

### **3.0. SOCIO-ECONOMIC REFORMS IN 2001/02**

#### **3.1. Macroeconomic Performance**

Tanzania's macroeconomic performance has continued to improve in 2001 and 2002. The annual growth rate reached 5.6 percent in 2001 and is projected to rise to 5.9 percent in 2002 despite substantial loss in the terms of trade. The rise in growth in 2001 was attributed to relatively strong performance in agriculture, mining, wholesale and retail trade, as well as manufacturing. The agriculture sector grew by 5.5 percent in 2001 up from 3.4 percent in 2000, with most of the growth emanating from crop production and fishing. The growth of the mining sector remained strong at 13.2 percent and increased its contribution to GDP to 2.5 percent from a negligible level of 1.7 percent in 1997. Wholesale and retail trade (including tourism) rose by 7 percent in 2001. Industry – incorporating manufacturing, utilities, construction, transport and communication, rose at an average of 6 percent, representing overall improvement over the year 2000.

While overall investment as a percentage of GDP did not increase significantly between 2000 and 2001, foreign direct investment (FDI) during the period rose by 16.6 percent up from US\$ 192.8 million to US\$ 224.8 million. Increased government expenditure in the priority sectors, enhanced the growth of public administration and other services, from 2.7 percent in 1997 to 3.5 percent in 2001.

Inflation as measured by the National Consumer Price Index (CPI) has continued to decline and was 4.5 percent by end June 2002. This decline is attributed to steady implementation of conservative fiscal policies supported by a cautious monetary policy. This provides a conducive environment for poverty reduction.

The current account deficit (before grants) of the Balance of Payments has continued to decline from over 12 percent of GDP in 1999 to less than 10 percent in 2001, partly due to the coming on stream of gold exports. The recent performance in merchandise exports has recorded improvement following declining trend during 1996-1999. With the continued decline in the world commodity prices of Tanzania's major primary exports, the structure of merchandise exports has shifted away from the dominance of traditional agricultural commodities towards non-traditional exports (minerals, fish and fish products, horticultural products and manufactured goods) which now account for more than 55 percent of merchandise exports. The export of services largely from transport and tourism has also increased in recent years, contributing about 50 percent to the total value of recorded exports. These developments, together with foreign programme assistance and debt relief under the enhanced HIPC initiative, have contributed to further strengthening of

international reserves. Gross official reserves increased steadily to the equivalent of 6 months of import cover of goods and non-factor services.

Domestic resource mobilization has continued to improve following reforms in tax administration and revenue enhancing measures. Nonetheless the Government recognizes that more measures need to be taken to enhance the revenue yield. The adoption of the Public Expenditure Review (PER) and the Medium Term Expenditure Framework (MTEF) process, the Integrated Financial Management System (IFMS), and the new Acts on Public Finance and Public Procurement have substantially improved budget management, transparency and accountability. These processes have facilitated increased integration of donor finance into programme financing notably through the Government budget frame.

The inter-bank foreign exchange market (IFEM) has continued to determine (freely) the exchange rate, with the intervention of the Bank of Tanzania limited to smoothening short-term fluctuations and occasional needs for meeting reserve targets. In the period under review, the exchange rate of the Tanzania shilling has been fairly volatile, mostly due to increased import demand, both for investment and consumption goods. The rate in the IFEM depreciated from shs. 888.9 per US Dollar in June 2001 to around shs. 980.00 per US Dollar by end-June 2002, before sliding back to around shs. 960.00 thereafter.

Average savings deposit interest rate declined from 4.2 percent in June 2001 to 3.5 percent by June 2002, while average lending rate declined from 19.6 percent to 16.4 percent over the same period. The spread between deposit and lending rates has remained wide, in spite of declining inflation over the period. While recent developments show that lending rates are becoming more flexible, the differential between short-term lending rates and deposit rates has remained particularly high during the period, with some deposit rates turning negative in real terms. Weaknesses in the legal and structural regime, (e.g. collateral enforcement) explain in part, the rigidity in the lending rates. The government is addressing these constraints with vigour (see 3.3).

