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Tanzania's Economic Reforms— and Lessons Learned

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Abbreviations and Acronyms

BEST	Business Environment Strengthening in Tanzania
BFIA	Banking and Financial Institutions Act
BoT	Bank of Tanzania
CCM	Chama Cha Mapinduzi (Tanzanian political party)
CEO	chief executive officer
cph	(container) crane per hour
CPI	Corruption Perception Index
EAGER	Equity and Growth through Economic Research
EIU	Economist Intelligence Unit
ERP	Economic Reform Program
ESAF	Enhanced Structural Adjustment Facility
ESRF	Economic and Social Research Foundation
FACEIT	Front Against Corrupt Elements In Tanzania
FDI	foreign direct investment
GDP	gross domestic product
HBS	Household Budget Survey
HIPC	Heavily Indebted Poor Country
HSDP	Health Sector Development Program
IMF	International Monetary Fund
IMG	Independent Monitoring Group
IPC	Investment Promotion Center
IRT	Investors' Round Table
ITN	insecticide-treated net
MDG	Millennium Development Goal
MoEC	Ministry of Education and Culture
MTEF	Medium-Term Expenditure Framework
NBC	National Bank of Commerce
NESP	National Economic Survival Program
NIPPA	National Investment Promotion and Protection Act
NMB	National MicroFinance Bank
OPG	Open General License
PSRC	Parastatal Sector Reform Commission
PEDP	Primary Education Development Plan
PER	Public Expenditure Review
PRGF	Poverty Reduction and Growth Facility
REPOA	Research on Poverty Alleviation
SACCO	Savings and Credit Cooperative Societies
SAP	Structural Adjustment Program
SP	sulfadoxine pyrimethamine
TACAIDS	Tanzania Commission on AIDS
TBL	Tanzania Breweries Limited
TIC	Tanzania Investment Center
TSh	Tanzanian shilling
UDS	University of Dar es Salaam
USAID	United States Agency for International Development

Executive Summary

Having experienced a steady economic decline in the late 1970s and a financial crisis in the early 1980s, Tanzania formally adopted an economic recovery program in 1986. It has since pursued reforms and made significant achievements: macroeconomic stability has been achieved and a wide range of structural reforms completed. Gross domestic product (GDP) growth per annum averaged 4.2 percent during this period, reversing per capita income decline experienced in the decade before 1986. The growth in per capita income led to a considerable decline in the level of poverty. The long-term poverty trend has been declining for most of the post 1986 period, as indicated by various poverty studies conducted between 1976 and 1996. The studies indicate that the post-1984 period in Tanzania was marked by an overall improvement in real incomes: a 1996 by Ferreira study found that poverty (defined as the number of households below the basic needs poverty line) declined by approximately 22 percent between 1983 and 1991. Despite the setbacks on the macroeconomic policy front between 1991 and 1994, when poverty rose by approximately 11 percent, the most recent (2000–01) household budget survey confirms that there was a sustained decline in poverty over the entire decade. The survey findings show that as per capita income accelerated, after the reform progress was reinforced in 1995, poverty is estimated to have declined by approximately 28 percent between 1994 and 2002. The survey further points out that poverty reduction has been more rapid in urban areas, in particular in Dar es Salaam, than it has been in rural areas.

Tanzania's adjustment and reform process has been gradual and at best cautious but steady, deep, and sustainable. Subsequent to the temporary setback in macroeconomic policy during the first half of the 1990s, the government achieved macroeconomic stability in the late 1990s. Inflation was reduced from about 30 percent in the 1980s and early 1990s to single digits in late 1990s, when severe fiscal imbalances were brought under control through prudent fiscal management; inflation in 2002 was 4.6 percent. Acceleration of structural and institutional reforms, as well as creation of new institutions, led to improvement in the investment climate, increased foreign direct investment (FDI) flows, and job creation. The balance of payments improved significantly, reflecting large donor inflows and increased export earnings, mainly from nontraditional exports. Tanzania's sustained commitment to economic reforms triggered its eligibility for debt relief under the enhanced Heavily Indebted Poor Countries (HIPC) Initiative in April 2000, making it one of the first countries to reach the completion point and to benefit from irrevocable and substantial debt reduction. Debt reduction in turn paved the way for additional donor inflows. The additional resources, including from the HIPC debt reduction, allowed the government to increase budgetary expenditure allocations to social sectors and other priority sectors, such as rural roads, the judiciary, and HIV/AIDS-related activities. This has led to visible improvements in public service delivery, in particular education and health.

The success and durability of economic reforms in Tanzania is attributed to a strong and “tested” sense of ownership of the reforms early in the process, a wide domestic consensus on economic reforms, and a broader understanding of the issues. This achievement resulted from a number of factors: a consultative and participatory approach, a series of “homegrown” programs, sustained commitment and political leadership, and consistent support from development partners. The openness and inclusiveness of the consultative process of the 1980s internal debates, led by the University of Dar es Salaam, brought together reformers and nonreformers, helped clarify and broaden the understanding of issues, and legitimized the need for economic reforms. The government’s use of national commissions as instruments for collecting views and building consensus on issues broadened the domestic constituency for the reforms, reinforced internalization of the process, and thereby underpinned reform ownership.

Experimentation with homegrown programs provided the government space to test, learn, and adapt reform measures to country circumstances and to minimize alienation of support groups. It also helped build confidence in the government to scale up the reform measures. Once the measures demonstrated a positive impact, the likelihood of policy reversal was reduced because the support of the measures had been demonstrated to a broader constituency.

The sustained commitment and political leadership demonstrated by Tanzania’s leadership has fostered sustainability of the reforms. President Nyerere’s departure in 1985 signaled a break from socialist policies and allowed the process to evolve in an orderly fashion. President Mwinyi’s liberalization efforts post -1985 and initiation of institutional and structural reforms ushered in a free market economy, and President Mkapa reinforced the importance of macroeconomic stability and ensured consolidation of a free market economy, after 1996.

Development partners have been an important and integral part of the process of economic reforms. Their contribution was manifest in two distinct ways: providers of substantial financial and technical assistance and adjudicators and monitors of government’s performance (or nonperformance) in implementing economic reforms. Financial support from development partners, both bilateral donors and multilateral institutions enabled the government to aggressively reverse the socialist policies after the 1986 reforms and helped to bring economic recovery and improvement in public service delivery. Technical assistance contributed to capacity building, strengthened institutional framework and helped to create a conducive environment for a market-driven economy. While donor support fell in the early 1990s when the reform effort temporarily collapsed, it rose again when reforms resumed under the Mkapa regime in 1995.

The implicit role of adjudicators and monitors of government’s performance (or nonperformance) was demonstrated through withdrawal of assistance when the government was reluctant to adopt economic reforms, in response to economic crisis in the early 1980s, and also in early 1990s, when macroeconomic reforms faltered. Conditioning aid on policy measures was a contentious source of tension: it was perceived to undermine sovereignty and government’s

ownership of economic management. It created tension between the government and its donors and prompted donors to evaluate their approaches in aid relations. For example, the disagreement between President Nyerere and the International Monetary Fund in 1980 was symptomatic of the government's assertion of sovereignty, ownership, and space for internal dialogue. The 1994 Helleiner process, an initiative to mediate between the government and its donors, though precipitated by the derailed reform process, underlined the imbalances in government/donor relations. The Independent Monitoring Group, an outcome and a culmination of the Helleiner process, now serves as an instrument of accountability and a performance monitoring tool, on behalf of the donors and the government. This was a direct response to government/donor tensions and the absence of a common adjudicating mechanism framework.

The direct dialogue with development partners has been an important catalyst in Tanzania's economic reform process. The dialogue informed the early debates on economic issues and indirectly contributed to homegrown programs. It also facilitated greater government ownership of the process and helped government/donor relations to evolve from confrontation to partnership approaches. Furthermore, it triggered the need to focus on aid effectiveness and to re-examine and improve aid delivery mechanisms.

Tanzania has made tremendous progress on many fronts. However, the remaining central challenge is making growth deliver more efficiently in terms of poverty reduction on pro-poor growth. To accomplish this, the focus should be on accelerating growth of agriculture and rural sector development, to engender economic opportunities in rural areas where poverty remains pervasive. Equally important is the need to sustain robust growth, a necessary element to achieving the Millennium Development Goals (MDGs).

Conclusions and key lessons learned

Since the inception of economic reforms in 1986, a large segment of Tanzania's population has benefited from gradual poverty reduction, which was driven mostly by steady improvement in economic performance, implementation of structural reforms, and, in the most recent past, greater attention to public service delivery. GDP growth has been sufficient to allow increases in income per capita, including in rural areas. Overall the long-term poverty trend has been declining. However the decline in poverty has been more pronounced in urban areas, while poverty in rural areas remains considerably higher. The HIPC debt reduction, which was followed by additional donor inflows, allowed the government to increase expenditure allocations to provision of public service delivery.

An important aspect of Tanzania's economic reforms has been the transition from a socialist to free market economy. In this context the government's main challenge and focus were how to implement economic reforms with minimum adverse effect on provision of social services, in particular to the vulnerable. For example, the government opposed the devaluation of the

currency because of fear of inflationary pressures and its impact on the vulnerable group. Such issues were discussed, clarified, and understood through a truly open and participatory debate. The implementation of the homegrown programs was a transitioning and learning processes in which the government learned what policies worked (or did not work) in eliciting economic activity.

