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Shaping economic transformation in Tanzania

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Current policy and research debates

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Key messages

On 23 February 2015, the DFID-ESRC Growth Research Programme (DEGRP), the Tanzanian research institute REPOA and the Overseas Development Institute (ODI) convened a high-level conference in Dar es Salaam to discuss challenges and potential solutions for economic transformation and growth in Tanzania. This publication is the result of the conference and features the keynote speech by the Governor of the Bank of Tanzania, Professor Benno Ndulu, as well as a selection of conference contributions and background notes based on DEGRP research. Below are the messages that emerged.

Attaining economic transformation is the only foundation upon which Tanzanians can be lifted out of poverty sustainably. The Tanzanian government has underlined the importance of economic transformation in its long-term policy plans.

To date, Tanzania's economic transformation has lagged behind. While Tanzania has grown faster than the average rate of growth in sub-Saharan Africa (since 2005, Tanzania's growth rate was 6.9% compared to 4.9%), the share of manufacturing in gross domestic product (GDP) remained at a low of 7% between 2007 and 2013 and poverty remains high.

However, recent data suggest that the pace of economic transformation has quickened. Consider:

- The rebased data suggest more transformation has taken place compared to old data (a greater share of services).
- Non-traditional exports have increased, with tourism surpassing gold as the major foreign exchange earner.
- The use of ICT has increased considerably in recent years.
- Labour productivity increased 3% annually over the period 2007 to 2013 (at a slower rate than before), three quarters of which is due to structural change across sectors.

The keynote address highlighted five key drivers of economic transformation:

- adding value to commodities and labour-intensive industrialisation
- productivity increases through technology-based innovation
- reducing the cost of doing business
- improving skills
- exploiting regional integration initiatives.

Tanzania's path to transformation is likely to differ significantly from an East Asian mass-manufacturing model, and could focus on promoting agricultural productivity, value addition and labour-intensive manufacturing; and building 'industries without smokestacks' including tourism, transit trade, horticulture and IT-based services.

A transition to large-scale industrial agro-processing in the short to medium term is unlikely as the existing supply chains will require significant upgrading. A middle way is suggested in which artisanal processors can become subcontractors supplying bulk products to urban-based small and medium-sized enterprises (SMEs), leaving them to focus on packaging, product development and meeting regulatory requirements. A policy framework to achieve this includes a range of tools such as incentives and mandates, and with a role for public–private partnerships.

Micro-enterprises in key growth sectors of the economy make little use of formal financial services, instead relying heavily on semi-formal or informal institutions. Unless financial inclusion is part of a package of inclusive growth that recognises the role of micro-enterprises in contributing to jobs and local economic development, their potential will be continually undermined.

As well as focusing on the right areas for economic transformation, it is also important to improve policy coherence, policy consistency and active coordination among different actors.

1. Introduction

The high-level conference in Dar es Salaam convened by DEGRP, REPOA and ODI on 23 February 2015 discussed challenges and potential solutions for economic transformation and growth in Tanzania. It brought together international experts and national policy-makers to explore how agriculture and manufacturing contribute to economic transformation, and whether and how the financial sector can support this.

Tanzania has grown rapidly in recent years but there are concerns about the quality and longevity of this growth. Unless there is an upgrading of productivity in the agricultural sector and a move towards industrialisation and productive services, growth may not be sustained. This risks future job generation and poverty reduction.

This set of essays is the result of the conference. It features the keynote speech by Professor Benno Ndulu, the Governor of the Bank of Tanzania, as well as a selection of conference contributions and background notes.

Chapter 2 sets the scene by providing an overall picture of the conference themes. It outlines briefly Tanzania's policy interest and economic record so far and poses questions on agriculture, industrialisation and finance and economic growth in Tanzania, with reference to DEGRP projects on Tanzania.

Chapter 3 contains Professor Ndulu's address. It provides recent perspectives on economic transformation and sets a number of priorities for the future.

Chapters 4 and 5 present the perspectives on economic transformation from two DEGRP grant holders. Chapter 4 discusses microfinance in the research led by Professor Alison Brown. The research examines the barriers, benefits and risks to urban micro-enterprises in accessing finance, and the potential of improved microfinance services to support innovation and growth in Tanzania. In Chapter 5, Dr Julius Gatune discusses agricultural value chains.

The workshop featured several other high-level contributions, a snapshot of which is included in the report in Chapter 6.

Chapter 7 summarises and draws out the main implications including policy issues for Tanzania.

Shaping economic tranformation in Tanzania

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2. Tanzania's economic transformation: setting the scene

Dirk Willem te Velde and Steve Wiggins, ODI
Sam Wangwe, REPOA[1]

Summary

Economic transformation is the key to lifting Tanzanians out of poverty sustainably. This essay looks at recent data suggesting there has been better progress on economic transformation than previously thought, although major weaknesses remain. It focuses on three paths to improvement:

- how to accelerate growth and productivity in agriculture, Tanzania's main source of livelihood
- how its manufacturing sector can contribute more to economic transformation
- how finance can meet the needs of a dynamic micro-enterprise sector.

Tanzania's pursuit of economic transformation

According to the Tanzania Development Vision 2025, the country aims to be a middle-income country by 2025. This is characterised by high-quality livelihoods; peace, stability and unity; good governance; a well-educated society; a competitive economy capable of producing sustainable growth and shared benefits; and a diversified semi-industrialised economy with a substantial industrial sector. Tanzania's President Jakaya Kikwete declared in 2014 that to reach the desired middle-income country status within the coming 15 years – with a nominal per capita income of $3,000 – would require a strategic socioeconomic transformation involving 'an increasing share of output and employment from high-productivity industrial and service activities with less reliance on traditional low-productivity, mainly agrarian activities' (Kikwete, 2014). This transformation will manifest itself in declining shares of agriculture in national output and employment and a rise in the shares of manufacturing and services over time.

The government's 'Long-Term Perspective Plan (2011–2025)' is divided into three five-year development plans (FYDPs). The first FYDP for 2011/12 to 2015/16 focuses on addressing growth constraints, such as energy and transport infrastructure, and strategic investments in agriculture and manufacturing for increased productivity. The second, 2015/16 to 2020/21, will focus on natural gas-based, agro-processing and medium-technology industries. The third FYDP, 2020/21 to 2025/26, would focus on improving competitiveness in all sectors, especially manufacturing and services.

The agency for strategic thinking on the national economy, the President's Office Planning Commission, drives and coordinates the implementation of transformation strategies. Its executive secretary, Dr Phillip Mpango (2013), has suggested eight factors for success: transformational leadership; relentless prioritisation of high-impact areas; radical improvement in agricultural productivity and industrialisation strategies; a strong developmental state; a stable and predictable political and macroeconomic framework; a complete change of mind-set (social norms, work ethos and professional etiquette); and understanding the country's unique advantages and seizing emerging opportunities.

Economic transformation in Tanzania: a brief review of historical and recent evidence

Since 2005, Tanzania has grown at a rate of 6.9% annually, more than the sub-Saharan African average of 4.9%.[2] While the growth rate has been impressive, poverty has not declined significantly (compared to Uganda or Ghana) and was still 28% in 2012.

Moreover, economic transformation in Tanzania has been limited over the last three decades up until 2010. According to internationally consistent historical data (pre-rebasing) compiled by the University of Groningen under a DEGRP project, the share of agriculture in the Tanzanian economy was 31% of GDP in 1990 and was still around 30.1% in 2010; the share of industry increased from 20.7% to 26.4%, but most of the increase came from mining; and the share of services actually declined from 48.9% in 1990 to 43.6% in 2010.[3] Even though labour productivity is 10 times greater in industry than in agriculture, and two times greater in services, much productivity change through sectoral movements had not been exploited.

However, a closer look at recent data for the Tanzanian economy suggests recent economic transformation is in much better shape than previously thought. For example, the recent rebasing of GDP data suggests evidence of slightly more structural change than initially measured. The base year shifted from 2001 to 2007 prices, and together with methodological updates, this resulted in raising the estimate of GDP in the base year 2007 by 27.8%. The strongest increases in value addition were in: (i) crops, hunting and forestry; (ii) real estate and business services; and (iii) transport services. The rebasing has led to an increase in the tertiary sector share in GDP by 3 percentage points (pp), in the base year; at the cost of a decrease in the primary (2 pp) and secondary (1 pp) sectors.[4]

While there has been some diversification and dynamism in trade services (transport, computer and information services, tourism), and in trade destinations (adding 10 more country destinations in 2013), Tanzania still lacks diversified merchandise trade. Exports are currently dominated by gold, copper, coffee, cashew nuts and tobacco. Furthermore, the local content of exports is often lower than in other countries. The annual growth rate in the domestic value addition (in gross exports, using Eora multi-region input-output (MRIO) data) was 5.4% in Tanzania over the period 1996 to 2011, but this was much less than other sub-Saharan African (SSA) countries (e.g. 8.8% in Kenya, 10.9% in Uganda and 15.9% in Zambia). Moreover, the share of domestic value addition in exports was 69.9% in 2011, compared to 90.1% in Nigeria, 75.1% in Zambia and 71.5% in Uganda (ODI, 2015).