Table 9: Trends in Selected Macroeconomic Indicators (1997-2002)

	1997	1998	1999	2000	2001
Real GDP growth (%)	3.3	4.0	4.7	4.9	5.6
Per capita income – Tshs.	147,026.3	170,732.7	193,169.2	208,894.0	231,426.0
Per capita income – USD	240.2	256.9	259.4	261.2	264.1
Population estimates (million) *	29.1	30.0	30.9	31.9	32.9
Real growth of agriculture (%)	2.4	1.9	4.1	3.4	5.5
Real growth of manufacturing (%)	5.0	8.0	3.6	4.8	5.0
Inflation (%) – annual average	16.1	12.9	7.8	6.0	5.2
Inflation (%) – year on year	15.4	11.2	7.0	5.5	4.9
Merchandise exports – USD (million)	752.6	588.5	543.3	663.2	776.4
Current a/c balance - USD (million)	-372.3	-826.9	-738.6	-388.4	-413.5

Foreign reserves (months of imports)	4.1	3.3	4.2	5.6	6.0
Exchange rate (annual average) Tshs.	612.1	664.7	744.8	808.4	876.4
Exchange rate (end of period)	624.6	668.0	797.3	803.3	916.3
Investments (% of GDP)	14.8	16.2	15.5	17.6	17.4
External debt service (% of exports)	36.9	36.4	27.2	28.6	21.6
	<b>1997/98</b>	<b>1998/99</b>	<b>1999/00</b>	<b>2000/01</b>	<b>2001/02</b>
Domestic revenue (% of GDP)	12.6	12.5	11.3	12.2	12.2
Total government expenditure (% of GDP)	14.8	14.8	17.1	16.8	18.8
Fiscal deficit (before grants) – (% of GDP)	-2.4	-2.3	-5.8	-4.6	-6.6
Growth of money supply (M <sub>2</sub> ) %	5.0	7.9	15.2	14.9	12.3
Average savings deposit interest rate (%)	10.0	7.9	7.1	4.2	3.5
Average lending interest rate (%)	24.0	24.5	22.1	19.6	16.4

\* Based on 1988 population census

Sources: National Bureau of Statistics; Ministry of Finance; Bank of Tanzania

### 3.1.1. Structural Reforms:

The Government is committed to improving the quality of public service delivery and is taking a series of measures to that end, including the following:

- A range of legal, regulatory and administrative reforms are under implementation, with a view to strengthening integrity of government's public financial management.
- Progress in public financial management reform was reviewed in depth in 2001 as part of a Country Financial Accountability Assessment. The findings of the review have been incorporated in a revised Public Financial Management Reform Programme.
- Public Expenditure Review process is well established, to monitor, inform and improve the quality of government spending in line with the PRS priorities and targets. The process is very transparent, involving the participation of all interested stakeholders including political parties, civil society, the donor community, faith organs and government ministries, departments and agencies (MDAs).
- An "expenditure tracking" study was conducted in 2001 as part of PRSP/HIPC, and it revealed that Tanzania has made very positive progress relative to other 22 countries included in the study. Tanzania met 8 of the 15 benchmarks and made encouraging progress on the remaining 7 benchmarks.
- The Government is publishing quarterly budget execution reports, drawn from the Integrated Financial Management System (IFMS). The government is also publishing in newspapers,

information on budget resource transfers to ministries, departments and agencies, including local government authorities. Individual and consolidated quarterly revenue and expenditure accounts of local governments are also underway for publication.

- This year has seen even further increased transparency and political debate in the media on budget proposals for 2002/03.
- A new National Debt Strategy has been developed to guide overall debt management with a view to ensuring debt sustainability. An important feature of the debt strategy is the tightening of approval procedures for new borrowings.
- A new Public Finance Act (PFA) and a new Public Procurement Act (PPA) were enacted by Parliament and became effective from July 1, 2001. The Public Service Act was passed by Parliament in April 2002, which will enable better enforcement of sanctions and disciplinary measures against non-compliance with financial and procurement regulations.
- The Office of the Controller and Auditor General (OCAG) has been reformed into National Audit Office (NAO) with greater independence and improved access to resources.

### **3.1.2. Linking Macro Policies, Growth and Poverty Reduction:**

As noted in previous sections, the performance of the Tanzanian economy at the macro level has been impressive. The Africa Competitiveness Report (2000) ranks Tanzania among the top most improved countries in Sub-Saharan Africa. This view is also shared by the World Bank and the Intelligence Unit of the Economist Magazine (1999). A notable outcome of the macroeconomic stability and moderate growth achieved over recent years is the improved fiscal performance. The Government has steadily increased budget allocations to PRS priority sectors mostly education, health, water and roads.

