3.6 percent from 8 percent in 1998. The rates were lower for two previous years—4.8 percent in 1996 and 5 percent in 1997 (BOT 2000). Hardest hit were fishnets, sisal ropes, cigarettes, petroleum products, dry cells and rolled steel. The poor performance of manufacturing is attributed to stiff competition from imported products following trade liberalization. Although efforts are

underway to project Tanzania in the competitive global market, it is necessary for both the government and the private sector to address the high cost of doing business before its export sector can be considered to be competitive in either the domestic, regional or global market.

The industrial sector constraints including inadequate skilled technical workforce, high cost of capital, high cost of energy and power and water supply interruptions remain formidable, for which reason export prospects appear to be bleak. It is also noted that over the late 1990s, declining inflation and dismal increases in salaries and wages somehow lowered production costs. At the same time, reductions in tariffs on imported raw materials and intermediate inputs were also beneficial to manufacturers of exports.[5] Apparently, however, these were not sufficient to reduce the costs due to numerous other constraints that prevented any significant increases in capacity utilization. On balance, in the 1997-99 manufactured exports declined (also the share of manufactured products in total non-traditional exports declined).

Manufacturers decry both "unfair" competition like dumping and the high costs of doing business in the country (high costs of utilities especially power, water, and communication infrastructure) as factors that undermine their efforts to become competitive even in the sub-region.

Table 7
Manufactured exports 1992-2000 (USD, mn and percent)

	1994	1995	1996	1997	1998	1999	2000*
(1) Non-traditional	182.5	299.4	327.5	317.2	232.2	262.1	170.6
(2) Manufactures,	77.0	109.3	122.8	111.3	35.7	33.3	16.6
(2) as % of (1)	41.2	36.5	37.5	35.1	15.4	12.3	9.7

Note and Sources: * Estimate for 2000 is for January-June: from Bank of Tanzania (2000) *Economic and Operations Report for the year ended 30th June 2000*; and Bank of Tanzania *Economic Bulletin* Vol. XXX, No. 1, March 2000.

"Other" category of unspecified non-traditional exports include natural resources such as fish and wood products, flowers and fruits and vegetables, hides and skins and garments. These show a consistent increase as a percentage of total exports and thus indicate potential areas

for export product diversification. The growth of these exports has been spurred by improved investment climate and business environment although this is far from suggesting that all is well. Nevertheless, the records from the Tanzania Investment Center show that most of the newly approved investment projects have high export potentials. Between October 1997 and September 1998, of the total 277 projects, 126 (45.5 percent) had the potential for export in the manufacturing, natural resources and tourism (Luvanga and Bol 1999). It should be bone in mind that there is a limit to which exporters of primary producers can influence market condition in world markets given that they are basically price takers.

Table 8

Tanzania's exports by major area of destination (*per cent*)

	1990	1995	1999	2000
Western Europe	42	36	40	40
North America	7	4.0	3	4
Eastern Europé	1	1	1	1
Asia, Oceania, Middle . East	38	38	42	44
Africa	8	7	8	3
Others	4	14	6	4
Total	100	100	100	100

Sources: Bank of Tanzania *Economic Bulletin (2000).*

In terms of the diversification of the export basket, non-traditional exports feature prominently. Overall, exports are still concentrated on primary, agricultural commodities after so many years of attempting to change this pattern into one that is more diversified and those for which the bulk of value-added is generated at home. This concern is more compelling in view of the fact that, unlike manufactured exports, agricultural commodity exports are associated with low technological dynamism because production still relies on rudimentary methods.

It is interesting to note that for decades, trade among African countries has remained very low. As Table 8 reveals Western Europe, and Asia (including Oceania and Middle East) has absorbed most of Tanzania's exports and a market for manufactured goods from the advanced

countries. Table 8 summarizes Tanzania's total exports by major area for selected years.

Western Europe takes the largest share of hulled coffee, un-manufactured tobacco, and fairly high amounts of tea, raw cotton and sisal fiber. The Asia/Oceania and Middle East market takes leading shares of cashew nuts and cloves, followed by tea and raw cotton. Significant importers here include Japan, Hong Kong, Taiwan, Singapore and Thailand. In terms of non-traditional exports India, Pakistan and Hon Kong are leading Asian destinations for minerals, vegetables and hides and skins. India, followed by Japan are major destinations of Tanzania's exports dominates the share of Asia. Although the share of Tanzania's major exports to other African countries is currently low, it is expected that the developments and progress made in the East African Cooperation (EAC) will pave way for increased trade among the three partners (Kenya, Uganda and Tanzania).

Diversification of export markets through regional trading arrangements has not had a strong impact as shown by the low proportion of exports to selected individual countries neighboring Tanzania compared to countries like India, Japan and most European countries.

Table 9

Destination of Tanzania's exports: Selected years (% of total exports)

	1993	**1995**	**1997**	**1999**
United Kingdom	7.8	5.9	5.0	17
India	10.0	8.5	8.9	21
Japan	9.2	9.6	8.0	8.0
Germany	11.9	10.6	9.0	6.4
The Netherlands	5.1	6.0	5.3	5.7
United States of America	2.9	3.5	2.9	3.3
Kenya	1.8	1.8	1.7	3.8
Uganda	1.3	1.3	1.5	0.9
Burundi	2.7	0.9	0.5	0.6
Mozambique	0.2	0.3	0.3	0.1
South Africa	n.a.	0.7	1.1	1.2
Zambia	0.7	1.5	2.5	0.5
Other countries	46.4	50.0	53.3	31.5
Total exports in US$(million)	**377.5**	**709.3**	**735.7**	**510.6**

Source: Computed from Bank of Tanzania (2000), Table 4.11

As table 9 reveals, the five major destinations for Tanzania's exports are India, Japan, United Kingdom, Germany and the Netherlands. India in particular imports from Tanzania raw cashew nuts while United Kingdom imports agricultural commodities like tea, coffee, and cotton.

Table 10

Imports from and Exports to Kenya: 1991-1999 (mn US $ and %)

	Imports	% change	Exports	% change	Balance	Exports to Import ratio
1991	38.6	n.a	8.0	n.a	-30.6	0.21
1992	44.7	15.8	8.0	0.0	-36.7	0.18
1993	79.4	77.6	7.2	-10.0	-72.2	0.09
1994	202.8	155.4	24.3	234.5	-178.5	0.12
1995	262.8	29.6	13.0	-46.5	-249.8	0.05
1996	275.6	4.9	16.9	30.0	-258.7	0.06
1997	262.6	-4.7	27.7	63.9	-234.9	0.11
1998	103.3	-60.6	25.4	-8.3	-77.9	0.27
1999	88.8	-14.0	19.6	-22.8	-69.2	0.22

Sources: Up to 1997, *East African Co-operation Trade Statistics* from ERB 1999 Study; 1998 and 1999 data from Bank of Tanzania (2000): converted at calendar year average exchange

rates.

The discussion above demonstrates that the volume of trade between Tanzania and the rest of Africa is low. This pattern can be observed in most African countries where intra-African trade is limited by lack of complementarity in the structures of production, undeveloped intra-regional transport and financial infrastructure, small markets in terms of incomes, language barriers, immigration procedures and wars and insecurity - which is why regional integration would seek to address issues beyond just trade.

Table 11

Imports from and Exports to Uganda (million US $ and %)

Year	Imports	% change	Exports	% change	Balance	Exports to Imports ratio
1991	1.0	n.a.	13.2	n.a.	12.2	13.2
1992	1.0	0.0	17.0	28.8	16.0	17.0
1993	1.0	0.0	9.0	-47.1	8.0	9.0
1994	1.0	0.0	23.8	164.4	22.8	23.8
1995	2.0	100.0	23.1	-2.9	21.1	11.5
1996	2.0	0.0	15.6	-32.5	13.6	7.8
1997	3.5	75.0	20.2	29.5	16.7	5.8
1998	2.2	-37.0	6.4	-68.3	4.2	4.2
1999	5.6	154.5	4.4	-31.3	-1.2	0.8

Sources: Up to 1997, *East African Co-operation Trade Statistics* from ERB 1999 Study; 1998 and 1999 data from Bank of Tanzania (2000): converted at calendar year average exchange rates.