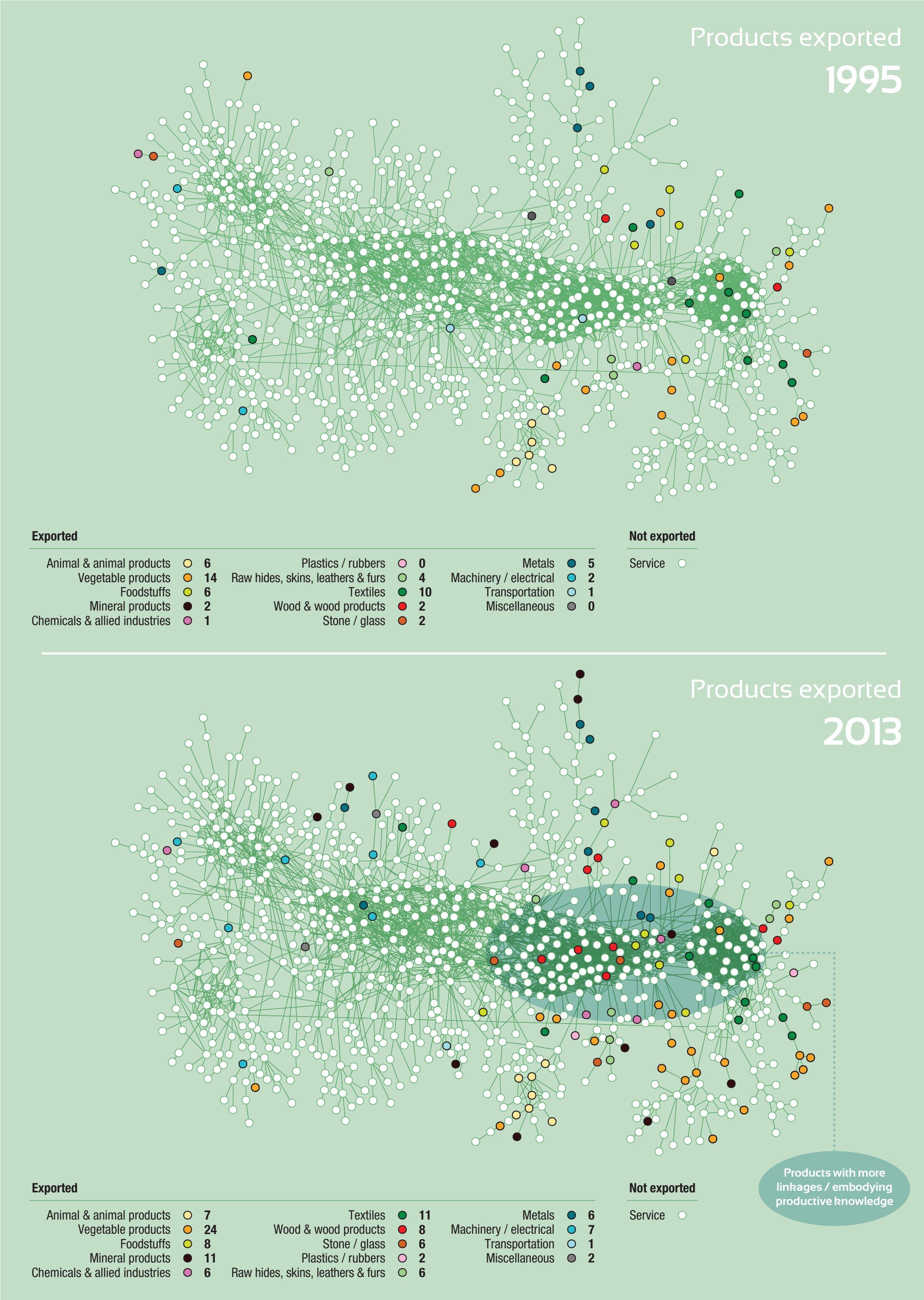
This is not to deny that Tanzania has made some progress on the complexity of its manufacturing production. Evidence suggests that the more complex a country's production and export structure, the faster its growth rate. Using the Hidalgo et al. (2007) product space analysis, Figure 1 overleaf provides an example of the type of products that Tanzania exported (indicated by dots) in 1995 and 2013. It shows that Tanzania has slowly moved away from specialising in peripheral products - products that don't lend themselves to easy diversification - towards specialisation in products that have clearer links to other products. These fall in the middle dense area of the product space related to machinery, electronics and garments. However, the process of change is ongoing and very slow.

Further encouraging signs that some economic transformation is underway are apparent. The World Bank (2014) detects three promising indications of transformation over recent years: a rapid expansion of non-farm businesses, up by 23% between 2008/9 and 2010/11, while the number of farms fell by 3%; the emergence of specialised firms in fast-growing sectors such as communication, mining and transport; and the widespread use of new ICT technology by households and private firms (two out of three Tanzanian firms report the use of mobile phones).

Lemma et al. (2015) analyse rebased data in combination with recent labour force data and conclude that labour productivity grew quickly by 3% per annum from 2007 to 2013, with three quarters of this due to structural change (see Table 1 overleaf).

The pace of economic transformation in Tanzania appears to have quickened recently.

Figure 1
Increased complexity in the Hausmann product space - Tanzania



SOURCE: CENTER FOR INTERNATIONAL DEVELOPMENT, HARVARD UNIVERSITY (2013)

NOTE: The above diagrams map the connections between different categories of goods that are traded, with each category represented by a circle. Goods towards the centre of the network are those with most interconnections, where producing and exporting such goods confers capabilities that lead to higher productivity and output. The core of the network consists of metal products, machinery, and chemicals, whereas the periphery features products from 'less connected' industries such as fishing and tropical and cereal agriculture.

Tanzania has traditionally exported goods towards the periphery of the product space (see first diagram), largely primary products, unprocessed or only a little processed. By 2013, however, the mapping shows that exports from more connected industries have started, although most exports still come from peripheral products.

Table 1. Productivity decomposition in Tanzania, 2007 to 2013

	Productivity due to			Sector % contribution to total labour productivity change		
	Within-sector changes	Bet ween-sector changes	Total	Within-sector changes	Between-sector changes	Total
Agriculture/ hunting, forestry and fishing	0.9%	-0.6%	0.3%	30.1%	-20.8%	8.9%
Mining and quarrying	-0.4%	0.4%	0.1%	-12.3%	14.6%	2.3%
Manufacturing	0.1%	0.2%	0.3%	2.5%	6.7%	8.8%
Electricity, gas and water	-0.1%	0.1%	0.0%	-4.1%	4.7%	0.6%
Construction	-0.4%	0.9%	0.5%	-13.1%	30.7%	16.9%
Wholesale and retail trade	-0.5%	0.8%	0.3%	-16.7%	28.2%	11.1%
Hotels and restaurants	-0.2%	0.2%	0.0%	-6.5%	6.8%	0.3%
Transportation/ storage and communication	-0.3%	0.8%	0.5%	-9.4%	27.2%	17.1%
Financial intermediation	-0.3%	0.5%	0.2%	-8.8%	17.0%	7.8%
Public administration and defence	0.2%	-0.2%	0.0%	7.5%	-7.5%	0.0%
Education	-0.1%	0.2%	0.1%	-3.6%	7.8%	4.0%
Health and social services	0.0%	0.1%	0.1%	-1.0%	3.1%	2.0%
Other (see below)	1.8%	-1.3%	0.5%	61.1%	-44.1%	16.3%
Total	0.8%	2.2%	3.0%	25.8%	74.2%	100.0%

NOTE: 'other' includes real estate/renting and business activities, other community/social and personal service activities and private households with employed persons. source: lemma et al. (2015)

Key questions on agriculture, industrialisation and finance and economic transformation

Agriculture and economic transformation

Agriculture has long been the main source of jobs and livelihoods in Tanzania as well as the principal export earner. More than 18 million people work in agriculture and since the early 1990s those employed in the sector have increased by more than 50%, making agriculture the main source of new jobs.

Agricultural growth, however, has tended to be slow, while productivity in yields per hectare and production per worker has long been low. Agricultural growth averaged 1.6% a year in the 1990s, and 4.6% a year since 2000. Given rapid population growth, even the faster growth since 2000 remains less than 2% a year per capita. Yields of cereals average around 1.25 tonnes per hectare, with hardly any improvement in the last 20 years. Labour productivity is also low: each person working in agriculture generates less than $500 a year on average, although that has risen by 25% since the early 1990s.[5] Most farming involves extensive cultivation without irrigation, with low use of external inputs, and carried out on small-scale family farms.

A key question then is how to accelerate growth and increase productivity. Lively debates exist around several questions:

- How much progress can be made with the many smallholders who currently occupy most of the land – would larger holdings lead to more investment and innovation?
- How much can agricultural development be left to market forces? Other than investing in rural public goods – roads, power, education, health, water and agricultural research and extension – how far does the state need to intervene to complement private efforts?
- Should efforts to stimulate agriculture focus on higher-potential lands, or should resources be spread across all agro-ecological zones? What kinds of public investments will generate good returns in different areas?

DEGRP funds the following projects that operate in Tanzania:

- **Agricultural supply chains, growth and poverty in sub-Saharan Africa:** market structure, farm constraints and grassroots institutions. http://bit.ly/1AX7zuU
- **Innovations to promote growth among small-scale irrigators in Africa:** an ethnographic and knowledge-exchange approach. http://bit.ly/17j1zAN

And four projects that are just starting:

- **Gender and pro-poor agricultural growth:** non-farm/farm linkages and village dynamics in sub-Saharan Africa. http://bit.ly/1w4rE2l
- **The generation and distribution of rural prosperity:** insights from longitudinal survey data. http://bit.ly/1Dzv677
- **Assessing models of public–private partnerships for irrigation development in Africa.** http://bit.ly/1w4s0Ge
- **Assessing the growth potential of farmer-led irrigation development in sub-Saharan Africa.** http://bit.ly/1JtpTS1

Industrialisation and economic transformation

Industrialisation is key to Tanzania's policy on economic transformation. However, according to the rebased data, Tanzania's manufacturing sector accounted for only 7.1% of GDP in 2007 and this has remained largely constant until 2013. There are various examples of weak manufacturing performance. For example, according to DEGRP research, local manufacturers in Tanzania are not sharing in the large and expanding market for health-related commodities; they supply a declining share of medicines as well as a narrow range of other supplies including bed nets, bed sheets and mattresses, topical products such as white spirit, medical furniture and cleaning products (Wangwe et al., 2014).

A DEGRP research project, **Industrial Productivity, Health Sector Performance and Policy Synergies for Inclusive Growth: A Study in Tanzania and Kenya**, (implemented by REPOA, ACTS, and the Open University)[6] examined to what extent improved supply of medicines and other essential supplies and equipment from local manufacturers into the health sector in Tanzania and Kenya could improve health system performance and contribute to industrial development. To seize market opportunities, local manufacturers must invest, upgrade and expand. To do so, Wangwe et al. (2014) argue that they require targeted industrial policy support.