What are the lessons learned?

- Early winners and good results help to build support for more ambitious and large scale reforms.
- Understanding of the issues by a wider segment of society through debates and participatory approaches engenders broad ownership of the reform process.
- It is important that the reform process is locally-driven. It increases the public's sense of ownership and ensures commitment to implementation and sustainability.
- It is important to carry out analytical work during the pre-reform period to be able to inform the internal policy dialogue and to frame the economic debate.
- Participatory approach helps bring a wide range of stakeholders on board—the open dialogue, and the various “home-grown” programs through which the reform process evolved, created broad ownership and allowed the government to formulate a reform program that was not only acceptable at home, but was also acceptable to development partners.
- Public acknowledgement of policy failure by political leadership sends a powerful message to the general public. It is a necessary and important step toward initiating change in policy regime.
- To ensure sustainability and credibility, it is important that the government rally public opinion in support of reform program. This requires a forthright and active effort to explain the benefits and costs of the reform agenda to civil society
- Sustained commitment to reforms and consistent message from the political leadership is critical to the credibility and sustainability of the process.
- Institutional impediments should be recognized at the outset in order to establish realistic expectations for reform outcome.
- Divestiture signaled a stronger commitment on the part of the government to private sector-led development, it led to increased domestic and foreign capital, technology, and managerial skills.
- In order to cultivate “buy-in” as well as the general public's support for privatization, there is need for successful privatized public enterprises which bring about lead to improved productivity, contribute to the tax base, and create employment opportunities for local investors.

TANZANIA'S ECONOMIC REFORMS—AND LESSONS LEARNED

- The gradual approach creates space for the government to adapt policies to its individual country circumstance. While it slows the speed of reforms, it engenders strong ownership, sustainability, and minimizes policy reversals.
- There is need for a strong institutional mechanism for accountability to sanction government's performance and donor behavior.
- Tanzania's open and direct discourse with its donors helped improve aid relations and aid effectiveness—and fostered partnership approaches—It resulted in improved donor coordination, increased government ownership, and a movement toward harmonization of processes.

Background and Context

Tanzania adopted an economic reform program in 1986 after experiencing a steady decline in economic growth in the late 1970s that led to a financial crisis in the early 1980s. The crisis was partly a result of economic policies pursued by Tanzania under a public sector-led economy embedded in the 1967 Arusha Declaration, and partly a result of exogenous factors, including deterioration in the terms of trade in the late 1970s and early 1980s, the collapse of the East African Community in 1977, and the war with Uganda's Iddi Amin during 1978–79. The objective of the 1967 declaration was to create an egalitarian society focusing on poverty alleviation and provision of welfare and social services to the majority of the population. The strategy was to be implemented through the public sector. Because of its focus on equity and poverty alleviation, the approach attracted financial support from a variety of development partners, including the World Bank. As a consequence, the government made substantial progress in meeting its social objectives, especially in extending primary education, health care, and water supply to rural communities through the mid-1970s.

**Table 1.1: Gross Domestic Product at Factor Cost, at Constant 1966 Prices
(annual growth rates in percent)**

	1973-79	1980	1981	1982	1983	1984
Gross domestic Product						
at factor cost	4.6	3.1	-2.6	-1.9	-0.7	0.6
Agriculture	3.6	4.7	-8.0	-5.9	-0.9	1.4
Manufacturing and mining	4.9	-15.8	-16.9	-26.0	-4.0	-5.0
Other	5.4	6.2	3.7	4.0	-0.3	0.7

Source: IMF Staff Report, 1984

Following the Arusha Declaration, the government adopted an interventionist approach through stringent price controls and established a large number of state enterprises with a view to creating public sector-led development framework. However, according to IMF, the approach produced adverse effects: it exacerbated distortions in the economy and led to a proliferation of parallel markets and unrecorded cross-border trade. These led to a decline in real GDP by an average of 1.7 percent per year during 1981–83, compared to an average annual increase of 4.6 percent registered in the 1970s (table 1.1) and a decline in real per capita income growth.

In the absence of growth, the social services expansion program could not be sustained. The government's own revenue and import capacity were inadequate, and operating and maintenance costs could not be financed through external assistance. Meanwhile the country's ability to meet current external payments obligations, including the servicing of external debt,

became severely constrained; as a consequence it accumulated large external payments arrears. As the government incurred large fiscal deficits, which were financed primarily by borrowing from the domestic banking system, high rates of inflation emerged during the first half of the 1980s, accompanied by a sharp decline in real wages. The government's expansionary policies, including massive growth of the public sector and stringent price controls worsened the economic difficulties and eroded incentives to produce.

It became clear that Tanzania's development strategy was not sustainable. Financial assistance began to lessen because most donors were unwilling to support what had become an unsustainable development model. However, Tanzania continued to pursue this approach reflecting President Nyerere's confidence in the model, reinforced by "moral" support and financial assistance from like-minded donor countries (Hyden and Karlstrom 1993).

The economic situation continued to deteriorate and domestic pressure for economic reforms mounted. The disagreement between President Nyerere and the IMF on the policy stance led to a suspension of an IMF-supported program in the late 1970s. This served to further dry up donor assistance. This pressure, together with continuing erosion external financial prompted an internal debate on the need for economic reforms. In reassessing its development strategy, the government initiated a series of "homegrown" programs (see box 1), including the 1984 homegrown reform package that were to be the key precursors to the subsequent Economic Reform Program (ERP).

Box 1. Homegrown Programs: Experimentation Process

1981–82. A National Economic Survival Program (NESP) was formulated to address the economic crisis. The NESP initiative sought, through government intervention and intensification of the control regime, to close the resource gap. The program failed to bring about economic recovery.

1982–83. A Structural Adjustment Program (SAP) was designed to finance the fiscal deficit largely through domestic borrowing in the absence of external assistance. The initiative was unsuccessful in turning the economy around because it did not address the fundamental issues of price distortions, including and in particular the exchange rate. (According to Ndulu (2003), devaluation of the exchange rate was considered a political issue: The government was preoccupied with devaluation in terms of its link to national prestige and strength, and fear of inflationary pressures.)

1983. An "economic saboteurs campaign" was initiated to address the proliferation of the parallel market and to control avenues for corruption. To enforce the campaign, parliament passed the Economic Sabotage Act (later replaced by the Economic and Organized Crimes Control Act). This initiative failed because the fundamental causes of shortages were not addressed.

1984. The government experimented with partial import liberalization measures through an "own-funded" imports scheme, whereby individuals were allowed to import goods without disclosing the source of their foreign exchange. The scheme brought in more imports even than had been envisaged. An export-retention scheme where exporters were allowed to retain a share of their proceeds was also introduced. The schemes were successful: the import scheme brought in more imports than envisaged, the export scheme led to a rise in official exports. Partial devaluation of the currency also was initiated. Government fears that inflationary pressure would follow proved unfounded; encouraged, the government gained confidence and scaled up economic reforms to a full-fledged Economic Reform Program (ERP).

1986. The ERP was initiated. It was supported by multilateral institutions, including the World Bank, IMF, and bilateral donors.

Episodes of Reform, 1986–2002

Tanzania's economic reform process can be classified into three broad phases: liberalization, derailed reforms, and successful reforms.

Liberalization, 1986–95

Upon assuming office in 1986, President Mwinyi spearheaded the liberalization efforts. Having championed the liberalization process, albeit on a smaller scale in Zanzibar, Mwinyi forcefully promoted the process on the mainland. This phase of reforms emphasized getting the prices right—it entailed dismantling a set of policies designed for a centrally-planned economy that emerged after the Arusha Declaration of 1967 (Box 2). By the end of 1991, the government had implemented a substantial element of the liberalization process.

Box 2. Summary Objectives of the 1967 Arusha Declaration

- Public ownership and control of the means of production and exchange (natural resources, the financial sector, large industries, and so forth)
- Self-reliance and the elimination of exploitation
- Establishment of democracy and the pursuit of equality
- Establishment of agricultural socialist production in *ujamaa* (“communal production”) villages
- Establishment of the supremacy of the ruling party
- Extension of welfare and social services program to rural areas

Source: Kahama, Maliyamkono, and Wells (1986).

Prices. Between 1986 and 1991, the government took specific measures to liberalize prices, building on the 1984 prereform efforts through a gradual reduction of items under price control, until all prices were liberalized and the National Price Commission (established in 1973) was abolished.

Trade. Liberalization of imports initiated in 1984 accelerated as a result of the success of the own-fund import scheme discussed in Box 1. Imports through the official foreign exchange channel were progressively liberalized through the Open General License (OGL) scheme established in 1989, which covered large volumes of eligible imports and later expanded from a system of permitted goods to a “negative list” identifying items that are specifically excluded. In line with trade liberalization, the simple average tariff declined from 32.1 percent in 1986 to 19.5 percent by 1994 and the weighted average tariff declined from 35 percent to 22.8 percent in 1988. Imports as a share of GDP increased from about 14 percent in 1986 to about 47 percent in 1994 (World Economic Outlook, 2003) By reintroducing cooperatives and allowing private sector participation in domestic trade, the government ended parastatals' monopoly in procuring, distributing, and marketing of agricultural commodities This gave producers some flexibility to export products directly, outside the official channels of the marketing boards (Lofchie 1993).

