FORUM TO ASSESS DEVELOPMENT POLICIES OF TANZANIA

ECONOMIC GROWTH, TRADE INTEGRATION AND EMPLOYMENT: REFLECTIONS ON TANZANIA

Commissioned Paper

Sub-theme 1: Is a High Rate of Sustainable Growth Achievable?

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1. Introduction

As an outsider to Tanzanian debates and discourses on development policies, it would be presumptuous for me to write a paper focusing on future development policies to be pursued in Tanzania. This paper, therefore, does not venture into explicit policy recommendations. Instead, it aims to provide some brief reflections on Tanzania's growth performance and on possible lessons which may follow from this for matters of development policy.

The basic premise of this paper is that economic growth matters for development and poverty reduction, but that its sustainability depends on the evolving nature of Tanzania's trade integration within world markets and on the character of employment it brings in its wake. What follows is work in progress, as yet preliminary, and, hence, somewhat cryptic in nature.

2. Some stylised facts on Tanzania's economic growth performance

As shown in the graph and table 1 below, Tanzania's growth performance has always been rather precarious, particularly in *per capita* terms.

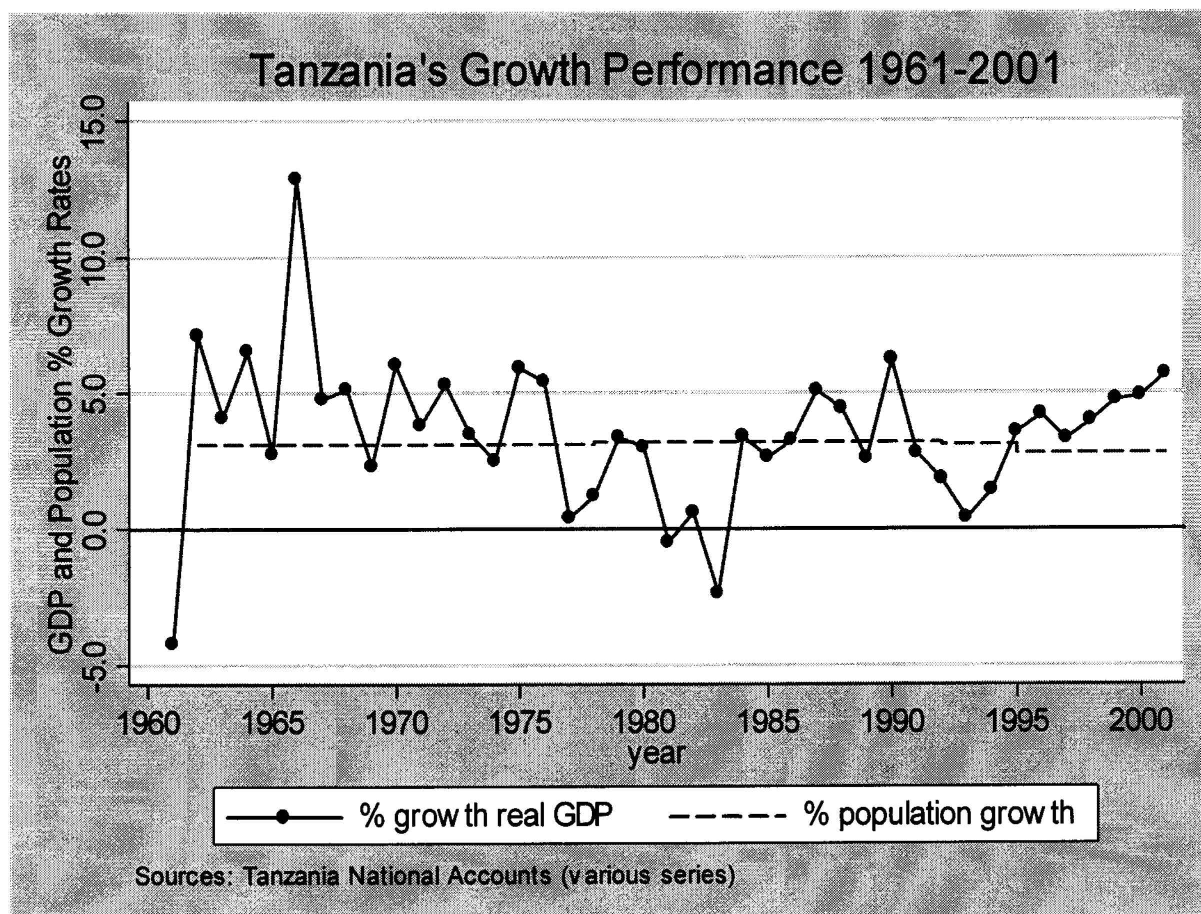


Table 1: GDP and Population (average annual % growth rates)

Period	*GDP*	*Population*	*GDP Per Capita*
1960-65	*3.8*	*3.1*	*0.7*
1966-76	*4.2*	*3.1*	*1.1*
1977-80	*2.6*	*3.2*	*-0.6*
