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MANAGING TANZANIA'S ECONOMY IN TRANSITION TO SUSTAINED DEVELOPMENT

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1. INTRODUCTION: AN OVERVIEW OF RECENT CHANGES AND KEY CHALLENGES

Over the past decade, Tanzania has vigorously pursued changes in the way her economy is organized, managed and driven. These changes began in earnest with the adoption of the Economic Recovery Programme in 1986. The programme ushered in a slow but steady movement away from a controlled economy with a dominant role for the public sector, to one that is increasingly liberal in nature and much more market-oriented in its operation. The role of the private sector under this new dispensation is expanding rapidly in virtually all spheres of the economy. The governance structure is similarly undergoing significant transformations. Most notable among these are the adoption of openly contested politics, with the first multi-party elections held in 1995, and the development of a more accountable and transparent government.

Other significant changes in governance include improvement in civil liberties, partly seen in a growing free press and increased public scrutiny of government policy and action. In order to appreciate fully the depth of these changes one needs to cast them against the operating environment of the Tanzanian economy in the previous two decades. While appreciating the success of building national cohesion, self-respect and human capacity, Tanzania could not then fully exploit its economic potential, partly due to the pervasiveness of controls that limited initiative, effort, choice and private sector contribution.

More specifically the thrust of the changes being pursued to improve the operating environment of the economy is in the following areas. One is emphasis on achieving and sustaining macroeconomic stability as a necessary condition for restoring growth and the dynamism of the economy. Two is opening up and freeing the trade regime for both external and domestic transactions, and with it the decontrol of the exchange rate. Three is the emphasis on market incentives for more effective mobilization and allocation of resources. Four is redefinition of the operations of the financial system, opening it up to private sector involvement and competition to enhance its efficiency and effectiveness. Five is scaling back the role of the public sector in production and commerce while refocusing its efforts and limited managerial/financial resources on efficient delivery of public services and collection of revenue. Six is a significant shift toward a dominant role for the private sector in production, commerce and finance. More recently this has been supplemented by increased participation of local communities, non-government agencies and the private sector in the provision of services such as health and education. Finally, there is the implementation of important changes in governance and institutional structures to establish congruence with the new open approaches to the management of the economy and civil society.

The combination of these measures has resulted in a modest recovery of growth and price stability, improvement of choice in consumption of goods and services, and enhanced civil liberties. Table 1 shows the key macroeconomic performance indicators during the period as evidence to these assertions. Real growth of the economy averaged 4.1% annually in the decade of reforms (1986–1996), compared with 1.1% in the first half of the 1980s. Revival of growth was spearheaded by agricultural activities and exploitation of natural resources. The sector registered an annual growth rate of 5.7% during the reform period, in contrast with 3% during 1980–1985. After a decline of per capita income in real terms at the rate of 2% during the period of crisis, a small increase was registered annually with a per capita real income growth of 1.3% during 1986–1996. Inflation in the 1990s was marginally lower than in the 1980s; the average for the 1990s has been 27.9% compared with 30.4% in the 1980s. The average for the past five years is 26.2%. Inflation in January 1997 reached 14%. Foreign perceptions of civil liberty in Tanzania have become marginally positive.

In spite of these improvements, poverty appears to be worsening of late, partly due to insufficient growth (and some indicators of human welfare have either remained stagnant or worsened relative to the 1970s and early 1980s). Economic recovery is also fragile due to excessive dependence on external aid. Although over the past two years there have been significant achievements in establishing fiscal balance, this has been largely at the expense of deteriorating public services and investment as well as institutional decay. The need for more public resources and their more effective use is evident.

In spite of the changes, the economy still seems to be awaiting signals of policy continuity, as evidenced by the wait–and–see stance of private investors and avoidance of irreversible capital investment, particularly in production as opposed to commerce. The industrial sector is recovering at a very slow speed from the deindustrialization of the 1980s. This problem is in part linked to the legacy of previous regimes with their related reputations and the continued perception of high non–commercial risk such as the potential for expropriation or policy reversals. Furthermore, previous delays in the privatization programme may have given rise to uncertainty about the government's commitment to carrying out its intentions.

The challenges ahead for cementing the reforms and developing well grounded credibility of the changes begun in the past decade are still grave. Sustained economic renewal and poverty reduction will require a strong political will and high quality management. In the subsequent sections of this paper we focus on these challenges in the context of the management of the economy. We have identified five broad categories.

The first relates to sustaining macroeconomic stability in the face of declining or unstable availability of aid resources. This is seen as central to strengthening the credibility of the economy and ameliorating risk perceptions by potential investors, both domestic and foreign. Key in this endeavour is establishing the long–term fiscal and external viability of the economy. Increased revenue collection and expenditure controls are fundamental to the former, while improved export performance is key to the latter.

The second is the promotion of widely–shared growth so as to reduce poverty. The essence of this challenge lies in expanding opportunities to earn a decent income to meet basic needs, particularly in the agricultural sector on which the majority of Tanzanians depend for their livelihood. It also entails paying attention to distribution issues and provision of safety nets for the more vulnerable.

The third is reducing the cost of doing business in Tanzania so as to encourage private sector expansion and initiative. The bulk of these costs relate to excessive bureaucracy, non–transparent operation of governing institutions, risks associated with unenforceable contracts and poor infrastructure.

The fourth and perhaps more daunting challenge is to induce a change in attitudes toward the conduct of both public and private sector business. A control mentality is still entrenched in the public sector, with performance still largely measured by expenditure rather than results.