Exchange rate. Building on the 1984 “homegrown” program, the government made progress on the exchange rate policy, despite continued political opposition. Experimentation with partial devaluation during the 1984 homegrown program had determined that it need not lead to inflationary pressures, as had been feared. As a result, the government was encouraged to pursue further realignment of exchange rate. In 1986, the real effective exchange rate was depreciated by more than 60 percent, then by a further 60 percent between 1987 and 1989 (Nord et al. 1993). In 1992 foreign exchange bureaus were introduced and authorized to buy and sell foreign exchange at freely negotiated rates; a system of weekly Bank of Tanzania (BoT) foreign exchange auctions to the bureaus was also introduced. Commercial banks and the authorities began to announce the auction rates as the official exchange rate, thereby unifying the exchange rate. With foreign exchange liberalized, in late 1993, the Exchange Control and Import Control Departments of the BoT were abolished in the context of restructuring the BoT. This gave prominence to new functions, including monetary programming, open market operations, and bank supervision. In July 1994 the auctions were replaced by interbank market operations. As of May 1996, the exchange rate floated freely and has been market determined ever since.

Financial sector. Treasury bill auctions were introduced in 1993 to develop a market-oriented financial system. Interest rates were liberalized. Two private commercial banks began operations after the Banking and Financial Institutions Act (BFIA) legalized the establishment of private financial institutions and gave the Bank of Tanzania the responsibility to license, regulate, and supervise banks and nonbank financial institutions. With the participation of domestic and foreign-owned private banks, issuing regulations governing licensing and prudential supervision, and undertaking comprehensive financial audits of the loan portfolios of the government-owned banks, the financial sector reforms were complete.

Investment climate. In February 1990, the government adopted a National Investment Promotion Policy and enacted the National Investment Promotion and Protection Act of 1990 (NIPPA) to enhance the investment climate. The act established an Investment Promotion Center (IPC) to approve, monitor, and facilitate foreign direct investment inflows as well as local investment. NIPPA was subsequently replaced by the Tanzania Investment Act of 1997, and the IPC was transformed into the Tanzania Investment Center (TIC). In addition the government enacted legislation establishing a Parastatal Sector Reform Commission (PSRC) charged with the task of guiding the divestiture of public enterprises. During this period, one-fourth of public enterprises earmarked for privatization were divested. Between 1992 and 1995, FDI increased from US\$12 million to US\$150 million. A large proportion of this FDI reflected investment in mining, but some of it reflected proceeds realized from privatization of public enterprises.

Outcome. The changes in the economic policy regime led to increased levels of economic activity stemming from liberalization efforts, availability of consumer goods, and market determined producer prices. GDP growth averaged about 5 percent per year between 1986 and 1992, reversing the real per capita income decline experienced in the early 1980s. Official development assistance rose sharply to US\$1.08 billion in 1991 from US\$666 million in 1986, reflecting resumption of donor inflows in support of economic reforms. Although the rate of inflation declined slightly, it remained at about 30 percent, fueled mainly by growth in domestic

credit reflecting lending to loss-making agricultural marketing boards and cooperative unions, which continued to exert influence.

Derailed Economic Reforms, 1992–95

Despite considerable progress on structural reforms and institutional restructuring, weakened leadership and commitment to further reforms saw the economic program derailed during the three years of President Mwinyi's second term due to. In particular, macroeconomic stability was not achieved mainly due to the government's inability to control credit expansion to public enterprises, massive tax exemptions, poor revenue collections, and tax evasion. The large increases in tax exemptions was symptomatic of corruption and governance issues. Meanwhile, gains made earlier in reducing inflation were reversed: inflation rose from about 22 percent in 1992 to 37 percent in 1994.

The government's waning commitment to reforms confirmed by its laxity in public finance management ran counter to the reform program objectives. This led to erosion in donor confidence and triggered suspension of adjustment disbursements from several donors, including the World Bank. GDP growth averaged less than 2 percent per year between 1991 and 1995, reversing real per capita GDP growth attained during the preceding six years. Because of poor economic management, the poverty simulations suggest that poverty might have increased by more than 40 percent between 1991 and 1994 (Demombynes and Hoogeveen, 2004, forthcoming).

The derailment of the program and weakened leadership led to loss of donor support and created an impasse in donor-government relations. The impasse led to the Helleiner process,¹ which had the objective of mediating between the government and its donors and facilitating restoration of relations. In its deliberations, the Helleiner process focused on aid effectiveness, government credibility and the government's ownership of the reform program.

The Helleiner process played a catalytic role in restoring government-donor relations. The short-term result of the initiative was to emphasize to the government that the macroeconomic program was indeed off track. But more importantly, the process initiated a more balanced framework for government-donor cooperation, provided a platform from which views might be expressed candidly, and through the independent monitoring group (IMG),² established

¹ The Helleiner process was an initiative of the Danish government in agreement with the Tanzanian authorities to evaluate Tanzania-donor relations during 1994. It was led by Professor Jerry Helleiner of the University of Toronto and a team of independent advisers on development cooperation issues. They included Professor Benno Ndulu (Tanzania), Professor Nguyuru Lipumba (Tanzania), and Professor Knud Erik Svendsen (Denmark)

² The independent monitoring group consists of two Tanzanians, Professor Samuel Wangwe (Consultant and the Chairperson) and Fadhili Mbaga (former Ambassador); the three non-Tanzanians include, Goran Anderson, from Sweden, (consultant and a retired SIDA official), Professor Rolf Hofmeier from Germany, (a retired academic and researcher), Professor Tony Killick from the U.K., (a retired academic and researcher), and Emmanuel Tumusiime Mutebile (Governor Bank of Uganda).

an institutional mechanism for accountability. The process thus fostered transparency, enhanced cooperation, and underlined partnership between government and its donors, as evidenced through newly established consultative mechanisms and processes between the government and its development partners. For example, the government-led Tanzania Assistance Strategy (TAS) provides a framework for partnership and helps delineate the role of external resources for development. The annual government-led Public Expenditure Review (PER) and Medium-Term Expenditure Framework (MTEF) involve members of parliament, government officials, donor community, and civil society. The Poverty Monitoring System is implemented through technical working groups involving representation from a wide range of stakeholders. The IMG has institutionalized periodic evaluation of government and donor performance.

Box: 2.1 The Independent Monitoring Group (IMG)--A Best Practice

The IMG was jointly appointed by the government and the donors in February 2002 to review progress in aid relationships and report to the next meeting of the Consultative Group in Tanzania. Its objective was to serve as a performance monitoring tool and an instrument of accountability on behalf of the government and its donors with respect to implementation of agreed terms of their development cooperation. The group consists of six independent observers, two Tanzanians from non-governmental institutions (not affiliated to government or donors), a senior Ugandan official with experience in negotiations between government and donors. The other three include nationals of Sweden, Germany and the United Kingdom independent of their governments or donor agencies. The basis of the IMG stemmed from the Helleiner process discussed above, which was catalytic in mediating and restoring relations between the government and its donors in the early 1990s, when government-donor relations were characterized by tension and mistrust. Through the Helleiner process, it became clear that there was a need to ensure enhanced government leadership in the development agenda as well as transparency, accountability, and efficiency in aid delivery mechanisms. Subsequently, both the government and the donors agreed that monitoring processes and systems would be beneficial and would need to be institutionalized. Since the 1997, 1999, and 2000 Helleiner reports, the IMG has met once and has presented one evaluation report during the 2002 CG meeting in Dar-es-Salaam. Its findings indicated that commendable progress has been made in building partnerships between all stakeholders, and that progress is also being made towards harmonizing and streamlining aid delivery and management modalities. Since then, there has not been a CG meeting. It is hoped that the IMG will present another evaluation report when the next CG meeting is scheduled. In summary, the IMG has brought about some balance in government-donor relations and has institutionalized periodic evaluation of government as well as donor performance. The IMG has become an embodiment of an accountability framework for the government and its donors and an instrument to foster a partnership approach to development.

Furthermore, the Helleiner process prompted donors to examine their aid delivery mechanism and their approach in managing development assistance, and broadened the concept of stakeholders to include civil society. By doing so, it expanded the group of beneficiaries and monitors of the reform program. Overall, the process underscored the need for accountability on the part of both government and donors, and recognized the need to provide sufficient space to facilitate greater government ownership. Its culmination in the independent monitoring group, which became an instrument to monitor performance of both the government and donors on agreed actions to enhance the reforms, reflects the need for strong institutions that facilitate ownership and accountability.

Recovery and Successful Reforms, 1996–2004

When he assumed power in late 1995, president, Benjamin Mkapa made the achievement of macroeconomic stability a key objective of his administration. Tanzania's reform process has since been robust and successful: macroeconomic stability has been achieved, donor relations restored, and structural and institutional reforms accelerated.