The World Bank (2014) also suggested that 'targeting specific sectors can help Tanzania to jump-start its growth in production, employment, and exports and bring faster benefits' highlighting three sub-sectors for their growth potential: (i) the leather industry for the expansion of small businesses; (ii) high-value vegetables for farms; and (iii) tourism for exporting services. With respect to the small firms in the leather sector, it suggests improving quality of skins and hides, promoting new investments in clusters of transforming industries, and reducing export tax on raw hides and skins with the objective of promoting gradual competition on inputs price and quality.

Key questions include:

1. What are the salient features of the role of the manufacturing sector in economic transformation in Tanzania?
2. What targeted interventions can support innovation and industrialisation for economic transformation? What is the most appropriate institutional setting in which this can be best implemented?
3. How can we best support the local manufacture of health products?

Finance and economic transformation

A sound, stable and efficient financial sector is indispensable for sustained economic growth and structural transformation. By enabling greater diversification, risk-sharing and investment in higher-productivity activities, financial development can facilitate resource allocation and therefore economic transformation (Te Velde and Griffith-Jones., 2013). There is often a lack of depth, access, efficiency and stability in the financial sector in sub-Saharan Africa. Financial sector support for the real sector remains weak, with corporate lending mainly for short-run projects. Several African countries also lack adequate competition, with an oligopolistic banking sector leading to inefficient pricing of financial assets.

There are many dimensions to the discussion on finance and economic transformation in Tanzania. Over the last decade, the share of financial intermediation in GDP has hovered around 1.6% and 1.8%. However, this understates the role of financial markets. The formal banking sector is still underdeveloped, with domestic credit to the private sector at only 17% of GDP. Financial inclusion remains limited in Tanzania, with only 8.4% of households holding a bank account. As a result of limited access to formal credit by commercial banks, small and informal businesses have depended on semi-formal and informal financing, including microfinance and mobile money.

Micro-enterprise remains a core component of the economy, and government policy attaches great importance to the contributions of the informal sector to national economic growth. Labour force data in 2006 found that 40% of all households in mainland Tanzania engaged in informal sector activities, with up to 55% in urban areas. With an estimated 850,000 new job-seekers entering the labour market each year, job creation through self-employment remains a flagship government policy.

However, a dynamic micro-enterprise sector needs access to secure financial services for savings, credit, insurance and money transfer. Although the financial landscape is changing rapidly, a 2013 survey found that 43% of people in mainland Tanzania and 63% in Zanzibar rely on informal financial services or remain financially excluded.

Tanzania has a rapidly developing finance sector, but microfinance provision still relies heavily on semi-formal or informal institutions, with a multiplicity of regulators and limited enforcement capacity. Many of the informal savings and loan associations are extending financial inclusion and reaching people with no access to normal banking, but their operations are not subject to oversight. Meanwhile, mobile phones are revolutionising access to money transfers and savings. Although mobiles are not yet widely used for payments or loans, this is likely to be a major area of expansion.

The challenge is to promote financial inclusion and ensure adequate consumer protection so that users of microfinance services have access to core information on the products they access, without stifling innovation in financial service provision. A DEGRP research project, **Inclusive Growth: Improving Microfinance Regulation to Support Growth and Innovation in Micro-enterprise**,[7] is exploring how that delicate balance can be achieved. Key questions include:

1. What are the crucial needs of micro-enterprises in gaining access to secure and transparent financial services?

2. How can a more coordinated supervisory and regulatory approach to microfinance provision be achieved?

3. How can rapid developments in mobile money and recent regulatory initiatives be strengthened to promote innovation and economic growth?

Beyond microfinance, there are questions around the role of formal financial sector development and managing capital flows in promoting economic transformation. Since economic liberalisation in the 1990s, Tanzania's financial sector has undergone substantial structural change. The reforms spearheaded by the Bank of Tanzania (BoT) aimed to promote development of a market-based financial sector to reinvigorate the deteriorating economy and accelerate economic growth. They allowed the private sector and foreign banks to participate, while financial markets and indirect instruments of monetary policy were introduced. The reforms resulted in a rapid increase in banking and non-banking financial institutions. This has brought gradual improvements in banking services to the private sector. However, development funding instruments are still lacking, relying mostly on the undercapitalised TIB Development Bank. Other challenges include perceived risks of lending, resulting in a wide margin between lending and deposit rates (Bohela Lunogelo, forthcoming), although according to World Bank data the interest rate spread in Tanzania in 2013 was lower than other East African countries.[8]

The composition of finance flows is also changing, which presents new challenges for using these to shape economic transformation. Domestic tax revenues are increasing while aid sources are declining (as a percentage of GDP) and are changing in nature. Remittances are low, but foreign direct investment (FDI) has been an important source of inflows (at more than 5% of GDP in the last decade) mainly to the natural resources sector which poses challenges for how such investment contributes to transforming the domestic economy. There are further discussions about the potential for using sovereign bonds to finance infrastructure.

Key questions around these other components include:

1. What are the priorities in financial sector development for economic transformation (e.g. microfinance, banking sector, bond and equity markets)?

2. What is the role of financial regulation in promoting a stable and efficient financial sector for economic transformation?

3. What is the relative role for domestic and foreign capital in promoting economic transformation, and how can these be managed?

3. The importance of economic transformation

Professor Benno Ndulu, Governor, Bank of Tanzania

Keynote speech, DEGRP/REPOA high-level conference

Dar es Salaam, 23 February 2015

Summary

Professor Ndulu argues that Tanzania's economic transformation will not be achieved through an 'East Asian mass-manufacturing' model alone. Here he outlines a three-pronged strategy: investing in agriculture as the primary livelihood; promoting labour-intensive manufacturing including low-skilled jobs migration from Asia; and promoting non-manufacturing, high-value activities such as tourism, transit trade and IT-based services. He explains the poverty-reducing power of agriculture and services, and highlights five drivers that will define Tanzania's economic future.

Let me start by thanking the organisers of this workshop for inviting me to deliver a keynote address on *the importance of economic transformation*. It is my honour and privilege to share a few thoughts with you on this important theme. The theme of this workshop 'Shaping Economic Transformation in Tanzania' continues to preoccupy the minds of policy-makers and academics in Tanzania, half a century after independence, just like it does in many other African countries. This is because attaining economic transformation is the only foundation from which we can sustainably lift Tanzanians out of poverty.

Tanzania's growth experience took a sharp turn in the last two decades. Its per capita GDP growth, which had averaged a paltry 0.8% in the three and a half decades ending 1995, has averaged nearly 3.5% for the period since then and it is now steady at this relatively high level in sharp contrast to the highly volatile and episodic growth of the past. This resilience has also been demonstrated during the challenging periods of the global financial crisis with its aftermath of a deep global recession since 2008.

While the poverty reduction impact of this growth has been comparatively smaller in the first of the two decades since 1995, it has picked up considerably in the current decade. The results from the recent household budget survey and the World Bank's Poverty Assessment completed very recently, confirm this positive turnaround of impact.

The recent growth experience has also been accompanied by some significant though not transformative changes in the structure of Tanzania's economy, changes in the sources of growth and sectoral composition of the sources of foreign exchange earnings. We divide the real economy (at 2001 prices) into three major sectors – agriculture (including crops, hunting, forestry and fisheries); industry (including mining, manufacturing, power generation, construction); and services. The share of agriculture has declined moderately from about 30% in 1998 to 21% in 2013. The share of industry has moderately increased from 17.7% in 1998 to 22% in 2013. The share of services has increased from 45% in 1998 to 50.5% in 2013. In terms of sources of growth, there has been a sharper decline in the contribution of agriculture from nearly 30% in 1998 to 13.3% in 2013. The contribution of industry to growth rose from 17% to nearly 24% while that of services rose from 45% to nearly 59%. The more rapid growth of the two sectors accounts for the sharper rise in both shares and contribution to growth.

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What is perhaps a more dramatic change in the structure is with respect to the sources of foreign exchange earnings. By 2014 nearly 90% of the foreign exchange earnings came from non-traditional exports; the traditional exports (the six major export crops) that accounted for 25% of foreign exchange earnings in 1998, contributed only 10% in 2014. Within the non-traditional exports, tourism earnings have risen from $400 million in 1998 to nearly $2 billion in 2014, contributing a quarter of total earnings in 2014. Manufacturing exports have very sharply increased from $35.7 million in 1998 to $1.3 billion in 2014 - a phenomenal growth. Earnings from transit services have also increased very sharply from $42 million in 1998 to $850 million in 2014, now accounting for 10% of total earnings, about the same as all traditional exports. The story of gold is better known, increasing its earnings from $3 million in 1998 to approximately $1 .7 billion in 2014, having suffered a setback in global prices. Gold now contributes about 21% to Tanzania's earnings of foreign exchange.

Towards economic transformation in Tanzania

In order to sustain and enhance the growth of our economy, Tanzania will need to pay attention to five key drivers. *First* is to pursue structural transformation by reducing reliance on raw commodities and natural resources, and to pursue a vigorous initiative to add value to its commodities by pursuing a natural resources based and labour-intensive industrialisation. *Second*, vigorously pursue a productivity-enhancing agenda largely driven by technology-based innovation, taking advantage of Tanzania's late-starter position to learn from others and adapt such knowledge locally. *Third*, to reduce the cost of doing business to help attract investment and to enhance the competitiveness of Tanzania's economy regionally and globally. This should include not only reducing the cost of infrastructure services - including power, transport and logistics – but also enforcing property rights, ridding the economy of corruption, and reduction of bureaucratic red tape. *Fourth* is to enhance the stock of skills to support structural transformation and innovation. In this respect Tanzania can exploit the youth bulge in its demography by transforming it into a skilled labour force much more adaptable to technology. *Fifth*, to exploit the emerging regional integration initiatives to gain scale and coordination in economic transformation.

I will next focus on structural transformation as a key driver of sustained growth and economic transformation of Tanzania by identifying opportunities the country has to diversify and change its structure; and then focus on potential areas of action for success.