The increase in trade between the East African countries since the mid-1990s has been attributed to a number of factors. The main factor seems to be related to the trade liberalization efforts that were going on in all the three countries and the goodwill towards regional integration as expressed by the political leadership since the mid-1980s. The events in the 1990s, for instance, all were accompanied by mutual easing of attitudes and trade policies towards one another and the peoples across the borders have strong historical bonds.

Tanzania's trade balance with a country like Uganda has, for the most part of the 1991 to 1999 period been positive. Since 1995 to 1999 however the export to import ratio between the two countries has declined from 23.8 per cent to 0.8 percent. While Tanzania has not been

able to increase its share of exports to Ugandan market the latter has increased its exports of cloth and plastics and other manufactured goods to the Tanzanian market.

The official statistics do not depict the entire volume of trade. The other dimension of trade that has been of concern to policy makers in all the three countries is smuggling. Anecdotal evidence of smuggling in the region abounds. The range of smuggled products include commodities that are listed as "traditional exports", especially coffee and cotton, and a number of food commodities such as maize, beans, wheat flour, sugar, rice and root crops. A list of frequently smuggled goods include charcoal and timber, fish, minerals and a range of goods that were imported and then re-exported. Possible reasons for smuggling of "ordinary goods" include across-the-border differences in relative prices, procurement policies and payment modalities to farmers, and the desire to evade or avoid taxes (Bagachwa and Maliyamkono 1990, Ackello-Ogutu and Echessah 1998, Banda 1999). Trophies like elephant tusks are also in the list of illegal cross-border trade goods. Studies indicate in general that informal trade activities are on the increase. In Tanzania, for instance, it is shown that in 1995/96, informal cross-border trade with neighboring countries was, on average 57.7 percent of total trade in ordinary goods; it varied from 10.5 percent with Kenya to 98.3 percent with the Democratic Republic of Congo (DRC).

According to available data Tanzania's informal trade with the Democratic Republic of Congo (DRC) for the year 1995/1996 included mainly foodstuffs like, maize beans fish, wheat flour, root crops, sugar, rice and fruit. With regard to the formal trade the net (export less import) trade between the two countries was about US $ 3,000,000. Commodities which are reported to have been officially traded between Tanzania and the DRC are cooking fats, petroleum products, textile, electronic equipments, car and bicycle parts and Salt (Ackello-Ogutu, 1998).

Table 12

Formal and informal trade between Tanzania and her neighbors (US $ mil, %)

	(1) **Formal 1995**	(2) Informal 1995/96	(3) (1)+ (2) Total	(2) as % of (3)
Kenya	161	18.8	179.8	10.5
Uganda	10	4.5	14.5	31.0
Zambia	14	9.7	23.7	40.9
Malawi	3	5.7	8.7	65.5
DRC	4	231.6	235.6	98.3
Mozambique	12	7.7	19.7	39.1
Total	204	278	482	57.7

Source: Ackello-Ogutu and Echessah (1999)

Because of the clandestine and "slippery" nature of the business and its participants, the regularity of informal trade and precision of the estimates of its volumes cannot be guaranteed. It is even more difficult to track the much more pernicious trade in dangerous commodities like illegal trade in trophies. However, the evidences leave an impression if "formalized" and recorded, cross-border trade could even expand the export basket and boost fiscal revenues. Regional (joint) ventures in infrastructure development and harmonization of macroeconomic and trade policies would go a long way to reduce informal intra-regional trade.

The formation of regional trade co-operation is expected to harmonize macroeconomic and trade policies (e.g. taxes, currency convertibility) and ease the cumbersome customs procedures, harassment of traders at the borders and poor domestic marketing and pricing policies.

In Tanzania, tourism is a service export that has in the last decade recorded high growth rates - an average of 29 percent increase in foreign exchange earnings from US$ 65 million in 1989 to US$ 570 million in 1998 (URT 2000a). Tanzania is now ranking behind South Africa, Morocco, Tunisia, Mauritius and Kenya in terms of tourist arrivals but comes second after Mauritius in terms of earning per tourist (Luvanga and Bol 1999). Data for 1999 indicate that foreign exchange earnings from tourism were second to agricultural exports. The sector has high employment and backward linkages by way of development of ancillary services.

However, the sector lacks modern, competitive tourism infrastructure and facilities, that is high quality hotels and ground services. After the economic liberalization, private and foreign investments have been invited to establish world-class hotels and improve training for local service providers. From a regional integration perspective, medium to long-term plans may be necessary whereby members agree on a common marketing strategy. In the case of the EAC, conditions of acceptable benefit sharing may be required for joint development of tourism in East Africa.

It is also important to mention a few of the formal cross-border services from Tanzania's geo-economic position in the region. The services in this case include transport, communication, construction, finance, information and communication technology as well as royalties and license fees. Ground, air, and marine and pipeline transportation – all contribute about 6 percent of GDP in Tanzania. Tanzania serves land-locked countries in East and Central Africa, using ground transportation and the seaports of Dar es Salaam, Tanga and Mtwara and important inland water transport on Lake Victoria, Tanganyika and Nyasa.

Financial sector services (e.g. banking and insurance) could be potential exports if the financial services become competitive enough at least within the context of regional integration. Tanzania's financial sector liberalization in Tanzania has seen a number of foreign banks and non-bank financial institutions established. To be competitive, the financial instruments such as commercial lending through overdraft facilities, property secured lending, check payment system and use of credit cards (vital for a smooth tourism industry) must be perfectly operative. Tanzania is lagging behind her neighbors on most of these aspects. The capital market in Tanzania is still nascent and its use is not yet fully understood. Tanzania is also a net importer of insurance services (URT 2000b). As with banking, the goal should include continued reform of the sector with a view to enabling local banking and insurance businesses to export their services in the long run starting with facilitation of trade and investment activities with neighboring countries.

Tanzania has also been a net importer of education services from the two neighboring countries – particularly primary and secondary education. In the context of regional integration, education, research and technology are ingrained in the Treaty and should be pursued with keen interest, especially where countries stand to benefit from joint programs.

3.2.2 Policy reforms and Prospects for External Trade Recovery

Prior to the mid-1980s, economic policy aimed at higher growth of income, and import substitution industrialization with little scope for the private sector. While impressive economic growth was recorded in the 1960s up to around 1978, with an average annual growth rate of about 5.4 per cent, the period 1979-85 saw economic performance faltering to negative growth rate. Capacity utilization problems and reliance on quantitative restrictions in the face of foreign exchange shortage reduced the prospects of the ISI-based manufactured exports. Shortages and stringent controls fuelled parallel market activities.

Starting with the first Economic Recovery Program in 1986 onwards, active trade policy increasingly relied on market incentives and less on controls. Trade policy reforms cover import and export trade with a view primarily to export development (diversification of the export basket and export markets). The liberalization of trade aimed to lead to market prices that could be compared to world prices and discourage inefficiency, promote private enterprise, induce parallel market activities into official channels and make the country unattractive to foreign investors.

Trade liberalization entailed reduction in the level and dispersion of tariffs, converting non-tariffs barriers into tariffs, import / export facilitation, and liberalization of exchange rate policies in respect of current and capital transactions. The institutions that carried out the implementation of these policies became subjects of gradual review - the customs, the trade payments departments of the commercial banks (most of which remained state-owned for quite a while until only recently), the Board of External Trade (BET), the Bank of Tanzania and Ministries. However, the smooth operations of these institutions would not improve

instantly, as expected. Another problem cited recently is the fact that the co-ordination of trade policy was scattered - that is, there seemed to be multiple institutions that handle similar trade policy issues (MOIC 1999). This was a critical problem that adversely affected the speed of trade liberalization in Tanzania.