Macroeconomic stability. The Mkapa administration from the outset pursued prudent fiscal management. By 2002, improved budgetary management procedures and operation of a cash budget system had reduced inflation from the 1995 level of about 27 percent to less than 5 percent. The cash budget ensured that it could only spend up to the equivalent of estimated revenue, plus any grants, for any given month. An integrated financial management system was introduced to foster coordination and collaboration among various ministries and the treasury, monitor expenditures, and enhance transparency in budget management.

To enhance revenue and address the problem of massive exemption and tax evasion, the government rationalized the tax system and improved tax administration through the strengthening of the Tanzania Revenue Authority. Value added tax was introduced to replace the cumbersome sales tax and broaden the tax base, and to minimize revenue leakage. The government eliminated sources of revenue differential on import tax rates between the mainland and Zanzibar, limited discretionary exemptions, and closed owner-operated bonded warehouses. In addition the government instituted legislative changes to allow prosecution of proven tax evaders.

Government revenue, excluding grants, improved from about 11.8 percent of GDP in 1993 to 13.5 percent of GDP in 1996. However, the revenue ratio to GDP declined to 12 percent in 1999. It has since stabilized around 13 percent. The overall deficit excluding grants improved from 7.5 percent of GDP to 2.8 over the same period (World Economic Outlook, 2003). During this period, GDP growth rate reached 6.3 percent in 2002, up from 3.6 percent in 1995, and growth in per capita GDP accelerated to 4.2 percent in 2002. As incomes improved, the number of households below the poverty line declined marginally from 38.6 percent in 1991-1992 to 35.7 in 2000-01. However, the decline in poverty has been more pronounced in Dar-es-Salaam, where poverty incidence declined from 28 percent to 18 percent over the same period. The modest decline reflects the impact of output contraction experienced during the first half of the 1990s due to poor economic management.

The balance of payments improved significantly, largely because of the resumption of large donor inflows and export earnings—particularly from nontraditional exports such as gold, gemstones, and fish products. Overall gross foreign reserves rose from the equivalent of 1.6 months of imports at the end of December 1995 to more than 6 months of imports at the end of December 2002.

Structural reforms. About two-thirds of earmarked public enterprises on the structural front were divested. In the area of public utilities—electricity (Tanzania Electricity Supply Company) has been placed under management contracts and water (Dar es Salaam Water and Sewage Authority)—has been placed under a lease to a private company. To improve efficiency

in telecommunications the government allowed operation of private cellular telephones and divested 35 percent of the equity in the Tanzania Telecommunication Company Limited; it has leased the container terminal at the port of Dar es Salaam to a private company to enhance port services.

Public service delivery. The Mkapa government has implemented a number of initiatives to improve access, enhance quality and delivery of public service in education and health services. With respect to the education sector, the government redoubled its efforts to improve access to primary school education and enhance its quality through increases in sectoral budgetary allocations in line with the poverty reduction strategy within the context of Primary Education Development Plan (PEDP). With donor financial assistance, the government abolished school fees in 2001, established the Education Fund for children from poor families, and introduced a capitation grant for expenditures on learning and teaching materials and school administrative purpose.

On the health sector front, the government raised awareness of the health sector reform program through the Health Sector Development Program (HSDP). A coordination desk was established to promote private sector participation in health service delivery, the media were used to advocate health sector reforms, a national malaria medium-term strategic control program was adopted, and new anti-malarial drug policy adopting Sulfadoxine + pyrimethamine (SP) as a drug of first-choice was introduced and insecticide-treated nets (ITNs) implemented. To bolster efforts and measures under the program, the Ministry of Health set aside additional funds to 82 reforming district councils and recently expanded to cover all 121 councils.

Governance. The government accelerated civil service and pay reform with the objective of enhancing accountability, transparency, and efficiency within the civil service. Over the period 1992–93 to 1998, the number of civil servants was reduced from 355,000 to 264,000. At the same time, a performance enhancement system and a streamlined pay structure were introduced. To address corruption and governance-related issues, the president appointed a Presidential Commission of Inquiry against Corruption, which was led by Judge Joseph Warioba, a former prime minister and first vice president of the United Republic of Tanzania. The mandate of the commission included examining the state of corruption, identifying avenues and loopholes, establishing its causes, and recommending ways of curbing it.

Investment climate. The government has undertaken a number of measures to improve the investment climate. The most notable of these are the passage of Tanzania Investment Act of 1997 (repealing the 1990 NIPPA) and of the 1998 Mining Act. The latter has had a far-reaching impact on establishing clear incentives for the mining industry in Tanzania. In addition the Tanzania Investment Center was established in the place of the Investment Promotion Center and mandated as a “one-stop” center to facilitate the process of setting up business operations in Tanzania.

The legal framework for FDI thus has become increasingly transparent. For example, foreign investment law protects against expropriation and guarantees investors’ rights to repatriate profits, dividends, loan repayments, and fees. In 1999 a commercial court was

established to expedite resolution of commercial disputes and to facilitate enforcement of legal contracts, with the aim of keeping the average period for case resolution to six months or less. Initiatives such as the Investors' Round Table (IRT) and the program for business environment strengthening in Tanzania (BEST) were instituted to seek investors' views and provide strategic focus for the government's efforts to create a conducive environment for private investment. In this context, President Mkapa meets biannually with chief executive officers (CEOs) of global companies interested in investing in Tanzania. Finally, the National Business Council and the Private Sector Foundation were established by local businesses, in conjunction with the government, to enhance public-private sector partnerships.

Despite some improvement in the legal and regulatory framework, many challenges remain (table 2).

Table 2 Contract Enforcement in Selected African Countries, 2002

Country	Number of procedures ^a	Duration ^b	Formalism index ^c
Kenya	25	255	3.09
Mozambique	18	240	4.48
South Africa	11	84	1.68
Tanzania	14	127	3.82
Uganda	16	99	2.60

Source: World Bank

a. Covers all independent procedural actions mandated by law or court regulation that demand interaction between the parties or between them and the judge or court officer.

b. Measures the total of average duration of the procedure in calendar days, including duration until completion of service of process, duration of trial, and duration of enforcement.

c. The formalism index, which ranges from 0.0 to 7.0, is an index of the degree of formalism in the procedures to resolve disputes. The index measures substantive and procedural statutory intervention in judicial cases at lower-level civil trial courts.

Impact of Economic Reforms and Poverty Reduction

Macroeconomic Stability

Tanzania has achieved considerable success in macroeconomic and structural adjustment since the mid-1990s. Reforms during the second half of the 1990s succeeded in reducing nonpriority government expenditures, as well as the overall deficit, which declined from 7.5 percent of GDP in 1993 to 3.1 percent of GDP in 1997. As macroeconomic stabilization was consolidated in the late 1990s, the government increased expenditure allocations to priority sectors, as reflected by the rise in the overall deficit, to facilitate growth and poverty reduction efforts (see table 3). The priority areas include education, health, water, agriculture, rural roads, land, and HIV/AIDS-related interventions.

CASE STUDIES IN SCALING UP POVERTY REDUCTION

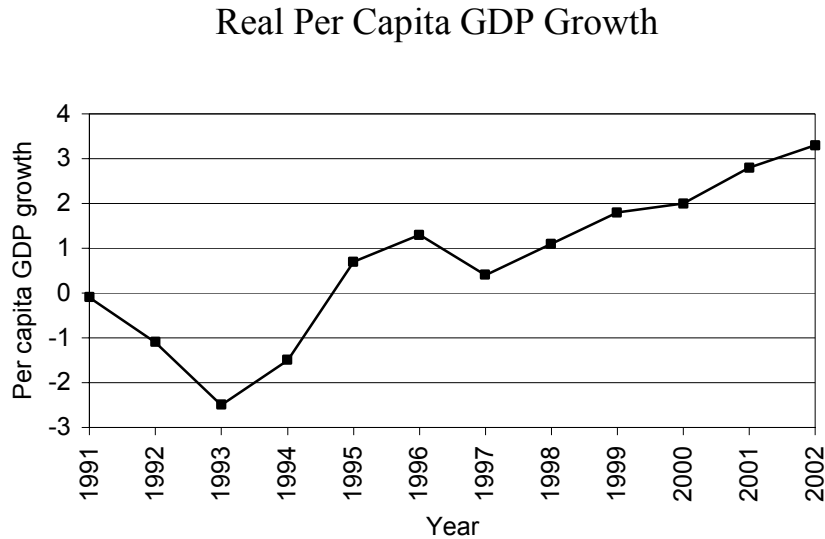
The annual inflation rate declined from an average of 29 percent during 1993–95 to an average of 5 percent during 2000–02. The balance of payments improved significantly, reflecting large donor inflows and export earnings, notably from nontraditional exports such as gold, gemstones, fish products, and horticulture. Nontraditional export earnings rose from US\$183 million in 1993 to US\$697 million in 2002. In terms of share of total exports, nontraditional exports rose from about 49 percent in 1991 to 70 percent in 2001 and to 77 percent in 2002. This was in part due to the collapse, of post-1996, of world commodity prices of Tanzania’s major exports—mainly coffee and cotton. Overall gross foreign reserves rose from the equivalent to 1.6 months of imports at the end of December 1995 to more than 6 months of imports at the end of December 2002.