Economic transformation is a multidimensional concept, which involves modernisation of a country's economy, society and institutions. The adjustments needed in society and institutions during transformation have been elsewhere described as a 'controlled revolution' (Kuznets, 1973). The management of transformation fundamentally requires legal and institutional innovations, in which the state and other institutions play key roles. Economic transformation is often underpinned by policy measures that are general in scope, such as improving the quantity and quality of infrastructure, setting up a welcoming environment for potential investors, building adequate human capital, promoting technological adoption and exploiting the comparative advantages of the economy. Transformation must seek to reduce income inequalities through inclusive growth and change the structure of the economy to make it more resilient to external shocks. According to Timmer (2009), four elements have defined successful economic transformations in the world: first is the declining share of agriculture in GDP and total employment; second is the migration from rural to urban areas and a rapid process of urbanisation that can gainfully absorb the migrants; third is the rise of a modern industrial and service economy; and fourth is the demographic transition from high to low rates of births and deaths.

It is important to note the implications of this pattern of economic transformation for poverty reduction. Recent World Bank research (Christiaensen et al., 2011 ; Filmer and Fox, 2013) confirms the importance of agriculture in Africa for poverty reduction, primarily because the majority of Africans depend on this sector for livelihood. A 1% annual increase in GDP per capita driven by agricultural growth can reduce poverty between 53% and 127% more than growth driven by the non-agricultural sector. However, more recent work by Ferreira (2014) shows that the poverty-reducing effect of growth from agriculture and services are comparable - 1% increase in GDP per capita led by agricultural growth reduces poverty by 0.67%, and the same increase led by services, reduces it by 0.96%. Hence the decline in the share of agriculture if compensated by the increase in the share of services would not be detrimental to poverty reduction. It is striking, however, that this observation does not hold for industry. The evidence shows that agriculture and services are more effective in reducing poverty among the poor than industry.

Let us avoid getting stuck in history

Tanzania's drive towards economic transformation dates back to the mid-1970s. The most significant of the deliberate initiatives was contained in the Third Five Year Plan (1976–81), which focused on the pursuit of basic industrialisation. Others in this room are better placed to talk about this initiative and why it didn't materialise, and why Tanzania instead actually went through a period of de-industrialisation in the 1980s. We have also witnessed during the same period the phenomenal growth of Asia's manufacturing sector which, while offering an example of what can be achieved by low-income countries, also presents a huge competitive hurdle for late starters.

A key question from both these observations is whether Tanzania has to pursue the same approach to economic transformation as the Asians or as in our previous unsuccessful attempt? The answer to this question depends on appreciating the opportunities that exist currently and the changed context for Tanzania as a late starter. I would like to venture my opinion that Tanzania's path to transformation will differ significantly from that of Asia and explain this later.

The five key influential factors that will define Tanzania's economic transformation

1. Tanzania has a strong comparative advantage in natural resources including arable land and water for irrigation; forest reserves and wildlife; and a wide range of ornamental and industrial minerals. Discoveries are at an early stage and potential is huge. What these endowments offer for economic transformation is resource-based industrialisation, food manufacture and agro-processing; and services linked to tourism to take advantage of our natural attractions

2. Tanzania's geographic location endows it with a potential of being the gateway to the landlocked countries of the Great Lakes region. With appropriate investment and policies, Tanzania can take advantage of its shorter distance to destinations without going through third countries. This opens up a huge opportunity for growth in transit and logistical services. If labour-intensive industries and warehouses from Asia can be relocated to coastal areas, this would provide a huge potential for growth of services in trade with the region.

3. The recent shift of dominant technology from mechanical to ICT as a dominant driver of productivity growth and expansion of affordable services opens the door for rapid growth of ICT-based or facilitated services. Fortunately Tanzania has made major investment in ICT infrastructure in the form of a 10,000km network of fibre optic cables and is well connected with all landlocked neighbours as a data gateway. This provides a major opportunity to develop and provide a wide range of IT-based products and services. The ongoing initiative to impart IT skills in schools as part of Tanzania' s 'Beyond Tomorrow Initiative' will further improve capabilities to exploit these opportunities.

4. Abundant and youthful labour is another opportunity the country can exploit against the background of ageing populations in developed and a number of emerging economies. Labour costs in Asia have been increasing with increases in wage/ incomes engendering relative disadvantage competition-wise for labour-intensive manufacturing. Tanzania can exploit this advantage if it fixes the problems linked to the high cost of doing business.

5. Regional integration initiatives currently being pursued offer opportunities to exploit regional demand for expanding industrial investment. In fact, the bulk of Tanzania' s manufactured exports are for the region. Africa's economy has now achieved scale, offering a large market. With GDP of $5.2 trillion measured at purchasing power parity, the region if integrated would rank as the fifth largest economy in the world. Excluding North Africa, SSA is still a large economy at $3.4 trillion. Africa also has the fastest growing middle class, currently estimated at 350 million with annual expenditure of $680 billion in nominal dollars – a very significant market. Finally the region also has the highest rate of urbanisation (3.6% annually) expanding rapidly the demand for services. Currently 36% of population live in urban areas and it is projected that by 2030 about 50% of the population will be living in urban areas. It is also noteworthy that regional trade would offer a learning ground for competition.

Strategies for speeding up economic transformation in Tanzania

Given the productivity differentials between Tanzania and Asian countries such as China, India, Malaysia etc. it is unlikely that Tanzania will succeed in promoting economic transformation through an 'East Asian mass manufacturing' model alone. Rather, we must also seek to build a broader range of high-valued activities such as horticulture, cut flowers, agroprocessing and tradable services including tourism and transit trade. This suggests a strategy built on three components: (i) promoting agricultural productivity and value addition; (ii) promoting labour-intensive manufacturing; and (iii) building 'industries without smokestacks'.

Promoting agricultural productivity and value addition

Agriculture is the main activity supporting the livelihoods of most Tanzanians and accounts for the employment of about 70% of the labour force. However, agricultural productivity in Tanzania remains very low. For example, the World Bank estimates that maize yields in Tanzania are on average five times lower than in China. Since most poor Tanzanians reside in rural areas, improving productivity in the agricultural sector could significantly contribute towards reducing poverty and income inequality in the country. A more productive agricultural sector will also entail the use of proportionally less workers in the sector, generating labour supply to other activities including within the agro-processing and manufacturing sectors. Policy interventions to promote agricultural productivity should be directed towards promoting the use of quality inputs to increase yields per hectare, making strategic investments in rural roads and formulating the right agricultural and land policies. Opening up the profitable markets for agricultural products is a key to improving productivity and sustainability of the sector.

Partnering smallholder farmers, commercial farmers and agro-processors, served by adequate transport, power, water and communication infrastructure is one way that this can be achieved. Efforts to improve agricultural production should go hand-in-hand with value addition through agro-processing in order to increase employment opportunities, which is an important vehicle for poverty reduction.

Concerted efforts should also be made to promote high-value activities in the agricultural sector including production of vegetables, fruits and cut flowers for export. The horticulture sector in Tanzania offers a realistic opportunity for economic diversification, given the sustained demand in domestic, regional and international markets.

Promoting labour-intensive manufacturing

Historically one can argue that the industrialisation of Asia occurred partly at the expense of African industrialisation. The ability of Asian countries to attract footloose industries from developed countries by way of relocation must have helped the region to build skills, improve technology and significantly enhance competitiveness. Asian countries' lower labour costs, combined with technological growth through adoption and adaptation rather than simply invention, put them in a good position to wrestle away labour-intensive manufacturing from developed economies and blunt the growth of industry in other regions which did not undertake similar policy actions. Africa's poor infrastructure, lack of skills and civil conflicts in some countries more than offset any potential labour cost saving, thus making it relatively uncompetitive.

But as we know, any industrial progress brings with it a rise in wage costs. As the Asia middle-income group grows and the per capita income rises fast, the relatively lower labour cost in the African countries including Tanzania may now open an opportunity to attract labour-intensive manufacturing from Asia. Some Asian countries are on the verge of graduating from low-skilled manufacturing activities, which will potentially open up many labourintensive jobs to African countries. Economist Justin Lin estimates the number of such potential jobs migration from Chinese manufacturing alone at 85 million.

Ethiopia provides a good example of an African country that has successfully taken advantage of the rising labour cost in Asia. As we speak today, one of China's leading shoe exporters - Huajian Group – has had a factory operating in Ethiopia since January 2012 to take advantage of the lower labour costs and great supply of raw material in Ethiopia. This firm has the bold ambition of transforming Ethiopia into a global hub for the leather industry within a decade. Like Ethiopia, Tanzania's leather industry is also competitive by international standards. For example, the World Bank estimates that the cost of producing a pair of leather shoes in Tanzania is 20% lower than in China. However, this industry has failed to develop in Tanzania and today about 80% of skins and hides are exported in raw form, which is a lost opportunity. Given the abundance of raw material - skins and hides – the leather industry can be instrumental in the industrialisation process in Tanzania. We also have huge potential in the fruit-processing and milk and dairy product subsectors, which could attract low-skilled labour-intensive manufacturing activities from Asia. But this can only be possible if the other complementary factors are available so that productivity growth combined with comparatively lower labour cost would form a basis of enhanced industrial competitiveness. These include reducing the cost of doing business particularly in targeted economic zones, given the difficulty of closing the infrastructure gap across the whole country; and developing skills needed for manufacturing activities identified.

Building 'industries without smokestacks '

Tanzania has some comparative advantages in various kinds of high-value added per worker, non-manufacturing activities, which could serve as drivers of structural change and job creation. Activities such as tourism, transit trade and horticulture closely resemble manufacturing and can open up space for economic transformation by enhancing export earnings and creating good jobs for development. Globally, these activities are growing faster than manufacturing.