The HBS 2000/01 also noted improvement in housing conditions, increased possession of consumer durables, decrease in distance to markets, shops, public transport etc., which are all pointers to improvement in welfare as a result of good macroeconomic performance. However, this improvement is not captured in the expenditure variables used to calculate poverty headcounts and hence potentially understating the decline in poverty incidence. The challenge remains on how to transform the good macro performance into micro level benefits, which would create more appreciation at the individual, micro level, an issue to be further explored. As part of the response package, the Government will continue to strengthen ties between the rural and urban economy, improve rural infrastructure, encourage development of SMEs, facilitate provision of micro credits,

strengthen local capacity and strive to bring about broad based economic growth. The government will continue also to ensure that poverty reduction continues to be the central objective of all macro and sectoral policies.

On tax policy, the Government has implemented many tax reform measures aimed at enhancing revenue, while also reducing the tax burden on the poor. Such measures include:

- (i) Abolition of all taxes on agricultural inputs
- (ii) Removal of stamp duty on farm produce sales.
- (iii) A 5% cap on produce and livestock cess
- (iv) Abolition of VAT on investments relating to education.
- (v) Abolition of primary school fees and other contributions.
- (vi) Abolition of taxes on life-saving drugs and supplies.
- (vii) Removal of various other taxes on agriculture sector.

There are sectors in Tanzania which have taken advantage of the reforms and have made great strides ahead of others. The “pacemakers”, are tourism and mining. However, studies on tourism in Tanzania have shown that the sector employs less than 1% of the labour force (17 million people), which is about 170,000 people, while contributing 14% to GDP. The Government is exploring ways for making the tourist sector more pro-poor (PHDR 2002).

The share of mining and quarrying in GDP is still small (2.5% in 2001). Large-scale mining in Tanzania has not yet made insignificant direct impact on the lives of the poor Tanzanians (excluding few who can access social services provided by mining companies). For instance, employees in the sector are estimated to be only 0.6% of the labour force (PHDR 2002). The Government is exploring various ways to support small mining activities.

Agriculture continues to be a dependable pro-poor sector. In 2001 the contribution of agriculture to GDP remained high, above 50 percent (about 44 percent of the sector contribution is non-monetary agriculture). Also, the sector contributes about 70-80 percent to total employment and about 55 percent of the country's foreign exchange earnings in 2001. The sector grew at 5.5 percent in 2001 compared with 3.4 percent in 2000 – still lower than the required rate of 6-7 percent required to have a significant impact on the lives of the poor. The experience of other countries, e.g., South East Asia suggests that rapid growth and poverty reduction require emphasis on improving productivity and incomes in agricultural and non-farm rural activities. In order to address the need for improving productivity in this critical sector, the government increased the budget allocation to the sector in 2002/03 by 102 percent. The funds are to be used in facilitating production of crops, livestock,

seeds, traditional irrigation, cooperatives, marketing, extension services, agro-chemicals, veterinary drugs, and rural roads with emphasis on the increased role of lower levels of government and the private sector. In addition, the government is designing a micro-finance strategy and programmes, which will enable the rural poor to access credit.

Another area is that of the competitiveness and impact of exchange rate on exports. The gains from the recent exchange rate depreciation of the shilling, especially for low income exporters (e.g. cotton, coffee and cashew-nuts) were substantially offset by the declining commodity prices in the world market.

On trade policy, the removal of excessive trade barriers, internal and external, has improved the distribution of food in the country – improving food security. It is, however, recognized that sometimes a change in macro incentives may not filter to individual farmers. Middlemen tend to benefit more than the poor producers. For example, the liberalization of the coffee and cotton marketing has increased competition in the sectors such that farmers are now paid promptly for their crops, but they are not getting good prices because of decline in commodity prices and locational disadvantages.

### **3.2. Poverty Orientation of the 2002/03 Budget**

Developments on this front are also impressive. The 2002/03 Budget is the second since the government launched this Poverty Reduction Strategy (PRS). In the area of expenditure, the budget provides a substantial increase in resources for the priority sectors in line with the PRS objectives. Also, the 2002/03 Budget has provided for civil servants salary increase as well as enhancement of minimum pension. Given the importance of SME to employment creation and poverty reduction, the budget has provided support to the SMEs. The government continues with the reform and privatization of the remaining parastatals, particularly those providing economic services. The aim is to increase their productive efficiency and reduce the burden on the government budget. Terminal benefits have been set aside in preparation for privatization of earmarked parastatals.

On the revenue front, the government has taken measures to enhance revenue collection, protecting the vulnerable and ensure that privatization contributes to economic growth, employment creation and poverty reduction. The government has written off all unpaid liabilities emanating from stamp duty on school fees and subsequently abolished them, rationalized the levies and fees collected by ministries, government departments and regions, written off arrears (unpaid) in land rent resulting from reduction of the rent rate in 2001/02. The income tax structure was also changed. A summary of budget measures targeting pro-poor sectors is presented in box 5 below.