Table 3. Key Economic Indicators
(percentage change unless otherwise indicated)

	1994	1995	1996	1997	1998	1999	2000	2001	2002
Real GDP growth	1.6	3.6	4.5	3.5	3.7	3.7	5.6	6.1	6.3
Real Per Capita GDP growth	-1.3	0.7	1.8	0.7	-0.6	2.7	2.2	3.4	4.2
Inflation	37.1	26.5	21.0	16.1	9.8	9.0	6.2	5.2	4.6
Overall fiscal balance excl. grants in % of GDP	-5.9	-5.4	-2.8	-3.1	-6.0	-8.1	-5.6	-6.3	-8.3
Overall fiscal balance incl. grants in % of GDP	-3.1	-3.3	0.2	0.2	-1.6	-3.3	-1.7	-1.6	-2.7
FDI in US\$ millions	50.0	150.0	148.5	157.8	292.7	517.4	463.4	327.2	283.8
Official reserves in months of imports	1.9	1.6	2.7	3.2	4.5	5.2	6.2	6.8	7.9
External public debt in % of GDP	147.6	130.0	116.6	103.0	91.5	80.4	72.7	67.3	68.6

Source: World Economic Outlook 2003.

Tanzania’s achievements resulted from a critical mass of reforms undertaken over a period of more than 15 years, as described elsewhere in this report. Consolidation of fiscal management during the late 1990s, liberalization of the financial sector and the external current account, and the partial liberalization of capital account led to a significant improvement in the investment climate. A combination of appropriate economic policies and improvement in the investment climate stimulated economic activities and led to an increase in real income and a reduction in poverty.

Figure 2 Real per Capita GDP Growth and Poverty in Tanzania

Source: World Economic Outlook 2003

Real GDP growth averaged 4.8 percent during 1997–2002, compared to 2.7 percent during 1990–95. According to the IMF (2003), the faster growth observed during this period was due largely to improvement in total factor productivity reflecting the effect of structural reforms, including the liberalization of agricultural production and marketing. Real GDP per capita growth rose to 4.2 percent in 2002 from 0.7 percent in 1995, reflecting prudent economic management. As income rose, between 1995 and 2001, poverty declined, it is estimated to have fallen further (figure 2 and box 3). Poverty studies conducted between 1995 and 1996 suggest that the long-term poverty trend has been declining (Sarris and Tinios 1995, Ferreira 1996), but the extent to which poverty declined over this period is subject to debate, given the non-comparability of the underlying data of the two studies. The most recent Household Budget Survey (HBS) (2000–01) estimates poverty to have declined significantly between 1994 and 2002. Progress in poverty reduction has been more pronounced in urban areas, in particular Dar es Salaam, than it has been in rural areas (see box 3). However, income inequality is widening, as demonstrated by the rise in the Gini coefficient from 0.30 in 1991–92 to 0.34 in 2000–01 in Dar-es-Salaam, and from 0.33 to 0.34 in the mainland Tanzania during the same period (HBS 2000-01).

Box. 3 Economic Reforms and Poverty Reduction

Poverty studies conducted between 1983 and 1991 have argued that poverty has been declining for most of the post-1986 period (Sarris and Tinios 1995, Ferreira 1996), but the non-comparability of the underlying data mean that the findings of these studies are subject to debate. The 1991-92 and 2000-2001 HBS data are comparable and provide an opportunity to assess the impact of economic growth on household consumption and poverty levels at the national level. The results of the two HBSs surveys show a small and statistically insignificant decline in the headcount rate (from 38.6 percent in 1992 to 35.7 percent in 2001) at the national level. However, poverty in Dares Salaam dropped significantly, from 28.1 percent in 1992 to 17.6 percent in 2001. However, it should be understood that the survey data offers only two snapshots in time and fails to represent the full evolution of poverty over the course of the intervening nine years. As the early 1990s are characterized by economic contraction (figure 2), the changes in poverty do not give a full account of the benefits of economic growth in the post 1994 period. A plausible pattern for the evolution of poverty during the 1990s is that poverty first increased during the period of economic stagnation that ended in 1994 and only declined, once rapid growth was achieved in the second half of the decade.

Using HBS data and per capita growth figures, Demombynes and Hoogeveen (2004) simulated poverty trajectories. Under a number of scenarios over the 1990s, poverty rates were demonstrated to have followed a U-pattern, increasing to over 40 percent or higher in 1994 and then dropping to below 36 percent in the 2000/01 survey. In urban areas, where per capita growth has been highest, the highest reduction in poverty occurred. Poverty decomposition analysis suggests that the poverty-reducing impact of growth has been partly offset by increasing inequality, particularly within Dar es Salaam. The simulation projections further suggest that poverty is likely to have dropped further in the post 2001 period.

Source: Hoogeveen (2004).

Investment Climate

Openness. Tanzania has continuously liberalized its trade regime, as demonstrated by the improvement in the IMF's trade restrictiveness ratings for Tanzania. Apart from Uganda, the simple average tariff in Tanzania is lower in comparison to other comparator countries, for example, 30 percent in India, 17 percent in Pakistan, and 19 percent in Kenya.

Table 4 Trade Restrictiveness Ratings

	1997	1998	1999	2000	2001	2002	2003
India	10	10	10	10	8	8	8
Kenya	6	6	6	6	6	6	6
Pakistan	8	8	7	7	7	6	6
Tanzania	7	7	6	6	5	5	5
Uganda	5	2	2	2	2	2	2

Note: 1 = most open; 10 = most restrictive.

Source: IMF staff calculation, 2003.

Foreign direct investment rose to higher levels, particularly in the second half of the 1990s, from US\$150 million in 1995 to US\$517.4 million in 1999 due to a combination of factors described earlier in the report. This is evidenced by the increase in Tanzania's share of FDI flows to Africa, from 1.1 percent of GDP in 1997 to 3.5 percent of GDP in 2001. This compares favorably with other countries in the region (see table 5). FDI inflows to Tanzania averaged US\$330 million between 1997 and 2002.

About 40 percent of FDI is related to the mining sector, reflecting the low cost of gold production in Tanzania as well as the generous tax incentives offered under the 1998 Mining Act. Total investment in gold mining is now nearly US\$ 2 billion. In 2002, gold exports accounted for nearly 40 percent of Tanzania's total exports, making the country one of the leading gold exporters in Africa. The first large-scale mine began operations in November 1998 after the enactment of the Mining Act in early 1998. It has since been joined by three other large-scale mines operated by multinational corporations. The four corporations involved are: AngloGold, Barrick, Resolute, Placer Dome, and Ashanti. A fifth mine is expected to become operational during 2004. According to the Ministry of Energy and Minerals, the large mining companies are estimated to have produced nearly 1.5 million troy ounces of gold in 2003³; they are expected to produce 1.7 million troy ounces of gold during 2004 in view of higher gold prices (EIU 2004).

Table 5. FDI Inflows, Percent of GDP, 1997–2001

	1997	1998	1999	2000	2001
Kenya	0.4	0.4	0.4	0.5	1.3
Mozambique	1.9	5.4	9.3	3.7	5.1
South Africa	2.6	0.4	1.1	0.7	6.3
Tanzania	1.1	2.1	2.1	5.1	3.5
Uganda	2.6	2.9	3.9	4.2	4.0

Source: IMF staff estimates.

Large-scale mining is not, relative to output, a large employer given the capital-intensive method of production: the four companies operational in Tanzania have created only an estimated 7,000 jobs. However, liberalization of the mining sector has also provided economic opportunities to artisanal or small-scale mining, filling an important role in the alleviation of rural poverty. A 2001 USAID sponsored study found that that artisanal mining activities in rural mining areas contributed significantly to rural job creation, raised income, and reduced poverty (Phillips et.al 2001). The study found that the basic income earned in mining towns was six times higher than the average wage from farm labor. It also highlighted the important secondary economic activities that arose around the small-scale mining industry: for every job created in small-scale mining, three associated jobs were created in shops and services. A 1995 sectoral baseline finding by Tan Discovery (1996) indicated that 550,000 people were employed in artisanal mining at the peak of the boom that occurred that year. The study estimates that there

³ Interview-- Mr. Patrick Rutabanzibwa, Permanent Secretary, Ministry of Energy and Minerals, March 17, 2004

were only 1.1 million middle salaried jobs in Tanzania at the start of the boom, and that within six years, artisanal mining had increased this number by 46 percent. The study concluded that no other sector or job creation program has injected dispersed incomes into rural areas, stimulated

Table 6 Gross Domestic Product: Percentage Annual Growth Rate by Sector

	1995	1996	1997	1998	1999	2000	2001	2002
Gross Domestic Product (mp)	3.6	4.5	3.5	3.7	3.7	5.6	6.1	6.3
Agriculture	6.6	4.5	1.5	2.3	4.9	3.9	6.5	5.8
Crops	8.1	5.0	0.7	2.3	5.6	3.6	7.3	6.3
Fishing	4.0	4.1	3.8	3.5	3.2	6.5	7.3	6.5
Secondary	-0.8	5.8	5.9	8.6	5.5	6.7	6.4	8.5
Mining and Quarrying	11.7	9.6	17.1	27.4	9.1	13.9	13.5	15.0
Manufacturing	1.6	4.8	5.0	8.0	3.6	4.8	5.0	8.0
Tertiary	2.7	3.7	3.1	4.3	5.3	6.0	5.7	6.4
Trade, hotels and restaurants	3.5	3.5	5.1	4.7	6.0	6.5	6.7	7.0

Source: IMF, 2004

cash flow, and reduced rural poverty on this scale.