Conclusion

Tanzania will require significant structural transformation in order to sustain the current levels of economic growth and address the problem of mass unemployment. Given the productivity differentials between Tanzania and its trading partners such as China, India and Malaysia, it is unlikely that Tanzania will succeed in pursuing the economic transformation agenda through an 'East Asian mass-manufacturing' model alone. Rather, Tanzania must seek to build a broader range of high-value added per worker activities to complement the recovering manufacturing sector. Our transformation strategy should involve three components:

- *First*, investing in agriculture to boost agricultural productivity and reduce income inequality given that agriculture employs nearly 70% of the labour force and accounts for about a quarter of the GDP. Policy intervention in agriculture should focus on development and dissemination of new agricultural techniques, improving rural infrastructure and market access, as well as supporting farmers' efforts to enter global value chains.
- *Second*, promoting natural resource-based industrialisation and labour-intensive manufacturing has potential for transforming the economic structure of Tanzania from lower to higher productivity activities and value. Concerted policy intervention will be needed in creating a favourable investment climate for attracting private investors – both domestic and foreign.

  Particular emphasis should be placed on reducing the cost of doing business and closing infrastructure and skills gaps.
- *Third*, where geography and other endowments provide a comparative advantage, efforts should be directed towards promoting industries without smokestacks and services in order to create a diversified economy. In particular, we should focus our emphasis in promoting tourism, transit trade, horticulture and IT-based services.

4. Inclusive growth and microfinance in Tanzania

Alison Brown, Peter Mackie and **Alastair Smith,** Cardiff University
Colman Msoka, University of Dar es Salaam
Emmanuel Mung'ong'o, Central Bank of Tanzania

Summary

This DEGRP multi-country research examines the barriers, benefits and risks facing urban micro-enterprises in accessing finance, and the potential of improved microfinance services to support innovation and growth. This essay highlights findings from Tanzania presented to DEGRP's *High-Level Workshop on Shaping Economic Transformation in Tanzania* on 23 February 2015.

Introduction

Since the Grameen Bank began making tiny loans to village savings groups in 1983, microfinance has become a key tool of development policy. From its origins as a grassroots movement to provide credit to the neediest, microfinance is now a major supplier of a wide range of financial services to millions of people in the emerging world. Yet major concerns have arisen about its accessibility and regulation, and in urban areas over the extent to which it can support economic growth and poverty reduction.

Led by Cardiff University and international experts,[9] this research undertakes a comparative study of four East African countries: Tanzania, Kenya, Ethiopia and Rwanda, and India, to examine the barriers to urban micro-enterprises in accessing financial services, and the potential for improved consumer protection in microfinance to support economic growth and innovation. Micro-enterprises are the backbone of urban economies in many countries, so the research focuses on growth sectors in major cities and secondary towns, as small towns play a key role in spreading the benefits of economic growth.

Tanzania's microfinance

Tanzania is witnessing a period of unprecedented economic transformation. Its economic growth rate in 2013 of 7% was among the highest in the world, while gas and mineral exploration opens new horizons of growth. Urban micro-enterprises will play a key role in this transformation, leading innovation and providing jobs for the country's burgeoning young workforce. For micro-enterprises, secure forms of saving and borrowing are important to underpin growth, and while microfinance is not a guaranteed route out of poverty, access to secure financial services is an important right.

With the generous collaboration of many national and local policy-makers, financial providers and more than 200 micro-enterprise operators in Arusha and Dar es Salaam, the research analysed access to finance and the growth potential of micro-enterprises in four economic sectors – manufacturing, tourism, trade and construction.

Tanzania has rapidly developing financial services, but microfinance provision still relies heavily on semi-formal or informal institutions, with a multiplicity of regulators and limited enforcement capacity. The Bank of Tanzania oversees banks and deposit-taking microfinance institutions (MFIs); financial NGOs support many smaller MFIs regulated under business

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laws; and the country's 5,559 Savings and Credit Cooperatives (SACCOs) are supervised under cooperative law. A highly successful self-help sector includes an estimated 32,000 Village Savings and Loan Associations (VSLAs) and 11,000 VICOBAs (Village Community Banks) operating the solidarity group savings and credit model, serving perhaps a million people.

Meanwhile, mobile money is revolutionising access to finance. Use of formal financial services has increased rapidly, and access to formal financial services in urban areas between 2009 and 2013 was found to have increased from 27% to 79% (FSDT, 2013). Much of this increase reflects the spread of mobile money, launched in 2008, and now widely used for remittances, savings and payments. By December 2013, there were more than 11 million active mobile money accounts in the country. Under interim measures adopted by the Bank of Tanzania, mobile money is subject to prudential and non-prudential oversight. Two companies have just started offering mobile credit, although unlike in Kenya, this is not yet widely used.

A recent World Bank review on consumer protection and financial literacy identified the need for a unified regulatory approach to ensure that all clients of formal and semi-formal MFIs have access to basic product information and are not subject to abusive sales and collection practices, and that fair treatment of microfinance consumers should be strengthened through targeted regulation, affordability assessments and reducing balance interest rates (World Bank, 2013).

Findings

Despite a plethora of provision, our surveys show that micro-enterprises in key growth sectors of the economy make little use of formal financial services, and instead borrow from family and friends. Many operate informally and lack the security to access formal bank accounts or individual microfinance services. The fear of debt and uneven income are critical barriers to accessing finance. Meanwhile they face a challenging and hostile business environment.

Operators of small businesses do not see MFIs as the first choice for savings. Instead, those contacted for this research mainly used banks (42%), saved at home (36%) or used mobile money (53%). Micro-entrepreneurs in Dar es Salaam were slightly more likely to use banks and mobile money than in Arusha. The reasons for saving were complex, with the same proportion saved for school fees as for business expansion (both 43%), showing the cross-over between personal and business needs. Two thirds felt they did not have the money to save.

Friends and family seem to be the most common source for borrowing. The majority (26%) borrowed from family and friends and 17% from other sources. Reasons for borrowing were for business development (71%), particularly for those working in tourism, or business emergencies, particularly those in trade (54%). Women were more likely than men to borrow for business development (60%) or school fees (20%). People often shied away from the group loans constructed by MFIs.

Vulnerability was a key factor, and access to finance was only one of a number of problems that micro-entrepreneurs face. They reported having no secure access to space, facing frequent police evictions, being cheated by customers to whom they gave credit, covering medical costs for employees who had no health insurance, and paying 'baksheesh' (bribes) to middle men. Informality is a wide-ranging problem affecting many small businesses.

Our preliminary findings suggest a critical need for an inclusive growth agenda, which addresses the need for space and security of business operations in parallel with financial inclusion. Micro-enterprises need a full range of financial services, with the focus on savings, insurance and consumer education rather than credit as the main objective. They fear getting into debt, but few loan agreements accommodate the irregular and unpredictable business income that many micro-enterprises face. Financial education is key, and regulators should develop a standard code of conduct with 'key facts' sheets providing comparable information across all loan products. Financial literacy needs to be tackled at all levels, through schools, the media and micro-enterprises training.

Insecure finance is just one of many of risks that micro-enterprises face, such as lack of secure operating space and no insurance. Unless financial inclusion is part of a package of inclusive growth that recognises the role of micro-enterprises in contributing to jobs and local economic development, their potential will be continually undermined.

5. The role of agriculture in promoting economic transformation in Tanzania[10]

Julius Gatune, African Center for Economic Transformation (ACET)

Summary

Although agriculture is central to Tanzania's economy, analysis of four agricultural supply chains reveals shortcomings: unproductive technology, lack of finance, poor infrastructure, but above all, lack of trust between participants and inadequate equipment used for processing. Quality of produce thus suffers.

Much scope exists to raise productivity, ensure consistent supply and quality, and create jobs in agricultural supply chains. In most cases, moving directly to capitalised and industrialised supply chains may be infeasible. An alternative, intermediate path would link artisan food processors in rural areas to small and medium scale processing enterprises in urban areas. Policies should look to favour domestic processing, while public-private partnerships can help increase investment in supply chains.

Introduction

Agriculture plays a key role in Tanzania's economy and provides 24.1% of its GDP, though this has been falling (World Bank, 2012, cited in ACET 2014. Though we have seen recent increases in agricultural productivity, we also see a trend in which agricultural imports are rising faster than agricultural exports. This implies that agriculture is still not competitive. Indeed the examination of agricultural value chains indicates that they are relatively under-developed and plagued by many challenges. Some of the challenges identified in our study are summarised in Figure 1.

The well-known challenges of agricultural value chains reiterated by many studies[11]- including low technology uptake, poor extension, poor infrastructure and lack of finance - continue to apply. Our studies revealed surprising challenges of low levels of mechanisation quality and low levels of trust across the whole value chain. These are somewhat related – for example, part of the reason for the low quality of rice is due to farmers mixing varieties, meaning that the rice varieties are harvested at different levels of maturity; lack of farm-level machinery means manual harvesting introduces impurities; and further downstream, use of very old machinery in milling rice further destroys the quality by breaking the rice. The challenges of quality are further compounded by lack of trust – traders have accused farmers of adding sand and water to cotton to cheat on the weight. The quality of Tanzanian cotton has deteriorated so much that it has been put on a blacklist[12] by the international market. The lack of trust works both ways – farmers also feel that traders cheat them on weight and on price by having the advantage of more information.

Agriculture-driven GDP growth has the potential to drive economic transformation of Tanzania. As pointed out by Professor Ndulu, (see Chapter 3), it can be particularly effective in reducing poverty. Further, ACET's Africa Transformation Report (ATR) points to agro-processing as a key pathway for countries to transform their economies (ACET, 2014). Indeed in Kenya, the agricultural sector directly contributes about 25% of the country's GDP and a further 27% through manufacturing, distribution and service sectors, underscoring the potential for agriculture to create value beyond the farm gate.

