Tanzania 1999

Obstacles to Private Sector Growth

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Country Economic Report

2000:4

This country economic report onTanzania is part of a series of annual studies, which are undertaken by the departments of economics of three Swedish universities in collaboration with the regional departments of Sida, under an agreement with the Secretariat for Policy and Socio-Economic Analysis. The purpose of these studies is to improve Sida's economic analysis and knowledge of the programme countries for Swedish development cooperation in order to enhance the effectiveness of programme as well as project support.

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ISBN 91-586-8952-4
ISSN 1404-031x

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1 Introduction*

In 1998, Tanzania's GDP grew faster than in many years—over 4 percent—and the trend is expected to be maintained in 1999. While surely welcome, such an increase translates into only minor increases in per capita income (population growth is estimated at 2.8 percent per annum). To be able to successfully fight poverty, Tanzania's economy would need to grow much faster. In fact, the modest objective of reaching a per capita income of the equivalent of one US dollar per day in 2025 would require GDP to grow at an average rate of almost 7 percent per annum for a quarter of a century.

Moreover, there are scattered indications that growth in the 1990s has failed to benefit the poorest groups. While no systematic evidence is available yet, the reason is probably that increases of real per capita incomes in the neighborhood of one percent per annum are not sufficient to generate the boost in demand for labor and agricultural goods that would be necessary for trickle-down effects to materialize. From a policy perspective, the conclusion is rather clear: Tanzania needs to focus on increasing the growth rate; this is likely to be the most viable strategy for improving, in the medium to long term, the situation of the poor.

Since Tanzania embarked on market-oriented economic reforms in 1986, most of the analysis has been focused on removing the remains of the socialist past—unprofitable public monopolies, regulations concerning (internal and external) trade, and heavily restricted factor markets—and to stabilize the macroeconomy, in particular by getting the fiscal balance under control. The strategy behind this reform process was to pave the way for the private sector as an engine of growth—to render it easier to create and operate private firms.

However, the viable private sector, capable of leading rapid growth has not yet emerged. The purpose of this report is to examine in some details the preconditions for rapid growth in the private sector. The analysis is divided into three major chapters. Chapter 2 looks at the macroeconomic environment. Chapter 3 examines the situation in the private sector and identifies remaining obstacles. Chapter 4 discusses the labor market in the context of the

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rural/urban and formal/informal dichotomies so often used in analyses of African economies. Chapter 5, finally, offers some concluding remarks with particular emphasis on the potential role of donors.

2 Major Economic Trends

Tanzania has come a long way towards reforming the economy since 1986 and, in particular, since the move to multi-party democracy and the election of President Mkapa, in 1995. Key macroeconomic balances are steadily improving, structural changes finally seem to be taking off, and solutions to the endemic problems of the size, scope and financing of public activities are moving towards consensus, through agreements (existing or pending) on taxation, privatization and public sector divestments. However, despite the enthusiasm over recent performance, it is necessary to keep in mind the fragility of the current situation. Tanzania is still—at least by official data—one of the poorest countries in the world, with a 1998 GDP per capita of about TSh 140,000, some USD 170. Small-scale agriculture is still the mainstay for the majority of the population and accounts for approximately half of total production (including the substantial subsistence sector). Since this sector is not advanced by way of use of fertilizers or capital, output varies with rainfall and a season with bad weather, such as the 1997 "el Niño" rains, may decrease GDP growth by several percentage points.

This chapter deals with some of the major economic trends in the economy, focusing on recent performance and on remaining problems, rather than accomplishments. We deal first with short-term macro indicators, trying to identify remaining problems. The next section looks at structural change in the economy in the 1990s and the final section deals with agriculture and, in particular, the deteriorating situation in the food sector during the past decade.

2.1 Macro-economic trends

In the mid-term review of the third annual arrangement under the ESAF, the IMF's board of directors made the following statements:[1]

> "Directors commended the authorities for their continued strong macroeconomic policy implementation....Directors regretted the delays in implementing structural reforms. However, they considered that these had been largely caused by technical factors, reflecting the complexities of the privatization process...Directors welcomed recent improvements in budgetary systems. They commended the

[1] News brief 99/43. Available from http://www.imf.org/external/np/sec/nb/1999/NB9943.HTM.

government for the successful implementation of the VAT and the further tax reforms announced in the 1999/2000 budget."

According to the IMF, then, Tanzania is on the right track. Deviations from the agreement are largely explained by external factors, such as adverse weather conditions and technical problems in privatization.

2.1.1 Fiscal Balance

One of the key balances in recent discussions between the GoT and donors is the fiscal balance, and in particular tax revenue collections and downsizing of the size of the public sector to be accomplished both through retrenchments and privatizations. Table 2.1 provides some key data for public revenue and expenditures.[2]

Table 2.1

Central Government Operations. TSh bn. Current Prices

	1995/96	1996/97	1997/98	1998/99	Deviation[a]
	Revenue				
Total	**448.3**	**572.0**	**619.0**	**689**	**-1.4**
Tax revenue	383.7	505.3	566.1	616	**-2.6**
o/w: Taxes on imports	*121.2*	*163.1*	*180.7*	*219*	**-1.1**
	Expenditure				
Total	**422.7**	**585.9**	**758.9**	**819**	**-10.7**
Recurrent	417.3	557.1	543.7	683	**4.5**
o/w: wages	*156.1*	*215.9*	*218.8*	*221*	**-9.9**
o:w: Interest	*59.6*	*113.2*	*95.2*	*94*	**-14.5**
o/w: other charges	*201.6*	*227.9*	*229.7*	*368*	**23.4**
Development	5.4	28.9	215.1	137	**-48.4**
Balance before grants:	**25.6**	**-13.9**	**-139.9**	**-130**	**-40.5**
Grants	31.1	81.4	130.8	170	**-12.3**
	Financing				
Foreign	-42.4	-44.4	81.5	-19	**-139.1**
o/w: project loans	*4.3*	*12.4*	*73.9*	*17*	**-73.1**
o/w: Amortization	*-50.4*	*-61.9*	*-72.4*	*-73*	**10.6**
Domestic	56.2	-41.9	3.7	28	**-368.6**

Source: Bank of Tanzania, *Economic and Operations Report*, July 1999
Note: Fiscal years run from July to June
[a] Percentage deviation of 1998/99 actual value from revised 1998/99 budget estimate

[2] A more detailed analysis of government operations is available in the Letter of Intent submitted for the request of the last trance of the third ESAF. It is available at http://www.imf.org/external/np/loi/1999/071499.HTM. Table 2.1 is constructed to bring out some of the major points made in the text and it is not intended as a comprehensive collection of relevant data.

As noted above, most commentators agree that Tanzania is on the right track, particularly with respect to government finances, but that much remains to be done. Table 2.1 brings out a number of points. First, while revenue collection has steadily improved since 1995/96, it still falls short of targets. Thus in FY 1999, tax revenue is 2 percent less that targeted. This is likely to be a consequence of the 1997 rains and the low agricultural output that ensued. However, in an international perspective, Tanzania's tax collections remain low. The World Bank's *Africa Live* data base suggest that revenue collections above 15 percent of GDP are necessary to finance the government's basic functions and that collections in excess of 20 percent may be considered high. At about 13 percent of GDP, Tanzania's revenue efforts remain among the lowest in the continent; only 10 African countries collects less revenue and among those are countries in distress, such as Sierra Leone, the Democratic Republic of Congo, Sudan and the Central African Republic. The major reason for Tanzania's low collection is widely attributed to rampant tax evasion, corruption in Customs and widespread smuggling. The problem is well known and measures are being taken to correct for it.

Second, while public expenditure has been contained, mainly thanks to the cash budget which was implemented in 1996, it is worrying to note that development expenditures seem to carry the lion's share of the costs for this, particularly in recent years when the scope for easy savings (such as liquidation of loss-makers, or elimination of ghost workers) has been severely limited. Development expenditures account in the 1998/99 budget for about 17 percent of total expenditures, most of which is donor financed. In addition, the cash budget requires the government to collect in the same quarter the money it spends.[3] Consequently, the budget and outcome may differ, depending on collection success. It is a notable feature of Tanzania's latest budgets that adjustments have taken place in the development budget, not the current one: in 1998/99, development expenditures were almost 50 percent less than budgeted (in the revised budget). The pattern is similar in earlier budgets. Given the state of infrastructure in Tanzania (cf. Chapter 3), a larger development budget is urgently needed. However, small development expenditures are not explained solely by the development budget being used as a residual: it is also because project grants often fail to materialize: as noted in the 1998 Public Expenditure Review (PER, 1998: 37), development expenditures in

[3] More precisely, government spending in a given month cannot exceed a third of revenue collection in the previous quarter.

FY 1997 were only two percent of the value in the revised budget, the major reason being the failure of donors to fulfill commitments.

Third, the implementation of the cash budget has raised concern (cf. Danielson, 1997; Danielson and Mjema, 1998) that maintenance of existing capacity may be neglected and that new public investment projects may fail to materialize. The concern was motivated by the allocation of expenditures in the cash budget: approximately 50% to interest payments, 40% to salaries and the remaining 10% to other charges, including counterpart funds, maintenance, and administration. Estimates from the TRA and the BOT suggest that a reasonable level for other charges would be around 20% of total expenditures (assuming total expenditures at a level consistent with revenue collection of 13-14 percent of GDP). The data suggest that the concern has proved unnecessary. In the data for FY 1999, other charges account for about 45 percent of total expenditures. Largely because of lack of time, we have not been able to pin down exactly the components of "other charges", but is seems worthwhile to conduct such an investigation: World Bank staff suggest that it is because the concerns raised in Danielson and Mjema (1998) have been addressed; the ESRF, a major think-tank in Dar es Salaam, suggests that the post is used to circumvent the cash budget constraints (ESRF, 1999: 8).

Table 2.2

Tax Buoyancy (central government revenue) FY92/93-FY97/98

	1993-94	1994-95	1995-96	1996-97	1997-98
Tax revenue	1.59	1.14	1.28	1.11	0.43
Income tax	0.96	1.5	0.72	1.14	0.65
Payroll tax	0.57	2.9	1.5	1.2	0.97
Sales tax	1.69	0.1	1.16	1.42	0.21
Import tax	1.96	2.54	1.19	1.39	0.56

Source: IMF (1999), Table 7

Note: Tax buoyancy is the elasticity of tax revenue with respect to GDP. It is defined as the percentage change in tax revenue between two years divided by the change in GDP over the same period. A value in excess of one indicates that revenue increases faster than GDP. Each periods in the table cover two fiscal years, i.e., 1993-94 means July 1992 – June 1994.

In sum, then, the government has been able to keep expenditures largely within the constrains imposed by revenues. The advantages of this are many, particularly in an economy with a long history of overspending. However, the cash budget, together with prudent monetary policies of the Bank of Tanzania, provides a potential obstacle to faster economic growth; domestic demand is constrained so the only option for expansion is through exports. As we shall argue below, the likely candidate for such an expansion is the agricultural sector but recent performance provides no reason for unqualified optimism. In addition, the focus of the Mkapa administration is to honor debt obligations, giving top priority to interest payments and trying to amortize both domestic and external debt. However, the major concern is whether Tanzania will be able to significantly increase revenue collections in the near future; the declining tax buoyancy estimates do not suggest so (Table 2.2).

2.1.2 Monetary Survey

The most spectacular success of the Mkapa administration has been the rapid decline of inflation—from over 30 percent at the 1995 elections to an annualized rate of less than 8 percent in June 1999. The major reason for this rapid decline is the implementation of the cash budget and the new central bank legislation authorizing the Bank of Tanzania to focus exclusively on monetary stability (Bigsten and Danielson, 1999). Key monetary numbers are in Table 2.3.