One of the earliest steps towards import liberalization was taken in 1984. This was the "own funds" import scheme. It was aimed at easing exchange controls in the face of acute foreign exchange reserves. Under the scheme, exporters were allowed to use part of their foreign exchange earnings. Data for the period 1984-96 show that significant levels of imports were recorded as a result of the own funds scheme, ranging from 19 percent in 1984 to maximum of 35 percent of total imports in 1988 (Tarimo 1996 for actual data). The trend in the improvement of recorded imports can partly explain the underlying tendency for "capital flight" that used to take place because of the stringent foreign exchange control prior to 1986. It is not certain that all importers willingly came out even when the authorities assured them that no questions would be asked about the sources of their foreign exchange especially in the first four-five years. However, the foreign exchange retention schemes increasingly assured exporters of their free use of foreign exchange they earned as the surrender requirements were gradually dropped. Own-funded imports were subsequently not necessarily recorded towards the end of the 1990s, as the distinction became less relevant with increased liberalization.

Table 13

Import-liberalization and related policy measures since 1987

Period	Policy events / measures
1987-92	*Tariff liberalization with compression of rates and categories* Introduction of "true" OGL in 1988 Introduction of foreign exchange bureaus in 1992 October 1992: Government appoint SGS and COTECNA to inspect imports valued USD 5,000 or above; later to collect customs duties
1993-94	1993/94:Tariff rates raised to cover unforeseen revenue shortfall (action temporary) Unification of exchange rates in 1993 and *de facto* abolition of licensing Inter-bank Foreign Exchange Market (IFEM) for market determined exchange rates - parallel exchange rate premium vanishes
1996	Tanzania Revenue Authority (TRA) was commissioned with powers to collect taxes under the customs tariff, sales tax, excise duty and stamp duty.
1998/99 2000/01	Tariff compression: 5 tariff bands, max. rate down to 25 % (from 60% 1992). Imposition of suspended duty Minimum dutiable value (MDV) in force
2001/02	MDVs replaced by "Agreement on Customs Valuation" (ACV) with exception of sugar that is governed by a special agreement* Suspended duty still in force

Note: * As an attempt to curb tax evasion "Minimum Dutiable Value" (MDV) were applied on imports that were often under-declared. See Ndulu et al (1999) p. 265.

Source(s): Adopted from Ndulu *et al.* (1999) p.265; Bank of Tanzania (1997) *Economic Bulletin* Vol. XXV No. 1, p. 18.

In 1988 the OGL was added to the liberalization gear. It allowed a more market-oriented allocation of foreign exchange. Even though importers were still required to obtain an import license from the Bank of Tanzania, it was less administrative. Another step towards import liberalization was contained in the 1992 Foreign Exchange Act that permitted the establishment of the bureau de changes and made it free for citizens to possess and sell foreign exchange. The bureaus acted as another window for financing imports until January 1996 when the Bank of Tanzania restricted the bureaus operations to over-the-counter money

changing operations.

Exchange rate depreciation since the 1986 devaluation aimed at both reducing imports and encouraging exports, with the normal caveats that beset the responsiveness of imports and exports to price and exchange rate adjustments. In particular, "elasticity pessimism" still haunts the trade balance, given the difficulties of cutting down the import bill when imports have been reduced to necessities such as oil, medicaments and even food, on the one hand, and the limited supply response of exports on the other hand. The supply response depends on a number of factors that are not always in favor of Tanzania: the long gestation period for most agricultural products and the time lag and costs of adjusting plant scales. Furthermore, the "pass-through" of exchange rate or foreign price change on to the producer prices was negatively affected by pricing interventions, especially price controls and the marketing intermediaries that tended to erode an intended increase on the domestic prices of exports.

With regard to import procedures, the Import Declaration Form (IDF) – was introduced in 1986. The IDF did not require prior approval of the Bank of Tanzania. All imports f.o.b value above US$5,000 would undergo Pre-shipment Inspection (PSI) and pay a fee of 1.2 percent of the f.o.b value to get a Clean Report of Findings (CRF). The Mtei Commission Report and the Confederation of Tanzania Industries (CTI) subsequently recommended that pre-inspection be extended to cover "own funded" imports to check under-valuation. To traders unnecessarily complex and inefficient procedures (ostensibly to curb malpractice) meant / mean costs in lost time, fees, handling charges etc. Pre-shipment inspection was introduced to check abuses related to sub-standard import of machinery and equipment and transfer pricing on capital equipment. During the 1990s the objective shifted towards verification of value for the purpose of tax and duty assessment and collection. The Customs Valuation Agreement under WTO aims at providing greater uniformity and certainty in the implementation of customs valuation procedures in fair, uniform and neutral systems that precludes the use of arbitrary or fictitious customs values. The principal of transparency entails publication of laws,

regulations, judicial decisions and administrative rulings by the importing country.

The various export promotion measures were beset by a number of problems in the administration of the export incentive schemes (Ndulu 1993; Musonda 1992). These included lack of transparency in the application of the incentives, bureaucratic hurdles, corruption and the long time it tool to get the benefit. The schemes were arguably, only "second best" course of action when the right way would have been to reduce the market or price distortions caused by trade and exchange controls. The presence, at the same time, of severe macroeconomic imbalances, shortages, etc. increased the propensity for the "directly unproductive" activities and diversion of trade flows away from the official channels.

Table 14

Trade taxes, incentive schemes and measures to rationalize export procedures since 1993

Period	Export tax (%)	Policy Changes/ Procedure	Promotional Changes
1993		Review of foreign exchange regulation	·Exporters no longer required to register with BOT or to have export license with BET [exceptions – exports of natural resources] ·Exchange rate system tied to weighted average of Bureaus rates ·Surrender requirement abolished on non-traditional exports
1994			·Surrender requirements on all traditional exports rescinded (except for coffee)
1996		Reintroduction of tax (2 percent) on traditional exports	Impact on producer incentive likely negative: government revenue from this to be devoted to improving services to the agricultural sector
1997		Customs Single Bill of Entry Form	·To be used in place of the IDF for imports and CD3 Form
2001/02		Abolition of export tax on scrap metal*	

* Trade in scrap metal is negligible.

Source: adapted from Ndulu *et al.* (1999) and budget speeches 1996/97 to 2000/01.

Table 14 shows major policy actions that aimed promote and to liberalize export trade. As indicated above, import liberalization measures also had positive implications / intentions to promote export expansion.

There is complementarity between import and export trade liberalization as shown in Table 10 and 11. Import liberalization, foreign retention schemes favorable to non-traditional exports, other schemes such as the duty drawback, and the taming of parallel market exports, to a great extent contributed to the recovery of exports. Attempts have been made to encourage private and foreign investors in export-oriented activities, as the government continues with efforts to institute a fair and operative competition policy. Tanzania recognizes that a lot more has to be done to establish competitive financial and trade-related services, at the same time as the macroeconomic policies must be conducted in such a way as to

safeguard Tanzania's external competitiveness.

In addition to these, policy actions aimed at rationalizing export procedure are important. The procedures the agents go through in order to export (and to import) play a role in that they imply "costs of doing business" which tax away proceeds expected from engaging in exporting (importing). The costs are in terms of time, storage/warehousing charges and lost earnings due to bureaucracy and customs delays.

3.2.3 Current trade policy frame and institutions

Domestic trade based on competitive market policies can enable domestic producers to improve their competitiveness on the international scene, and attract foreign investments. Prospectively, in a regional bloc, foreign investors would be more attracted to a country with a more competitive investment and trade environment. The following are among the issues that have attracted recent policy attention in drawing the main elements of the trade policy framework. The main premises of this approach are found in the "Integrated Framework for Trade Development" (MOIC 1999; 2000a; 2000b) and the draft trade policy document (URT 2000a) which emphasize, *inter alia*, diversification of the export base, empowering of the private sector to that effect and capacity to effectively participate in the multilateral system.