Second to mining, the manufacturing and services sectors together account for 35 percent of the FDI inflows. FDI in the financial sector grew rapidly after the liberalization of banking and nonbanking financial services.

Strengthening property rights. The reforms have also addressed land ownership issues. For example, the processing of applications for urban land has been reduced from five years to within one month of submission of the application. The title deed process has been reduced from 10 years to two months between the offer of the title and its registration. Progress has also been made on the issue of access to village land. Under the Village Land Act (5) of 1999, a deed should be issued by a village council within two months of application. Issue of the deed has in the past taken as long as 10 years. The Land Act (4) has also been amended to reflect the concerns of the Tanzania Bankers Association regarding the use of land as collateral for bank lending.⁴

Infrastructure. Some progress has been made in telecommunications and transport, although the high cost and unreliability of power are major impediments (see Table 7). The number of cellular telephone operators rose from one to five between 1994 and 2002, despite the withdrawal of one company, Tritel, at the beginning of 2001. The number of cellular phones in use increased from one per 1,000 people in 1997 to 12 per 1,000 people by 2001 (World Bank 2004b). The number of fixed telephone lines rose only marginally during the same period, reaching a level of about four lines per 1,000 people, in 2001. Access to the Internet and use of

⁴ Electronic communication from Ms. S.T. Sijaona, Permanent Secretary, Ministry of Lands, 22 March 2004.

computers also is rapidly spreading. In a speech to Parliament on 12 February 2004, President Mkapa noted that in all but three regions of Tanzania Internet services are available.

Between 1995 and 2003, 249 kilometers of tarmac roads were constructed and 68 kilometers of roads were rehabilitated or expanded in order to enhance market accessibility through the road network. A major bridge was constructed across the Rufiji River, connecting Dar es Salaam and the southeastern part of the country, a cashew nut-producing area. The government has budgeted to provide about US\$2 million per month for the next two years for further road repair or construction of targeted roads.

Table 7 Share of Firms Reporting that Infrastructure Is a “Major” or “Severe” Impediment to Business Operations (Percent)

	<i>Telecommunications</i>	<i>Transport</i>	<i>Power</i>
China	17	19	28
Kenya	44	37	49
Pakistan	9	10	39
Tanzania	12	23	59
Uganda	5	23	44

Source: World Bank (2004), preliminary draft.

In addition to enhancing the investment climate and generating revenue for the Tanzanian treasury, the privatization of public enterprises has delivered other benefits. Investment made by the new owners in new technology and training has seen the divested enterprises increase production and improve employee skills. Consumers have benefited from an increased supply of quality goods and competitive pricing, and the divestiture program has also contributed to the development of the capital markets, providing Tanzanian investors with the opportunity of making local equity investment.⁵

Examples of the successful privatization of public enterprises include the leasing of the Dar es Salaam container terminal to a private company (see Table 8). This has improved the port's competitiveness by enhancing its productivity and efficiency: The number of days needed to clear imports through customs has been reduced by more than half, from 32.7 days in 2000 to 14 days in 2003 (Parastatal Sector Reform Commission, 2003)

⁵ Key companies floated on the Dar-Es-Salaam Stock Exchange to date include Tanzania Breweries Ltd, Tanzania Cigarette Company, Tanzania Tea Packers, Tanzania Oxygen Limited, Dar-Es-Salaam Airport Handling Company, and Simba--a cement company.

Table 8 Tanzania International Container Terminal Services Ltd.

	2000	2001	2002	2003
Number of containers units handled per year (thousands)	123.0	149.0	166.0	200.0
Productivity ^a	10.0	14.7	16.8	20.0
Days to clear a container from the port	32.7	19.1	19.8	14.0
Royalties to Tanzania Harbours Authority (US\$ million)	3.6	11.9	13.7	16.5
Taxes and levies to government (US\$ million)	1.2	6.3	8.4	11.5

a. Measured by the number of containers handled by each container crane per hour.

Source: Parastatal Sector Reform Commission.

Productivity, as measured by the number of containers handled by each container crane per hour (cph), increased by 100 percent, from 8–10cph in 1999 to 16.8cph in 2002. The number of ships in the port has increased by more than 40 percent, and those ships are spending fewer hours in port and paying less in wharfage charges. Improvement of the port operations has also resulted in an increase in the royalties paid to the Tanzania Harbours Authority and in the taxes and levies paid to the government. Despite this progress, however, there remains much room for further improvement: the port and customs delays suffered by enterprises in Tanzania are considerably longer than those endured by enterprises in comparator countries (see Table 9).

Table 9. Median Number of Days to Clear Customs, 2003

	Imports	Exports
China	5	3
India	7	3
Kenya	7	4
Pakistan	10	5
Tanzania	14	7
Uganda	4	2

Source: World Bank (2004), Preliminary report.

The privatization of Tanzania Breweries Limited (TBL) was similarly successful in turning around the company, increasing its market value from US\$50 million in 1993 to about US\$470 million in 2003 (see Table 10). Within nine years of becoming a private company, TBL quadrupled its production capacity, from 525,000 hectoliters in 1993 to 2,050,000 hectoliters in 2003. It furthermore increased the market share of its products from 25 percent in 1992 to about 98 percent in 2003, and turnover increased from 22 billion Tanzanian shillings (TSh) in 1993 to TSh

160 billion in 2003. The improvement in TBL's operations has contributed significantly to government revenue (about 1 percent of GDP), skills development of TBL employees, and enhanced employee earnings. In addition, the new TBL contracts out all noncore activities to private companies, thereby creating employment.

TANZANIA'S ECONOMIC REFORMS—AND LESSONS LEARNED

Table 10. Tanzania Breweries Limited

	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Production, hectolitres (thousands)	525	575	875	1,200	1,450	1,500	1,659	1,551	1,545	1,828
Dividends in TSh billion	0	0	4	8	13	17	—	21	25	26
Profits	losses	losses	11	16	16	19	—	25	29	34
Excise and sales tax	12	12	23	27	28	36	—	38	38	35
Taxes paid in TSh billion ^a	—	—	—	32	45	48	—	46	50	75

TSh Tanzania shilling.

a. Includes dividend to government.

Source: Parastatal Sector Reform Commission (PSRC).

Governance. Governance is an important aspect of the investment climate. The measure of governance as defined by Kaufmann, Kraay, and Mastruzzi, comprises six components: voice and accountability, political stability, government effectiveness, regulatory quality, the rule of law, and control of corruption (Kaufmann, Kraay, and Mastruzzi 2003). Tanzania ranks above average for low-income countries on the five out of six governance measures, but it performs poorly with respect to control of corruption (World Bank 2004b). Some progress has nonetheless been made in this area. For example, the government has created the institutional framework to combat corruption, enacting the Finance Act in 2001 and the Public Procurement Act in 2002, and publicly pronouncing zero-tolerance position with regard to corruption. The success of these measures in reducing corruption appears to have brought about some progress in the late 1990s and early 2000s. Although progress remains modest,⁶ the slight improvement is reflected in Tanzania's rating by the Transparency International Corruption Perception Index (CPI) from 1.9 in 1999 to 2.7 in 2002, consistent with the improvements observed in Kaufman et al. (2003). The country's record of improvement compares favorably with that of neighboring countries (see Table 11).

Table 11. Corruption Perception Index for Selected Countries

	1998	1999	2000	2001	2002	2003
Kenya	2.5	2.0	2.1	2.0	1.9	1.9
Uganda	2.6	2.2	2.3	1.9	2.1	2.2
Tanzania	1.9	1.9	2.5	2.2	2.7	2.5

Source: Transparency International CPI, 1998-2003

Note: The index ranges from 10 (highly clean) to 0 (highly corrupt).

⁶ The State of Corruption in Tanzania, Annual Report 2002, ESRF, and FACEIT.

Public Service Delivery

Education. Government, community, and donor efforts have reversed the decline in school enrollment. Net enrollment in primary education rose to 85 percent in 2002 from 65 percent in 2000. The gross enrollment ratio rose to 100 percent in 2002 from 78 percent in 1990, exceeding the program target of 85 percent. This achievement reflects the abolition of school fees and the concerted enrollment drive in which the government and communities engaged. New classrooms have been built, additional teachers recruited, and school nutrition programs enhanced. The Primary Education Development Plan (PEDP) has been successful not only in increasing the enrollment rate, but also in improving teaching facilities; as evidenced, for example, the book-to-pupil ratio. This has motivated teachers and improved the teaching and learning environment. The major challenges that remain include resolving disparities between regions in the gross enrollment ratio, improving the quality of primary education, and reducing illiteracy from the 2000 level of about 25 percent.