Figure 1
Summary of challenges facing Tanzania's agricultural value chains

	Production structure	Logistics	Processing	Marketing and distribution
Issues	• Low yields • Saved seeds • Inputs (fake, costly) • Little expertise • Poor quality • Lack of equipment • Cheating • Mixing varieties • Labour challenges • Subsistence orientation	• Post-harvest losses (up to 50% reported) • Storage e.g. evening • milk, pests • Transport • Middle men/women stranglehold • Payment on quantity rather than quality	• No supply guaranteed • quantity, quality and • price • High costs (energy, packaging) • Access to equipment • Product development	• Informal markets dominance thus low value addition • Low product diversity • Low quality products • Inability to address changing markets • urban poor • urban rich
Policy questions	• Who to support (small holder?) • What to subsidise? (inputs or info?) • Farmer organisation	• Formal vs informal (milk trader question) • Market infrastructure (govt vs private vs PPP	• Artisanal vs formal • Trade policy (e.g. cassava bread) • Industrial policy • equipment • fabrication vs • imports	• Food import bans vs tariffs? • Mandates vs incentives

DEGRP /ACET sought to better understand the challenges of Tanzanian agricultural value chains and potential interventions

Value chains studied: cotton, rice, cassava and dairy due to their potential for rural transformation

Undeveloped value chains due to:
-Weak institutions
-Poor infrastructure
-Bad policies

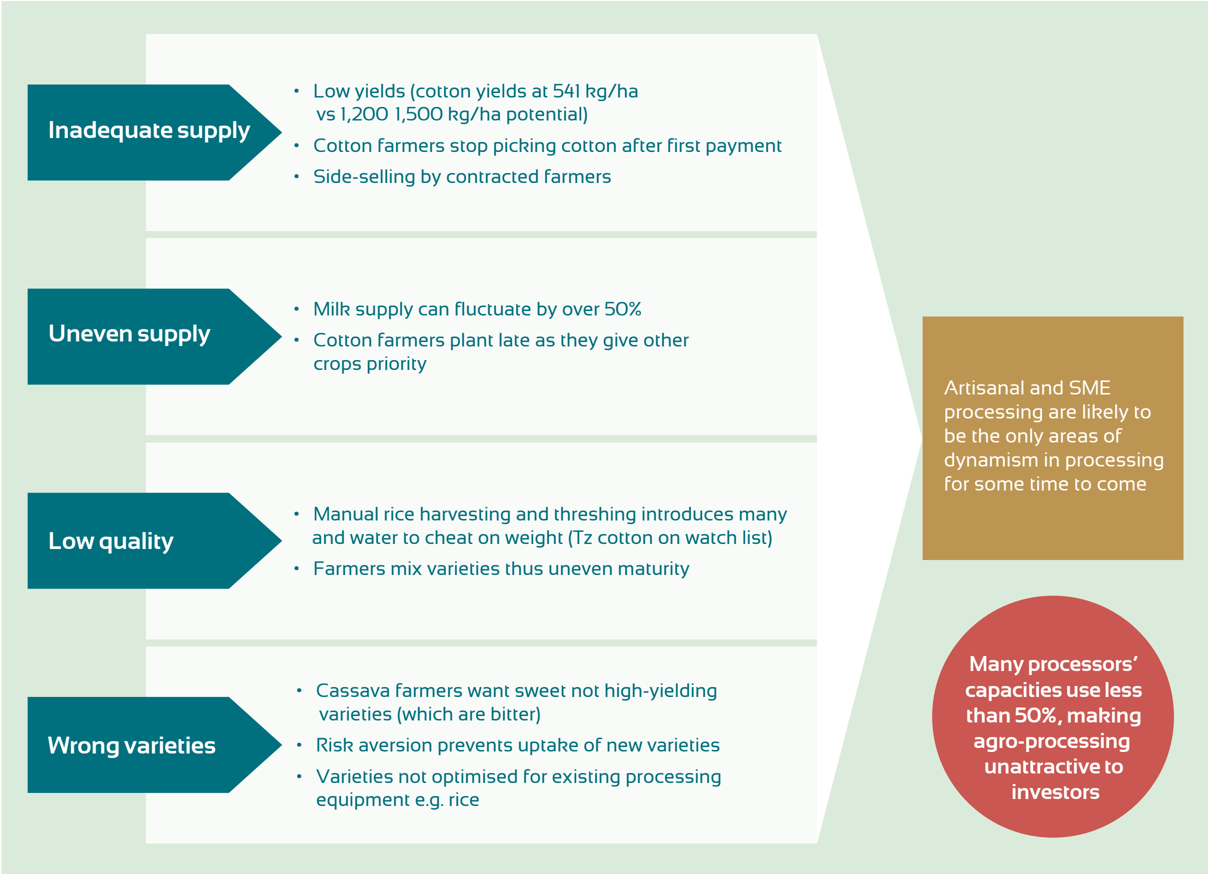
SOURCE: ACET (2015D)

However, for agro-processing to drive transformation, agricultural value chains will need to be upgraded to ensure consistent supply, consistent quality and low prices, key pre-requisites for the emergence of a vibrant processing sector. Tanzania has some distance to travel before a strong agro-processing sector can emerge. Figure 2 summarises the key challenges identified by the ACET Tanzania study (ACET, 2015a).

To overcome supply challenges, processors have developed contracting schemes. However these are plagued with side-selling by contracted farmers. While it is possible to use legal instruments to prosecute traders who buy cotton from farmers not in their catchment area (and not registered with them), the high cost of litigation is not likely to make it worth the while for processors. Indeed poor farmers side-sell because they are hit by emergencies and need instant cash. Farmers lack credit and insurance, and thus are unlikely to have the means to cope with emergencies.

At the heart of the problem of securing supply is developing trust on the one hand and also helping farmers increase their resilience on the other. One way is to have contractual arrangements that help farmers to diversify their income beyond just selling to the processor. Ginneries – mills for extracting cotton seed - can support cotton farmers to diversify to livestock farming. Ginneries can use cotton seedcake to make animal feed and also support farmers with extension services on livestock production. This not only creates extra income for farmers, reducing their vulnerability, but also builds trust through a two-way relationship.

Figure 2
Challenges to developing a strong processing sector



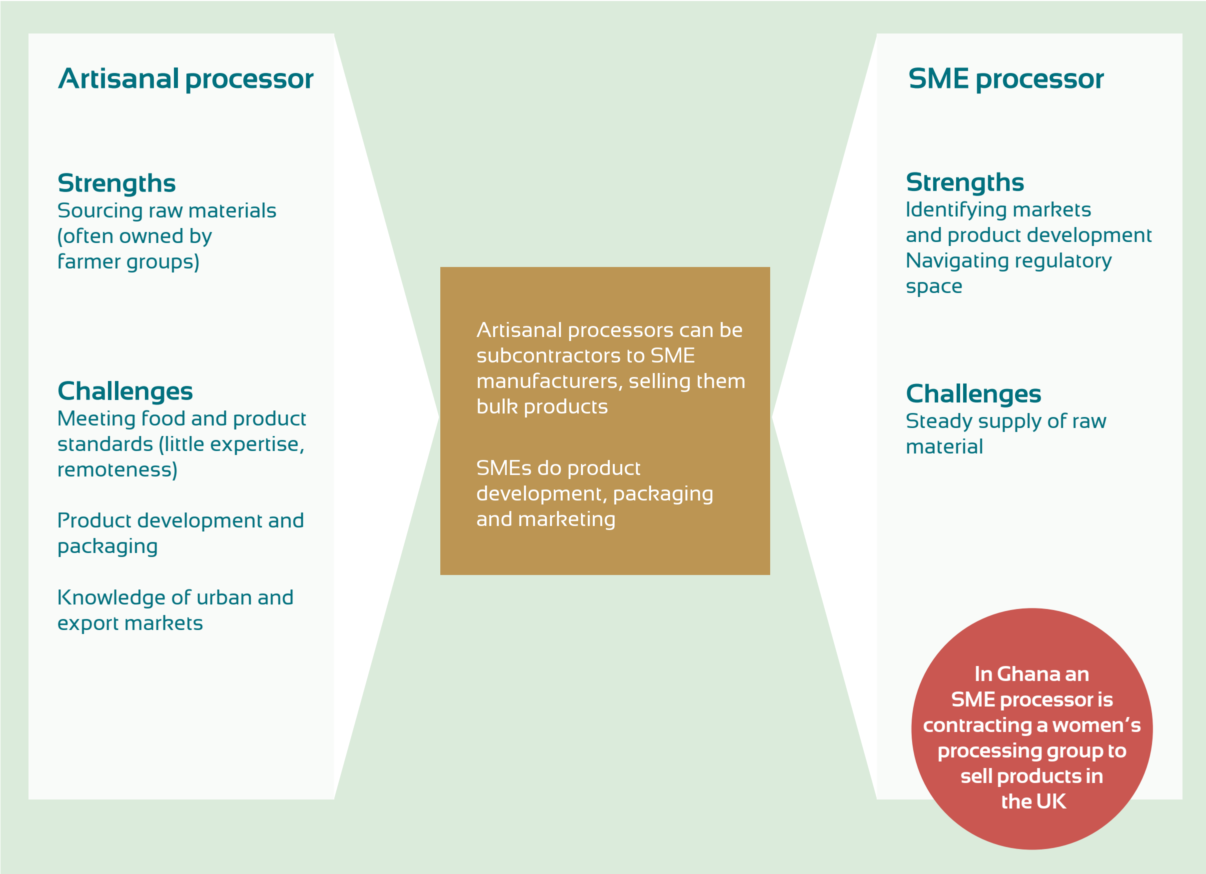
SOURCE: ACET (2015D)

Strengthening processing

It is unlikely that we will see a transition to large-scale industrial agro-processing in the short to medium term as the existing supply chains require significant upgrading. However a middle path exists. Urban markets are creating new food markets that are served by an emergent small and medium enterprises (SME) food processing sector. These SMEs have developed expertise in packaging and product development while navigating the regulatory requirements required to market food in urban markets. SME manufacturers tend to struggle with getting adequate supplies. This is mainly due to underdeveloped and fragmented value chains dominated by many small-scale traders. The result is inconsistencies in supply and very poor quality of inputs. At the same time, farmer groups carry out artisanal processing in rural areas (and also sell processed food products mainly in the rural areas). Thus, artisanal processors in rural areas tend not to experience supply challenges. For them, the challenge lies in selling to urban markets as they lack the equipment and expertise to meet the food standards required to sell in urban markets. There is thus an opportunity for urban and artisanal processors to work together byleveraging their respective strengths. Artisanal processors can become subcontractors to urban-based SMEs and thus supply a bulk product, while the urban SMEs can focus on packaging, product development and dealing with regulatory requirements.