Table 1. Tanzania: Macroeconomic performance indicators 1986-1996

INDICATOR	1986-89	1989-91	1992	1993	1994	1995	1996
Real economy							
Real growth of GDP	4	4.9	3.8	3.9	3	4.5	4.7
Real growth of agriculture	4.8	6.7	3.5	6.9	0.4	7	10
Real growth of manufacturing	2.5	5.5	4.3	2.1	-3.4	7	-
Investment/GDP total	25.4	33.6	32.7	32.2	30.7	16.1	-
Investment/GDP private	20	20.4	19.8	19.8	19.4	-	-
Domestic savings/GDP	4.4	10	2.2	4.1	2.7	-	-
Current account deficit/GDP	0.9	0.05	0.02	0.028	0.026	-	-
Export/import ratios	31.3	38.5	27.5	29.4	34.6	40.2	56.6
Money supply (M2) growth	24.3	36.5	38.5	28.8	32.5	26.2	12.1
Money supply (M3) growth	24.3	34.9	42.7	39.3	35.5	32.2	8.7
Foreign reserves (weeks of imports)	3.6	4.5	12.8	9.6	9.2	-	-
Food reserves (SGR, metric tonnes)	112,221.3	83,772.6	97,782	94,500	65,563	91,742	83,783
Key price movements							
Inflation	31	31.6	22	25	33	29.8	21
Savings deposit rates (Dec)	17.6	26	22	24	25	21	11
Prime lending rates (Dec)	15-24	20-31	20-31	18-31	22-31	27.7-39	27.7-45
Treasury bill rates (Dec)	9.2-10	14.5-15.5	12.5-13.5	28.9-75.7	21.3-41.7	21.3-41.7	31-46
Exchange rate Tsh/$ - official	86.8	207.6	335	479.87	523.4	558.2	590.48
Exchange rate Tsh/$ - bureaus	na	na	413.58	482.82	534	605	604.5
*Real minimum wage index (1985=100)	88.2	82.3	98.2	109.7	117.7	158.8	231.7
Social indicators							
Primary school enrolment	68	69	68	69	77.7	77.6	-
Secondary school enrolment	10.5	14.6	13	13.3	14.3	15	-
**Infant mortality rate	96.5	103.3	92	84	-	-	-
Nutritional status (calorie intake)	2,279	-	2,181	-	-	-	-

*The real minimum wage is calculated by deflating nominal minimum wage by the national consumer price index (1994 = 100). The real minimum wage index is obtained by expressing the 1985 real minimum wage as the base year.

**IMR: 1988 - 115/1,000 live births (according to census); 1991 - 92/1,000 live births (according to 1991/92 DHS).

Sources: BOT *Economic Bulletin* (various issues); Economic Surveys (various); World Bank (1996a/b); World Tables IMF International Financial Statistics; Ministry of Agriculture, Food Security Department; URT, Civil Service Department.

Rewards for professionalism and success in performance do not receive adequate attention and openness in the public policy process is still wanting. On the side of the private sector, earning "rents" still appears to be the main motor of business. A competitive attitude needs to be cultivated, and a much higher dose of professionalism and efficiency is necessary.

Finally, as the world economy is undergoing rapid changes toward globalization and integration, both opportunities and impatience with poor performance are on the rise. Increased capital mobility has reduced protection against capital flight, just as it has increased opportunities for attracting capital from elsewhere (as long as the policy environment is right and a stable civil environment exists). At the same time there is a plethora of new arrangements in the making for more open and liberal global trade. To make good use of the opportunities, Tanzania must develop capacity and knowledge to ensure compatibility with its dynamic environment.

We elaborate on each of these challenges in turn in the following sections.

2. PURSUING SUSTAINED MACROECONOMIC STABILITY

Among the greater achievements of Tanzania's economic reforms has been significant progress toward establishing price stability, and a narrowing of previously precarious and unsustainable resource gaps. As a result, inflation has come down significantly, averaging 26.6% during 1991–1996 compared with an average of 30.9% in 1980–1990. The past half year has seen a particularly strong downward trend in inflation to 14% in January 1997 and projections are for a further decline. This has resulted from a combination of three factors: stringent controls on monetary expansion; a more systematic and willful approach to expenditure controls, primarily via cash budgeting; and improved revenue collection. More noteworthy is that this achievement in controlling external inflation has occurred despite negative net foreign financing and external grants that earlier (1992–1994) contributed more than 22% of budgetary finance, compared with 10% in the last six months.

Sustaining this trend will require maintaining the momentum of reducing liquidity in the economy, persisting with budgetary discipline and enhancing efforts to collect revenue. Based on Uganda's and Kenya's experience, for example, single-digit inflation is within Tanzania's reach. Achievement of this target will permit better business planning, stem the rapid erosion of real income, reduce pressure on loss of value of the local currency and restore the credibility of the economy. Most fundamental for this achievement is further insulating the monetary authority and public banks from politically-motivated borrowing by the government and other public agencies. The Bank of Tanzania Act (1995) provides the legal framework for such insulation but adherence to its application is fundamental to signal commitment to this agency of restraint.

Stabilization of the exchange rate is another measure that has been pursued since the initial maxi devaluations to compensate for the previous gross over-valuation of the Tanzanian shilling. The exchange rate has stabilized in the relatively narrow range of Tsh550–620 per

US$1.0 in the past two years with movements in both directions. Following the unification of the official and parallel segments of the market, the rate is currently determined in the inter–bank market with a small premium for foreign exchange bureaus, most probably due to differential transaction costs. Tanzania is currently a signatory to Article VIII with the IMF, which liberalizes the exchange regime for all current account external transactions.

Stabilization of the exchange rate at the current level of inflation, however, raises a tension between importers and import users on the one hand and exporters on the other. As long as Tanzania's inflation exceeds that of its trading partners, barring changes in other fundamentals affecting the value of the shilling, profitability of exports will erode over time through maintaining a stable exchange rate in nominal terms. The value of the shilling in real terms appreciates, which also reduces the competitiveness of Tanzania's exports. On the other hand, the cost of imports in real terms declines and, given a more rapid rise in the domestic prices for these and other goods, commercial importers' profits rise. At the same time, the cost of direct imports for production declines in real terms. The advantages of stability lie also in enabling better business planning. The ideal solution would be for Tanzania's inflation to equal the weighted average inflation of the trading partners so that any movements of the exchange rate would truly be affected only by the conditions influencing supply and demand for foreign exchange.