Other achievements in managing primary education include strengthening of the institutional mechanisms. The on-going institutional innovations are embedded in the government's overall public sector reform program—the local government reform program and the financial institutional arrangements. The organizational responsibilities of the education sector including development of programs, implementation and accountability, have been mainstreamed at all levels of government. From the central government, to the district council level as well as the school and community level. More specifically for example, the role of the Ministry of Education and Culture (MoEC) now focuses on policy making, standard setting, and quality assurance of education programs. The local government authorities have the responsibility to oversee primary education development program delivery under their jurisdictions by providing a participatory framework for the communities and also by playing a supportive and coordinating role to enable school communities and committees to effectively participate in the implementation of decisions. The school communities and village councils have the responsibility to implement school plans; these reflect input from school management and pupil councils. This arrangement provides a direct link between the center, local authorities, and the village government, delineates responsibilities at each level, and ensures transparency and accountability of the program. The arrangement is in turn underpinned by commitment at political, administration, and community and village government levels, signifying ownership to the approach. Similar reforms have taken place in the secondary school education program.

Furthermore, a systematic financial institutional arrangement has been developed to ensure transparency and accountability in financial management of primary school funds. The arrangement is embedded in the integrated Financial Management System (IFMS) underpinned by financial management and procurement legislations. The arrangement provides a direct link in transferring and disbursing funds from the Ministry of Finance (MoF) to local government authorities, and to the beneficiaries-- primary schools. The local government authorities, through the councils, supervise financial matters for primary education including transferring funds directly to school accounts. The MoF transfers funds, upon receipt of all approvals from local

government, MoEC, Basket Fund committee, directly to education bank accounts of the respective councils. The funds are subsequently transferred to the respective primary school bank account managed by a village council and a school committee.

Health sector. The achievements thus far realized under the Health Sector Development Program (HSDP) have included improvement of the funding for and availability of drugs and medical supplies in primary health service units. Expenditure on preventive and district services has also increased. The Drug Revolving Fund has been introduced in all district hospitals, Community Health Funds have been launched in 37 districts, and all civil servants are now covered under the National Health Insurance Fund scheme.

Other successes under the HSDP include an increase in the proportion of births assisted by trained personnel (from 50 percent in 1999 to 80 percent in 2001–02); a rise in the number of children under the age of two years who are immunized against measles and diphtheria–pertussis–tetanus (from 74 percent in 1999 to 85 percent in 2003); and expansion of the integrated management of childhood illness (from no coverage in 1999 to provision in 30 districts in 2003). Under a separate initiative the government has intensified the fight against HIV/AIDS, initiating an awareness campaign, mainstreaming HIV/AIDS activities in all sectors, and including HIV/AIDS in the public expenditure/medium-term expenditure process. A commission on HIV/AIDS, the Tanzania Commission on AIDS (TACAIDS), was established as a multisectoral coordinating institution for the national HIV/AIDS response and is now fully operational. HSDP is supported by development partners, and reflects the shared priorities of these partners and the Tanzanian government.

Financial Sector

The liberalization of the financial sector has substantially transformed the industry into a diversified, competitive, and vibrant sector. Until the beginning of the 1990s, the sector was dominated by one publicly owned commercial bank and other financial entities, it now comprises 22 private commercial banks⁷ of which 13 are foreign owned, 12 nonbank financial institutions, pension funds, 14 insurance companies, and more than 63 foreign exchange bureaus. The banks account for about 80 percent of the financial sectors assets. In addition, the sector has more than 1,000 savings and credit cooperatives (SACCOs), other microfinance institutions as well as the Dar-es-Salaam Stock Exchange. The liberalization of banking services has also led to a rapid rise in inflows of FDI in banking sector. With extensive changes in the ownership and market share of different banks in the past several years, competition for creditworthy borrowers has intensified, particularly in Dar-es-Salaam. It has led to some reduction in gross interest rate spread for largest borrowers and in a fall in the lending interest rates from 20 percent in early 2000-01 to 13.8 percent in 2003-04. Meanwhile, there has been a substantial increase in bank credit to the private sector, from about 2.5 percent of GDP in 1996 to about 6 percent at end-2002. The increase in part reflects the expansion in the private sector of both small, medium and large

⁷ Of the privately owned banks, the five largest are subsidiaries of well-known international institutions—Citigroup, Standard Chartered, Stanbic, Barclays, and ABSA.

enterprises, and in part reflects the competition in the banking sector that has forced banks to lend to small borrowers and a push into consumer loans to salaried secured by salary deduction. Although the percentages are among the lowest in sub-Saharan Africa, they represent a marked improvement in the Tanzanian context in view of the non-market economy condition that prevailed prior to the reform period.

The considerable transformation of the financial sector is further evidenced by the marked improvement in the quality of the portfolio. According to the Bank of Tanzania, the ratio of nonperforming assets to total loan assets has improved dramatically from 15.9 percent at the end of 2000 to about 4.5 at the end of 2003. Other improvements and innovations include introduction of new products. These include use of payment cards, primarily debit and card-based electronic money, funds transfers, especially direct debit or credit transfers. Four banks have installed Automatic Teller Machines (ATMs) and the ATM infrastructure has grown rapidly, from 6 ATMs in 1998 to 43 in 2002. The number of cardholders has risen from 11,000 to 83,000 during this period. One bank has successfully introduced electronic money services for its customers which relying on chip card technology used as a prepaid card. The total clearing period for checks-- the second most popular form of retail payment in Tanzania after cash-- have been reduced from 14 days to 2 days on checks drawn on banks in Dar-es-Salaam and to seven days in the rest of the country (from 5 to 30 days in 1998) because of the establishment of an electronic clearing house by the Bank of Tanzania. Despite the inroads, a large part of the economy still work with little formal credit, in particular in agriculture and the rural economy.

Access to credit. The government passed into law a legal and regulatory framework to guide microfinance institutions, including the National Microfinance Bank (NMB) with the objective of enhancing access to credit, in particular in the rural sector, and of facilitating deepening of sustainable financial intermediation. The NMB has about 40 percent of the bank branches in Tanzania, of these, more than 50 percent provide microfinance lending. According to the Bank of Tanzania, between 2000 and 2003, the NMB lent the equivalent of US\$58 million to finance activities that ranged from small-scale peasant agriculture to trade, manufacturing, and services provision. It also makes consumer loans. The value of the NMB's outstanding loans at the end of December 2003 was about US\$29 million.⁸

The government has encouraged the development of Savings and Credit Cooperative Societies (SACCOs) or microfinance-type institutions. Most of the SACCOs are rural and community based. The number of SACCOs increased rapidly between June 2000 and the end of 2003, from 803 to 1,264.⁹ At least five regional community banks—the Kilimanjaro cooperative bank, Mwanga community bank, Kagera cooperative bank, Mufindi community bank, and Mbinga community bank—have been established through grassroots initiatives.

⁸ Interview with Mr. Ballali, Governor of the Central Bank of Tanzania, February 2004.

⁹ State of the Nation address by President Mkapa, 12 February 2004.

Catalytic Factors in Implementing Economic Reforms

Overall, the implementation of reform was catalyzed by five factors: participatory approach, learning and experimentation, commitment of political leadership, development partners, and institutional framework.

Participatory Approach

The participatory approach to reform was spearheaded as early as 1980 by the University of Dar es Salaam (UDS), through organized workshops to discuss the economic crisis facing the country. The debates were partly encouraged by President Nyerere's 1981 speech, in which he acknowledged making mistakes on the economic policy front and urged "*kujikosoa*" (a Swahili term meaning "a critical self-assessment"). The debates were also a response to internal domestic pressure for economic reforms. The UDS annual workshops were open, inclusive, and well represented by government policymakers, supporters and nonsupporters of economic reforms, ruling party members, civil society, academicians, donors, and members of parliament.

The workshops set the stage for a policy framework and provided a platform where all stakeholders could discuss policy issues, including identifying problems and providing solutions. For example, currency overvaluation had to be recognized as a constraint to economic reform before the debate on policy options could proceed. For example, the idea of the "own-funded" import scheme (see Box 1) resulted from the discussions in the UDS workshops. The scheme served as a precursor to import liberalization and, because of its success, it was eventually endorsed by even the hardliners within the government.

The participatory approach brought the debate into public domain, helped clarify the issues among stakeholders, and created a sense of ownership of the process, thus legitimizing the need for economic reforms (as a consequence decisions reached under this process could not be easily reversed). The process played a catalytic role in bringing both reformers and nonreformers into the debate and provided the government with an analytical framework of the issues, leading to a "homegrown" economic program that later formed the basis for scaling up economic reforms.

Learning and Experimentation

Before the full ERP was developed, the government implemented a series of homegrown programs (see box 1) to address the economic crisis. Despite programs' weaknesses and failures, they provided a learning experience that helped build the government's confidence in the viability of the economic reforms that it ultimately would implement. The government perceived, as being inherent in economic reforms, the risk that they might provoke civil unrest and political instability; experimentation via the homegrown programs provided the government space to test, learn, adapt, and formulate its reform measures to the specific circumstances of Tanzania. This

experimentation also helped to cultivate consensus and to broaden the constituency for reforms. Once a reform measure demonstrated that it could have a positive impact on economic performance, the likelihood of policy reversal was minimal given that the measure would have been vetted by a broader constituency.