This is an approach that one SME food manufacturer in St. Bassa, Ghana, has successfully adopted.[13] Using this model, products made by a women's processing group based in Northern Ghana can now be found in African stores[14] in Europe and the United States where St. Bassa has developed markets through the 'African Store' network.

Figure 3
Linking artisanal processors to urban-based SMEs



SOURCE: ACET (2015D)

Policy implications and way forward

A value chain approach is needed when considering policy options for making agriculture a driver of economic transformation. Agriculture and trade policies will need to be aligned. While existing policies to support farmers to improve yields are important, equal attention should be paid to improving quality. Significant value is lost through poor quality – most importantly, lack of quality means that agro-processing sectors cannot scale up unless quality issues are addressed. Farmers will continue to lose out on imports for the emerging urban markets. Some of the subsidies directed towards fertilisers could be used to subsidise simple equipment like tarpaulins and threshers that could greatly improve quality.

There is a need to rethink policy on industrialisation and provide incentives to strengthen the symbiotic types of linkages discussed. A contracting model based on a two-way relationship helps build trust, a key factor in ensuring coordination between the production and the processing sectors. Stronger relationships between artisanal and SME food processors can greatly improve the functioning of food markets, addressing both market and coordination failures. Tax breaks and subsidies on equipment could be extended to firms that have developed contracting models with rural farmers and also to SMEs that want to subcontract with artisanal processors.

Hand-in-hand with this should be support for marketing and branding, directing part of the agriculture budget to advertising firms to help promote products from the more innovative companies.

Mandates, such as the 5% inclusion of cassava flour in wheat flour, are another policy tool that can be used to create markets and encourage investments. However the sequencing of policy will be key – supply currently may not be able to respond quickly enough to meet the huge demand created by such a mandate. It would

Figure 4
A multi-pronged approach

Incentives

- Tax breaks to upgrade equipment
- Land for commercial farming
- Subsidies to support symbiotic ecosystem

Mandates

- Local content laws e.g. 5% cassava bread
- Need to ensure that undue burden is not put on processors while balancing need to challenge them

PPPs

- Where risks and capital requirements are high, government may need to intervene
- Can we incentivise investors to relocate via agro-processing parks?

Questions

- What should be subsidised   farm production, processing, product development, distribution or promotion?
- What is the role of policy (government)?
  - What should food policy look like?
  - How should industrial and agricultural policies be harmonised?
  - How do we align the budgeting process to support emergence of strong value chains?

Nigeria banned import of barley forcing brewers and food processors to turn to sorghum and develop the supply chains. This has been a great success

SOURCE: ACET (2015D)

therefore be preferable to start with incentives to encourage entry first and create capacity, then slowly introduce mandates.

Public–private partnerships (PPPs) are another policy tool. In some cases investments required are too big and risky to attract private enterprise. So today, the Tanzania textile industry, which could use most of the cotton produced in the country, currently uses only about 20% of the domestic supply. The development of a vibrant textiles and garments industry will require significant investment in industrial capacity. Spinning and weaving industries even in the most successful countries have seen significant investment and support from governments. The history of government participation in industry in Tanzania is weak. Many state companies fail to deliver mainly due to issues of political economy. However, PPP models provide an opportunity for a model that is sheltered from the vagaries of political economy.[15]

Thus a policy framework that employs a range of tools including incentives, mandates and also public–private partnerships, is needed if agriculture is to become a driver of economic transformation. Sequencing will be key so that policies build on previous achievements.

6. Major themes from the Dar es Salaam workshop

23 February 2015, Dar es Salaam, Tanzania

Co-hosted by DEGRP and REPOA

Summary

This chapter outlines the main themes discussed at the Dar es Salaam workshop on economic transformation in Tanzania, with three leading sessions on agriculture, industrialisation and finance. Discussions covered underdeveloped agricultural value chains, the need for public–private partnerships and greater diversification, the challenges of harnessing Tanzania's growing urban populations, the vital role of micro-enterprises and removing barriers in access to finance, among several other issues.

In February 2015, DEGRP, REPOA and ODI convened a high-level workshop to explore the challenges and potential solutions for economic transformation in Tanzania. The event brought together nearly 200 participants, comprising local and international economic and research experts; national policy-makers, including members of parliament; civil society; and media representatives to discuss the role of agriculture, the financial sector and manufacturing in the country. Professor Benno Ndulu, Governor of the Central Bank of Tanzania, gave the keynote speech.

The meeting began with opening remarks from Professor Sam Wangwe (Executive Director of REPOA) on the importance of economic transformation for Tanzanian growth. 'This workshop comes at an opportune time,' he said. 'As efforts are underway to chart a five-year development plan for Tanzania, the issues raised in this meeting will have useful input.'

Following this, Dr Dirk Willem te Velde (ODI Senior Research Fellow and DEGRP Research Lead) introduced the DFID-ESRC Growth Research Programme (DEGRP) and spoke about the importance of economic transformation. Turning to the Tanzanian context he spoke of recent rapid economic growth, but highlighted concerns about growth longevity, particularly with respect to economic transformation. While exports are growing, diversification is low. Looking to the future, Dr te Velde suggested that there are promising signs of economic transformation in Information and Communications Technology (ICT) and farm enterprises.

The keynote address was delivered by Professor Ndulu, Governor of the Central Bank of Tanzania, who discussed recent significant changes to the country's economy. While there are lessons to be learned from Asia, the professor stressed that Tanzania is not compelled to follow the Asian model. He identified five key characteristics of economic transformation in Tanzania: a strong comparative advantage in natural resources; geographical location as a gateway to landlocked inland destinations; rapid growth of ICT services through investment; an abundant and youthful labour force (while Asian labour costs have increased); and regional integration initiatives to exploit regional demand. Professor Ndulu closed with the message that Tanzania needs to concentrate on capitalising on these opportunities for sustainable growth.

The first session focused on the role of agriculture in promoting economic transformation in Tanzania. Session chair Steve Wiggins (ODI Research Fellow and DEGRP Agricultural Lead) introduced the discussion, noting that agriculture is a central source of jobs and livelihoods in Tanzania. But how do you increase agricultural growth and productivity? Can small-scale family farms be the basis for investment? Can agricultural development be left to market forces? Does the state need to intervene in supply chains?

In answer to some of these questions, **Dr Julius Gatune (from the African Centre for Economic Transformation – ACET)** reported findings from a DEGRP project on agricultural supply chains in Tanzania. Agriculture may be vital for economic transformation, but Tanzania's agricultural sector remains uncompetitive due to undeveloped value chains. In addition infrastructure, logistics, fertiliser supply and technologies need upgrading. Poverty is a major issue facing the sector, with low consumption and a lack of market predictability. Solutions range from supporting small-scale industries to make them more competitive and reach wider markets with their produce to promoting access to middle-class consumer markets. Supply chain innovations are taking place across Africa, often involving small-scale firms: lessons for Tanzania can be drawn from these.

Dr Geoffrey Karenga (from Southern Agricultural Corridor of Tanzania – SAGCOT), identified public–private partnerships in Tanzania as an opportunity to maximise agricultural potential along the Northern corridor, where 12 million people live. The Corridor initiative aims to mobilise $3.5 billion to invest with the aim of lifting 2 million people out of poverty. SAGCOT seeks partnerships with responsible investors, those whose investments will generate jobs, be environmentally sustainable and improve food security. The key for agricultural transformation lies with improved technology and better access to markets – two priorities for SAGCOT.

Subsequent discussion covered the role of cooperatives, trade policy and protection for rice and sugar producers; whether SAGCOT would benefit smallholders or just larger-scale producers; and the importance of women as farmers, including designing farm and processing machines so that women can operate them.

Session two looked at industrialisation and economic transformation in Tanzania. Professor Wangwe opened the session with a presentation on a DEGRP project on the pharmaceutical industry. He suggested that the pharmaceutical industry serves as a case study for how Tanzania can identify opportunities for improved local supply and health sector performance. Imports are rising but access is a challenge. Furthermore, the local share of medicines is declining due to: rising barriers to market entry for local firms; increasing import price competition; infrastructure constraints; and tariff structures that incentivise imports. Transformations needed include: more reliable public and donor funding; a lower proportion of medicines bought in private shops; and more access at free or low cost. He highlighted the importance of good industrial public policy, the consistent implementation of that policy and the need for a strong political economy.

Dr Phillip Mpango (Executive Secretary from the Government of Tanzania's Planning Commission) argued the need for Tanzania to move towards a diversified semi-industrialised economy if it is to achieve middle-income country status by 2025. The government has a long-term plan for how this transition should take place, he said, including increasing the share of manufacturing in GDP and reducing the share of agriculture. Tanzania has an abundant mineral source, which will be a key enabler to this plan. Other enablers include: a skilled and adaptable workforce; a favourable political and legal environment; and coordination between the government, businesses and researchers. Malaysia is a good example of how the government and private sector have worked closely on investment and planning, he suggested. But Tanzania still has a long way to go.

The discussion that followed concentrated on the need to promote coherence, consistency and active coordination among different

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types of policies. For example, trade policies, education policies and procurement policies need to work in unison. The other challenge highlighted was the problem of policy inconsistency. Some policies are still operating in individual ways, for example, land is not ready for investment. Policy coordination is also insufficient. Experiences of other countries show that there is some way to go, for example, in Malaysia where the government and private sector work very closely so that the government knows about key investors and what they are planning. This does not happen adequately in Tanzania.

Closing session two, Mr Omari Bakari (Executive Director of the Small Industries Development Organisation) summarised that industrialisation in Tanzania should be inclusive and sustainable. Policy coordination and commitment are key to building a strong system. The market is a major challenge to industrialisation in Tanzania, and effective and efficient investment will be critical for higher productivity and increased investment.