Table 2.3

Monetary Survey. TSh bn.

	1995	1996	1997	1998	1999[a]	Growth[b]
Foreign reserves	70.6	78.1	77.1	110.9	107.6	10.5
M0	314.9	335.8	364.9	418.7	387.5	4.6
M1	428.3	449.2	493.9	545.5	509.0	3.8
M2	613.7	685.0	760.3	844.9	830.7	7.1
M3	752.9	818.1	927.1	1027.0	1 034.9	7.5
Foreign assets	165.8	290.3	398.9	458.0	472.3	36.9
Claims: Government	279.2	295.8	239.5	276.6	314.1	2.5
Claims: Private sector	247.8	141.3	183.0	248.3	256.3	0.7
Other claims	60.0	90.6	105.7	44.1	-7.8	-22.6

Source: Bank of Tanzania, *Economic and Operations Report*, June 1999

[a] June

[b] Average annual rate of growth (percent), 1995-99.

Note: M0, or base money, is foreign reserves plus cash in circulation outside banks. M1 is M0 plus demand deposits. M2 is M1 plus time deposits and savings deposits and M3 is M2 plus foreign currency deposits.

The structure of the BoT's assets has changed drastically over the period. In particular, claims on government grows rather slow—in particular, it grows slower than any measure of broad money. In addition, the lion's part of increases in the money supply can be attributed to an accumulation of foreign reserves—on average, these have increased by over 10 percent per annum since Mkapa took office. Consequently, the growth rate of the standard measure of broad money—M3—need not worry those concerned about inflation as long as the structure of that increase is geared towards accumulating foreign reserves.

More worrying, however, is the fact that claims on the private sector have grown at less than one percent per year implying either that the BoT is reluctant to meet credit needs from the private sector or that the private sector does not have any need for credit. Interviews suggest that the demand for credit on the streets is high but that intermediaries—i.e., banks—do not work as theory predicts.[4] Although we shall return to this issue in Chapter 3, it is worth noting here that while the prerequisites for competition in the financial sector have improved considerably since the early 1990s, interest rates are still high, spreads still wide, and the variety of loans on offer limited.

Table 2.4 provides some indicators of conditions in the financial sector and the relation between inflation, interest rates and the real exchange rate. The major points to bring out here is that while fiscal prudence has managed to bring down the rate of growth of the money supply (particularly narrow money) to rates consistent with low inflation, the emphasis on strict monetary policies by the Bank of Tanzania has implied that nominal interest rates are still high. While the discount rate has gone down considerably, lending rates are still between 10 and 25 percent in real terms. In addition, medium-term lending rates should be interpreted carefully: loans extending over one year is available only to a select few and there is, for instance, no institution offering housing mortgages after the collapse of the Tanzania Housing bank (THB), in 1995 (Bigsten and Danielson, 1999). The lack of cheap and readily available finance from the financial sector is potentially a serious obstacle to private sector developments and we return to it in Chapter 3.

The lower half of the table shows inflation, the exchange rate and the real exchange rate. As noted above, the rate of inflation has come down drastically in recent years but remains above that in neighboring countries, notably Kenya and Uganda. To combat the appreciation of the real exchange rate that follows from a relatively high inflation, the BoT has actively managed a gradual depreciation of the currency; however, as seen in the last row of the table, this has not been sufficient: the real exchange rate has appreciated for almost four years, even though recent months have seen a slight real depreciation.

[4] Needless to say, the reason for this is that reality fails to fulfill necessary assumptions made in economic theory.

Table 2.4

Monetary Indicators. Percent per annum unless indicated

	1995	1996	1997	1998	1999[a]
Discount rate	39.9-50	14.9-40.8	10.7-20.5	15.5-20.7	11.8-16.6
Savings rate[b]	13-33	2-33	3.5-13.5	2.5-13.5	2.75-12.25
Lending short[c]	27.7-45	28-46	21-28	15-30	17.5-30
Lending medium[d]	31-40	29-38	21-32	20-32	20-22
Inflation	28.4	21	16.1	12.8	8.2
Exchange rate[e]	595	596	624	665	713
Real exchange rate[f]	100.00	83.13	75.67	73.00	76.50

Source: Bank of Tanzania, *Economic and Operations Report*, June 1999; IFS database

[a] End of June

[b] 3-6 months deposit

[c] Less than one year

[d] Over one year

[e] TSh per US dollar. Period average

[f] Calculated as annual average nominal exchange rate divided by annual average consumer price index. Index, 1995=100. Calculations for 1999 cover January-June. A decrease is an appreciation.

It deserves to be noted, however, that the BoT's monetary policies have a limited impact on the rate of inflation; in Tanzania almost 70 percent of the weight in the basket of goods used to calculate inflation consists of home-grown food the price of which to a large extent is determined by weather conditions. Consequently, to the extent that the real appreciation is perceived as a problem, the proper action would be to accelerate the nominal depreciation of the currency. This, on the other hand, may jeopardize the BoT's inflation target.

2.1.3 External Balance

While Tanzania has make substantial progress with regard to inflation and the fiscal balance, the same cannot be said with regard to the external balance; earnings of foreign exchange are not likely to be able to finance forex expenditures in the foreseeable future. However, the simplified balance of payments (Table 2.5) provides indications that some progress has been made, but it also illustrates the fragility of the situation.

The most important item in the current account is exports and imports of goods, captured in the trade balance. In 1998, the most recent data available, exports covered approximately 43 percent of imports (both measured fob). This is a worsening of the situation compared to 1997 (and years before that) when export receipts covered almost two-thirds of imports. The major reason is the adverse weather conditions experienced in late 1997 and early 1998—first heavy rains and then drought. Consequently, food imports increased significantly, while exports of cash crops dropped. Hence, the heavy dependence on weather, both for the earnings of foreign exchange and for the production of food makes Tanzania extremely vulnerable to events outside the control of political authorities. It is therefore important to realize that while policy progress has been made, the structure of the economy is still biased towards an unsophisticated agricultural sector, so food production and the trade balance is potentially subject to large swings depending on exogenous events. Due to the adverse weather conditions, the trade deficit in 1998 was twice as large as that in 1997.

Table 2.5

Balance of Payments, TSh bn.

	1995	1996	1997	1998
Trade account (net)	-380.4	-247	-243.6	-515.7
Services account (net)	-124.6	-161.8	-187.4	-288.3
Investment income (net)	-63.4	-36.9	-75.6	-75.3
Transfers (net)	194.4	196.3	162.9	259.9
CURRENT ACCOUNT	**-374**	**-249.4**	**-343.7**	**-619.4**
Capital Account	109.7	110.8	102.2	183.1
Financial Account	61.3	11.9	-74.7	34.1
Errors and Omissions	-11.7	-3.2	-71.1	-15.1
OVERALL BALANCE	**-214.7**	**-129.9**	**-387.3**	**-417.3**
	FINANCING			
Foreign Reserves (- inc)	24.3	-113.7	-58.2	-23
LCFAR[a]	5.3	13.5	0	0
Exceptional financing	**185.1**	**230.1**	**445.5**	**440.3**
o/w: Arrears	154.8	181.1	80.2	87
o/w: Rescheduling	0	0	97.7	114.9
o/w: Debt relief	0	0	118.6	98
o/w: BoP support	32.4	56.9	95.7	112.1
o/w: Use of Fund credit	-2.1	-7.9	53.3	28.3

Source: Bank of Tanzania, *Economic and Operations Report*, June 1999

[a] Liabilities Constituting Foreign Authority Reserves

The only item in which there is a net positive inflow on the current account is transfers where, of course, bilateral aid plays an important role, even though private transfers have also been picking up in recent years. However, inflows of grants are far from sufficient to cover deficits on remaining balances; net transfers to government are about a quarter of the current account deficit.

Turning to the remainder of the table the magnitude of foreign direct investments should be noted. While much is currently said about these flows—and they are even pictured as the *deus ex machina* by some commentators—it is important to realize two things. First, flows are comparatively small—less than US$150 million in 1998. Foreign direct investments have certainly grown fast in the past three years or so, but this is mainly because calculations are made with a tiny base (FDI inflows in 1998 are about eight times those in 1992, but in 1992 FDI inflows amounted to a paltry US$ 20 million). However, the accelerated inflows may be an indications of the credibility of current policies. To the extent that this is the case, it is reasonable to expect further accelerations in the future. Second, most FDI inflows are geared to the mining sector. This has two consequences for the external position. First, mining investments are usually import intensive meaning that for every dollar invested in the mining sector, imports may be expected to go up (during the up-start phase) by over 50 cents. Second, mining investments are long-run projects and positive results in the form of higher exports may not be realized until after several years. Consequently, large-scale investments in the mining sector may well lead initially to a deterioration of the current account.

Finally, a comment on the financing of the balance of payment deficit. As noted above, a strategy from the BOT in recent years has been to accumulate reserves which is also evident from Table 2.5. Financing comes essentially from three sources: arrears on outstanding debt, various forms of debt relief, and bi- and multilateral balance of payment support (which is really budget support since the currency has been floating since 1995).[5] In any case, structure of financing the balance of payment deficit indicates that the external debt is a major factor in Tanzania's external relations. We conclude this section with a brief analysis of this.

2.1.4 The Debt Situation

Table 2.6 provides key data for Tanzania's external debt situation. For some years after initiation of the HPIC in 1995, Tanzania was not on the list for potentially eligible countries. However, recent years, and particularly after the revisions of the eligibility criteria than came out of the 1999 G8-meeting in Cologne, the analysis has been revised and eligibility discussions will commence in early 2000. Expectations are that Tanzania will qualify before summer 2000.

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[5] There are several issues involved here which space constraints prevent us from commenting upon. One important one is the extent to which balance of payment support per se has been creating the large deficit

The total outstanding debt is around US$6.5 bn and has remained relatively stable for the past years. However, the structure of the debt has changed significantly; in particular, the multilateral share has increased from 43 percent in 1994/95 to over 50 percent in 1998/99. This, of course, is the consequence of two events: bilateral debt forgiveness in the Paris Club, and the fact that Tanzania, in the 1990s, has chosen not to borrow internationally, except on highly concessionary terms (which essentially means IMF credits under ESAF arrangements and IDA-type loans). In any case, this change in structure implies that the potential impact of HIPC relief will be even greater.

Table 2.7

External Debt Indicators

	1994/95	1995/96	1996/97	1997/98	1998/99[a]
Outstanding debt (USD bn)	6.92	6.5	6.53	6.38	6.58
Structure (% of outstanding debt)					
Bilateral	49.6	46.2	45.0	43.7	42.6
Multilateral	43.6	46.5	47.9	48.4	50.6
Commercial	3.3	3.7	3.5	4.5	3.8
Other private	3.5	3.7	3.5	3.1	3.0
Total debt service (USD mn)	180.1	212.0	218.7	204.6	187.9
Principal	115.6	140.1	122.6	138.0	112.2
Interest	61.7	71.8	95.5	66.4	75.6
Disbursements (USD (mn)	241.2	320.2	341.7	307.9	221.7
Net transfers (USD mn)	61.1	108.2	123.0	103.3	33.8
Debt service ratio[b]	16.5	17.3	17.5	16.2	17.4

Source: Bank of Tanzania, *Economic and Operations Report*, June 1999

[a] Provisional

[b] Debt service as percent of exports of goods and services

Net transfers (i.e., inflow of new loans less debt servicing) are positive which explains why the debt stock has remained relatively stable despite massive debt relief. Given that new loans are concessionary, the average terms of Tanzania's outstanding debt is becoming increasingly generous (and this is also reflected in the fact that the rate of amortization is high; in fact more than half of all debt service is repayment of principal).