As it is, the concerned authorities may have to consider corrections through selling and buying foreign exchange to influence rate changes in the desired direction. Given the critical importance of stimulating export growth to achieve external viability, the authorities may wish at the moment to take measures to avoid the appreciation of the shilling while pursuing reduction of inflation to the level of that in the trading partners' economies. This may not be as easily done as said, partly because depreciating the value of the shilling through large purchases of foreign currency by the BOT may entail injecting liquidity into the economy, which may frustrate measures to reduce inflation. The options for the same authorities to sterilize the effects of sudden large inflows of foreign capital, which tend to appreciate the value of the shilling, are also very limited. Nevertheless, this is an issue that must be resolved in a manner that contributes to the longer–term external viability of the economy through vigorous growth of exports.

Following significant reforms in the financial sector, the Bank of Tanzania's discount rate, which is a key price of finance to commercial banks and the government, is currently market–determined. It is pegged to the prevailing return to the auctioned treasury bills plus a fixed premium. Ideally the deposit and lending rates should trace the movement of this rate over time, albeit with a reasonable spread between them to cover the cost of intermediation and bank profits. Recent experience raises some concerns. The deposit rates, which have continued to trace the movement of the discount rate, have turned seriously negative in real terms. The savings deposit rates in banks range between 7% and 12%, against average inflation of 21% for 1996. Savers are rapidly losing the value of their deposits over time, which in the long term may discourage deposits and domestic savings generally. The lending rate, on the other hand, remains quite high and positive in real terms, ranging between 30% and 36% against the same level of inflation. Lending rates have stayed stubbornly high in spite of the precipitous fall in deposit and treasury bill rates. The spread between the lending and deposit rates is excessive and the exorbitant real cost of credit stifles business operations and investment.

This situation is a major impediment to the revitalization of investment and growth. It appears that insufficient competition in the banking sector sustains such spreads. If indeed, as is often argued, this situation is driven essentially by the high–cost operation of the leader in the banking sector, i.e., NBC, it remains difficult to comprehend why the rest would not try to attract business away from this player rather than cozily reap rents. The very high profits earned by banks in spite of frequent complaints of high excess liquidity is symptomatic of the absence of competitive pressure. The authorities concerned need not only to apply moral suasion but also to take policy measures to strengthen competition and sustain the current relatively low rates for treasury bills, which to a very significant extent are the favourite investment instrument—a way to make easy money rather than pursue investment opportunities in the real sector. One hopes that the advent and subsequent growth of the stock market will provide an attractive alternative to credit from commercial banks and stir up healthy competition for savings by the public. Better information to the public on returns from savings placed in alternative instruments will also help to galvanize competition. Ultimately these measures will ensure that the benefits of stringent liquidity controls are shared with investors and savers rather than simply raising the profit margins of financial intermediaries.

Finally, we would like to reflect on issues related to sustainable fiscal and external balances. Two important recent developments are pertinent. First is the visible trend to reduced aid budgets in donor countries that has translated into lower disbursements. Much more emphasis is now placed on the effective use of these shrinking resources. Related to the latter is that flows of aid resources have become unstable, in line with monitoring requirements for effectiveness and compliance with ex–ante conditionality. The second development is that of initiatives to reduce the debilitating stock of external debt of poor countries to free up current and future resources for development efforts. In this case, too, conditions are applied to avoid recurrence of the problem by ensuring that solvency is restored primarily through growth.

Both of these developments have important consequences for sustaining fiscal and external balance. Recent efforts in revenue collection and expenditure controls have significantly reduced the fiscal deficit to about 0.9% of GDP (first half of 1996/97) before external grants and a small surplus of 0.6% of GDP after grants. The discipline exercised should not be compromised by the prospects of reopening access to external financing. The additional resources will undoubtedly improve the provision of public services, which were severely starved of resources by the stringent controls, but they should not be allowed to lead to relaxed controls.

What is perhaps more significant is the impact of budgetary and external payments relief. The recent write–down of the Paris Club stock of debt and further rescheduling of payment of outstanding debt will provide significant relief in the debt servicing burden of the budget. The freed up resources would help to finance development activities. However, in order to gain access to even more relief and better terms, continued good performance is necessary under the terms of initiatives for multilateral debt relief. Adherence to this pays a double dividend—success in renewing growth and increased relief from resource constraints. External debt relief will substantially reduce pressure on foreign exchange earnings as far as external payments obligations are concerned.

A related problem is the recent rapid increase of domestic debt as government borrowed from the public by issuing its own paper to finance expenditures. Although Treasury bills are partly used by the monetary authority to mop up liquidity and constrain recourse to monetary financing of the budget deficit, the build up of the debt constitutes a large burden in its future servicing. This is particularly acute in light of the extremely high returns demanded by the holders during the first three years of aggressive sales. As a consequence, total domestic debt increased from US$7,603 million in 1993 to US$7,888.5 million in 1996 (BOT, 1996). Interest payments on this debt have now reached 0.5% of recurrent revenue. Although treasury bill rates have come down significantly from an average of 42% during 1993–1995 to the current 18%, continued use of this form of financing will exacerbate the already heavy servicing burden. There is need to stem further growth and use this instrument primarily for open market operations in the conduct of indirect monetary policy. Recent measures to restrict the use of treasury bills for budgetary finance are a step in the right direction. A secondary market for them will allow trading of the stock of paper (TBs) without expanding it.

Another element of fiscal stability relates to expenditure controls. Discipline on expenditure controls has lately been instilled by operating on a cash budget allocated on a monthly basis. A cash budget of this kind is riddled with uncertainty and imposes a short–term planning horizon. Moreover, the squeeze on expenditure has not been accompanied by clear redefinition of the key functions of government and equally clear priorities for government expenditure. The tendency to spread resources too thinly over too many commitments persists. Sustainability of fiscal stability will require explicit definition of government's priority functions, greater autonomy for budget managers to allocate resources efficiently and longer planning horizons—e.g., yearly rather than monthly budget allocations.