The need to experiment, learn, and internalize the process of reform was particularly important in Tanzania because of the “transitional” nature of the process, the country was moving from a centrally planned to a market economy. A gradual approach to reforms was therefore considered to be more appropriate than a massive “quick fix.” Furthermore, it was necessary to reorient the mind-set on economic reform through a demonstration that specific economic reform measures could actually improve economic performance and thereby improve the standard of living. For example, the success of the own-funded import scheme, a process from which hardliners also benefited, played a catalytic role in swaying anti-reformers and paved the way for import liberalization efforts. In contrast, the government’s first homegrown program, the Structural Adjustment Program (SAP), was unsuccessful in bringing about economic recovery, in part because it did not address the fundamental issue of the exchange rate. Although the group that was advising on the design of the SAP had proposed devaluing the currency, such a move was still considered to be a political issue because a critical mass had not been established to support it. The second and third experiments were equally unsuccessful also for lack of a broad based consensus, demonstrating the influence of the hardliners within the government at the time. The fourth experiment, which adopted a partially market-oriented approach was successful because it delivered desired results, this in turn generated sufficient internal support for change in policy stance.

Sustained Commitment and Political Leadership

The Tanzanian leadership played an important role in advancing the reform process. The work of each leader served as a building block for the next set of reforms and maintained the consensus-building approach that characterizes Tanzania’s decision-making process.

President Nyerere’s administration (1961–85) initiated the reform process in the context of the 1984 budget. By stepping down from the presidency, Nyerere himself initiated and enabled an orderly break from past policies. Nyerere was regarded in Tanzania as “the Father of the Nation,” and his work in building political consensus within the ruling political party, Chama Cha Mapinduzi (CCM), the key institution in the country and a major beneficiary of the prevailing system, was instrumental in setting the tone for the reforms that followed. Consensus building was essential because the CCM needed to perceive the reforms as integral to its own manifesto, and as such had to secure members’ acceptance across the party spectrum.

President Mwinyi was inaugurated as Tanzania’s second president (1986–1995) with a clear political mandate to implement economic reforms. He ushered in the free market era and set the stage for structural and some institutional reforms, reversing the decline in per capita GDP that had occurred in the early 1980s. An array of new structural reforms followed during Mwinyi’s second term, but his commitment to macroeconomic stability waned during this period.

Nonetheless, his presidency played a major role in unleashing of market forces, including initiating the privatization process and institutional and structural reforms.

Tanzania's third president, President Mkapa, has taken personal charge of the reform process. He supervised the implementation of the Enhanced Structural Adjustment Facility (ESAF) program and its successor, the Poverty Reduction and Growth Facility (PRGF), and has closely followed Bank-supported programs as well as programs supported by other multilateral and bilateral donors. To engender a sense of national ownership of the process, he undertook a series of country-wide education missions in which he explained the benefits and costs of economic reforms. He has introduced a monthly thematic radio and television address to inform the nation of progress, and as CCM chairman, he has periodically briefed party members on various aspects of the reform process. In addition, he has met with a variety of stakeholders, held brainstorming sessions with cabinet members and private sector CEOs, and led workshops with regional commissioners to educate, inform, and to solicit feedback on economic performance.

Institutional Innovation

Institutional reforms were necessary to facilitate the transition to a market economy. The government undertook numerous measures to ensure that the economic environment was conducive to the development of a market economy and that it was capable of fostering transparency and good governance. The 1997 Tanzania Investment (TIC) Act was introduced to help investors through the process of setting up operations in Tanzania, opened up nearly all sectors of the economy to FDI, and provided investors the right to repatriate dividends and profits. It also protected investors against expropriation. Commercial courts were established in 1999 to expedite the resolution of commercial disputes, and the Public Finance Act (2001) and the Public Procurement Act (2002) were enacted to enhance transparency and governance. The establishment of the Tanzania Revenue Authority was critical in enhancing revenue mobilization and the establishment of the Parastatal Sector Reform Commission facilitated the privatization process. Other innovations included the setting up of the Investors' Round Table (IRT), the objective of which was to identify a strategic focus for the government's efforts to create a conducive environment for private investment. The IRT forum, comprising CEOs of international businesses as well as local businesspeople, meets biannually and is chaired by President Mkapa.

The government-led Medium-Term Expenditure Framework and Public Expenditure Review have become institutionalized and are today key tools for integrating into the annual budget all social and pro-poor expenditure programs, including those with donor financing. This has encouraged donors to provide an increasing share of their aid in the form of budget support.

Other institutional innovation efforts include the building of partnerships between the government and the private sector. The Tanzania National Business Council and the Private Sector Foundation were established to enhance public-private sector partnership and to expedite the government decision-making process.

Development Partners (Donors)

The financial support from development partners played an important role in complementing the government's resources to achieve its development goals. Progress made by the government during the 1970s in meeting its social objectives—especially in extending primary education, health care, and water supply to rural communities—benefited from aid inflows and official financing from both bilateral donors and multilateral institutions. The deterioration in the quality of public service delivery that was experienced in the late 1970s into the first part of 1990s coincided with the economic downturn but also reflects a reduction in donor financial support. The correlation between aid and improvement in social sectors that is suggested by these experiences is further underlined by the improvement in public service delivery that has followed the recent increase in aid flows and the receipt of HIPC debt relief. As indicated earlier, the additional official assistance has enabled the government to reintroduce universal primary school education and abolish school fees resulting in a jump in primary school enrollment and improvement in the learning environment. Improvement in the health sector, through funding for and availability of drugs and medical supplies in primary health service units, also reflects the impact of donor assistance. Other examples include expansion and rehabilitation of the road network.

Policy dialogue and advice helped inform the debate on reforms and bring about policy regime change, and technical assistance reoriented the institutional framework to underpin reforms. For example, technical support to the Bank of Tanzania strengthened its capacity in banking supervision, an essential element in establishing a supportive and enabling environment for private commercial banking. Support and training for the Tanzania Revenue Authority streamlined and strengthened revenue administration; the introduction of an integrated financial management systems expenditure management enhanced accountability among ministries. Program support through the balance of payments facilitated the liberalization of trade and payment systems. While the Helleiner process helped build trust between government and donors and fostered transparency on both sides, thereby enhancing the quality of the relationship and policy dialogue. More importantly, it launched the partnership approach to development.

Conclusions and Key Lessons Learned

Since the inception of economic reforms in 1986, a large segment of Tanzania's population has benefited from gradual poverty reduction, which was driven mostly by steady improvement in economic performance, implementation of structural reforms, and, in the most recent past, greater attention to public service delivery. GDP growth has been sufficient to allow increases in income per capita, including in rural areas. Overall long-term poverty incidence appears to have been declining. However the decline in poverty has been more pronounced in urban areas, while poverty in rural areas remains considerably higher.

An important aspect of Tanzania's economic reforms has been the transition from a socialist to free market economy. In this context the government's main challenge and

preoccupation was how to implement economic reforms with the minimum interruption in the provision of social services to the vulnerable group. For example, the government vehemently opposed the devaluation of the currency because of fear of inflationary pressures and its impact on the vulnerable group. Such issues were discussed, clarified, and understood through a truly open and participatory debate. In this regard, the implementation of the homegrown programs served both as transitioning mechanism and learning process in which the government learned what policies worked (or did not work) in turning around the economy.

What are the lessons learned

- Understanding of the issues by a wider segment of society through debates and participatory approaches engenders broad ownership of the reform process, and good results early on in the process helps to build support for more ambitious and large scale reforms. Equally important is that the reform process must be locally-driven to underline the public's sense of ownership and ensure commitment to implementation and sustainability.
- The participatory approach helps bring a wide range of stakeholders on board—the open dialogue, and the various “home-grown” programs through which the reform process evolved, created broad ownership and allowed the government to formulate a reform program that was not only acceptable at home, but was also acceptable to development partners.
- It is important to carry out analytical work during the pre-reform period to be able to inform the internal policy dialogue and to frame the economic debate. It is equally important to continue analysis during the reform period to keep reforms on track.
- Public acknowledgement of policy failure by political leadership sends a powerful message to the general public. It is a necessary and important step toward initiating change in policy regime.
- To ensure sustainability and credibility, it is important that the government rally public opinion in support of reform program. This requires a forthright and active effort to explain the benefits and costs of the reform agenda to civil society
- Sustained commitment to reforms and consistent message from the political leadership is critical to the credibility and sustainability of the process.
- Institutional impediments should be recognized at the outset in order to establish realistic expectations for reform outcome.
- Divestiture signaled a stronger commitment on the part of the government to private sector-led development, it led to increased domestic and foreign capital, technology, and managerial skills.
- In order to cultivate “buy-in” as well as the general public's support for privatization, there is need for successful privatized public enterprises which lead to improved productivity, contribute to the tax base, and create employment opportunities for local investors.

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- Adopting a gradual approach creates space for the government to adapt policies to its individual county circumstances. While it slows the speed of reforms, it engenders strong ownership, improves their chance of sustainability, and minimizes policy reversals.
- There is need for a strong institutional mechanism for accountability to sanction government's performance and donor behavior.
- Tanzania's open and direct discourse with its donors helped improve aid relations and aid effectiveness. It also helped to foster partnership approaches. This resulted in improved donor coordination, increased government ownership, and a movement toward harmonization of processes.

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