Finally, the debt service ratio is relatively stable, and fluctuations are explained more by fluctuations in the value of exports than in the value of interest and principal repayments. The

observed in the table and what adjustment mechanisms that would be triggered in the absence of such support. Danielson and Nilsson (1999) provide a brief analysis of these issues.

actual debt service ratio is currently well below the benchmark conventionally used as an indicator of an unsustainable debt service burden—20 percent of exports.[6]

2.2 Structural change

The principal objective of market-based economic reform programs is to increase the rate at which the economy is able to grow over the long run, preferably without the assistance of exceptional finance. Intermediate objectives—targets—include shifting resources from nontradeables to tradeables and, in particular, from the public, nontradeables-producing sector to the private, tradeables-producing sector. Several theoretical mechanisms underlie this strategy, but the most important would seem to be that economies are supply constrained prior to reforms—growth cannot occur, because supply does not respond. Liberalization, privatization, deregulation and an increased role for market mechanisms are thought to remove the principal bottlenecks for supply. This section looks at Tanzania's performance with respect to three key indicators: income growth; structure of output; and size and structure of exports.

2.2.1 Growth

Compared to the situation in the 1980s, growth in Tanzania has picked up. However, volatility is still high, reflecting the inability to cushion exogenous shocks (mainly terms-of-trade changes and the weather) and the dominance of a traditional agricultural sector. Table 2.8 provides key data.[7]

The major reasons why the rather respectable GDP growth rates in the monetary sector have failed to translate into substantial increases of per capita incomes are two. First, the subsistence sector—basically crops for own-consumption—account for over one quarter of total output and shows no sign of decline. For some years (e.g., 1996 and 1998) non-monetary GDP growth has been substantially below that of monetary GDP, so total GDP growth has to be revised downwards. Second, growth of population is high—the convention is to use a figure of 2.8 percent per annum, although the exact figure is unknown. It is useful to put

[6] This is not the benchmark used in the HIPC analysis. These are in present value terms and take into account not only the debt service ratio, but also the debt stock-to-export ratio and the fiscal impact.

[7] The eternal issue of data quality enters here. The size of the non-monetary sector was estimated in 1990 and later figures are extrapolations based on that data. It should also be noted that there is a substantial informal sector—accounting for somewhere between 30 and 60 percent of total output—which adds to income, but which is not recorded in the national accounts.

things in perspective. In 1998, per capita incomes were TSh 50,200, which roughly translates into US$ 70. The World Banks rule-of-thumb for absolute poverty is a-dollar-a-day (i.e., about TSh 292,000 per annum and capita. Now, the Government of Tanzania has published a development vision that stretches to 2025. If the 1998 growth (which is the highest growth rate recorded for many years) is maintained until 2025,[8] per capita incomes will then be about 70 percent of the one-dollar-a-day benchmark.

Table 2.8

GDP Growth. Percent. Constant 1992 TSh

	1992	1993	1994	1995	1996	1997	1998
Monetary GDP	1.6	-0.6	1.2	3.2	4.6	3.2	4.9
Non-monetary GDP	2.4	3.1	2.0	4.5	3.1	3.6	1.7
Total GDP	1.8	0.4	1.4	3.6	4.2	3.3	4.0
Per capita GDP growth	-1.0	-2.4	-1.4	0.8	1.4	0.5	1.2
GDP per capita ('000 Tsh)	50.4	49.3	48.6	48.9	49.5	49.8	50.2

Sources: Bank of Tanzania; IFS database; World Bank *Africa Live* database

To put things differently: in order for Tanzania to achieve a per capita income corresponding of one dollar a day in 2025, the average annual rate of growth between 2000 and 2025 has to increase to over 6 percent per annum. In addition, this should be regarded as an absolute minimum. For purposes of poverty alleviation, higher rates of growth are likely to be necessary: trickle-down effects work slowly and growth is usually uneven, so the poorest segments of the population are to benefit from growth is seems likely that average growth rates of 8 percent or more are necessary.

The major conclusion from this analysis is that growth has to be an overriding objective of policies. In the short-term, the growth objective should probably take precedence to other objectives, notably distribution and attempts to focus growth on the poor.[9]

2.2.2 Output

Table 2.9 provides data indicating how the structure of the economy has changed since 1992. Changes in the economic structure are relatively marginal (although large changes may have occurred with in sectors; sectors in the table are rather aggregated). Thus, for instance,

[8] Preliminary figures for 1999 suggest a GDP growth of 4.3 percent.

[9] This does not mean that distributional or poverty aspects should be disregarded. As argued below, it is important to find a viable growth strategy for agriculture, both because that is where the majority of the poor eke out a living and because it is the dominant sector in Tanzania's economy.

agricultural output (in the monetary sector) has grown at an annual rate of less than 3 per cent per annum between 1992 and 1998 and has thus barely kept pace with population growth (and we shall return to this below). The fastest growing sectors in the late 1990s—mining, manufacturing, tourism, and construction—occupy relatively small portions of total GDP and consequently this growth is barely visible in the table.

The most significant change is the decline of public services, which is a direct consequence of downsizing and retrenchments in that sector. The public sector in Tanzania has traditionally acted as an absorber of additions to the labor force, so the consistent attempts to dismantling this sector has had severe consequences for the labor market situation, a topic discussed in Chapter 4.

Table 2.9

Structure of Production. Percent of monetary plus non-monetary GDP.

	1992	1995	1998
Agriculture	26.6	28.3	27.4
o/w: crops	18.3	19.8	19.1
o/w: other[a]	8.3	8.5	8.3
Mining	1.1	1.4	2.0
Manufacturing	8.2	7.9	8.4
Power	1.5	1.6	1.7
Construction	4.5	2.9	3.5
Public services	9.2	8.2	7.8
Other[b]	13.9	13.4	13.9
Non-monetary GDP	26.7	27.8	27.0

Sources: Bank of Tanzania; Bigsten and Danielson (1999)

[a] Includes livestock, forestry and hunting, and fishing

[b] Includes trade, transport and financial services

Finally, it deserves to be noted that the data in the table are based on the revised national accounts published in 1997. Major changes were made, both with regard to income levels and the structure of incomes. Thus for instance, the revision estimated agriculture's contribution to GDP (monetary plus nonmonetary) at less than 40 per cent in 1992. Earlier national account estimates put agriculture at over 60 percent of GDP (IMF, 1999: 6). Tanzanian national accounts are still afflicted with serious deficiencies, particularly with regard to the measurement of exports. This has consequences, in turn, for the estimates of savings and consumption. Such revisions are pending.[10]

2.2.3 *Exports*

A major component in Tanzania's reform programs is the revitalization of traditional export sectors and the stimulation of nontraditional exports. The instruments used are liberalization (by, for instance, dismantling export boards) and exchange rate changes. It is questionable to what extent this strategy may be labeled a success (Bigsten and Danielson, 1999), but it does not seem that Tanzania has done considerably worse than comparable countries. Table 2.10 provides data for the major export commodities in terms of volume and unit price.

Table 2.10

Principal Exports. Volumes and Unit Prices

		1992	1995	1997
Coffee	Volume[a]	50.7	48.0	46.6
	Unit Price[b]	1.2	3.0	2.5
Cotton	Volume[a]	72.8	70.9	77.3
	Unit Price[b]	1.3	1.7	1.5
Sisal	Volume[a]	4.1	11.3	13.7
	Unit Price[b]	0.3	0.6	0.6
Tea	Volume[a]	20.4	21.6	20.4
	Unit Price[b]	1.1	1.1	1.5
Tobacco	Volume[a]	12.7	17.1	6.2
	Unit Price[b]	2.1	1.6	2.1
Cashew	Volume[a]	29.3	75.6	100.8
	Unit Price[b]	0.8	0.9	0.7
Minerals[c]		40.8	44.9	92.8
Petroleum[c]		10.6	11.0	12.4
Manufactures[c]		64.2	109.2	172.0

Sources: IMF (1997); FAOSTAT database
[a] Thousands of metric tons
[b] US$ per kilogram
[c] Total export value in US$ mn

Commodities that have traditionally provided the backbone of Tanzania's exports, such as coffee, are slowly declining over an extended period of time. Although replanting projects are ongoing, it is likely that any positive effects of this will not come about until after about 4-5

[10] Danielson (1996: 8-12) provides a discussion of these issues and attempts rough estimates of correct values.

years after planting. Also, output of cotton remains high, although complaints of low quality prevent Tanzanian farmers from gain from the general increase in world market prices. Among cash crops, cashew nuts seem, possibly together with tea, to provide a glimpse of light. Output of latter increased in the aftermath of the 1997 el Niño rains and output from the former has increased consistently for some time.

As for nontraditional exports, the dominating are minerals and manufactured goods. Both sectors show sharp increases and particularly the former is expected to grow fast as foreign investments in the minerals sector mature.

It deserves also to be mentioned that the response to liberalization seems less than spectacular. FAOSTAT data (not shown here) fail to reveal any correlation between prices received by producers (in constant TSh) and volumes of output.[11] The conclusion from this is not necessarily that farmers are unresponsive to price incentives, but rather that Tanzania's export agriculture is distressed by numerous bottlenecks which prevent farmers to fully respond to improved price incentives. A policy conclusion, then, is that price liberalization is not enough to revitalize export agriculture in Tanzania.

2.3 Agricultural Output

As noted above, agriculture is the mainstay in Tanzania, in terms of employment as well as production, incomes and export revenues. Consequently, developments in agriculture to a large extent determine developments in the economy as a whole; it is probably no exaggeration to state that agricultural growth is a necessary precondition to over-all economic growth. This section looks into some major trends in agriculture, focussing on the longer term. In particular, we are interested in the behavior of production (total and per capita) and exports. It goes without saying that data for agriculture in Tanzania are marred by wide margins of error; however, by looking at longer trends, it is possible to avoid some of these problems. In addition, while the data in this section come from the FAOs database FAOSTAT, the major trends identified can also be found in data from the BoT and the TAKWIMU.

[11] Even though a fully fledged econometric model estimating supply response may produce results more in line with expectations, it deserves to be noted that even though producer prices for some goods (e.g. coffee or cotton) have increased substantially since 1990, there is a strongly negative correlation between that price and volume of output in the period 1964-1998 (using FAO data).

Tables 2.11 and 2.12 provide data on production and production per capita for major aggregates. Note that these include formal sector as well as non-monetary production. The general trends for agricultural production is slight growth over the entire period. There are, however, exceptions, the most notable being food and cereals. The recorded production of these commodities has fallen slightly particularly in the late 1990s.

A more worrying picture is painted in Table 2.12, which shows per capita output of major aggregates in the agricultural sector. Production indices for all aggregates show a decline over extended periods of time, and for some aggregates, the declines are substantial. Thus for instance, the per capita output of food in 1995-98 is about 20 percent below that in 1980-85 (which, admittedly, is an all-time high) and per capita output of crops has fallen by almost 25 percent since the early 1970s.

Table 2.11

Agricultural Production. Annual Averages. Index, 1980-85 = 100.

	1961-69	1970-79	1980-85	1986-90	1991-94	1995-98
Agriculture, total	59.9	79.9	100.0	113.9	115.9	100.5
Cereals,	36.3	66.2	100.0	132.2	120.2	101.1
Crops	58.5	79.8	100.0	111.4	108.4	95.7
Food	55.9	76.7	100.0	113.7	114.7	99.8
Livestocks	62.9	80.0	100.0	121.3	138.7	113.0
Non Food	112.2	122.2	100.0	116.2	130.1	108.4

Source: FAOSTAT

Table 2.12

Agricultural Production per capita. Index, 180-85 = 100.