1981-84	*0.2*	*3.2*	*-3.0*
1985-91	*4.1*	*3.2*	*0.9*
1992-94	*0.9*	*3.1*	*-2.2*
1995-01	*4.3*	*2.8*	*1.5*

The *Poverty and Human Development Report (PHDR) 2002* noted that there has been no significant decline in income poverty in Tanzania (apart from in Dar es Salaam) between 1991/2001, notwithstanding the good macroeconomic performance during the 1990s. This – the report argues – raises questions about macro-micro linkages for poverty reduction. This conclusion, however, should be put against the background that, between 1991 and 2001, GDP growth averaged *3.61%* per annum, while population grew at *2.83%* per annum, implying a GDP per capita average annual growth rate of only *0.8%* (similar to that for the period 1985-91). Even with optimistic assumptions about the overall elasticity of poverty reduction with respect to GDP per capita, the resulting effect on poverty reduction would have been modest at best, given also the slight increase in income inequality over the period concerned (PHDR, 2002: 10).

This is not meant to belittle the importance of the nature of macro-micro linkages for poverty reduction. On the contrary, the latter – I would argue – are important in its own right and not merely in terms of addressing the perceived anomaly between trends of GDP growth at the macro level and of poverty reduction at the micro level. The reason is that macro-micro linkages reflect the qualitative and distributive character of the growth process and not just its overall quantitative expansion.