One cannot overemphasize the critical importance of continued export expansion to the reduction of trade and current account deficits. Merchandise exports more than doubled between 1986 and 1996, from $325 million to $762 million. However, they currently still finance only 60% of merchandise imports. The correction of gross over–valuation of the shilling through maxi devaluations in the first years of reforms has substantially improved the profitability of exporting activities. Some diversification of the export basket is taking place, and the share of non–traditional exports has expanded to more than 40% of total exports.

The need to sustain the profitability and competitiveness of exports was discussed earlier in relation to exchange rate policies. Strengthening export competitiveness and export competence, providing better marketing information, facilitating exports by reducing bureaucratic red tape, and bolstering strategic investment are among the key measures needed for further export expansion (Bol, 1995; Ndulu and Semboja, 1995). For this to occur it is necessary that investments made by exporting firms and government build up core capabilities, especially technological capabilities. Policies are needed at macro, sectoral and firm levels to support investments in technology and other core capabilities. These are not in place yet, as indicated by a recent study on manufacturing competitiveness (Wangwe et al., 1997).

3. PROMOTING GROWTH THAT REDUCES POVERTY

The World Bank country report for Tanzania (World Bank, 1996a) contains very revealing evidence on the relative impacts of growth and income distribution on the level and structure of poverty in the country. We would like to restate here the main conclusions, which will inform strategies for reducing poverty in Tanzania. First, while both growth and income inequality significantly affect poverty levels, reduced inequality has a threefold impact on poverty compared with the impact of increased growth. Second, and partly related to the first, growth in rural incomes has much more effect on reducing poverty than does growth in urban incomes. The comparisons here are that a 1% increase in rural income reduces the total poverty level by 2%, while a similar increase in urban incomes reduces total poverty by only 0.44%, a fourfold difference. Third, education—particularly that of women—together with infrastructure and market integration are the strongest determinants of household income and welfare.

In the 1970s and the first half of the 1980s, Tanzania attempted to reduce poverty through income-distribution policies. However, the heavy taxation of the agricultural sector and the lack of emphasis on overall growth may have more than offset any positive impact of these policies. The revival of growth in the post reform period significantly reduced the proportion of the rural population below the poverty line, from 65% in 1983 to 49.7% in 1993 (World Bank, 1996a). Poverty worsened between 1993 and 1995, however, with a rise in the proportion of the rural poor to 58.6%. This rise was in large measure explained by a significant expansion of the inequality gap over the same period (as measured by the increase in the Gini coefficient). In particular, the condition of the poorest of the poor worsened. Despite recent income growth, basic human welfare indexes appear to be stagnant or worse when compared with their status in the 1970s or early 1980s. The most recent period has clearly ignored distribution concerns.

These findings point to the key elements of a strategy for reducing poverty. The elements include encouraging rapid growth that is widely shared, and greatly enhancing opportunities for earning a decent income to improve access to basic needs. At a more operational level, the implication is to concentrate growth in the agricultural and informal sectors, as these make up the single largest source of income for Tanzanians (over 85%). These sectors are also the most important source of income for the poor. Furthermore, the strategy should entail raising basic human competence and capacity through better education and health, and improved supportive infrastructure to enhance access to opportunities for earning income. In essence, expenditures on these services are an investment in raising capabilities to earn rather than in consumption, as they are currently treated under national accounts. Poverty-reducing growth thus combines both growth and distribution concerns.

The World Bank report (1996a), drawing from these findings, projects that a 6% annual real growth rate would be required to reduce the poverty level to 5% of Tanzania's population in 20 years. If such growth is strategically spread to benefit the rural and urban poor, the time required to achieve this target may be significantly shortened since the distribution effect will enhance the effectiveness of growth in reducing poverty. For this to occur, policies for improving the performance of the agricultural sector need to go beyond better price incentives.

Agricultural transformation must be moved to centre stage. Policy support for raising agricultural productivity, pursuing market integration via improved infrastructure, and redefining the roles of the state and the private sector in these endeavours is crucial. Better education and skill formation are essential for the adoption of better husbandry, as are research and extension services. The question of a more coordinated channelling of investments into areas and activities where the poor live and are most active will need to be addressed in order to stimulate productivity and growth in those activities. Because over 75% of the rural population earn their income from more than one source (World Bank, 1996a), diversification of income–earning opportunities is needed to help the rural poor to supplement earnings from crop production. A strategy for raising production and productivity in rural non–agricultural activities needs to be worked out to support diversification efforts.

For the urban poor, the informal sector is the single largest source of income. Expansion of formal job opportunities is sluggish, and so the absorption of the youth and retrenched workers into the informal sector holds the most promise. Technical and entrepreneurial skills are necessary for making use of opportunities in this sector. A poverty reduction strategy should provide for skills formation and support the development of small–scale enterprises, partly through the growth of micro finance, increased involvement of the private sector and technical support services.

Since the provision of social services and investment in human capital are crucial for reducing poverty, increased attention needs to paid to cost–effective delivery of public services. For the foreseeable future the public sector will retain a dominant role in this endeavour. However, encouraging the participation of the private sector and local communities in the provision of services is critical to enable expansion and improvement of services. There are encouraging signs of revitalization of the private sector, non–government organizations and community participation in this area (Semboja and Thirkildsen, 1995). A crucial point is for the government to create an enabling environment to catalyse participation of these providers.

4. PROMOTING PRIVATE INVESTMENT BY REDUCING THE COST OF DOING BUSINESS

The traditional view of development economics has always been that capital accumulation is a fundamental cause of economic growth, and that differences in stocks of capital across nations are the prime determinants of the corresponding differences in national incomes. More recently, however, both theoretical arguments and strong empirical evidence suggest that human capital and technical knowledge are at least as critical to the growth process (Elbadawi and Ndulu, 1995; King and Levine, 1993). Foreign investment coupled with improved human competence to absorb new technologies are the important elements in technological advancement. The impressive growth performance of the Southeast Asian "tigers" attests to these assertions.