	1961-69	1970-79	1980-85	1986-90	1991-94	1995-98
Agriculture, total	103.6	102.2	100.0	97.5	85.6	82.3
Cereals	63.3	82.7	100.0	113.2	88.8	82.8
Crops	101.1	102.0	100.0	95.4	80.1	78.4
Food	96.8	97.8	100.0	97.3	84.8	81.8
Livestocks	108.7	102.6	100.0	103.7	102.3	92.6
Non Food	192.1	157.8	100.0	99.1	95.7	88.9

Source: FAOSTAT

It is difficult to escape the conclusion that these figures suggest that Tanzania's agricultural sector face major problems, problems that have to be solved before the country will be able to embark on a sustained growth path which will benefit the majority of the population. As we shall note in the next chapter, declining per capita output in the agricultural sector is a problem per se—because increasing food imports put pressure on an already strained balance of payments—but, more importantly, the data in Table 2.12 suggest low and falling productivity in the agricultural sector. This, in turn, acts as a push factor for people entering the labor force and thus adds to rural-urban migration streams. Since the public sector no longer acts as an absorber of additions to the labor force, the likely result is an expansion of urban informal sectors, at an accelerating pace.

The situation resembles part of the dual economy model as suggested by classical economists, notably Ricardo, and formalized by Lewis (1954) with the important exception that in Tanzania there does not appear to be any non-agricultural sector which is able to absorb migrating labor, which therefore ends up in petty trade with low productivity and low incomes. Two major challenges for policy-makers, therefore, are, first, to create an environment in which non-agricultural activities are able to expand in order to absorb migrating labor and, second, to provide the groundwork on which a sustained increase in agricultural productivity can be founded. This is the only way in which the trends depicted in Table 2.12 can be reversed (because the rate of growth of population cannot be substantially altered in the short run). This, in turn, is probably necessary for take-off in Tanzania.

2.4 Concluding Remarks

The major conclusions that emerged from the preceding analysis are these:

- Macroeconomic key data indicate substantial improvements over the past few years. The economy has reached stability, at least if one looks at inflation, or the fiscal balance.

- Macroeconomic problems remain, particular in the financial sector. Real interest rates are still high, and activity among formal sector financing institutions remains low, particularly with respect to longer term lending.

- The external position remains unsustainable. While debt-servicing accounts for a major chunk of foreign exchange, the net resource inflow is positive and external balance problems will not disappear even if full debt relief was granted. The major problem here is that exports have not responded swiftly to price incentives, suggesting the existence of major bottlenecks in the agricultural sector from where most exports emanate.

- Changes in the production structure are surprisingly small, given that Tanzania has been on structural adjustment programs continuously since 1986. Agricultural still is the most important sector in terms of employment, output and exports. Other sectors—in particular mining and manufacturing—have showed rapid growth in recent years, but the base is still narrow, so the impact on total output is not significant.

- Severe long-term problems appear in the agricultural sector; these are manifested by falling per capita output—per capita food output in 1998 is about 25 percent below the value recorded in 1986. This suggests low productivity, which in turn puts increasing pressure on nonagricultural sectors to absorb increasing shares of the labor force.

- The major challenge to policy-makers seems to be to find ways of (i) increasing agricultural productivity, (ii) identifying nonagricultural sectors with a substantial growth potential and (iii) creating an environment in which growth in these sectors become possible and sustainable.

3 Problems and Prospects in the Private Sector

As noted in Chapter 2, the major objective of Tanzania's reform programs is to enter a path of sustainable growth. As the reforms are market-oriented, the private sector is thought of as being the engine of that growth. Such an approach is not unproblematic and several important questions are discussed in this chapter. First, the place of private sector in Tanzania's development strategy is discussed. We thereafter try to identify a number of sectors with the potential of acting as leaders (both in Tanzania and in the East African Cooperation (EAC) arrangement, which is now quickly moving forward). The bulk of the chapter deals with potential obstacles to private sector growth, both such identified by a recent study by the PriceWaterhouse-Coopers (PWC, 1999), and such identified by interviewees or emerging in the literature.

3.1 The Need for Private Sector Expansion

At least since the Arusha Declaration, the development strategy in Tanzania has been one in which the state has played a prominent role. The commanding heights of the economy—in agriculture, industry and infrastructure—was increasingly taken over by the public sector and private sector operations—barring small-scale trading activities—was actively and explicitly discouraged. The Basic Industrialization Strategy, the *ujamaa,* and later villagization, program, and the doctrine of self-reliance, largely the brainchildren of Nyerere were all geared at the active planning, participation, and later on dominance by the state in economic life.[12]

The commencement of reforms in 1986 changed all that. Intended policy changes included a dismantling of the state and a sharpened focus on core activities, such as administration, preventive health and primary education; wide-ranging privatization of parastatals and a gradual liberalization of goods and factor markets. While success of the reform program as a whole may be best described as limited (Bigsten and Danielson, 1999), the role of the public sector—in terms of employment and output—has undoubtedly diminished radically in the past 15 years.

[12] Useful discussions of the period leading up to reforms are contained in Kahama et al. (1986) and Raikes and Gibbon (1996).

The implicit assumption behind market-oriented reforms was that the public sector should be replaced by a private sector. Consequently, reforms focused not only on a reduction and rationalization of state activities *per se* but also on building the foundations for private sector growth. Such measures have included liberalization of the formal financial sector in order to improve the access to finance; trade liberalization to improve competition in the goods market; dismantling of marketing boards to expose potential exporters to world market prices; and streamlining of the investment code (to facilitate both local and foreign investments).

While a formal private sector so far has failed to emerge—or at least grow at the rate expected—the necessity of private sector expansion cannot be overestimated. Prior to reforms, the public sector acted as a sponge, which absorbed a large part of the annual additions to the labor force. Reforms have implied not only that this function of the public sector has ceased, but that a substantial portion of the public labor force has been retrenched. To this should be added the accelerating rural-urban migration triggered by low—and probably falling—productivity in the agricultural sector. Consequently, reforms have removed the public sector as the main sponge in which additional labor is absorbed, but failed to stimulate the rapid growth of an alternative. The result is probably—although data do not exist—a rapid expansion of urban informal sector activities.

Consequently, Tanzania's situation resembles somewhat that pictured in standard dual economy models (Lewis, 1954). Low productivity in the agricultural ("traditional") sector trigger migration to urban centers. Unless the formal urban sector absorbs that labor, the consequence will be an increase in the urban informal sector—a sector that is characterized by little legislation and low productivity.

We shall deal later on with the potential bottlenecks that prevent the private sector from taking off. However, it is useful first to consider briefly which sectors of the economy that may have the potential for leading the private sector onto a rapid growth path.

3.2 Potential Growth Sectors

The lack of reliable data and the existence of a large—and imperfectly documented—informal sector mar any analysis of the private sector in Tanzania and its potential. Casual observation suggests that informal activities are concentrated in three areas: agriculture, small-scale mining, and trading activities. There does also seem to exist a substantial gray area in the sectors for construction, financial services and transportation. Most of informal businesses are relatively small—in terms of both employment and output—mainly to avoid exposure and attention from e.g. tax authorities. As noted above, the size of the informal sector is not known—estimates range from 30 percent to 60 percent of GDP—and it is difficult to know how this sector has changed over time. On the one hand, the process of gradual liberalization suggests that informal activities become absorbed in the formal sector. On the other hand, outward migration from agriculture together with public sector retrenchment and increasingly strict tax collection benchmarks suggest that the informal sector may well have increased in size—absolutely as well as relative to the formal sector.

The informal sector aside, analysis of the data suggest four major sectors with a potential for rapid growth. First is the *mining sector*, which has grown at spectacular rates in recent years, thanks mainly to an accelerating inflow of foreign direct investments.[13] In current TSh, FDI in 1998 was over 30 times the inflow in 1992. In absolute numbers, inflows are still modest—less than US$ 150 million in 1998—and this accounts for the spectacular growth rates. While estimates suggest that Tanzania is very rich in minerals, the sector is rather small and accounts for about 2 percent of GDP (BOT, 1999). While current figures are not known, the sector's contribution to employment is probably even less. While mining is likely to continue to grow in the near future, its potential as an absorber of labor is limited. Large-scale mining (which is to where FDI is directed) requires little labor. Moreover, investments in that sector are long term and rely heavily on imported inputs. Consequently, the benefits, in terms of increasing contributions to GDP and export proceeds, may not be realized for some time. The most important long-term contribution of the mining sector is likely to be the huge investments in infrastructure that are required and that currently are to a large extent financed by investors themselves. Mineral resources are mainly found in the hinterland with poor infrastructure; to the extent that mining companies facilitate the road-net and the access to electricity and water, agriculture may benefit as well.

Second is the *manufacturing sector*. It has grown rapidly in the past years, between six and eight percent per annum and accounted in 1998 for slightly above eight percent of GDP. Expansionary sub-sectors include biscuits and pasta, wheat flour, paint and some beverages.

[13] Major subsectors include gemstone and gold. Official recoveries of these have more than quadrupled in the 1990s.

Textiles are recovering after the collapse in the mid 1980s, while other products such as sisal ropes, fishnets, iron sheets and aluminum are on long-run downward trends. An expansion of this sector could have an impact on employment and also be linked more closely to agriculture through food-processing industries. In addition, a large part of Tanzania's imports from neighboring countries—particularly Kenya—are light manufactures. With adequate policies for quality control and maintained stability in the foreign exchange market, there is likely to be an export potential. However, as we shall see below, major problems afflict this sector, preventing it from growing fast, including incentives for entrepreneurs to stick to the informal sector, lack of formal sector finance, and lack of skilled and adequately experienced labor.

Third is *tourism*. The sector too has grown rapidly in the past years, partly as a consequence of tourists' fears for social unrest and crime in Kenya. While the potential for Tanzania to attract large masses of tourists is there, a number of obstacles remain. First, Tanzania has embarked on a strategy of "low-quantity, high quality" tourism in order to earn foreign exchange without jeopardizing environmental values. Second, infrastructure is badly developed and massive investments are needed, both to rehabilitate the Northern Circuit and to development the largely unexploited Southern Circuit—focusing inter alia on Ruaha and the Selous. In fact, official data on tourism seem questionable: in 1999 the number of visitors are expected to be over 530,000 with an average spending of about US$1,200 (BOT, 1999: 14). This represents an increase in the number of visitors by over 10 percent from 1998. Yet, information from hotels regarding capacity and occupancy rates suggest that Tanzania had about 220,000 visitors in 1998, a little less than half of the official figure (ESRF, 1999: 5). At the contrary, hoteliers in the Northern circuit—which account for approximately 80 percent of Tanzania's tourism earnings—complain that they have been affected by the drastic drops in charters from Europe to Mombasa—down from 27 in 1998 to only 5 in 1999. In any case the tourism sector has a large potential, provided that the necessary infrastructure can be financed. Moreover, the service sector in general is likely to be rather labor intensive, so rapid growth in that sector may ease the pressure on urban informal sectors significantly.

The final sector with a potential for rapid expansion is *agriculture*. In fact, it is difficult to envisage a growth strategy for Tanzania's private sector that does not involve agriculture, both because it is so important in GDP and employment and because better conditions in the agricultural sector may diminish the outflow of labor. Agriculture also accounts for employment for the bulk of the population and about two-thirds of export proceeds. In addition, the dependence of the economy on the production of agriculture was clearly demonstrated in 1998 when "el Niño"-related weather caused export proceeds to drop by over 7 percentage points of GDP and imports to increase substantially. However, large parts of agriculture are traditional—the hoe being the primary capital input—and productivity is low. Consequently, a take-off in traditional agriculture would require very large capital investments. The alternative is, of course, non-traditional exports, such as horticultural products, processed fruits, or products from aquaculture. However, although such sectors have a potential for rapid growth, it is not likely that they will be able to replace traditional agriculture, neither in terms of income generation, not in terms of employment.