The first one is the creation of an enabling policy environment with attention to maintaining a macroeconomic framework including control of domestic inflation, fiscal balance, exchange rate stability and a long-term solution to the debt problem. Serious failures could lead to uncertainties in trade and investment. At the micro-level this implies a continuous adjustment of (inherited) legal and regulatory framework and corresponding administrative procedures that impact on business performance. Despite the recent reforms, there are residual impediments to efficient business sector performance that lead to high transaction costs and risk and thus can discourage foreign and regional investment flows.[6]

Second, export product diversification continues to get priority and recently mining, tourism and fisheries exports have shown great potential. The need to increase the domestic

value-added to export through processing (e.g. of cashew nuts and fruits) is also emphasized but, as a prerequisite, the processing and packaging capacities are required. Moreover, as noted by UNU/AERC (1998:6), attention must be paid to the competitiveness of domestic enterprises. Competitiveness in this regard is critical if the country's products are to gain a foothold in regional and global markets.

Tanzanian authorities already realize the need for selective promotion policies such as the export processing zones (EPZs). The EPZ has not been operational due to the heavy capital investment in the required high quality infrastructure and the need to sort the labor laws to be applied in view of experiences from other countries such as countries in East Asia. The premonition is that the EPZ models should be carefully studied before they can be copied and / or adapted. On the other hand, bonded warehouses, duty exemption and drawback schemes are in operation although they are beset by operational problems. It is realized therefore that "selective protection and promotional measures" cannot be effective without the necessary institutional and human capacities.

Third, there is increasing concern about the predominant use of import tariffs as a revenue instrument. High tariff on a narrow range of basic imported goods can have an adverse effect on the country's productivity, cost of living and national competitiveness and capacity to attract investors. It is disadvantageous to enter a regional integration scheme while on a higher tariff level than that of partners. What is important is to find viable alternative sources of revenue.

Fourth, Tanzania recognizes the need to pay more attention to trade in services. Possibilities lie in the development of "hard" infrastructure – road and port facilities for the country and for the regional trade, for transit trade services and for tourism. In the context of regional integration, research into costs and benefits of joint services e.g. tourism in the context of EAC or SADC is also accorded significance.

Capacity building for effective participation in the regional trade arrangements for the public and public sector personnel is also regarded as vital - i.e. a need to raise public and private sector awareness of opportunities and obligations associated with the various international trade arrangements such as the different international commodity arrangements (e.g. for coffee, tea, minerals, the multi-fiber agreement, the WTO, AGOA, etc.).

A number of institutions deal with trade development (and with exporters and importers of goods and services as well as capital or investments). These include the Tanzania Investment Center (TIC), the Board of External trade (BET) and the Ministry of Industries and Commerce (MOIC), the TRA (now administering the duty drawback), Ministry of Finance and Bank of Tanzania. Greater co-ordination among these institutions may help array the many fears by investors. On the regional level the need for co-ordination with similar institutions in other countries is also recognized.

3.3 Sensitivity of Export Projections

The projections made generate certain results. However, as a general rule, the uncertainty of projections increases the longer the projections. It is therefore of interest to check how sensitive results are to changes in the projections. However, as we have not had access to the exact model used to calculate the sensitivity of debt ratios to projections,[7] we focus here on the projections for exports, as this is one of the key variables, both for Tanzania's development strategy and for the debt analysis in the CP document.

3.3.1 Total exports

In the CP document DSA, traditional export revenue (in US$) grows at an average annual rate of 6.1 percent for the 2000-2020 period. In addition, the DSA assumes that the total export-to-GDP ratio will stabilize at 15 percent of GDP, however without specifying the year when this is likely to occur.

Table 15

Sensitivity analysis of exports. Average annual growth, 1999-2020

Table 15(a): Export-to-GDP ratio of 15 percent is reached in 2005

Growth of Traditional exports	6.1	5	3	1
Growth of Nontraditional exports				
1999-2005	8.0	8.9	10.2	11.4
2006-2020	6.1	7.0	7.7	8.0
Nontraditional exports as share of total exports in 2020	52.4	61.7	74.5	83.1

Table 15(b): Export-to-GDP ratio of 15 percent is reached in 2010

Growth of Traditional exports	6.1	5	3	1
Growth of Nontraditional exports				
1999-2010	7.6	8.6	9.9	10.8
2011-2020	6.5	8.1	10.0	11.1
Nontraditional exports as share of total exports in 2020	52.4	61.7	74.5	83.1

Source: Base data from IDA/IMF (2001). Assumptions described in text.

If we assume that the export ratio reaches 15 percent in 2005 (from 14 percent in 1999), that approximately half of export revenue emanates from nontraditional exports and that traditional exports grow at 6.1 percent throughout the period, nontraditional exports will have to grow at 8.0 percent per annum to 2005 and at an average rate of 6.7 percent per annum for the entire period 1999-2020. In the latter year, then, nontraditional exports will comprise 52.4 percent of total export revenues (as compared to 50 percent in 1999). We perform two different kinds of sensitivity analyses. First, we check how fast nontraditional exports will have to grow if the rate of growth of traditional exports is lower than 6.1 percent per annum (Table 15(a)), while we assume that the export ratio of 15 percent is reached in 2005. Second, we perform the same analysis assuming that the export ratio of 15 percent is reached in 2010 (Table 15(b)).

Obviously, the slower the rate of growth of traditional exports, the faster will nontraditional exports have to grow to reach the target export-to-GDP ratio in 2005. Equally obvious is the fact that the slower the rate of growth of traditional exports, the larger will the share of nontraditional exports be in 2020, given that the export-to-GDP target is reached on time.

What is perhaps less obvious is that the required rates of growth are relatively insensitive to the year when the export-to-GDP ratio is assumed to reach 15 percent. Assuming that the

ratio is reached in 2010 rather than in 2005 means that the required rate of growth of nontraditional exports falls by 0.3 or 0.4 percent per annum. In addition, Table 5 (on page) shows that the rate of growth of traditional exports in the second half of the 1990s was negative; unless this changes drastically, the sensitivity analysis suggests that nontraditional exports will have to grow extremely fast in order to fulfill the DSA projections.

3.3.2 Traditional Exports

When export receipts fluctuate over time, this is either because prices change, volumes change or both. Regression analysis (the results are not shown here) shows that fluctuations of prices account for most of the variations over time in export receipts: for coffee, cotton, sisal, and tea variations in price explain over 70 percent of variations in export receipts.[8] This supports Danielson's (2002) finding that agricultural supply elasticities are low: farmers do respond to price changes, but only slowly which is likely to be because of structural constraints in agriculture. Since supply responses have the "correct" sign in Danielson's study (i.e., farmers increase production when prices increase and vice versa), the low elasticities dampen the fluctuations caused by price swings.

Table 16 uses data from the IMF (2000) – data that are likely to have been used for the formulation of export projections in the CP document DSA – to look at growth of the major traditional export crops. Average growth of export proceeds for the 1993-99 period is about four percent per annum, but there are huge differences between commodities. There are also major differences between rate of price growth and rates of volume growth.

From the first half of Table 16 it would appear that the assumption in the DSA of an average annual rate of growth of 6.1 percent for 2001-2020 is not far-fetched: a number of measures are currently being implemented in the agricultural sector that should make it possible to increase the rate of growth. However, there are two comments to make. First, the lower half of Table 16 singles out the performance of traditional export commodities for the three last years of the period: 1997-99. Volumes produced decreased for five of the commodities, and

for some, e.g. cotton, dramatically so. For four of the commodities prices decreased. Here as well, fluctuations were dramatic for some of the commodities, such as cotton and tea. Overall, export revenue from traditional export crops decreased by over 22 percent per annum for these three years, despite an average rate of growth of over four percent for the period from 1993 to 1999. This clearly point to large fluctuations in the revenue earned from the export of traditional cash crops. Second, when some of the structural obstacles in agriculture are removed, farmers will be able to respond more swiftly to changes in price. This will tend to make the swings even more pronounced, since farmers in general increase output when prices increase and vice versa.