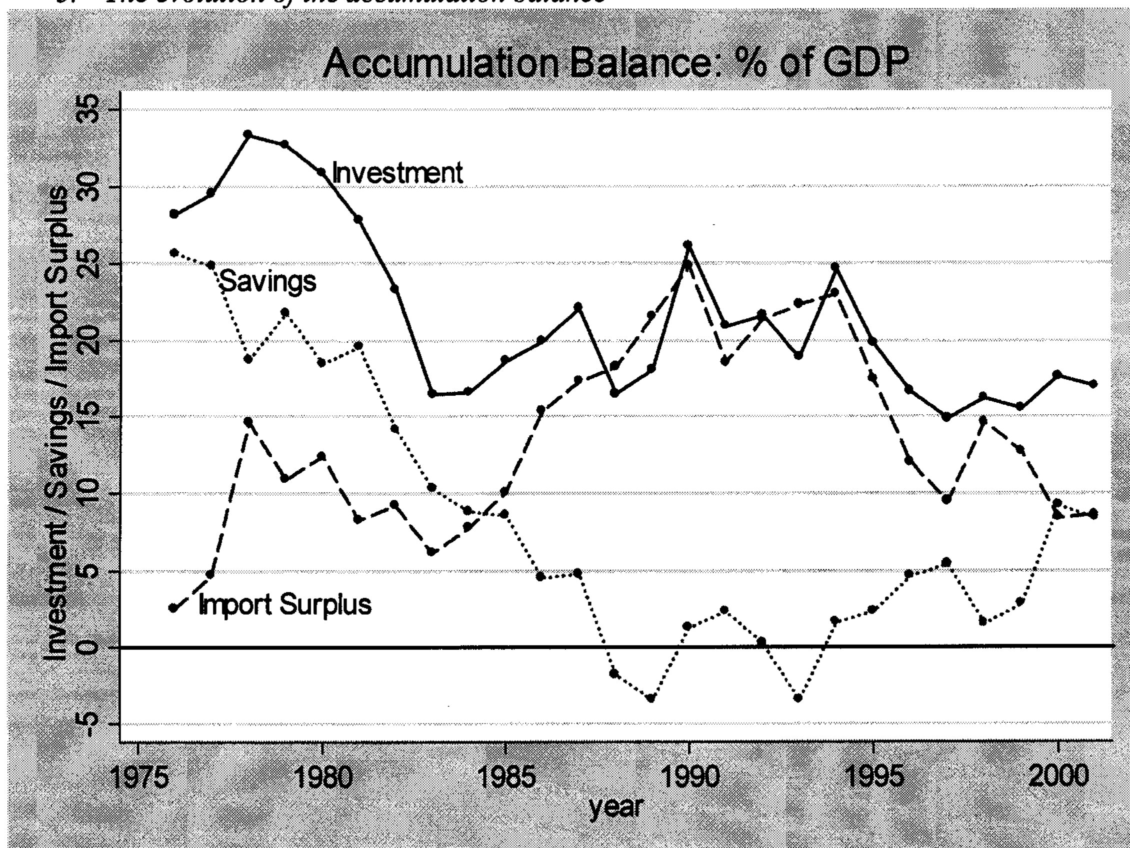
Table 2: GDP growth and its decomposition between agriculture and other sectors [1]

	Sector growth rates (% average per annum)		*GDP growth and its decomposition (% average per annum)*		
Period	*(1) Agriculture*	*(2) Non-Agriculture*	*Agriculture [% share of (3)]*	*Non-Agriculture*	*(3) GDP*
1987-91	3.9	4.1	1.9 [*48%*]	2.1	4.0
1992-94	2.6	-0.7	1.2 [*133%*]	-0.3	0.9
1995-01	3.3	5.3	1.8 [*42%*]	2.5	4.3

[1] Components of GDP growth rates have been slightly adjusted (no more than ± 0.1%) to make sums tally, since growth rates calculated using regression estimates will only provide an approximate decomposition of GDP growth rates, leading to small discrepancies in the sums.

As shown in the table above, during recent years, agriculture continues to be the single most important sector of the economy, both in size and in its contribution to the growth momentum.

3. *The evolution of the accumulation balance*



During most of the period concerned, the import surplus (imports minus exports) is mainly accounted for by the net inflow of foreign aid. Towards the turn of the century the Tanzanian economy witnessed a significant rise in foreign investment, mainly in mining and in tourism. But, even so, the country continues to remain largely dependent on aid as its predominant source of foreign finance.

In the second half of the 1970s, domestic investment and domestic savings were both high (as a share of GDP) and, in part, fuelled by project aid. Typically, project aid financed the foreign exchange costs required to imports the necessary capital goods and to pay for foreign expertise, while the local partner (usually, the government or public sector enterprises) had to raise the necessary domestic finance (in shillings) to fund local costs (the costs of local labour, materials, etc.). (Wangwe, 1983; Wuyts, 1994). When taxes or loans against monetary savings deposited in banks or other financial institutions were insufficient to provide the necessary local counterpart finance of project aid, the government simply resorted to 'printing money' (or, more technically, borrowing from the central bank) to finance the gap. That is, when savings could not be mobilised through regular fiscal and financial processes, they were obtained through inflationary mechanisms, leaving the economy to adjust willy-nilly to this policy of forcing the pace of investment through forced savings (Wuyts, 1994). Not surprisingly, with the onset of the crisis of the early 1980s, accompanied by "donor fatigue", all three components – investment, domestic savings and the import surplus – fell sharply in unison.