**Box 5: Highlights for the 2002/03 Budget Measures**

Agriculture	<ul style="list-style-type: none"> <li>• Reduction of suspended duty rate on all imported fresh milk from the current rate of 25 percent to 20 percent. The measure aims at reducing the price of imported milk for those areas that do not have sufficiently locally produced milk.</li> <li>• Abolished suspended duty on milk products e.g. powdered milk, cheese, and yoghurt) etc to supplement locally produced products.</li> <li>• Introduced suspended duty of 10% on imported fully refined edible oil. This measure is intended to encourage local industries, including small-scale industries, to use domestic oil seeds produced by Tanzanian farmers and therefore encourage farmers to increase production.</li> <li>• Re-introduction of VAT refund system for VAT paid by farmers on transportation, processing and packaging material for export crops.</li> <li>• Write off of arrears (unpaid) land rent which was fixed at Tshs. 600/= per acre, accrued before the introduction of the new land rent of 200/= in 2001/02. This measure aims at removing unnecessary burden on farmers and livestock keepers.</li> <li>• The government has established an export credit guarantee scheme under the management of Bank of Tanzania.</li> </ul>
Private sector investment and development	<ul style="list-style-type: none"> <li>• Promotion of export processing zones.</li> <li>• Encouraged production of exports within the framework of manufacturing “under bond.”</li> <li>• Goods sold by domestic industries to foreign institutions operating in Tanzania, which enjoy exemption from import duty, are recognized as deemed exports, and the concerned industries are entitled to duty drawback facility in respect of imported raw materials.</li> <li>• Extension of duty drawback application period from three months to six months. This measure aims at enabling eligible industries to claim refunds of import duty without undue impediments.</li> <li>• Customs duty on raw materials reduced to zero.</li> </ul>
Employment	<ul style="list-style-type: none"> <li>• The Pay-As-You-Earn (PAYE) threshold has been increased to Tshs. 50,000/= per month. The aim is to exempt from tax those earning below Tshs. 50,000/=.</li> <li>• Increase of the minimum threshold for taxation of benefit in kind to employees from Tshs. 1000/= to 50,000/=, the aim being to provide tax relief to low-income earners.</li> <li>• Rationalization of levies and fees rates collected by ministries, government departments and regions to ensure conformity with the fiscal policy objective including minimizing hurdles for employment creation.</li> <li>• The budget has set aside Tshs. 1.0 billion to support the development of small and medium size enterprises sector.</li> </ul>
Education	<ul style="list-style-type: none"> <li>• Abolition of stamp duty on school fees earned by government owned schools, colleges, private schools and training institutions.</li> <li>• Write off of all unpaid liabilities emanating from stamp duty on school fees.</li> <li>• The government has set aside Tshs. 1.5 billion for helping those students with excellent academic ability but denied the right of continuing with further studies due to poverty.</li> </ul>
Roads	<ul style="list-style-type: none"> <li>• Adjustment of fuel levy rate up by Tshs. 10/= per litre. This move is intended to enhance resources for the road fund for improving road maintenance.</li> </ul>
Health	<ul style="list-style-type: none"> <li>• Increased budgetary allocation for health sector</li> </ul>
Water	<ul style="list-style-type: none"> <li>• Increased budgetary allocation for water sector.</li> </ul>
HIV/AIDs	<ul style="list-style-type: none"> <li>• Increased budgetary allocation for war against HIV/AIDs.</li> </ul>
Legal and Judicial system	<ul style="list-style-type: none"> <li>• Increased budgetary allocation for Legal and Judicial system.</li> </ul>
Governance	<ul style="list-style-type: none"> <li>• Continued progress in Civil Service Reform including adjustment of civil servants salary structure.</li> <li>• The minimum pension has been adjusted upward.</li> </ul>
Structural Reform	<ul style="list-style-type: none"> <li>• The budget made a provision for terminal benefits to workers of public enterprises earmarked for privatization/ leasing. These include DAWASA, TRC and ATC.</li> </ul>

**3.3. Private Sector Development**

The government recognizes the central role the private sector plays in the development process in the country. The government has thus been undertaking wide ranging fiscal and structural reforms to foster private sector development in the country. The overarching focus of government policy is to maintain a conducive environment for private sector led growth and development. The corner stones of government policy in providing a conducive economic environment are:

- Maintaining macroeconomic stability to ensure predictability in the operating environment;
- Continuing with the privatization programme, now focusing on large utilities and banks;
- Rationalizing the taxation system with a view to making it more transparent and efficient;
- Improving the jurisprudence system so that ‘the rules of the game’ remain enforceable and property rights protected; and
- Improving human capital and physical infrastructure for improved competitiveness.