Table 16
Average Annual Rates of Growth of Major Agricultural Exports

			1993-99				
	Coffee	Cotton	Sisal	Tea	Tobacco	Cashew	**Total[a]**
Volume	-9.5	-12.0	20.1	2.2	13.5	17.1	**4.3**
Unit value	7.2	-1.6	0.0	-1.5	2.7	8.5	**4.1**
Value	-2.2	-13.9	20.8	0.9	16.7	24.8	**4.2**
			1997-99				
Volume	-10.9	-56.3	1.0	-0.5	-13.3	-9.9	**-17.6**
Unit value	-11.2	-20.3	-9.1	-15.5	2.6	17.8	**-7.9**
Value	-22.2	-76.4	-11.0	-13.2	-10.6	4.1	**-22.3**

Source: Calculated from data in IMF (2000), Table 20

[a] Totals for volume and unit value weighted by share of total traditional export receipts

Consequently, even if Tanzania manages to maintain an average rate of growth of traditional exports of six percent per annum, there are few reasons to believe that the large fluctuations that have characterized the recent past should suddenly disappear. If anything, removal of structural barriers in agriculture are likely to increase supply elasticities and thus volatility. This means that even if the average rate of growth is as projected there will be years in which the need for additional inflows of external resources will be necessary to maintain the necessary import capacity. Whether this has been taken into account in the current debt relief strategy is not clear.

3.3.3 Nontraditional exports

As was noted in Table 15, if traditional exports fail to reach the rates of growth assumed in the DSA, nontraditional exports will have to grow fast in order to achieve the desired export-to-GDP ratio. Much hope has been put into the growth of nontraditional exports, particularly mineral (gold). A rapid increase of nontraditional exports would have the additional benefit that the economy would become less dependent on traditional exports. This would probably decrease fluctuations of export earnings.

However, recent history does not provide a bright picture. Table 17 shows – again on the basis of IMF data – the development of principal nontraditional exports for the period 1993 to 1999. First, it should be noted that the sector has grown rapidly over the period – by over nine percent per annum. If this trend continues, it means that traditional exports could grow at a rate below five percent per annum without jeopardizing the objective of an export-to-GDP ratio at 15 percent by 2005.

Table 17

Structure of nontraditional exports, 1993-99 (US$ mn)

	Petroleum	Minerals	Manufactures	Other	**Total**
1993	9	38.8	52.9	50.1	**150.8**
1994	5.5	30	77	70	**182.5**
1995	11	44.9	109.2	134.3	**299.4**
1996	15.8	55.9	127.1	133	**331.8**
1997	7.1	51.1	111.3	147.8	**317.3**
1998	0.1	26.4	35.7	170.1	**232.3**
1999	0.5	71.6	32.3	157.8	**262.2**
Annual growth (%)	-48.2	10.2	-8.2	19.1	**9.2**
Share of nontraditional exports (%)					
1993	5.9	25.7	35.1	33.2	**100.0**
1999	0.2	27.3	12.3	60.2	**100.0**

Source: Calculated from IMF (2000)

Second, dramatic structural changes have taken place. Manufactures that in 1993 accounted for over one-third of all nontraditional exports is down to about 12 percent in 1999, and the (nominal) dollar value of manufactured exports in 1999 is only 60 percent of its 1993 value.

The minerals sector which – according to some commentators – holds enormous potential and which is the sector to which the bulk of foreign direct investment has flown has grown by around 10 percent per annum. However, it deserves to be pointed out that it is still relatively small: in 1999 that sector accounted for about one-quarter of nontraditional exports, that is to say less than two percent of GDP.

Third, and perhaps somewhat surprising, fluctuations in revenue does not appear to be significantly less in the nontraditional than in the traditional export sector. Export of manufactures, for instance, increases from US$ 52.9 mn to US$ 109.2 mn in just two years and then it falls from US$127.1 mn to US$ 35.7 mn in another two years. A similar phenomenon can be noted for the petroleum and minerals sectors.

In conclusion, nontraditional exports have shown an impressive growth record in the 1990s, but the growth rates have differed sharply among sub-sectors. In particular manufacturing shows sign of collapse – having shrunk on average eight percent per annum since 1993. However, minerals perform well. How growth rates of this sector will develop in the future, however, is difficult to say. On the one hand, foreign direct investments continue to pour into the mining industry, which points to continuing high growth rates. On the other hand, growth rates are high, partly because of the small size of the sector. This points to a decline in the rate of growth, as the sector becomes larger.

4. Growth, Inequality and Poverty Alleviation

4.1 Sensitivity Analysis of Debt Sustainability

The sensitivity of the economy to shortfalls in the DSA projections is illustrated in the CP document. In a section entitled "Sensitivity Analysis" the authors perform to "what-if" calculations: one in which the rate of growth of GDP falls short of projections and one in which the flow of grants becomes less than planned. The consequences for debt indicators are shown in Table 18.

Table 18
Sensitivity Analysis of Debt Sustainability

	Baseline scenario		Low growth[a]		Low grants[b]	
	2005/06	2020/21	2005/06	2020/21	2005/06	2020/21
NPV of debt-to exports	132.8	117.4	136.3	176.9	138.4	148.2
Debt service ratio	7.8	6.4	8.7	10.4	8.0	8.5
Debt service-to-revenue ratio	8.8	4.9	10.1	8.5	9.0	6.6
Grant element in total debt	58.7	49.6	59.2	50.9	58.9	49.2
Grant element in new debt	61.0	53.4	60.6	52.9	59.3	48.9

Source: IDA/IMF (2001): Table 17

[a] GDP growth is assumed to average 3.1 percent per annum over the period 2001-2020

[b] Grants are assumed constant in nominal terms at US$ 740 mn over the period 2001-2020

The table shows that the outcome in the DSA, i.e., the attainment of debt sustainability after the conclusion of the HIPC exercise is quite sensitive to the assumptions made. Thus for instance, if GDP growth becomes 3.1 percent per annum instead of the assumed 6 per cent per annum (the low growth scenario) the external debt will not be sustainable in 2020. The reason for this is that Tanzania's financing gap remains so new loans will have to be contracted.[9] If the economy does not grow fast enough, the debt will pile up and the country will fail to reach the sustainability targets. It is not clear how the discrepancy between exports and important in the low growth scenario will be financed; from the last row in the table it appears that the CP document assumes that the larger financing gap (which results from slow exports) will – at least partly be financed by loans; consequently the grant element in the total debt stock will

be smaller than in the baseline scenario.

The second scenario – smaller grants – assumes that grants stay at their 2001 level in nominal terms. This too means that the borrowing requirements of Tanzania increase as compared to the baseline scenario, and so the external debt increases more rapidly than under the baseline scenario. It should be noted however that the baseline assumes that the share of external grants as percent of GDP will decrease over time. Although not explicitly stated in the CP document, it seems likely that the underlying assumption is that all new loans are contracted on IDA-conditions. The second sensitivity analysis – lower grants – thus represents a worst-case scenario.

The authors of the CP document draw two principal conclusions of the sensitivity analysis. First, that it "clearly shows the importance of achieving high and sustained growth through maintenance of macroeconomic stability and continued pursuit of structural reform." (p. 17); and, second, that the analysis "underlines the importance of following prudent debt management policies and avoiding a new build-up in debt." (ibid.) Given the second conclusion, it is not clear why the baseline scenario assumes that grant aid will remain virtually constant in real terms; clearly, an increase in grant aid – particularly program aid – would assist in helping Tanzania to achieve a sustainable debt even if all projections are not met.