3.3 Growth Constraints

There are several reasons why the private sector has failed to assume a leading role in Tanzania's development. Some of these are examined here. However, since we draw extensively on the recent and excellent PWC study (PWC, 1999), our summary is brief. It is useful to follow the approach developed in the *Investor's Roadmap* (USAID, 1995) and to account for problems under three different headings: setting up a business; financing production; and cost of production. We do not, however, deal explicitly with trade barriers, mainly because one of the problems associated to high costs of trade—poor infrastructure—is discussed elsewhere, and because a full study of import restrictions in Tanzania's trading partners is outside the scope of this report.

3.3.1 Cost of Setting Up a Business

Interviews suggest that the problems relating to initiating a business are more severe for foreign than for local investors and also more severe for investors new to Tanzania than for investors familiar with the bureaucratic environment. The major obstacles here are red tape and lack of coordinated facilities. Problems are numerous and time-consuming: some investors estimate that the time from filing the first application to reception of necessary documents may run into several months, costing up to 15% of initial investment outlays. Problems are partly because of the many Tanzanian institutions involved in the typical investment application process—PWC (1999: Appendix 2) lists the various institutions and the approximate time taken to be granted a permit. That many governmental or paragovernmental institutions have to give their say to an application is nothing unique to Tanzania; it is the standard process in many countries. However, what makes the Tanzanian experience cumbersome is the lack of a facilitating agency in the country—a one-stop center that can assist potential investors with paperwork and contacts.[14] While the 1997 Investment Act set out to create a one-stop center out of the Tanzania Investment Center (TIC), investors do not seem content: rumors have been circulating that corruption has not been abandoned and one interviewee sarcastically remarked that the TIC certainly has become a one-*stop* center.

A number of these problems can be addressed without excessive costs. Thus for instance, part of the problem with the TIC is infant maladies: the TIC has been operational for less than two years and most probably will regular revisions of the *Investor's Roadmap* (and similar surveys) help the TIC to improve operations. Also the problem for foreign investors of having local contacts that may facilitate investment may be addressed through staff at diplomatic missions. Moreover, as electronic communications spreads the problem of lack of relevant forms in English can be solved easily.

The major problem relating to starting up a business, however, would seem to be one of attitude. An noted above, the pre-1986 system actively discouraged private business and that mentality remains in part of the government administration and it seems particularly vital with respect to foreign investors. Since the proof of the pudding is in the eating, it is likely that this attitude eventually withers away, if inflow of foreign capital will have demonstrably beneficial effects on the economy.

3.3.2 Financing

Although it is not completely clear how much finance that is available for the local investor from the informal sector, the formal financial sector still has a number of problems that render it more difficult for entrepreneurs to raise funds for investment and operation.

The financial sector has improved considerably since 1986 and in particular since the new Banking Act in 1993 and the associated liberalization of interest rates and lending legislation. Banks were then allowed to set interest rates without regard to Central Bank policy, and

[14] This may be even more important in Tanzania than in some other countries since some ministries reportedly have forms in Kiswahili only.

devise their own system for determining borrowers' eligibility (within the frame of banking prudence). The number of banks have increased rapidly and is in late 1999 over 20 in operation, despite a number of back crashes in recent years; the total number of financial institutions has increased from 4 in 1990 to 43 in 1998.

However, an analysis of the relevant banking data (from the BoT and the *Financial Times*, Dar es Salaam) reveals the following noticeable features of Tanzania's banking system:

(a) Although many bank quote lending rates for medium and long-term loans, in practice no such loans exist apart from to a select few. Lending is limited to short-term credit, appropriate for financing a running business or as trade credits. In fact, following the collapse of the Tanzania Housing Bank in 1995, there is no institution providing housing mortgages.

(b) The discrepancy between savings and lending rates is still very large. Table 2.4 showed that while this discrepancy has narrowed somewhat, lending rates (for short credit) are still approximately 15 percentage points above savings rates. A similar discrepancy exists between the discount rate and lending rates. Consequently, credit volumes are modest and the major reason for this is likely to be that it is difficult and costly for banks to assess risks of projects and reliability of prospective borrowers (full collateral is required for all credits). Table 3.1 sets out some pertinent facts about the private banking sector.

Table 3.1

Commercial Bank Lending (bn Tsh unless indicated)

	1995	1996	1997	1998	1999[a]
Domestic Lending	270.3	147.3	184.8	251.1	282.6
Foreign loans	0.5	0.8	0.3	0.7	0.6
Structure (% of domestic lending)					
Overdraft	75.2	78.1	93.3	78.6	69.5
Commercial bills	4.4	5.6	2.7	2.7	0.4
Other loans	20.3	16.4	4.0	18.7	30.1
Reserve ratio (%)	18	12	10	10	10

Source: Bank of Tanzania, *Economic and Operations Report*, June 1999
[a] End of June

The table reveals several interesting features. First, credit volumes have increased since 1996. Since 1996 is also the year in which the cash budget came into operation, and thus the borrowing requirements of the government diminished radically,[15] the last few years have seen a significant shift in the structure of credit in favor of the private sector.

Second, however, the overwhelming majority of this credit—about 70 percent in 1999, but close to 80 percent in recent years—is overdrafts. Only 30 percent is "regular" credit. This is about 2 percent of monetary GDP and substantially lower than in most other sub-Saharan African countries.

Third, there is no apparent relation between the reserve ratio requirement imposed by the Bank of Tanzania and lending volumes. This suggests that the reserve ratio is not binding: banks prefer to keep more than required in (interest-free) accounts at the Central Bank. If anything, this is an indication of the uncertainty surrounding financial market activities in Tanzania.

Moreover, although this cannot be extracted from Table 3.1, the lending-to-deposit ratio has fallen from about 1.6 in 1989 to about 0.2 in 1997. Although a slight upward trend is discernible between 1997 and 1998, the latest available data suggest that only approximately 40 percent of all deposits are re-lended.

In sum, firms face grave problems when they attempt to raise investment finance from the formal financial market. Lending is subdued and concentrated to the major cities; small-scale borrowers are discriminated; full collateral is required and credit is expensive. In addition, it is virtually impossible to raise finance for longer-term projects, meaning that local entrepreneurs without foreign backing are limited to either engaging themselves in trade—which does not require much long-term capital—or resorting to the informal sector. It its difficult to overstate the importance of a better functioning formal financial sector as a prerequisite to private sector growth in Tanzania.

Consequently, there are two major, and interrelated, problems in Tanzania's financial sectors that will need to be addressed immediately. The first is the bias against small-scale borrowers; the second, the inability to assess and price the risk of potential projects. It seems seasonable to believe that the second problems dominates the first, i.e., if the second problems is

[15] The increased share of credit allocated to the private sector is also a result of privatization of loss-making parastatals.

satisfactorily solved, the first will also be solved. One possibility is the introduction of credit-guarantee schemes; another is the development of a centralized institutions that is able to assess risk. While the second solution would seem more in line with the market-focused strategy in Tanzania, it is important to realize that it would probably have to involve government agencies as well. While World Bank sources suggest that the development of such institutions is being considered, their realization lie some time in the future.

3.3.3 Cost of Production

While Tanzania can be regarded as a low-wage economy,[16] cost of production is nevertheless relatively high, compared to other countries in the region. This has to do with four factors: taxes, the productivity of labor, the trade regime, and the state and cost of infrastructure. We deal with these in turn.

The major problem with *Tanzanian taxes*, according to interviewees, is not the rates per se, but rather the plethora of taxes and the fact that sometimes Customs' instructions are in conflict with those of the TRA. As noted in Chapter 2, tax revenue as a share of GDP is low in a sub-Saharan African context and since tax rates are not significantly lower than in other countries, the implication is that tax evasion is more prominent in Tanzania.[17] Taxes on labor income can serve as an example. Here, employers are required to pay several different taxes, all of which are related to the size of the salary—PAYE, housing allowance, contribution to pension funds, and contributions to vocational training. Apart from the costs of administrating these taxes, it is sometimes difficult for employers to see through the system: it is difficult to estimate how, say, a promotion, will affect the cost of labor. This tends to diminish employers' willingness to hire labor.

An additional, and related problem is that of *labor productivity*. As reforms have cut public expenditures, quality of education has gone down. Consequently, labor with formal qualification is not always able to fulfill its tasks properly mainly because of inappropriate training: "You can find a lot of welders in the market. If you need to construct bars for the

[16] It deserves to be noted that the relatively low wages in Tanzania are mainly because of low productivity in the agricultural sector. A consequence of improvement in that sector is thus that non-agricultural wages are bound to increase. Consequently, to make sure that an agricultural development strategy is not self-defeating, it is important to facilitate improved productivity in the nonagricultural sector as well.

[17] In contrast to Uganda, which also displays a low collection ration. Here, however, tax rates are generally low and this accounts for low collection.

windows, their qualifications will be fine. But if you need them to weld a pipe which will be subjected to pressure, you cannot find welders with the required skills, even if their papers say that they can do it."

The problem of inadequate training is magnified by the lack of opportunities to receive continuous on-the-job training. As the public sector has retrenched large segments of the non-agricultural labor force, most of these have ended up in the informal sector where most jobs are not requiring high skills. Consequently the large (and probably growing) unemployment accelerates the human capital depreciation and makes it even more difficult for the private sector to provide competitively priced goods, particularly to other countries.

The third problem is related to how *imports* are treated. There are two aspects. The first is that imports are surrounded by a cumbersome bureaucracy, insufficient cargo capacity at the major ports, lack of harmonization for valuation of goods and widespread corruption. The second problem is the level of import taxes. As for the first problem, PWC (1999: 80-2), calculates the average import costs of 6,000 tons of steel and finds that the total costs approximates US$1,400 distributed over four weeks. The major part of the cost is associated to taxes and duties, but the cost related to storage is also significant since red tape and inadequate handling capacity at the port creates delays. Furthermore, "[t]he whole process can take between one and two weeks and involves more than 20 steps and eight organizations. Delays of up to three months are not unusual and this creates and incentive for importers/exporters to offer bribes in order to speed up the system" (PWC, 1999: 81).

As for the level of protection, Tanzania still collects approximately one-third of total revenue from trade taxes. As with the tax system in general, trade taxes are numerous and time-consuming. Forms for declaration are sometimes not available and Customs do not accept faxed documentation. In addition, Customs' may carry out revaluation of goods (despite pre-shipment inspection, PSI, on all cargo valued at more than US$5,000), leading to higher tax payments. Finally, an element of uncertainty is added as the tax rules by which Customs' operate are not consistent with those used by the TRA; for instance, the two organizations use different definitions of capital goods (which are exempted from import duty under the investment incentive scheme).

The final problem relating to the cost of production in Tanzania is *infrastructure*; the low quality of roads as well as the high price of utilities—water, telecommunications and electricity—in comparison to other sub-Saharan countries. In addition, these services are often of poor quality, with frequent power breaks, sometimes shortage of water, and non-functioning telephone lines. In particular, power tariffs are a subject raised by interviewees. These are not only seven times the tariffs in South Africa and almost 50 percent above Kenyan tariffs, but they are also—contrary to standard in most countries—increasing with consumption. The major reason for this is likely to be that the TANESCO—the yet-to-be-privatized power company—is both inefficient and severely indebted; to make the company more attractive for private investors some of these debts have to be cleared.