With the initiation of economic reforms, and exchange rate policies in particular, both the import and export coefficients rose steeply – the growth in the former exceeding that in the

latter, thereby widening the trade gap. As shown in the figure above, in this period, the trade gap and domestic savings no longer moved in unison, one parallel to the other. In fact, at first, during the late 1980s and early 1990s, domestic savings disappeared from the picture altogether, even turning negative in some years. Investment, therefore, was almost exclusively financed by aid.

Consequently, aid ceased to drive investment in quite the same way as it did in the pre-reform period. The earlier link between aid, investment and domestic savings was effectively dismantled. On the one hand, the imposition of strict demand management meant that the earlier practice of financing investment – in particular, public investment – through money creation was brought to a halt. On the other hand, the shift from project to programme aid meant that aid came to be used to pay for recurrent imports to revitalise the economy out of the goods famine it experienced in the early 1980s. As a consequence, private consumption revitalised. For example, in 1979, the last year of the state-led investment boom, private consumption only constituted 62% of GDP. It rose to about 70% in 1982, the depth of the economic crisis, against a background of falling GDP and particularly of falling investment. By 1987, however, the share of private consumption had risen to about 82%. The greater availability of consumer goods, therefore, led to the upward readjustment of private consumption as a share of GDP and to the corresponding fall in the savings ratio.

Subsequently, towards the turn of the century, the gap between both curves widened again and, hence, domestic savings became again significant, though at a low level, but this time against the background of a falling trade balance. This question of the mechanisms underlying the recovery of the savings ratio is worth pursuing further.

4. *The form and level of trade integration in the world economy*

Historically, Tanzanian discourses and debates on development policy have witnessed shifts in emphasis concerned policies relating to the nature of trade integration in the world economy.

In the pre-reform days – from the Arusha declaration onwards until the early 1980s – the main emphasis was on changing the *form* of trade integration. The late Justinian Rweyemamu, for example, criticised the economic policies of the early independence days as follows:

> There was in fact a belief that the major impulse of the economy was to come from the foreign sector, *regardless of the form of that sector*. That is to say, there was no expressed intention to alter the ratio of foreign trade to the national product, nor was there a change in the composition of that trade or the importance of trading partners contemplated (1973: 39).