In order to promote investment by both domestic and foreign entrepreneurs, however, a range of conditions that affect the perceived and real cost of doing business needs to be present. These conditions fall into five broad categories. First are costs associated with business uncertainty; they relate to macroeconomic instability, particularly inflation, exchange rate instability and variations in the cost of finance, which all militate against sound business planning. Even more crucial is the investor perception of the sustainability of the current stable economic environment into the future. Government policy and credibility are a large part of this perception. An investor risk rating for Tanzania, based partly on these factors, shows a significant improvement, from 10.9 in 1987 to 17.7 in 1996 out of a total possible score of 100. The best ratings in Africa currently are those of Botswana at nearly 50 and South Africa at 46. The index reflects credit ratings based largely on economic performance but also on institutional quality.

It is clear that Tanzania still rates very poorly in the perception of investors, though improvements have been registered (see comparative scores in Figure 1). It is anticipated that some recent developments will have a positive impact on the investor risk index for Tanzania. One is the Investors Forum, held in November 1996, in which investment policy statements were made by the top political leadership to potential investors. Moreover, the efforts the government has shown in following up on the commitments made at the Investors Forum may bear fruit. In particular, the arrangements for joint action on this matter between government and the private sector is an encouraging initiative. Finally, the enactment of a new investment code (expected in April 1997) is likely to address many of the concerns of investors since its contents are being tabled to the business sector and other interested parties for discussion and comment. Fourth, the Investment Promotion Centre is being restructured to make it more promotional and facilitating.

The second broad category is an environment of civil stability. Civil strife and an unstable political environment are threats to private property. A recent study by Collier (1996) showed that civil instability militates against investment and growth, and that the repercussions of unstable episodes linger for a long time. Avoiding rather than quelling civil disorder has a high investment pay-off. In addition to other factors such as ethnic disputes, gross inequalities have been singled out as fertile grounds for civil strife. In this regard, civil stability in Tanzania is not under serious threat as yet, but if developments in income inequality are not checked the current civil stability could be in danger.

Figure 1a. Tanzania's investor risk rating (1992-1996)