Infrastructural problems are serious in Dar es Salaam, but much worse in the rest of the country. Thus, while the median delay for electricity service in the commercial capital is a months, it is a year in remote Mbeya and about six months in Arusha. Similarly, the median delay for telephone services—which is negligible in Dar es Salaam, possibly due to increased competition—is almost 4 months in Iringa and a staggering seven months in Arusha (PWC, 1999: 88). To round off, the problems of transport are severe—roads are in bad shape and often only useable during the dry season; the railway system does not work well, and many areas—with significant potential for agricultural production, mining activities, and high-quality tourism—are simply not connected to the road network. In the Selous game reserve, for instance—Africa's largest and almost the size of Ireland—there is only one airstrip, designed for small planes and useable in the dry seasons.

3.4 Regional Cooperation in the EAC

The study by Musonda et al. (1997) argued that the increased drive in regional cooperation as manifested in the revival of the East African integration arrangement (EAC, the East African Cooperation) may stimulate growth in the region, but also that a number of killer factors have to be taken into account. Moreover, while regional integration arrangements usually benefit the region as a whole, there are often severe distributional implications, which may leave some parts of the region worse off as a consequence of liberalization and harmonization between politically independent states. In particular, rapid liberalization of the flows of resources between Kenya and Tanzania can lead to "causally cumulative circles" (Myrdal, 1957) whereby initially dominant countries in the regional arrangement gain at the expense of initially disadvantaged ones.

In the case of the East African Cooperation, this possibility is a real one. Thus, for instance, while the natural scenery and wildlife along Tanzania's Northern circuit is often perceived as more attractive to tourists than southern Kenya, the infrastructure in the latter is much better than in the former. As a consequence, many tourists have for a long time chosen to stay in Kenya and spend only a couple of days in Ngorogoro, the Serengeti and Lake Manyara. From the Tanzanian point of view this has been seen as an unfair division of tourism proceeds and, accordingly, Tanzania has closed the border between Kenya and the Serengeti. Moreover, trade between Tanzania and Kenya is highly unbalanced with Tanzania importing approximately 20 times as much from Kenya as she exports.

It is important to understand that economic theory offers few ideas how to solve these matters. Integration is in theory usually a good thing, because allocative efficiency in the integrating region as a whole improves, so overall welfare increases. The distribution of resources (and thus welfare) changes, between sectors as well as between countries but standard theory does not allow for explicit comparison of changes in individuals' (or countries') welfare levels. However, integration is welfare-improving, because total output usually increases so much that it is possible to compensate losers while increasing welfare of at least some groups.

It is difficult to predict how intensified integration within the EAC will affect Tanzania. On the one hand, reduction of barriers will allow for increased imports from Kenya, which is likely to affect domestic industries negatively. On the other hand, increased competition will force Tanzanian industries to improve efficiency, which is likely to increase the possibility of successful expansion on world markets as well. Since Tanzania's comparative advantages to a substantial extent rely on natural resources (agriculture, mining as well as tourism), improvements in physical infrastructure are likely to be critical.

3.5 A few sobering comments

The preceding pages have painted a rather dismal picture of Tanzania's private sector. While there is a substantial potential for rapid growth—and sustained growth in the range of 6-8 percent per annum of GDP is probably needed for growth to have an impact on poverty in the medium term—problems abound and many of these seem solvable only in the longer term or with the assistance of massive capital injections.

It is therefore appropriate to conclude this chapter with a few remarks intended to put Tanzania's problems into perspective. We shall not elaborate these points in any detail; but we feel that they sometimes disappear in the often rather dejected accounts of the private sector.

First, there are severe obstacles to overcome before the private sector can be expected to take the lead in Tanzania's economic growth. However, these problems are present in most of sub-Saharan Africa. While electricity prices are very high in Tanzania, there are almost equally high in Uganda; while the road network is small and of poor quality, land transportation is as expensive and slow in Mozambique. Consequently, to the extent that the strategy for growth is one in which a private export sector is the driving force, the relevant comparison of infrastructural quality is not Western Europe, but the quality and price of such services in countries which house the potential competitors to Tanzanian firms. In that perspective, there are still problems, but not as severe as most accounts would seem to suggest.

Second, reforms continue more or less unabated. There seems to be a general consensus that President Mkapa will win the elections in October 2000, and his determination to pursue reforms does not seem to diminish. In addition, even if Tanzania has a long way before she becomes a fully working market economy, tremendous improvements have been made in the past fifteen years. It is reasonable to expect the pace of reform to slow down—because the "easy" reforms have been implemented and the "difficult" ones (such as privatization of utilities or the implementation of a new constitution) remain—but there are no signs suggesting policy reversals. One example is the formal financial sector where, as we have discussed above, several problems prevent investors for utilizing that sector. However, credit volumes to the private are increasing; interest rate spreads are decreasing and new instruments for raising finance are being developed. A country cannot change its entire infrastructural, economic and legislative framework overnight; and the behavior of a population raised under socialism will adapt to the market economy only slowly. Consequently, while the pace of change in Tanzania may be slower that some commentators would expect or wish, the country is certainly on the right track.

Finally, despite Tanzania's huge problems foreign investments keep pouring in at an accelerating pace, and domestic private investments also seem to have picked up. This suggests that there is a certain amount of confidence in Tanzania's reform efforts. Investors thrive in a stable environment, and Tanzania is able to offer stability—politically, socially, and economically. Stability is a key word particularly for foreign investors who have alternative locations for business and who make long-term commitments in mining or tourism. As noted by Catterson and Lindahl (1999), Tanzania's stability and the strong sense of unity among Tanzanians which is so important for stability is likely to be a result from the strong support that Nyerere received from Western donors. To maintain that stability in the new millenium, foreign aid has an important role to play.

4 The Labor Market

4.1 Some Theory

In perfect labor market conditions and, under the assumption of a profit maximizing firm the demand for labor is determined mainly by its marginal productivity. In this case the wage rate (w) has to be equal to the employees' marginal productivity while the firm's demand schedule for labor is downward sloping; implying that a higher wage rate (w) the firm employees only few workers while at a lower wage rate the firm employees many workers. Such labor demand analysis is relevant to advanced economies characterized by, perfect labor market information, perfect competition, powerful trade unions, geographical and vertical labor mobility and adequately trained employees. These labor market characteristics hardly apply to developing countries like Tanzania.

In Tanzania and in most other LDCs labor markets are notoriously imperfect. Apart from the lack of information on labor market conditions the dominant features of Tanzania labor market is the existence of a two tiered employment structure consisting of dualistic labor market mode of formal and informal sectors (Bagachwa, 1996, Mjema, 1999).

Furthermore since majority of the population of LDCs (including Tanzania) reside in rural areas and agriculture constitute the largest industry in terms of employment the focus of literature and that of policy makers has naturally tended to be on rural labor markets. The concern has thus been that of determining the opportunity cost of removing a laborer from the agricultural sector. In the early stages it was presumed that agricultural laborers would be shifted to the industrial sector without a reduction in total agricultural output. That, in a nutshell, is the basis of the surplus labor theory in which it is often assumed that the shadow wage of an agricultural laborer is zero (Ranis and Fei, 1961, Lewis, 1954).

For these (LDC) countries neo-classical models have to be carefully applied in such a manner that would seek to optimize the objective function of peasants (Stigliz, 1974 and Rosensweig, 1980). Such models would seek to analyze carefully other determinants of rural labor markets such as how peasants allocate (labor) time between production for subsistence and leisure and the rural-urban migration trends. In short, the analysis of labor market has to be finely distinguished between theories that are appropriate to advanced labor markets and these must suitable to labor markets in developing countries like Tanzania.

4.2 Some Stylized Facts about Tanzania's Labor Force

4.2.1 Sources of imperfections in Tanzania's labor markets

Data deficiencies. One of the most serious limitations to the analysis of Tanzania's labor market is lack of coherent data especially on the size of the labor force, labor demand, wages and other essential labor market data. During the late 1960s and early 1970s this information could be obtained from employment exchange bureaus (also known as labor offices) set up throughout all the regions. However the government, for unclear reasons, decided to abolish the regional labor offices in 1974. Not much is known concerning the level and trend of formal sector wages either in public or private enterprises because such data ceased to be published in 1984. The Bureau of Statistics (BOS) used to publish average labor productivity data for public sector employees but such a publication has also ceased.

Even the size of the country's labor force is not known for certain. A 1995 ILO study for instance estimated that about 12.1 million people constituted Tanzania's labor force. Two years earlier in 1993 another ILO study had estimated that the country's labor force at a higher estimate of 14 million people., It is quite a difficult task to reconcile such diverse data sources (Mjema and Shitundu, 1997).

The seemingly comprehensive surveys on formal and informal sector employment in Tanzania are the 1990 Labor Force Survey (1990 LFS) and the 1990/91 National Informal Sector Survey (1990/91 NISS).[18] There have been efforts to update the 1990/91 NISS however the coverage of the 1995 Dar es Salaam Informal Sector Survey was limited to the analysis of informal sector in Dar es Salaam City alone. With respect to the formal sector no serious efforts have been made to update the 1990 LFS although there exist estimates of some labor force characteristics including total labor force and public and private sector employment by the Ministry of Labor and Youth Development (1995) and the International Labor Organization (ILO) and the World Bank (1991).

The Ministry of Labor and Youth Development for instance estimates that the country's labor force has some 13 million people out of which a total of 11 million people (or 85%) are involved

[18] Both of these surveys were conducted by the Bureau of Statistics in collaboration with the Ministry of Labor and Youth Development.

in either wage or self employment. The ministry estimates that about 30% of the labor force is either unemployed or underemployed (MLYD, p. 1).

The most serious data deficiency in the analysis of labor markets in Tanzania is however that the existing data sources do not attempt to provide estimates of labor productivity. Since labor is employed for what it is capable of producing and the efficiency with which it is producing the output the importance of including labor productivity data in labor force surveys can not be over emphasized.

The Formal-Informal Labor Market Dichotomy. According to the World Bank (1991) only a small proportion of Tanzania's labor forces (about 3%) is in formal wage employment while rest (97%) is in informal. Bagachwa (1986) and Bol and Luvanga (1987) have succinctly explained the importance of the informal sector to Tanzania's economy.

Table 4.1
Tanzania's Labor Force by Economic Status (mn)

Category	Rural	Urban	Total	Rural	Urban	Total
Formal Wage employment	0.20	0.34	0.54	0.18	0.52	0.70
Informal Sector Employment (of which):						
Own account	6.40	0.47	6.87	7.82	0.77	8.59
Employment	0.24	0.10	0.34	0.29	0.16	0.46
Total Labor Force	6.84	0.95	7.79	8.29	1.52	9.81
Total Population	15.10	16.41	17.51	19.28	22.89	23.17
Participation rate (%)	45	39	44	43	39	42

Source: World Bank (1991).

Formal wage employment is relatively higher in urban than in rural areas. Most (about 88%) of Tanzania's labor force is absorbed by the 'own account' of the informal sector category which is basically rural based. The informal sector activities are diverse ranging from street vendors roaming the streets of major towns mostly in Dar es Salaam selling an assorted lot of commodities including second hand clothes and other imported commodities to small scale mining activities in mineral producing regions like Arusha, Mwanza, Shinyanga and Ruvuma. It has been difficult (almost impossible) to get reliable information on the activities and involvement by gender and income generated from informal sector activities.

In terms of employment reliability however there have been serious doubts to many Tanzanians as to whether the informal sector is a genuine employer to the unemployed labor force or it is merely a survival strategy (Bagachwa, 1987).