The establishment of the Tanzania National Business Council (TNBC) has enabled increased dialogue between the government and the private sector on development issues. Some of the measures undertaken by the government as a result of the dialogue include:

- In July 2002 Tanzania hosted an International Investors Round Table. The International IRT members acknowledged the advanced level of development of private-public partnership in Tanzania, and undertook to be part of the advocacy in creating positive image of Tanzania. The IRT also acknowledged issues and recommendations of the local investment roundtable and the GoT commitment to resolve outstanding issues, key ones being:
  - Use of land as collateral, land registration, etc.
  - Labour law
  - Tax and tax administration
  - Governance
  - Bureaucracy (red tape), and
  - Enhancement of regulatory framework

The International Investors Round Table agreed to meet again in Tanzania in the near future.

- Four Community Banks have been established as microfinance facilities
- The establishment of a credit guarantee scheme to guarantee credit for marketing of agricultural crops, and later other exports.



- A comprehensive review of micro credit schemes has also been carried out and a sector-wide study, covering banks and non-bank financial intermediaries, and the insurance schemes has been carried out.
- Substantial progress has been made in reducing the number of licenses (and collecting agencies) impacting on individual businesses.
- The government has prepared a draft Construction Policy, which together with the Public Procurement Act, 2001 clarifies the role of the private sector in the construction of roads.
- The government has taken steps to enable Tanzania to benefit from international and regional risk guarantee schemes.

The government has strengthened the effectiveness of the Tanzania Investment Centre (TIC) in promoting and facilitating private sector investment. The TIC has been restructured, with its role transformed from granting investment certificates and tax incentives, to providing the services of a modern investment facilitation center.

#### **3.4. Globalization and Poverty**

The process of globalization is an inevitable reality and no country can afford to opt out. The challenge is how Tanzania positions itself and works out modalities for meaningful participation in ensuring maximum gain. This is to be done within the context of Vision 2025 and the PRS. As Tanzania implements its Poverty Reduction Strategy, which among others, entails transforming the economy for higher and equitable growth, it has to take into account the challenges brought by the forces of globalization in terms of the changing economic environment, technological advances, and movement of capital and labour. Tanzania is bracing herself to deal with issues emerging from the global interdependences to take the fullest advantage of the opportunities arising from such changes. Cognizant of the fact that Tanzania's economic growth can only be sustainable if it is responsive to the international competitive environment to fully capture export opportunities as they arise, the Government is taking measures to enhance the promotion of Export Processing Zones (EPZ) and the development of processing capacity to add value to agricultural produce and encourage exports of final products to the extent possible.

Increased trade liberalization at global level, growing regional integration (e.g. EU, SADC, EAC, etc.) have created challenges for promoting economic growth and sustainable development, that is necessary in combating poverty. In line with these developments Tanzania has adopted policies, in particular industrial and trade policies, to respond to increased competition in regional and international markets. Steps taken to enhance private sector development form part of the strategy.

Measures that are taken to respond to the challenges posed by global competition and changes in technology include the following:

- Diversification of exports with increasing value addition through processing and new non-traditional agricultural exports.
- Improving efficiency in production, processing and marketing of current and potential export commodities to strengthen Tanzania's competitiveness in the world markets.
- Establishment and maintenance of sound, consistent and stable investment policies, which are conducive to encouraging development and promotion of investment, technology and the export sector.
- Restructuring aid relationships in ways, which ensure control and ownership of the development agenda by Tanzania, through the implementation of Tanzania Assistance Strategy (TAS).
- Enhancing and encouraging intra-regional trade and other forms of regional cooperation.
- Attaching great importance to development of ICT.

### **3.5. Public Debt Management and Debt Sustainability**

Public debt developments have broadly been on track. A revised National Debt Strategy was adopted by the Government in August 2002. The strategy enunciates the importance of fiscal sustainability of public debt through improved management of risks, development of local financial markets, and a strengthening of the legal and institutional arrangements for borrowing and debt management. The strategy also presents options for dealing with the likely fiscal implications of the debt arising from the parastatal privatization process. Domestic debt market developments were particularly favourable during the year. Encouraged by the successful floatation at the stock exchange of the 5-year treasury bond in February 2002, the government launched a 7-year fixed rate treasury bond in August 2002. The new 5 and 7-year bonds are expected to be an important test for the ongoing efforts to convert unsecuritized debt into marketable securities.