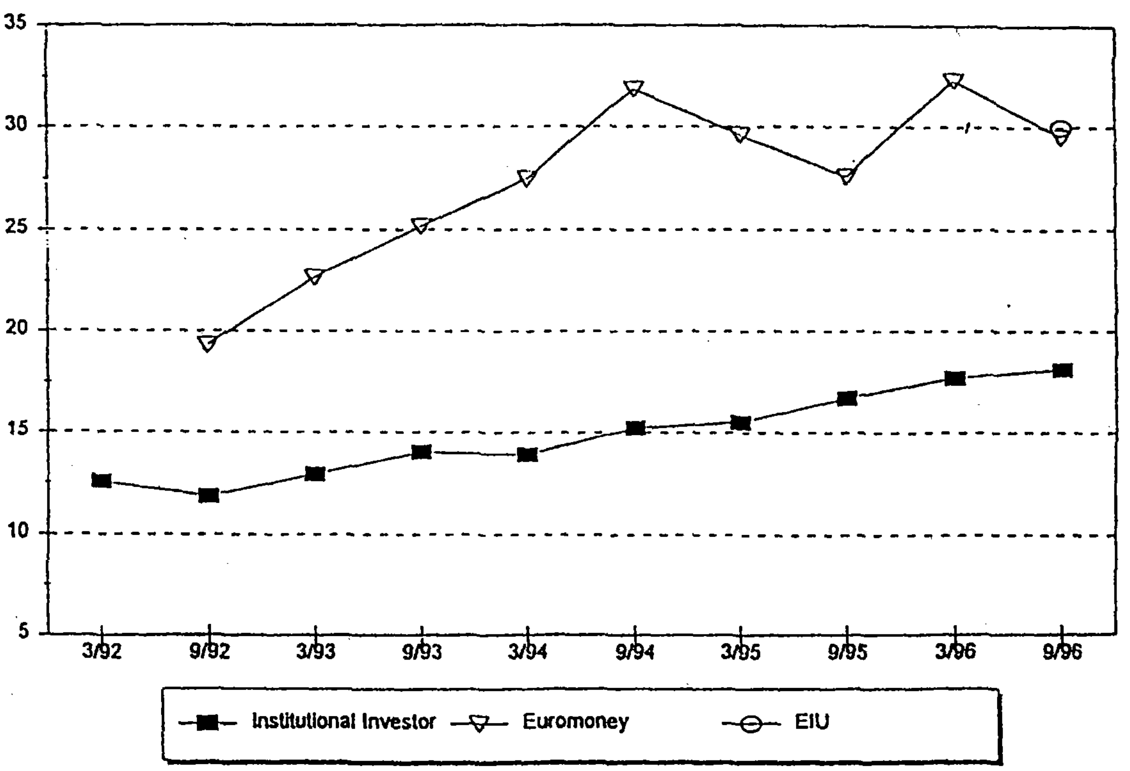
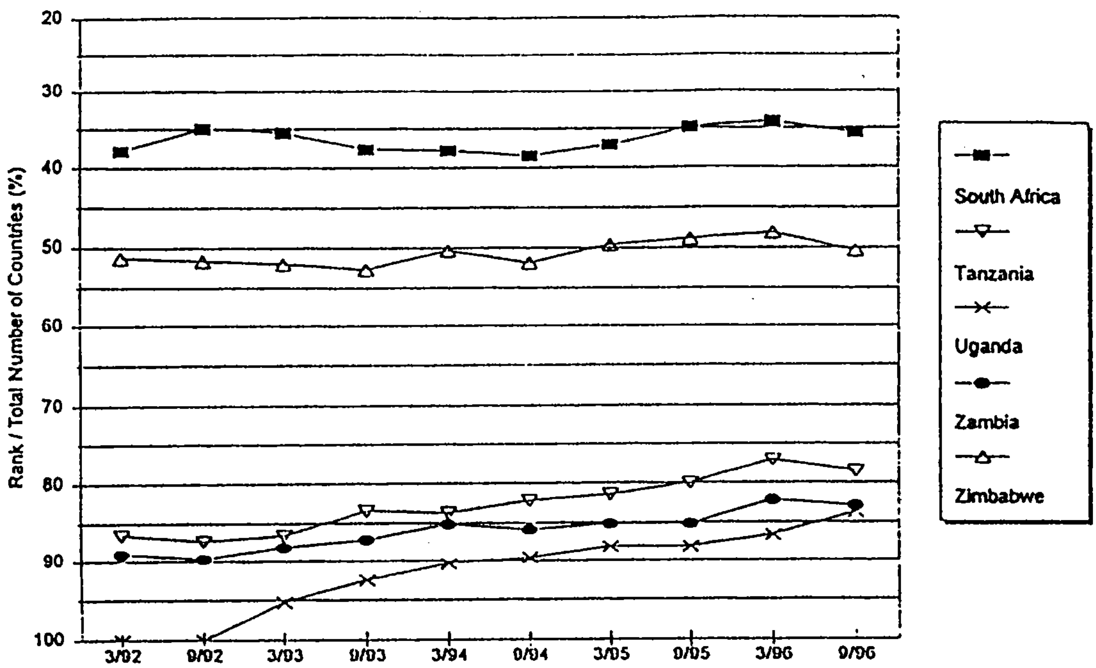
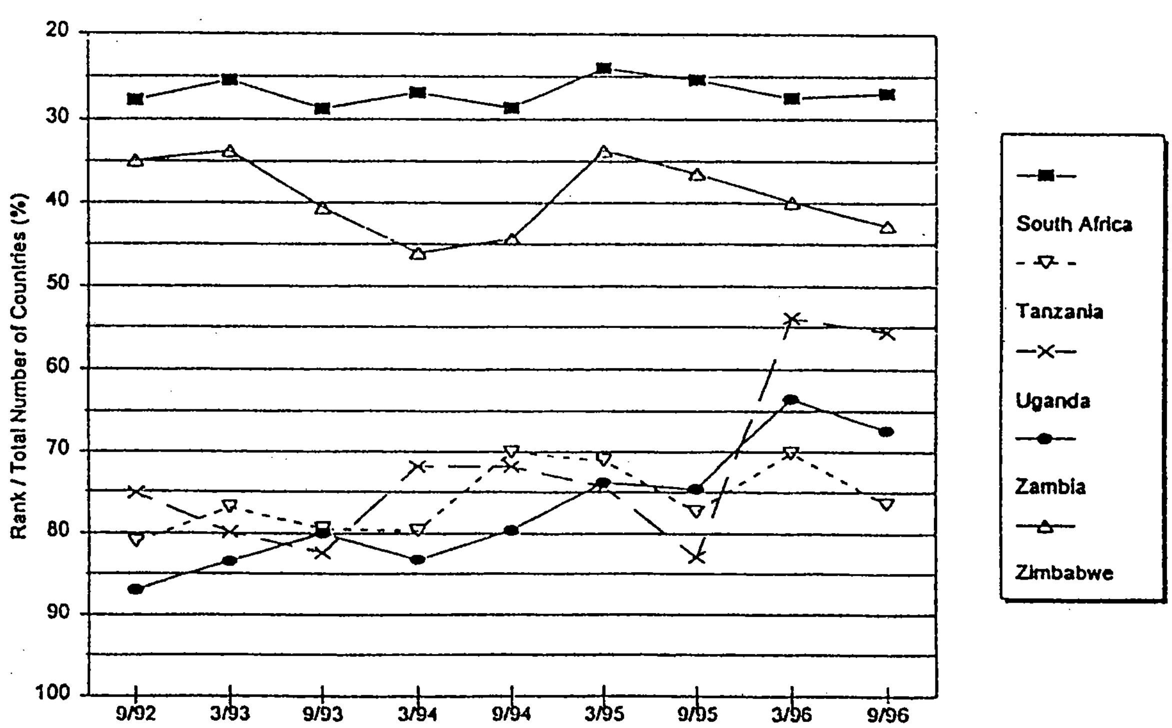


Figure 1b. Institutional investor ranks (percentile of sample, 3/92–9/96)



Source: "Private Capital Flows to Sub-Saharan Africa - A Supply-like Study" by S. Griffith - Jones, N. Bhinda and M. Martin (1997) A study of External Finance for Africa

Figure 1c. Euromoney ranks (percentile of sample, 9/92–9/96)



Source: "Private Capital Flows to Sub-Saharan Africa - A Supply-like Study" by S. Griffith - Jones, N. Bhinda and M. Martin (1997) A study of External Finance for Africa

Third, the lack of institutional capacity to enforce contracts contributes to higher transaction costs, as agreements can be broken with impunity without fear of retribution. The losses associated with such flagrant abuse of law can be very substantial. Apart from strengthening the judicial system more generally, expeditious dealing with disputes in industrial courts is essential for curbing such losses. Guarantees against risks of expropriation are also fundamental. It is worth noting that perceptions of institutional quality also enter into the investor risk rating mentioned above. In Tanzania this is an area where most investors perceive weakness in the current legal framework. It is believed that the judicial system has not geared itself to the new environment of private sector led development.

Fourth are the infrastructure costs associated with poor services for business operation, such as power, water, communication and financial services. These are essential for efficient and timely communication, reasonable utilization of installed capacities, and access to working capital and investment finance. Fifth, but by far not least, are bureaucratic constraints to investment and business operations. Where these are pervasive they hinder expeditious clearance for establishing new ventures and constrain flexible responses to changing conditions that require unencumbered restructuring of operations. Licensing delays, corruption and multiple clearance points discourage businesses and raise set-up costs.