4.2.2 Unemployment and Underemployment

Using the international (ILO) and frequently used definition of unemployment, the 1990/1991 Labor Force Survey (LFS) revealed that the overall unemployment rate (i.e. people without wage employment but available for work) in Tanzania was 3.6 percent. In the rural areas the unemployment rate was slightly lower (2.2 per cent) compared to 6.7 per cent in urban areas.

Table 4.2

Gender and Geographical Characteristics of Underemployment in Tanzania

Category	Total	Urban	Rural
Total	4.3	6.2	3.9
Male	4.6	3.8	4.6
Female	4.1	9.5	3.3

Source: 1990/91 LFS.

According to the 1990/91 LFS the country's state of underemployment (defined as occurring when a person's employment is inadequate in relation to specified norms or alternative employment) is relatively higher than the unemployment rate. Underemployment can be measured in relationship to person's low hours of work, low income, and underutilization of skill or in terms of low productivity. In Tanzania underemployment rates are higher in urban (6.2 per cent) than in rural (3.9 percent) areas. The cause(s) of underemployment are varied. Majority of underemployed people especially in rural areas (about 75%) cannot find more work. This is especially so after the harvesting season. Other cannot find suitable land on which to cultivate crops and are forced to cultivate on marginal land. Yet others (especially those employed in the manufacturing and processing sector) are forced to be underemployed whenever there is lack of raw materials and machine breakdown.

The underemployment rate for urban based females is almost three times higher than that of rural based females while urban based males have a slightly lower (3.8% per cent) underemployment rate than that of their rural based males (4.6 per cent).

The message from the underemployment figures appears to be that, on average, females (especially rural women) are less underemployment than males. That partly explains the gender division of labor in most of rural areas of Tanzania.

4.2.3 Gender dimensions of the labor force

In Tanzania men constitute nearly 48.7 per cent of the country's total population and about 49.8 per cent of the country's labor force. Women on the other hand make about 51.3 per cent of Tanzania's total population and 50.2 percent of the labor force. There are however slight rural-urban variations in the gender composition of the labor force. In rural labor force for example women are the majority (51.5%) but in the urban areas men constitute the majority (55.9%) of the labor force. Men tend to migrate to the urban areas in search for employment opportunities.

Even within the female labor force there are rural-urban disparities in terms of labor force participation rates. Rural females have, for instance, a much higher participation rate (73.5%) compared to their urban counterparts. Nearly half of the urban female population is economically idle (1990/91 LFS).

Majority of women is employed in the agricultural sector and hence active in most of the activities in that sector excepts cattle keeping, fishing and cotton growing which is traditionally male dominated. Other sectors in which female labor force out-number that of males include retail trade, restaurants and hotels and other domestic services.

Women employees are significantly few (less than 5 per cent) in repair services, fishing, mining and quarrying and in building and construction sectors. Apart from agriculture, the sales services employ about 4 percent of the total female labor force.

In both formal and informal sectors women occupy the relatively lower occupational positions compared to men (Table 3). While for example about 1.6% of the male labor force is in the administrative/management category, the corresponding proportion for female labor force is 0.4%. The exception is in the "agricultural-own farms" category, which absorbs about 45% of the female labor force compared to 38.7% of male labor force.

There are two other occupational categories where the proportion of female labor force is almost equal to that of males in both rural and urban areas. These are the services/shops and laborers categories. It has been argued elsewhere that both of these categories demand relatively low skills and are also lowly paying (Mjema, 1999).

Table 4.3:

Employment by Occupation, Gender and Rural-Urban Categories

Gender and Occupation	Total (%)	Urban (%)	Rural (%)
Total labor force	**100**	**15.6**	**84.4**
Admin/Manager	2.0	1.2	0.7
Professionals	0.2	0.1	0.0
Associate Professionals	1.6	0.8	0.8
Clerks	0.9	0.7	0.1
Service/Shops	2.5	1.6	0.9
Agriculture-own farms	83.7	5.8	77.9
Crafts	3.4	1.8	1.6
Plant/Machine Operators	1.1	0.9	0.3
Laborers	4.7	2.6	2.0
Male labor force	**50.1**	**9.1**	**41.0**
Admin/Manager	1.6	0.9	0.6
Professionals	1.1	0.6	0.5
Clerks	0.5	0.4	0.1
Service/shops	1.4	0.9	0.5
Agriculture-own farms	38.7	2.4	36.3
Crafts	3.1	1.7	1.4
Plant/Machine Operators	1.01	0.2	
Laborers	2.7	1.4	1.3
Female labor force	**49.9**	**6.5**	**43.4**
Admin/Manager	0.4	0.3	0.1
Professionals	0.0	0.0	0.0
Associate Professionals	0.5	0.3	0.2
Clerks	0.4	0.4	0.0
Service/Shops	1.1	0.7	0.4
Agriculture-own farms	45.0	3.4	41.6
Crafts	0.3	0.2	0.1
Plant/Machine Operators	0.1	0.1	0.0
Laborers	2.0	1.2	0.7

Source: 1990/91 LFS.

With respect to employment by private and public categories women employees are the minority in all sectors except in traditional agriculture. They constitute only 30% of total government employees and about 22% of total parastatal employment. About 36% of women in the labor force are in the informal sector.

The downsizing of government activities and the employee lay off that followed might have affected the shares of male and female employees in government and parastatal sectors.

Table 4.4
Employment of women by major sectors

	Total	Female	Female %	Male %
Total	1,202,761	512,365	42.6	57.4
Government	12,159	356	2.9	97.1
Parastatal	5,191	1,074	20.7	79.3
Traditional Agricultural	306,513	95,272	31.1	68.9
Informal Sector	847,212	408,958	48.3	51.7
Other	31,685	6,705	21.2	78.8

Source: 1990/91 LFS.

4.2.4 Level of education within the labor force

According to the 1990/91 LFS the majority of the labor force (about 43 percent) completed primary education level. On average about 60 percent of the paid employees, self-employed, unpaid helpers and those in traditional agriculture have also completed primary school education.

Over 4 percent of the labor force in the paid employees' category have secondary school level education and above while only 1 percent of employees in the traditional agricultural category have such educational level. The level of education affects employee's productivity and efficiency.

4.2.5 Youths in the labor force

The youth are defined according to the International Labor Organization (ILO) as "males and females in the 15-24 years category". Accordingly there are two sub-categories of youths i.e., teenagers (15-19 years) and young adults (20-24 years). It is estimated that about 700,000 youths (most of them primary and secondary school levers) join the reserve of unemployed labor force annually. There is a considerable rural-urban migration among the youths. This is partly because of the deteriorating socio-economic conditions in rural areas. The ability of the economy (public and private sector) to create new employment opportunities has been limited to about 10,000 to 20,000 jobs annually. That suggests that over 90 per cent of unemployed youths are not able to find formal wage employment (Mjema, 1997).

The repercussions of youth unemployment have been devastating to the Tanzanian economy. Apart from the 'lost' production especially in rural areas unemployed youths have been a source of congestion in urban areas (hence shortage of housing facilities and other social services), increasing crime rates an drug abuse and the increasing social urban unrest in general.

Noting all these consequences the 1994 National Income Generating Program (NIGP) warned that,

> the rapid growth of the labor force and the inability of the economy to generate enough jobs for the youths and women is a time bomb (our emphasis), if left undiffused, could explode and shelter the peace and unity that the country has been enjoying since independence (IGP, 1994).

There is an urgent need for the central government, the private sector, the local government and other social partners to seriously address the problem of youth unemployment in Tanzania.

4.2.6 Income of the employed labor force

In 1990/91 the nominal mean income for all occupations in the labor force was Tshs. 4,950 per month (equivalent to USD 30 using the nominal exchange rate during that period). The overall average income for women employees was considerably lower than that of males. There were also huge income variations across sectors. The agricultural sector, the informal sector and trade (especially small and medium scale enterprises) had relatively low incomes. Sectors with relatively high average income (over USD 60 per month including transport and communications and Finance and Business Services e.g. Banks, Insurance, Companies and Railways.

Table 4.5

Average Monthly Paid Income by Sector and by Gender (TSh)

Industry	Total	Males	Females
Total	4 950	5 150	4 300
Agriculture	3 140	3 340	2 280
Mining and Quarrying	4 540	4 870	n.s.
Manufacturing	5 240	5 560	3 910
Electricity and Gas	4 700	4 760	4 540
Trade	3 880	3 970	3 640
Transport	6 160	6 210	5 720
Finance	6 690	6 940	6 000
Personal Services	5 100	5 330	4 610

Source: 1990/91 LFS.

According to the 1990 LFS for instance the average monthly income paid to female workers were only 68.3% of the income paid to male workers. In the whole sale and retail trade sector which absorbed 3% and 4% of female and male labor force respectively the average monthly paid incomes to females workers was 92.1% of the male incomes. There is a seemingly "crowding out" of females, at least in terms of paid income in some sectors like mining and quarrying which are male dominated.

4.3 Employment and Labor Market During SAP[19]

Prior to the adoption of the adjustment measures in the mid 1980s the annual growth of the country's labor force was estimated at 2.8% (equivalent to growth in the country's population). Formal wage employment was growing at a range between 3.1 and 6.6 percent. Between 1984 and 1986 there was a significant decline (0.1 percent) in growth in formal wage employment partly as a result of the retrenchment exercise that was undertaken at the start of the reform period.

The sudden mushrooming of the informal sector activities is partly accounted for by the shrinkage of the formal wage employment (Bagachwa 1996). Prior to the reform period informal sector activities in Tanzania absorbed about 7.21 million people (about 92% of the labor force). During and after the adjustment measures the informal sector continued to absorb over 9.05 million people (or 93% of the labor force) compared to about 0.7 million people (about 87% of the labor force) who were engaged in the formal (wage) employment sector (Mjema and Shitundu, 1996). To some people (especially the unemployed youths) the informal sector has almost become the "employer of last resort" (Bagachwa, 1996). However to some analysis employment in this (informal) sector is just a survival strategy.

4.3.1 Change in Formal Sector Employment

In Tanzania the agricultural sector is the mainstay of the economy and the largest labor employer. There are however different estimates concerning of the size of the sector in terms of its contribution to GPE (Mjema and Shitundu, 1996). the 1990/91 LFS indicated that traditional agriculture alone (formal wage and informal sector employees) engaged a total of 9,115,935 (about 85%) of the labor force in that year.

The collapse of large scale farming during the economic crisis years 1980s was responsible for decline of wage employment in the agricultural sector. In other sectors like manufacturing, transport and construction formal wage employment increased especially immediately after the

[19] This section is partly based on Mjema, G. and J.L. Shitundu, "Employment and Labour Markets During Adjustment: The Case of Tanzania", Report submitted to ILO-EAMAT.

introduction of ERP I (1986-1989). The sector had 219,032 employees in 1986 but increased to 231,809 (equivalent to 32.6% of total wage employees).

Although there was a significant increase in formal wage employment in this (manufacturing, transport and construction) sector there is no evidence to suggest that labor productivity improved. To the contrary Mjema and Shitundu (1996) claim that both value added and employment in that sector appear to have stagnated since 1992 and the sector's capacity utilization dropped to below 50%. This has serious and negative implications on labor productivity, employment and on wages.

Formal wage employment in the public administration and service sector was in 1991 the dominant formal wage employer in Tanzania (ILO; 1991). Out of the 633,380 total formal wage employees, the sector accounted for 41.3%.

Concern about the 'overgrowed' public sector formal wage employment plus its disappointing performance and poor remuneration led to the downsizing of the public sector employment. Initially the government planed to lay off some 27,291 employees, but, this being a politically charges issue only 4,665 employees were actually retrenched. However pressure from International Financial Institutions (IFIs) have resulted into significant employee layoffs.