4.2 Poverty Alleviation through Growth

The package of strategy papers associated to the HIPC process are focused on poverty alleviation through two distinct, though interrelated, channels: growth which increases the income of the poor and reallocation of government expenditures. The impact of the latter will depend on a host of factors most of which are closely monitored in the annual Public Expenditure Review exercise. Most of those involved appreciate that it is not just a matter of changing the allocations in the budget, but the flow of money from the Treasury to the final beneficiary can be diverted, misappropriated or simply spent badly which decreases the value

of that money for the final user.[10] It should also be noted that while better supply of services from the government are an important component in the fight against poverty, the government cannot eradicate poverty – it can only render it more easy for poor people to increase their income, be it through better access to commodity or labor markets, or by lowering the costs of making economic transactions.

The key to sustainable poverty reduction is of course economic growth. This is what economists traditionally refer to as "trickling down", although in most development textbooks the details of the process remain in a black box. Generally speaking, the poor can potentially benefit from economic growth in three distinct ways. First, growth increases incomes in the economy, so demand for food will increase. To the extent that the poor produce food, their incomes may increase. Second, since growth increases demand in the economy, output, and therefore demand for labor, will increase. Depending on whether the labor market is characterized by labor scarcity or not, the poor may benefit either by expanding employment opportunities or by rising wages. Third, economic growth usually increases tax revenue, so the poor may benefit by higher government expenditures.

The extent to which economic growth reduces poverty in reality depends on a host of factors. As noted by Dollar and Kraay (2000), incomes of the poorest quintile rise on average in tandem with median income. Consequently, if per capita incomes increase by three percent, incomes of the poorest 20 percent of the population also increases – on average – by three percent. This is just another way of stating the (well-known) fact that there is no strict relation between the distribution of income and the level of income.

It is important, however, to qualify the conclusion of Dollar and Kraay. As several authors have noted (cf. Danielson, 2001*a* for a survey), there is enormous variation in the results; in some cases, the poorest quintile increased its income by more than the median; in other, incomes of the poorest quintile actually fell when average incomes increased (Timmer, 1997 contains a useful discussion). One of the more important factors determining the extent to

which the poor benefit from growth is the pattern of growth: if growth takes place in sectors to which the poor have few linkages (such as, for instance, heavy industry), their benefit is likely to be smaller than if growth takes place in, say, small-scale agriculture.

The impact of growth on poverty is nicely summarized by the concept "poverty elasticity". It measures the percentage decrease in the number of people below a poverty line when (median) income increases by one percent. Proper poverty elasticities cannot be calculated without access to at least two data sets (preferably household budget surveys) for which data have been collected using identical methodologies. However, it is possible to construct a benchmark with access to only one such data set. In that case one assumes that the distribution of income remains unchanged (i.e., one *assumes* that the incomes of each quintile increases at the same rate). While this is usually not a realistic assumption, the exercise provides a useful point of departure for the analysis of different growth patterns.

In Table 19 a few simulations are presented. The point of departure is the poverty elasticity from TAKWIMU (2000: Table 50), which is based on calculations from the 1991/92 household budget survey. We assume – with GoT (2000: 14) – that the share of the population falling below the basic needs poverty line is 48 percent in the year 2000; that population growth is 2.8 percent per annum for all income classes, and that the distribution of income remains unchanged. Given these assumptions, a real GDP growth of 6% implies that per capita incomes increase by 3.2% (6% - 2.8%). This in turn means that the share of the population below the poverty line decreases by -0.69*3.2% = 2.2 % per annum. Similar calculations are made for other GDP growth rates to illustrate the sensitivity of the poverty strategy on the assumption concerning GDP growth. The last row of the table indicates the year when the intermediate poverty objective has been achieved, i.e., the year when the share of the population under the poverty line has been halved.

Table 19

Growth and Poverty Alleviation in Mainland Tanzania: Different Scenarios

	8%	6%	4%	2%

2005	35	37	40	43
2010	25	29	33	38
2020	13	18	23	31
Poverty at 24%[a]	*2011*	*2014*	*2020*	*2032*

Source: Poverty elasticity from TAKWIMU (2000). Poverty estimates from GoT (2000).
Note: Population is assumed to growth as 2.8% per annum throughout the period. Income distribution is assumed to be constant. Poverty elasticity is –0.69. The share of the population under the poverty line in 2000 is assumed to be 48%.
[a] Indicates the year when 24 percent of the population falls below the national basic needs poverty line. This represents a halving of the current poverty rate.

This exercise assumes that the distribution of income remains constant, i.e., that when GDP grows at six percent (so per capita incomes increase at 3.2 %), everybody's income grow at this rate. This is clearly an unrealistic assumption, for growth is by its very nature an unequal process that is concentrated to particular sectors or areas, and may eventually spread. In general, if growth is associated to a more even distribution of income, incomes of the poor grow faster than the national average and poverty is reduced faster, and vice versa.

What we have is a set of estimated poverty elasticities based on the 1991/92 HBS that assume that the distribution of income is constant. There are several indications that this is not realistic, so we use the estimated elasticities from the 1990/91 HBS to simulate the rates of growth required to halve the number of people below the national poverty line by 2015 under the assumption of improving, constant and worsening income distribution. The results are in Table 20.

Table 20
Required Annual Real GDP Growth to Halve Poverty by 2015. Three Scenarios

	Food Poverty	Basic Needs Poverty
One percent increase in inequality p.a.	6.2%	7.6%
No change in inequality	4.6%	5.9%
One percent decrease in inequality p.a.	3.5%	4.9%

Source: TAKWIMU (2000), Table 53
Note: Calculations are based on the results from the 1991 Household Budget Survey. Inequality is measured as the Gini coefficient. Population is estimated to grow at 2.8 percent

per annum.

Based on these data and the assumptions that (a) GDP will growth by six percent per annum; and (b) the agricultural sector will grow by 5 percent per annum, the current poverty reduction strategy (GoT, 2000: 14) includes three objectives:

- Reducing the proportion of the population below the basic needs poverty line from 48 percent in 2000 to 42 percent in 2003 (with a long term target of 24 percent by 2010);
- Reducing the proportion of the rural population below the basic needs poverty line from 57 percent in 2000 to 49.5 percent in 2003 (with a long term target of 29 percent in 2010);
- Reducing the proportion of food poor from 27 percent in 2000 to 23.5 percent in 2003 (with a long term target of 14 percent by 2010).

The first PRSP progress report (GoT, 2001) revealed that poverty levels had not changed very much over the 1990s. One possible conclusion for this is the one drawn in the PRSP progress report, viz. that "the significant improvement in economic growth during the second half of the 1990s barely compensated for the poor performance in the first half of the decade." (p. 8).

However, another possible conclusion is that the improving growth recorded from 1995 and onwards has failed to reach the poor, mainly because growth has been principally in sectors to which the poor have few linkages. This suggestion is supported by the fact that formal sector employment appears to have fallen in the 1990s – and poverty is linked to informal sector employment. Data from the Integrated Labour Force Survey and preliminary data from the 2000/01 Household Budget Survey suggest that the proportion of household heads with principal employment in the informal sector (outside agriculture) had increased, between 1991 and 2000, from 30 to 43 percent in Dar es Salaam, from 23 to 29 percent in other urban areas, and from 9 to 14 percent totally in mainland Tanzania (GoT, 2001: Table 1(i)).

In conclusion then the strategy for poverty alleviation under the HIPC initiative contains

many potentially weak links. First, the strategy assumes a rate of GDP growth that has not been attained since the early 1970s. While the rate of growth has increased in the second half of the 1990s – probably due to the improvements in the economic climate that have taken place – the economy is still vulnerable to external shocks, which the "el Niño" event in 1997 vividly illustrates.