Tanzania, like a large number of other African countries, seems to place undue emphasis on investment sweeteners such as special tax treatments and holidays. Available studies suggest that these have relatively little significance in affecting investment behaviour (Kimura et al., 1994; Helleiner, 1989). In addition, the fiscal costs of such sweeteners are not trivial, as experience in Tanzania with investment incentives has shown. The costs of the resultant macroeconomic instability are much more grave, and so is the reduced ability of the government to provide badly needed infrastructure services. As the government contemplates investment policies, it needs to consider the potentially serious trade-offs across these factors.

5. ATTITUDES TO BUSINESS IN A NEW ENVIRONMENT

The Tanzanian economy has been operating in an environment of administrative controls over resource allocation and public sector led development. In this context, the private sector was frowned on as capitalism in a country aspiring to build socialism. The approach of government to business and its vision since 1967 was that of ultimate control over the economy as both investor and allocator of resources, which increasingly marginalized the private sector. The private sector that survived (and part of it flourished) during the hostile era learned to reap rents from gaps inadvertently or otherwise left by state operations or from favours in the allocation of scarce resources.

Many of the capabilities built up in the private sector were geared to doing business in a non-competitive environment in which public sector controls and ownership were extensive. Many of the capabilities that were appropriate for this kind of business environment were rendered redundant as economic management shifted in favour of market orientation, competition, and reduced public sector participation in direct investments and ownership of productive assets.

The challenge of managing business in the new environment has been daunting. There is need to change attitudes in government and private sector alike and adapt them to the requirements of a competitive market environment in which the private sector leads in making direct investments and the government leads in policy making and economic management, regulation and investment in basic infrastructure.

Government's attitude of control has not yet fully come to terms with the need for facilitating and providing efficient service to business. On the other hand, the perception of monopoly of policy analysis and policy making is giving way, albeit gradually, to acceptance of participatory and consultative approaches to policy dialogue.

On the side of the business sector, the attitude of protection and quick high returns to investments has not given way to the attitude of competition and moderate returns meant to improve the quality and competitiveness of goods and services.

New attitudes will need to be cultivated. As the experience of Eastern Europe has shown, the transition from the culture and attitudes of an administratively controlled economy to the culture and attitudes of a competitive economy has turned out to be more challenging than anticipated (World Bank, 1996b).

The gaps between attitudes of government officials and business sector operators can be reduced through institutionalized consultative mechanisms. Although encouraging steps have been taken in this direction, these have largely been ad hoc. These initiatives need to be nurtured through institutionalized consultative mechanisms.

6. CHALLENGES OF GLOBALIZATION AND INTEGRATION

Recent developments in global trends and regional integration challenge Tanzania to brace itself to respond to change and carve out an appropriate position in the global and regional economy.

The world economy is undergoing technological and market changes that could influence the position of Tanzania and the role it may play in the world market. Globalization is a result of rapid advances in technology, growth of world trade and competition, and policy changes toward economic liberalization. These factors (technology, trade and policy) are interrelated and their interrelationships must be analysed to form the basis for action to be taken in the concrete conditions of Tanzania.

In addressing the place of Tanzania in the world economy and in the region in particular the major contextual developments that deserve serious consideration are:

- Changing world market conditions and advances in technology.

- The dismantling of apartheid and advent of majority rule in the Republic of South Africa.

- Renewed interest in regionalism world-wide.
- The recent conclusion of the Uruguay Round of the General Agreement on Tariffs and Trade (GATT) and the establishment of the World Trade Organization.
- The liberalization, de-regulation, commercialization and privatization of national economies in the region.
- Increased democratization, transparency and public accountability, and political liberalization in the region.

This paper limit its discussion to the implications of three of these aspects of change: changing markets and competition, implications of technological advances, and implications of regionalism and regional integration.

6.1 Changing Markets and Competition

The business environment in which economic units must be prepared to operate is characterized by unprecedented opportunities to tap new markets, and traditional markets are changing dramatically toward competitiveness. Competition stems not only from traditional adversaries in traditional markets but also from new entrants and from disintegration of barriers to previously protected markets. With competition arising from diverse and unexpected sources, enterprises can no longer be confident about their market shares; they must constantly be prepared to face stiff competition. The Uruguay Round agreements and the establishment of the World Trade Organization (WTO) can be interpreted as a process of formalizing a global trend of intensifying competition.

6.2 Technological Advances

Technological change has important implications for the competitiveness of all economic activities in an economy. The policy implications of changing technological conditions are likely to surface at two levels: focus on monitoring emerging technologies to inform policy decisions relating to learning about/adopting new technologies at the right time; and focus on internal conditions of technology characteristics and demand conditions.

Recent technological developments have led to shifts in the composition of factors of production with considerable decline in raw materials and energy and labour inputs, and increase in knowledge intensity. Technological developments have considerably influenced the pattern of manufacturing industry in the highly industrialized countries as services take the lead, especially new skill-and-capital intensive services such as informatics. This makes Engels' elasticities more difficult to predict and the growth of many traditional capital goods industries has slowed (e.g., construction materials, electrical machinery industries, general engineering, machine tools, iron and steel industries).

For example, the new paradigm in information technology (IT) is characterized by profound changes in the business application of computers, the nature of the technology itself and the leadership of use of technology. The application and impact of IT has been so pervasive that it has even permeated many traditional industries. The main features of the information revolution are the falling costs of communication and the knowledge revolution. The implication is the end of geography as a limiting factor, as characterized by globalization of capital and financial markets, goods markets, labour markets, and information and knowledge markets.

The structure of employment is changing with a shift from manual to mental work as indirect production/support activity gains ground over direct work. Practical skills have to be complemented by higher levels of theoretical skills in science and modern technologies and there is preference for personnel with multidisciplinary skills. As a starting point, user-oriented strategies for new technologies can result in improvements. The relevant question is how much learning is necessary for effective use of new technologies. Computer literacy and basic electronic hardware maintenance skills are likely to be essential. These shifts have important implications for the education system and the changes that must be made to cope with evolving workforce requirements. Economic management in Tanzania has not given attention to building the capacity to respond to these changes in ways that are in the interest of the country.