Table 4.6

Employees Lay-off Since 1993

Age	1993	1994	1995	Total
Unspecified	827	840	86	1 667
Above 55	1	14	2	17
51-55 years	38	990	65	1 093
46-50 years	197	7 353	1 439	8 889
36-45 years	274	8 303	1 677	10 254
26-35 years	147	6 635	1 077	7 859
16-25 years	4	640	38	682

Source: Kasilati, T.M. (1996), p. 5-6.

With the privatization exercise still under way more employee layoffs are envisaged especially in the public administration and in the financial sector institutions.

4.3.2 Trends in employment creation

While the growth of formal wage employment has slowed down considerably during the 1990s the growth of active labor force is projected in some estimates (ILO, 1995) to be between 2.8%

and 3% annually, The World Bank (1995) estimates that with this kind of (fast) growth in labor force at least some 600,000 to 700,000 new job seekers (mainly youths) enter the unemployed category annually. Only 1.4% of the 700,000 job seekers is absorbed in the formal wage employment. This percentage is likely to shrink even further as the ability of the public sector to create new employment opportunities shrink. The government is in the process of "rolling back" its active participation in the economic activities. That role, including the task to create new employment opportunities for job seekers will rest on the private and informal sectors.

Moreover, it is important to take into account the declining employment elasticity noted by Wangwe and Tsikata (1999). The concept relates to the relative change of employment in relation to changes in GDP. Thus, for instance, an employment elasticity of 2 would mean that a rate of growth of GDP would be associated to an increase of employment by 10 percent. Wangwe and Tsikata (1999: 34) show that the elasticity has declined from 1.2 in 1970/75 to about 0.6 in 1986/88. While it means that employment has become less responsive to economic growth it is also important to recall that a falling elasticity is usually indicative of increasing labor productivity. Consequently, the fall reflects the changing role of the state, from being one that absorbs newly released labor to one that focuses on core activities and uses the resources necessary for this. However, while it is difficult to see a viable alternative to the main lines of the current reforms, the costs and consequences in terms of increased unemployment should not be underestimated.

It is also important to note the relation between urban and rural areas in Tanzania. One reason for rural-urban migration is falling productivity in the former; another is a reasonable probability of gaining employment in the latter. The diminished role of the state, and the low rate of growth of private urban activities, have implied that the incentives to migrate have become weaker. When the rate of migration falls, labor becomes more abundant in the rural areas. This, in turn lowers productivity in agriculture until the net incentive to migrate has returned to the previous level. The only basic difference between the new situation and the old, before the decline of state activities, is that in the new situation, the productivity in agriculture has fallen even further. This is likely to be a major reason why per capita food output has shown a consistent decline since the advent of economic reforms in 1986.

The Tanzania Investment Center (TIC) formerly known as the Investment Promotion Center

(IPC) has approved over 700 foreign and domestic private sector investments in a wide range of sectors and these have generated significant employment opportunities for Tanzanians.

Apart from private sector operations the informal sector has, since the early 1990s become a significant labor force employer. According to the 1991 NISS there were 1,801,542 informal sector enterprises employing a total of 2,369,980 persons. Out of these establishments some, 1,114,136 were in rural areas and observed over 60& of the total informal sector employees.

Table 4.7

Total Informal Sector Employment by Gender and Geographical Location

Gender	Dar es Salaam	Other Urban	Rural	Total
Male	190 971	354 526	985 597	1 531 093
Female	124 587	279 619	433 680	838 286
Total	315 958	634 145	1 419 277	2 369 380

Source: 1991 NISS.

4.3.3 Changes in real wage

At the time of adopting the reform measures in 1986 the average nominal wage in Tanzania was Tshs. 1163 per month. In real terms however (after deflecting for consumer price index) the average wage was Tshs. 148 (or about USD 5 using the corresponding exchange rate at that time).

The World Bank (1991) notes that the real value of an average civil service wage in 1986 was less than 18% of the 1976 real wage level and could cover only a quarter of the basic necessities of a typical household. According to Mans (1994) by 1986 the minimum wage in Tanzania was less than a third of its 1970 level.

The salaries of professional and skilled staff fell more rapidly compared to those of other (especially lower) cadres. It is during this period that has seen the movement by some professionals in Tanzania to other (neighboring) countries in search for better wages.

4.4 Incentive Structure and the Role of the Private Sector

4.4.1 Incentive Structure

Prior to the adoption of the economic reforms in 1986 public sector was the major labor employer. With the objective of maximizing employment the state owned sector seemed to take pride in increasing employment with less regard on labor productivity. The sector offered not only monetary (salary and wage) incentives but also other employment fringe benefits like house allowance, meal allowance, and travel allowance. Besides, there were employment guarantees in that unless fired by the state most employees had permanent and pensionable employment terms. The government went a step further to set statutory minimum wages. It also operated via the labor unions to influence both public and private sector operations and decisions.

With the ushering in of economic reforms a number of changes have been introduced in the incentive structure of the labor force in Tanzania.

First, with the on-going measures to down-size the public sector employment and the objective to reduce the employment wage bill a number of fringe benefits have been removed from the employee's salaries and wages. One of the rationales of the employee lay-off was to reduce surplus employees and 'ghost' workers so that the remaining labor force would not only be productive but also well remunerated. While it is true that in some institutions (e.g. TRA and a number of banks) the monetary wages and salaries have significantly improved there is no documented evidence that employee productivity has correspondingly increased.

Second the government has stated categorically that it intends to confine its activities within the focus of maintaining law and order and less on economic activities. This suggests that in future the task of creating employment opportunities for the unemployment labor force will fall more on the private sector.

4.4.2 Role of the Private Sector

Local and foreign private sector operators have to take advantage of the favorable government policies in revamping the economy and unissued in areas where not only employment for Tanzanians will be created but also profits will be generated. For example the private sector can benefit from the 1992 employment freeze by employing qualified labor from graduates from universities in Tanzania and others from higher learning institutions who have not been absorbed in other sectors. A number of foreign and local private banking institutions are already employing graduate students from these institutions.

As already noted in Chapter 3, there are also concerns from foreign investors that there is a considerable amount of bureaucracy in investment registration. The role of the private sector is to negotiate with the government and reach a consensus on how these constraints could be realistically minimized.

5 Concluding Remarks: Implications for Development Cooperation

5.1 Introduction

The overall conclusion of this report is that rapid economic growth is a necessary condition for successful poverty alleviation in Tanzania. While Tanzania's growth record has improved in recent years, it is still not sufficient for viable poverty alleviation: a illustrative calculation is that to reach the conventional threshold for absolute poverty in 2025 (in terms of per capita incomes), an increase of GDP growth in the range 2-3 percentage points per annum must be regarded as an absolute minimum. To be able to accomplish this, the Tanzanian authorities must be able to develop a viable engine of growth that is capable of leading the rest of the economy into a new era of economic growth.

Current growth is led by the private sector and it is likely that this will continue in the future. The key questions do not revolve around ownership of the growth engine—because most stakeholders agree that it has to be private—but it is difficult to identify likely sectors or subsectors that are prepared and able to carry the burden. Moreover, although Tanzania's major problem is an absence of rapid growth there are other features which potentially may turn into growth obstacles—in particular the large and probably growing share of the economy that is outside the control of the government. While the existence of an informal sector the size of Tanzania's should be seen not only as a consequence of past regulations but also as testimony of the formal sector's inability to provide sufficient purchasing power to the population, it is important to appreciate that informal activities are, from all perspectives—bar the tax evaders'—inferior to formal activities. In particular, it is difficult to rationalize or justify government policies or bilateral development cooperation aimed at stimulating the informal sector.

The major obstacles to private sector growth identified in this report include legacies from the socialist past as well as a piecemeal tax system and high costs of production and distribution. Some of these problems can be solved swiftly and inexpensively—given the political will. Others will require massive injections of capital, finance that is not likely to be supplied by private financial markets. Others still require coordination among various players, notably the government (which in this context is not necessarily a homogenous entity), the donor community (which also is characterized by heterogeneity and diversity of objectives), Tanzania's partners in African regional cooperation arrangements, and the private sector.

5.2 The Role of Development Cooperation

Even though the government is actor that ultimately decides Tanzania's growth strategy, the partners in development cooperation have an important role to play. This role has become even more important with the advent of the new partnership which implies closer cooperation between government and donors and, no less important, better coordination between donors.

What can donors do to promote growth in Tanzania? In our view, the most important thing is that donors explicitly acknowledge the role of growth as the vehicle for sustainable improvements in the standard of living of the poor. Since the revival of bilateral aid following reforms in 1986, donors have emphasized funding to social sectors. The reasons for this are manifold, but an increasing concern that the poorest and most vulnerable groups did not benefit from what growth there was is an important part of the explanation. An increased focus on social sectors has the advantage that it is possible—in principle—to target specific groups. However, while social sector spending by donors has increased over the past decade, there is also the concern that it has been a substitute, rather than a complement, to government social spending. Moreover, the link from improved conditions in the social sectors to viable economic growth is long and winding—if it exists at all.[20]

Second, there is a consensus that the private sector has to be the engine of growth. There is less consensus, however, as to which productive activities that are able to lead the process. This report has identified four different sectors—mining, tourism, agriculture and manufacturing—that may have the potential for rapid growth. Given that most donors has poverty eradication as the major objective it seems reasonable to focus on agriculture, for several reasons: most poor people are rurally based; mining and tourism are sectors in which private capital has shown much interest and which thus may growth without the assistance of foreign aid; improvements in agriculture may hamper rural-urban migration by improving conditions in agriculture and, thus, indirectly contribute to improved standards of living in the urban formal and informal sectors; and improvements in agriculture may help reduce the fragility of the country's production structure (as discussed in Chapter 2).

Third, donors are able to assist Tanzania in streamlining bureaucratic procedures relating to the establishment of new private businesses. Several donor countries have substantial experience in promoting private sectors in their own countries, particularly small and medium-sized businesses. Moreover, Tanzania should be able to profit from the experience in donor countries regarding potential obstacles for private sector growth. Such—relatively inexpensive—assistance should be extended to cover issues in finance and taxation. As noted in Chapter 3, a major problem in Tanzania is the availability of formal sector finance, which is likely to be a result of imperfect instruments for measuring and evaluating risk. Export credit boards in most donor countries have substantial experience in risk assessment, something that could be utilized.

Fourth, we simply do not know enough to make a balanced assessment of Tanzania's potential regarding private sector expansion. This lacuna covers most fields, from the labor market (including employment, skills and labor market imperfections), over Tanzania's comparative advantages vis-à-vis Kenya and Uganda to bottlenecks in agricultural production (what is, for instance, the rate of return on feeder roads in the western part of the country?). There is a need both for national surveys of e.g. the labor market and small, focused studies in specific areas (such as infrastructural bottlenecks in the production of perishable goods, or the potential of offshore fishing). It is important to utilize local expertise in the design and execution of such studies.

Finally, with regard to Tanzania's role in the East African Cooperation, donors have a role to play. However, it is not clear what the optimal strategy is. On the one hand, the signal of determination submitted through rapid integration may stimulate confidence in the government and attract additional investments. On the other hand, the integration of unbalanced countries may trigger cumulative circles, which may in turn lead to perceptions of Tanzania as the "loser" and Kenya as the "winner". This paves the way for policy reversals, which are counterproductive.

[20] Possible mechanisms include the impact of a healthier population, or better educated labor force, on economic growth. While econometric studies certainly reveal a correlation between public health and growth, and between education and growth, the direction of causality is still an unresolved issue.

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ISBN 91-586-8952-4
ISSN 1404-031x