Second, although HIPC projections in the CP document have been moderated from the DP document, they are still on the high side. Traditional exports, have grown at a moderate rate, and fallen dramatically in recent years. In addition, if traditional exports fail to grow as fast as projected, non-traditional exports must grow very fast – our sensitivity calculations show that if traditional exports grow at the same rate as they did from 1993 to 1999, nontraditional exports will have to grow in the range of nine percent per annum.

Third, if this fails, GDP growth is likely to be negatively affected. Export growth is a key variable in the HIPC equation, mainly because this will determine the capacity to import investment goods, which are vital for growth. If earnings of foreign exchange fall short of that projected, there are three alternatives: (a) to import less which is likely to affect GDP growth; (b) to borrow more, which leads to a more rapid accumulation of debt and jeopardizes the debt sustainability target; or (c) to rely on aid grants. The third alternative appears to have been written off in the CP document, for unclear reasons.

Fourth, even if average rates of growth meet projections, there is the danger of fluctuations of income. We have seen that both traditional and nontraditional export revenues have fluctuated sharply in the 1990s, and there are few reasons to think that stability will ensue. On the contrary, as structural impediments in agriculture are removed, farmers will become more responsive to price changes and there is a risk of increasing fluctuations. If export proceeds fluctuate over time, so will the capacity to import. To avoid fluctuations in imports (and thereby fluctuations in the rate of economic growth), short-term contingency funding (buffer funds) should be considered. It is unclear to what extent donors are able or willing to provide

such funding, but it is something that should be taken into consideration.

Fifth, even if the actual rate of growth will meet projections, it is not clear that it will be sufficient to meet poverty targets. As we have noted, the poverty impact of growth depends, inter alia, on the pattern of growth. While agriculture appears as a priority sector in the poverty reduction strategy, it appears that focus in budget allocations is more on fighting nonincome poverty through prioritizing social sector expenditure. It remains however to be seen to what extent the fruits of the growth experienced in the past six years or so have actually trickled down to the poorer strata of the population.

4.3 Growth, Inequality and Simulated Growth Patterns

The relations between growth and poverty alleviation discussed above are based on shaky data and assume for the most part that the distribution of income remains constant during growth episodes. This amounts to saying that all sectors in the economy will grow at the same rate – an assumption that is clearly violated in recent history. Here, we make some simulations to illustrate how changes in average income level and inequality interact to affect poverty measures. The data are those used earlier in this chapter, so the results should be seen as illuminating a few particular points rather than being realistic projections of likely growth scenarios.

A change in a poverty measure such as the headcount ratio depends on two factors: the rate of growth of median income and changes in the distribution of income, often captured as changes in the Gini coefficient. It is possible however to decompose a change in the poverty measure into growth and inequality components. This is particularly useful if one wants to see how a changing growth rate in a particular sector affects median income and the distribution of income.

In this section, we rely on the method developed by Ravallion and Datt (1992) to illustrate the impact on poverty and income distribution of varying the rate of growth of agriculture. This is

a relevant exercise for an economy such as Tanzania where agriculture is the dominant sector in terms of employment and poverty, but also a sector with rather slow growth. In addition, the exercise serves to show that it is very difficult to attain the PRSP poverty targets unless the agricultural sector in general, and small-holder agriculture in particular enters a phase of significantly higher growth. The reason for this is that growth in nonagriculture is likely – at least in the absence of rural-urban migration – to increase income inequality, which tends to counteract the impact of growth of poverty.

Table 21
Decomposition of Headcount Poverty, 2000-05, 2005-10, 2010-20

	Annual Rate of Growth of Agriculture in real terms			
	8%	6%	4%	2%
A. 2000-2005 (all data in annual terms)				
Poverty effect	-7.8	-4.6	-2.8	-1.6
Growth effect	-5.9	-4.6	-3.2	-2.7
Inequality	-1.9	0.0	0.4	1.1
B. 2005-2010 (all data in annual terms)				
Poverty effect	-7.6	-4.4	-2.7	-1.5
Growth effect	-5.9	-4.4	-3.3	-2.7
Inequality	-1.7	0.0	0.5	1.2
C. 2010-2020 (all data in annual terms)				
Poverty effect	-7.2	-3.8	-2.5	-1.3
Growth effect	-6.0	-3.8	-3.1	-2.6
Inequality	-1.2	0.0	0.6	1.3

Sources: Own calculations based on 1991/92 HBS data, adjusted to reflect conditions in 2000 (TAKWIMU, 2000), Ravallion and Datt (1990) and Ramdas et al. (2002). SimSip Poverty, available as an Excel program from www.worldbank.org/simsip was used for actual calculations.
Note: The growth effect and inequality add up to the poverty effect. A minus sign indicates a reduction in poverty. The poverty measure used is the headcount ratio. The error term that almost always results from poverty decompositions has been divided equally between growth and inequality. In all cases it is less than ten percent of the poverty effect.

Two separate sets of simulations are presented. In the first, it is assumed that the overall growth rate of the economy is six percent per annum for 2000-10.[11] The poverty impact of varying rates of growth of agriculture is simulated and the poverty impact is decomposed into

inequality and growth components.[12] We further assume that the rate of growth of population is 2.8 percent per annum in all sectors, and that the shares of population in the different sectors remain constant over time. The latter assumption implies that there is no net migration between sectors – an assumption that could be questioned. However, the simulations are for illustrative purposes only, and should not be taken to represent an effort to project what will actually happen. Table 21 gives the results.

The column headed 6% gives the same poverty impact as that in Table 19. The reason is the assumption of an overall rate of growth of 6%: if agriculture grows at that rate, there are no changes in the distribution of income. Consequently, the poverty impact will simply be the rate of growth of median income multiplied by the aggregate poverty elasticity. The two items Growth effect and inequality in any given row will always add up to the total poverty effect. The poverty effect, in turn, will have a negative sign when poverty is decreasing and the number shows the percentage change in *the share of the population* being below the (basic needs) poverty line. It is thus possible in these simulations to have a negative poverty effect while at the same time the number of people below the poverty line increases.

The patterns in the three sub-tables are similar, and we therefore focus on the sub-period 2000-05. When agricultural growth is below 6 percent, inequality increases and the inequality effect thus neutralizes part of the poverty impact that emanates from growth. At the same time, the growth effect becomes smaller the lower the rate of agricultural growth. Both of these effects reduce the rate of poverty reduction.

On the other hand, the column headed 8% illustrates the efficiency of agricultural growth for poverty reduction. Recall that we assume that the overall rate of growth of the economy is 6 percent, so if agriculture grows at 8 percent, nonagriculture grows at an average rate of 4 percent.[13] There are two points to make from this. First, it would seem very difficult to achieve the rapid poverty reduction rates assumed in the PRSP without high and sustained agricultural growth. Second, a government that is committed to reducing poverty has to have

very strong arguments not to focus most of its efforts on agriculture. A reading of the Tanzania PRSP is not very convincing – at least not as far as budget allocations are concerned – regarding the government's determination to raise agricultural growth.

In the next simulation we explicitly recognize the fact that there are huge differences between different sectors within agriculture. In particular, average incomes are significantly lower among those working in subsistence agriculture than among those in e.g., export agriculture. We assume that subsistence agriculture comprises half of the agricultural sector (and thus 25 percent of total output), and we simulate the poverty impact of different rates of growth of subsistence agriculture. Results are in Table 22.

As expected, the results from Table 21 are amplified – the poverty impact is higher the higher the rate of growth in subsistence agriculture, and the distribution of income worsens considerably as soon as the economy's average rate of growth exceeds that of subsistence agriculture. Again, it seems that a sensible strategy for reducing income poverty in the economy should focus very hard on subsistence agriculture, as the poverty impact there – despite a relatively low aggregate poverty elasticity – is significant.