The third and final session of the day considered finance and economic transformation. Professor Alison Brown (from Cardiff University and a DEGRP grant holder) stated that Tanzania is on the cusp of economic transformation: urban populations will double in the next 20 years and the challenge will be to harness this urban potential. She presented a DEGRP-funded research study on small-scale micro-enterprises in growth sectors, focusing on trade, construction, manufacturing and tourism. Professor Brown stressed that while microfinance "is not a silver bullet", it is important for all to have access to credit, savings and insurance. The findings show that despite a plethora of financial provision, micro-enterprises make little use of formal financial services, instead borrowing from family and friends. Fear of debt and irregular income are critical barriers to accessing finance. Inclusive growth should consider micro-enterprises as key players. Furthermore growth has to be sector-specific, with different agendas for manufacturing and tourism.

Dr Blandina Kilama (from REPOA) presented a study on the behaviour of banks and how they allocate credit, as part of a three-phase project investigating the broader relationship between saving and investment at the micro level. **Dr Abel Songole (Executive Director of the Economic and Social Research Foundation – ESRF)** presented key findings from a study on the role of finance in infrastructure in economic transformation.

Concluding the third session, Dr te Velde suggested that a nuanced view of microfinance is needed. A range of finance options is already available in Tanzania, but there is a need to look at how to use them most effectively. The discussion raised questions over whether commercial bank lending is going to the right sectors, he said. The case studies discussed here show that there is no lack of financing, but work is still required on how to allocate resources to the right places.

Closing remarks were provided by Professor Wangwe, who encouraged further discussion and debate on these important policy issues in the run-up to the elections in October 2015. He thanked all those who participated and encouraged government representatives and candidates to take heed of the discussions and research presented at the workshop.

Read more on the DEGRP event page or view a Storify of the conference. For video interviews with key participants, visit DEGRP's dedicated YouTube playlist.

A selection of local media coverage:

- Keep track of demographic shifts for productivity – Ndulu, *Business Times*
- Agriculture contributes less to GDP, *Tanzania Daily News*
- Street hawkers not a nuisance but vital for economic transformation, *Business Times*
- Economy on track to achieve middle income status by 2025 - BoT Governor, *IPP Media*
- Prof Ndulu: Utalii unaongoza kulingizia taifa pato la kigeni, *Mwananchi*

7. Conclusions and implications

Summary

The importance of economic transformation for Tanzania is beyond doubt. The keynote address by Professor Ndulu argued cogently that 'attaining economic transformation is the only foundation from which we can sustainably lift Tanzanians out of poverty'.

The DEGRP and REPOA workshop on economic transformation, informed by leading speakers as well as DEGRP research, gained insights into the multiple facets of economic transformation, and the factors and policy directions shaping transformation in the short to medium term.

Facets of economic transformation

There was agreement that there had been little economic transformation in the past, but recent experiences are more positive. Chapter 2 identified recent progress in macro production and labour data, with labour productivity growing at 3% per annum over the 2007 to 2013 period, while Professor Ndulu pointed out that 90% of the sources of foreign exchange are from non-traditional sectors such as tourism, manufacturing growth and gold. Professor Ndulu used data in 2001 prices to show that the share of agriculture declined by around 10 percentage points, while that of industry and services increased by around 5 percentage points. The use of current prices output data provide a less dynamic picture though, with a disappointing levelling of the manufacturing share at around 7% from 2007 to 2013.

While poverty levels are still stubbornly high, some improvements are visible, and developments in the various sectors contribute to this. As Professor Ndulu argued, the poverty-reducing effect of growth from agriculture and services are comparable: a 1% increase in GDP per capita led by agricultural growth reduces poverty by 0.67%, and the same increase led by services reduces it by 0.96%. Agriculture and services are more effective in reducing poverty than industry.

There was much debate about the importance of large and small firms in transformation. Professor Brown and colleagues argued that urban micro-enterprises are expected to play a key role in transformation, leading innovation and providing jobs for the country's burgeoning young workforce. Micro-enterprises are seen as the backbone of urban economies and small towns play a central role in spreading the benefits of economic growth. Others such as Dr Karenga pointed to the need to foster large and small agriculture farms jointly in economic corridors.

Shaping economic transformation

Professor Ndulu highlighted five key drivers of economic transformation: (i) adding value to the country's commodities by pursuing a natural resources-based and labour-intensive industrialisation; (ii) a productivity-enhancing agenda driven by technical innovation; (iii) reducing the cost of doing business to help attract investment; (iv) enhancing the stock of skills to support structural transformation and innovation; and (v) exploiting emerging regional integration initiatives.

Tanzania can transform its economy, benefiting from the presence of natural resources, geography, ICT, abundant and youthful labour, and regional integration initiatives. Tanzania's path to transformation is likely to differ significantly from that of

Asia, as the 'East Asian mass-manufacturing' model alone is not sufficient. Professor Ndulu suggested that Tanzania must also seek to build a broader range of high-value activities such as horticulture, cut flowers, agro-processing and tradable services including tourism and the transit trade.

He advanced a strategy built on three components:

1. *Promoting agricultural productivity and value addition*. Policy should promote the use of quality inputs to increase yields per hectare, making strategic investments in rural roads and formulating the right agricultural and land policies. Horticulture, in particular, offers an opportunity for economic diversification given the sustained demand.

2. *Promoting labour-intensive manufacturing*. This requires reducing the cost of doing business particularly through targeted economic zones. There is a legacy of opportunities from China, with Ethiopia seen as an example. The leather, fruit-processing and milk and dairy industries are instrumental. Tanzanian manufacturers are not sharing in the large and expanding market for health-related commodities.

3. *Building 'industries without smokestacks'*. This could include non-traditional industries such as tourism, transit trade, horticulture and ICT-based services.

Dr Gatune argued that a transition to large-scale industrial agro-processing in the short to medium term is unlikely, since the existing supply chains require significant upgrading. However a middle pathway exists in which urban markets create new food markets served by an emerging SME food-processing sector. Artisan processors in rural areas can sub-contract to supply to urban SMEs that focus on packaging, product development and meeting regulations – thereby capitalising on the strengths of each actor. Much remains to be done, however, to improve agricultural value chains and to remedy low technology uptake, poor extension, poor infrastructure, lack of finance, low quality of mechanisation and low levels of trust across the chain. Policies need to be sequenced so as to build on achievements.

Finance will play an important role across the range of industries and actors. As Professor Brown and colleagues point out, for micro-enterprises, secure forms of saving and borrowing are important to underpin growth. Tanzania is rapidly developing financial services. Access to formal financial services in urban areas was found to have increased from 27% in 2009 to 79% in 2013 and in December 2013 there were more than 11 million active mobile money accounts.

However, they further note that microfinance provision still relies heavily on semi-formal or informal institutions, with a multiplicity of regulators and limited enforcement capacity. Micro-enterprises in key growth sectors of the economy make little use of formal financial services, instead borrowing from family and friends; fear of debt and uneven income are critical barriers to accessing finance. Unless financial inclusion is part of a package of inclusive growth that recognises the role of micro-enterprises in contributing to jobs and local economic development, their potential will be continually undermined.

Policy implementation

The discussions at the workshop argued that apart from focusing on the right areas for economic transformation, it also important to consider the need to promote policy coherence, consistency and active coordination among different types of policies. How is it possible to develop a pharmaceutical industry if education and trade policies misalign? How can Tanzania attract investors in promising areas of comparative advantage if the land is not ready? How can Tanzania ensure the same type of coordination between public and private sectors as in the case of Malaysia?

Endnotes

1. Professor Wangwe is Executive Director of REPOA and Co-Investigator of a DEGRP project on inclusive growth in Tanzania and Kenya.

2. Data on real GDP growth from World Development Indicators.

3. Data prepared under a DEGRP grant and available from GGDC: http://www.rug.nl/research/ggdc/data/10-sector-database

4. Data from National Bureau of Statistics, Tanzania.

5. Statistics derived from FAOSTAT data.

6. Project website: http://bit.ly/19hlexf

7. Project webpage: http://bit.ly/1E9Xdc9

8. Private investors in sub-Saharan Africa face additional costs of around $15 billion owing to an interest rate spread that is on average 2% higher for SSA than for low- and middle-income countries (LIC and MIC). Competition and innovation policies that would lower the interest rate spread to the LIC and MIC average would increase the availability of finance by 1.2% of GDP equivalent to a 6% increase in investment in SSA. See Te Velde (2014).

9. Collaborators: Dr Colman Msoka, University of Dar es Salaam; Dr Emmanuel Mung'ong'o, Central Bank of Tanzania; Dr Rosemary Atieno, University of Nairobi; Professor Tegegne Gebre-Egziabher, University of Addis Ababa; Professor Darshini Mahadevia, CEPT University, Ahmedabad; Thierry Ngoga, consultant, Rwanda.

10. This briefing summarises findings of four value chains studies (cotton, rice, dairy and cassava) undertaken in Tanzania, supported by DEGRP and the Bill & Melinda Gates Foundation.

11. See for example World Development Report (2008).

12. The low quality and inability of Tanzania's ginneries to meet their obligation to international cotton traders has seen five ginneries put on a blacklist. Overall Tanzania's cotton was treated as third rate in the world and is discounted by about 5% on the international market. See http://www.ippmedia.com/frontend/index.php?l=41071

13. Based on personal interviews with the managers of the St. Bassa Food Processors, as part of the survey conducted by ACET in the Ghana cassava value chain study.

14. These small stores mainly serve the African diaspora by supplying so-called ethnic foods. Traditional supermarkets now see ethnic foods as a big opportunity and have aisles dedicated to such products. Indeed some SMEs in Ghana like Praise Exports supply their food products to supermarkets in Europe.

15. Political economy issues that plague many state-run enterprises range from incompetence with managers appointed for political reasons to outright theft by appointed cronies. PPP models mainly put the private sector in charge of running the business, and since they also have invested in the enterprise they have a stake in making the enterprise work. They are also shielded from daily politics. Other factors cited for the collapse of cotton mills in Tanzania during the 1980s include lack of power, high power tariffs, unfair competition from imports and devaluation of the Tanzanian shilling making it difficult to import spare parts for the textile mills (ACET, 2015a).

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