6.3 Regionalism, Regional Cooperation and Regional Integration

The volume of trade for many countries in the world is substantially influenced by regional cooperation and trade agreements. This suggests the need for serious reassessment of the viability of small-scale import substitution and far more attention to regional cooperation and regional trade, which enable economies of scale to be tapped and international competitiveness to be attained. The unfolding of open competition accelerated by trade liberalization initiatives has shown that even to sustain regional markets, competition with other regions of the world will have to be faced sooner or later. There is always a danger of losing the regional markets to competitors from other regions (Wangwe, 1995) if continuous efforts are not made to develop competitiveness in terms of quality and price. The challenge now is whether regional cooperation arrangements and regional integration can be designed to facilitate (through investments and joint technological activities) the process by which firms and institutions in Tanzania and other member states can build up technological capabilities.

Regional cooperation and regional integration will need to be given appropriate interpretations under the new conditions of economic and political liberalization. The approach should rely on market forces rather than administrative discretion for its incentives and preferences. One implication of this approach is that public intervention should focus on policy formulation, especially the creation of a regional policy environment that enables market-based integration to work. The business sector should also be made more accessible and more participatory than it was in the past. In order to promote the role of the business sector in regional economic cooperation and regional trade, it is important that business associations establish mechanisms for cooperation, create strategic alliances and exchange information.

Economic reforms have been designed and implemented in the context of national concerns, without explicit consideration for their regional implications. National policy-making mechanisms and processes need to be designed to take regional implications into account. There is need for a consistent mechanism for discussing the implications of regional issues for national policies and vice versa or across interested parties. Regional macroeconomic policy coordination and programming will need to be adopted to minimize inter-state economic distortions and harmonize national policies.

In a number of sectors, the ability to remove constraints and meet investment requirements (including access to new technology) necessary for raising the level of competitiveness may require a regional rather than a national solution. For every such sector it is recommended that efforts be made to identify cases where a regional solution is superior to a national solution. Such regional solutions should be articulated and ways of integrating them into national policy making should be identified.

Changes in world market and technological conditions that have taken place in the recent past, in particular in the last decade, pose new challenges to the development of a competitive economy in Tanzania. Four main categories of change are most relevant: changes in market conditions; changes in technology hardware and software; changes in organization of production; and changes in globalization and regionalism. These market and technological changes are likely to have considerable implications for the direction of knowledge-intensity of production and the kinds of capabilities that must be developed to cope with the changes. First, greater effort will be needed to monitor these changes to enable adaptation to the new situation. This will often imply selective adoption of new technologies in production and marketing at the right time and in the right applications according to the dictates of quality, precision, speed and productivity requirements. Second, greater effort will be needed to create a conducive environment for the creation and development of core capabilities within firms and in the institutions that interact with those firms to enable them to cope with the changing conditions in the regional and world economy.

7. CONCLUSION

This paper identified and presented what in our opinion are the major issues and concerns in the management of the Tanzanian economy in the transition to sustained development. The paper has made the following main observations:

- The combination of measures that have been taken so far has resulted in a modest growth recovery, price stability, improved consumer choice and enhanced civil liberties. However, excessive dependence on aid, deterioration of public services, low investment response and institutional decay continue to present formidable obstacles. The challenge is that of establishing long-term fiscal and external viability of the economy. Sustainability of fiscal stability will require on the revenue side continued efforts to strengthen revenue collection and on the expenditure side clearer definition of priority functions that must be performed by government.

  As well, it is necessary to give greater autonomy to budget managers to allocate resources efficiently and to facilitate planning with longer budget horizons—yearly rather than monthly. Given the critical importance of stimulating export growth to achieve external viability, the authorities may wish to take steps to avoid the appreciation of the shilling while pursuing measures to reduce inflation to the level of that in the trading partners' economies. However, this is an issue that will need to be resolved in a manner that supports the longer–term external viability of the economy through the vigorous growth of exports and development of technological capabilities in the export sectors.

- The spread between bank lending and deposit rates is excessive, and the exorbitant real cost of credit stifles business operations and investment. This situation is a major impediment to the revitalization of investment and growth. It appears that there is not enough competition in the banking sector to compel reduction of such spreads. The authorities need not only to apply moral suasion but also to take policy measures to strengthen competition.

- The gains in growth and price stability apart, the poverty situation has not improved significantly. The kind of growth that has been achieved has not been sufficiently high or broad based to increase the incomes of the bulk of the poor. The challenge is to pay greater attention to the quality of growth so that it is more effective in reducing poverty. Such growth should, among other things, increase productivity in the agricultural sector, where the majority of the poor are active, and pay attention to issues of distribution and provision of safety nets for the more vulnerable.

- Private sector expansion and initiative still face many obstacles, resulting in high costs of doing business. Initiatives need to be taken to enhance transparency in the operations of governing institutions, reduce bureaucracy, and improve the legal framework and supportive infrastructure.

- The approach to the conduct of both public and private sector business in the economy is not sufficiently transparent or consistent with efficient market operations. The control mentality is still entrenched in the public sector, while the private sector still has an attitude and culture of earning quick high profits from investments in a non–competitive environment. New attitudes and a new culture will need to be cultivated in both the government and business sectors so that they are consistent with facilitation and promotion of business in a competitive market environment.

- Recent developments in global trends and regional integration challenge Tanzania to respond by carving out an appropriate position for itself in the global economy. Markets are becoming more competitive and the speed of technological advance is increasing. The policy implications of the changing technological conditions are likely to surface at two levels: focus on monitoring new and emerging technologies to inform policy decisions related to learning about and adopting new technologies at the right time; and focus on internal conditions of technological characteristics and demand. Greater effort is needed to build the capacity to monitor the major trends in the regional and world economy to enable Tanzania to respond and adapt to the new situation by tapping opportunities and averting threats. The new regionalism points toward the need to change the approach to regional integration by giving greater attention to the principles of variable geometry, subsidiarity, international competitiveness, business sector participation and incorporation of regional dimensions in national level policy making.

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