Table 22
Decomposition of Headcount Poverty, 2000-05, 2005-10, 2010-20

	Annual Rate of Growth of Subsistence Agriculture in real terms			
	8%	6%	4%	2%
A. 2000-2005 (all data in annual terms)				
Poverty effect	-10.1	-6.6	-4.1	-2.4
Growth effect	-7.7	-6.6	-4.7	-3.1
Inequality	-2.4	0.0	0.6	0.7
B. 2005-2010 (all data in annual terms)				
Poverty effect	-10.0	-6.5	-4.1	-2.3
Growth effect	-7.5	-6.5	-4.6	-2.9
Inequality	-2.5	0.0	0.5	0.6
C. 2010-2020 (all data in annual terms)				
Poverty effect	-9.4	-5.9	-3.9	-2.1
Growth effect	-7.0	-5.9	-3.2	-2.7
Inequality	-2.4	0.0	0.7	0.6

Sources: See Table 21
Note: The note to Table 21 applies here as well. In addition it is assumed that subsistence agriculture employs half of those active in agriculture. Growth rates include changes in non-monetary GDP (all of which is assumed to be subsistence agriculture).

It deserves to be repeated that these calculations are based on shaky data and bold assumptions. Nevertheless, they serve to illustrate a fundamental fact: if the majority of the poor are located in a certain sector, growth in that sector may have a large impact on poverty, even if the over-all poverty elasticity is low. The reason for this is that the growth effect and the income distribution effect pull in the same direction: if growth of agriculture is higher than the economy's average, the distribution of income will become more even with amplifies the growth effect.

A final word should be said about the assumption that there is no net migration between sectors. The reason for making this assumption is technical: SimSip_Poverty does allow for comparison of two time periods only, and the rate of change of net migration is likely to change as relative incomes sectors change. Full inclusion of migration effects on the sizes of sectors would require a program that could trace those effects on an annual basis. However, there are several reasons why inclusion of migration effects into the simulations would serve to strengthen the results. The reason is that we have theoretical and empirical reasons to believe that the rate of intersectoral migration is partly determined by intersectoral income differences, and that average productivity in the sector experiencing net emigration is likely to fall. Consequently, if the rate of growth of agriculture (or subsistence agriculture) is higher than in the rest of the economy, net emigration from agriculture will fall. This in turn will have two possible effects: productivity in agriculture will not fall as much as it otherwise would have and poverty in the nonagricultural sector will not increase. Consequently by assuming in the simulations that there is no net migration between sectors, the positive impact of agricultural growth on poverty is underestimated.

5. Concluding Remarks

Tanzania has made tremendous progress in improving the economic climate for growth and poverty reduction in the past decade, and in particular since 1995. The phase of stabilization could be regarded as completed a few years ago, and consolidation is well under way. The road seems to be paved for rapid progress with regard to poverty alleviation.

However, there are a number of potential potholes on that road. The first one is the expectations created by having very optimistic projections on the future growth path. The current projections are indeed less optimistic that those of the Decision Point document, but there is still much to be desired. Moreover it is difficult to see, from the official documentation, the rationales for making the assumptions that are being made: recent history provides little guidance, and in the documentation there are vague references to the benefits of a stable macroeconomic framework and faster and deeper reforms.

We identify two areas in which problems may be severe, i.e., two areas in which Tanzania may not be able to meet projections. First are exports. While exports have increased over the 1990s, we find, first, that both traditional and nontraditional exports have been characterized by large fluctuations – something that may increase as structural impediments are eliminated in traditional cash crop agriculture. We also note that traditional exports have performed badly over the past years – mainly an effect of deteriorating prices – and that this puts much pressure on nontraditional exports in order to achieve the targets of the DSA. Since export revenue fluctuates considerably – sometimes with a cycle extending over several years – and since sufficient export earnings are key to the growth strategy (by paying for imports of investment goods), donors should consider the construction of a buffer fund facility to dampen the impact on import capacity of these fluctuations.

The second area is the link between growth and poverty reduction. The full results from the 2000/01 household budget survey are not yet available and to the extent that they differ from

those of the 1991/92 HBS this conclusion will have to be modified accordingly. However, the relation between growth and poverty reduction in Tanzania is rather weak – even in an African context. The poverty elasticity calculated for a constant distribution of income is a mere –0.69 for the mainland, which means that for each percentage point growth in per capita income, the share of the population under the poverty line is reduced by 0.69 percent. This means that poverty reduction is not likely to be fast – not even under the assumptions of the PRSP. In addition the relation is very sensitive to changes in that growth rate. Thus, if grows over the period averages 4 percent rather than 6 percent, the target of halving the share of the population under the basic needs poverty line will not be met in 2014, but in 2020. Taking the impact of growth on the distribution of income into account is likely to prolong this period even more: growth in Tanzania is likely to worsen, not improve, the distribution of income.

What can be done to speed up the rate of poverty reduction? It is difficult to find African examples of sustained growth rates in excess of 6 percent, so the strategy of raising GDP growth to higher levels seems unrealistic. What remains is to increase the impact of growth on poverty, i.e., to increase the absolute value of the poverty elasticity. The best way of accomplishing this is likely to be a focused strategy for improving conditions in small-scale agriculture with regard to finance, water and roads. In theory, the strategy for developing the agricultural smallholder sector is integrated in the poverty reduction strategy, but with a limited resource envelope it is difficult to the optimal allocation of resources between priority sectors. While such an analysis is clearly outside the scope of this report, it is quite clear that sustained reduction of income poverty in Tanzania will be difficult to attain without sustained growth in smallholder agriculture.

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[1] The exact number depends on the pattern of growth and how growth affects income distribution. Chapter 4 provides some suggestive calculations.

[2] In principle, one can either start with a set of macroeconomic assumptions and determine the amount of debt relief necessary to achieve a specific objective at a specific point in time or start with a certain amount of debt relief and – working "backwards" – arrive at the necessary growth rates of macroeconomic variables. The HIPC documents are assumed to use the first method, but in the light of the often overly optimistic projections the possibility that the second method has been used in reality cannot be excluded.

[3] See in particular papers from EURODAD (www.eurodad.org) and Jubilee Plus (www.jubileeplus.org).

[4] However, it should be noted that the recent depreciation of the currency increases import costs.

[5] Among the areas earmarked for immediate review and facilitation are: central and local government taxation, land planning, labour laws, business licensing and registration, import and export procedures and sector specific deregulation plans.

[6] The Web-page www.worldbank.org/simsip will eventually contain a link to the program used for making debt sustainability analyses in the PRSP process, but at the time of writing that link was still inactive.

[7] If P_X is the price of an export commodity and X the volume exported, $P_X X$ is export receipts. Changes in export receipts are then $\Delta(P_X X) = P_X \Delta X + X \Delta P_X + \Delta X \Delta P_X$. The last term on the right-hand side can be ignored if changes are relatively small. The first term on the right-hand side is the change in export volume and the second one the change in price.

[8] The assumption of slower growth in the CP document carries with it an assumption that the average rate of growth of exports will be only 4.2 per cent per annum, compared to 7.2 per cent in the baseline scenario. This means that the capacity to finance imports will be circumscribed accordingly. It is of course possible to interpret this scenario as being one in which exports fall short of projections, and that this in turn limits important and growth. This is however not considered in the CP document.

[9] Thus for instance Reinikka and Svensson (2001) show that approximately 13 percent of the funds allocated to primary education in Uganda's budget actually hit the ground, i.e., reached the schools.

[10] When we assume an agricultural rate of growth of less than six percent, the growth rate of all other sectors are scaled up to arrive at an aggregate rate of six percent.

[11] The particular program for doing these calculations was developed by Ramdas et al. (2002) as part of the World Bank's consultations for the PRSP-preparations. The Excel-program used is available at www.worldbank.org/simsip

[12] We have assumed that the share of agriculture in total output is 50 percent.

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