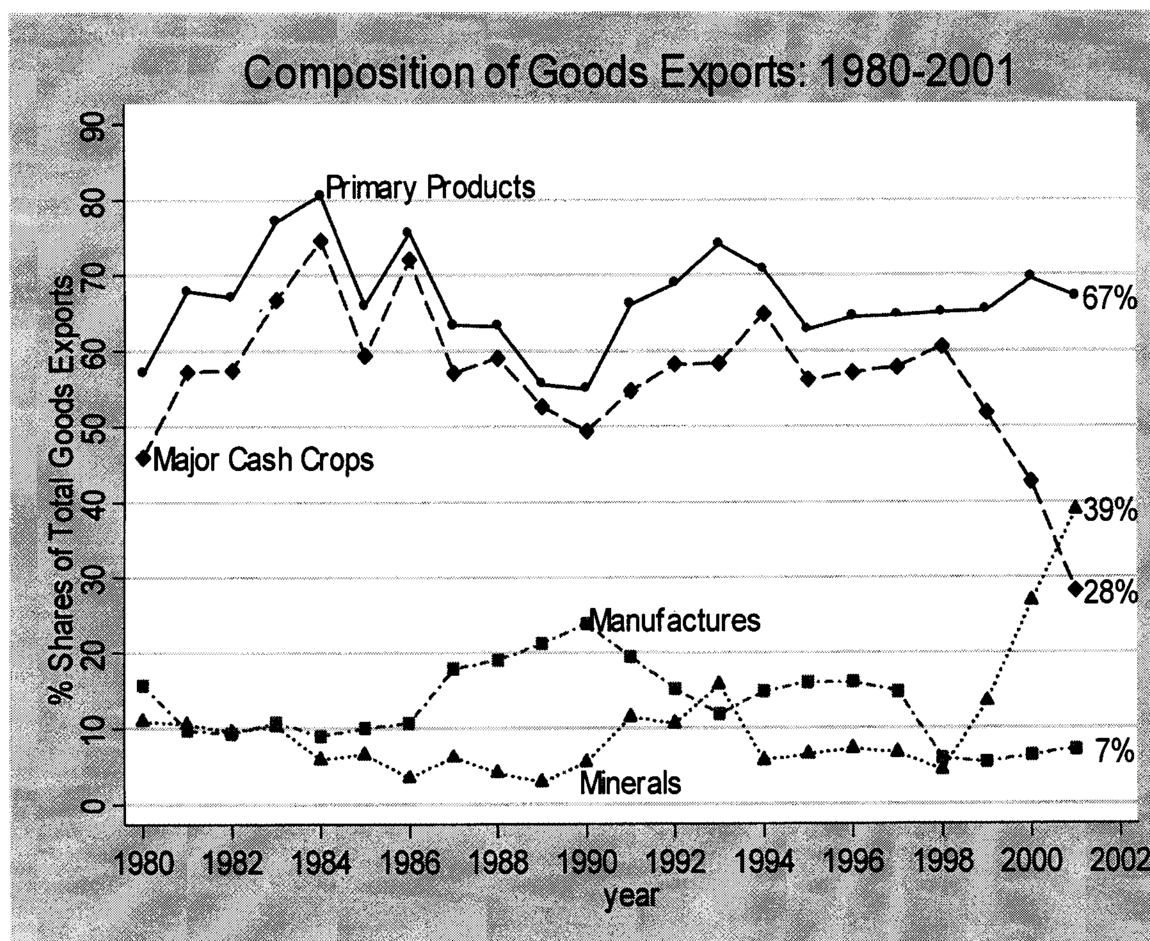
In contrast, in the wake of the Berg Report (1981) and of the structural adjustment policies that followed, the emphasis shifted towards intensifying the *level* of trade integration by opening up the economy through trade liberalisation and exchange rate policies. In matters of trade integration, therefore, while the former period put the emphasis on the terms of trade as the key relative price variable for policy making, the latter period instead tended to focus on the real exchange rate. I would argue, however, that both aspects matter a great deal and are in fact complementary in nature, rather than opposites. It can be argued, for example, that the success of the East Asian export performance was largely due to the way this interplay between changing the form and raising the level of trade integration was managed over time (Forbes and Wield, 2002: particularly, chapter 3, pp. 44-62).

In the Tanzanian context, the form of trade integration in world markets has definitely changed under the impulse of the economic reforms started from the mid-1980s onwards.

Some of these changes are positive in nature; others give cause for concern. Both present challenges to policy makers in terms of the future direction of the Tanzanian economy.

Tanzania's export structure continues to reflect the rudimentary nature of its economy as witnessed by its predominantly agrarian nature, its insignificant level of industrialisation, and its explicit specialisation in and reliance on the production of primary commodities for exports. In contrast, the country imports a large variety of goods – manufactured consumer goods; equipment and machinery; agricultural inputs such as fertilisers and industrial intermediate goods; and even part of its food requirements. The figure below depicts, respectively, the shares of major cash crops, minerals, their sum – the exports of primary produce – and manufactures as percentages of the total exports of goods in recent times.

Traditionally, in terms of its exports of goods, Tanzania relied on a narrow range of agricultural primary commodities – coffee, cotton, cashew, sisal, tea, tobacco and cloves – to pay for imports. The end of the period, however, near the turn of the century, witnessed the rapid growth in the *share* of primary exports of mining products (gold, diamonds and precious stones), mirrored by the dramatic fall in *share* of the major cash crops. As far as manufactured exports are concerned, its share peaked at about 24% by 1990, but subsequently declined significantly to about 7% in 2001.



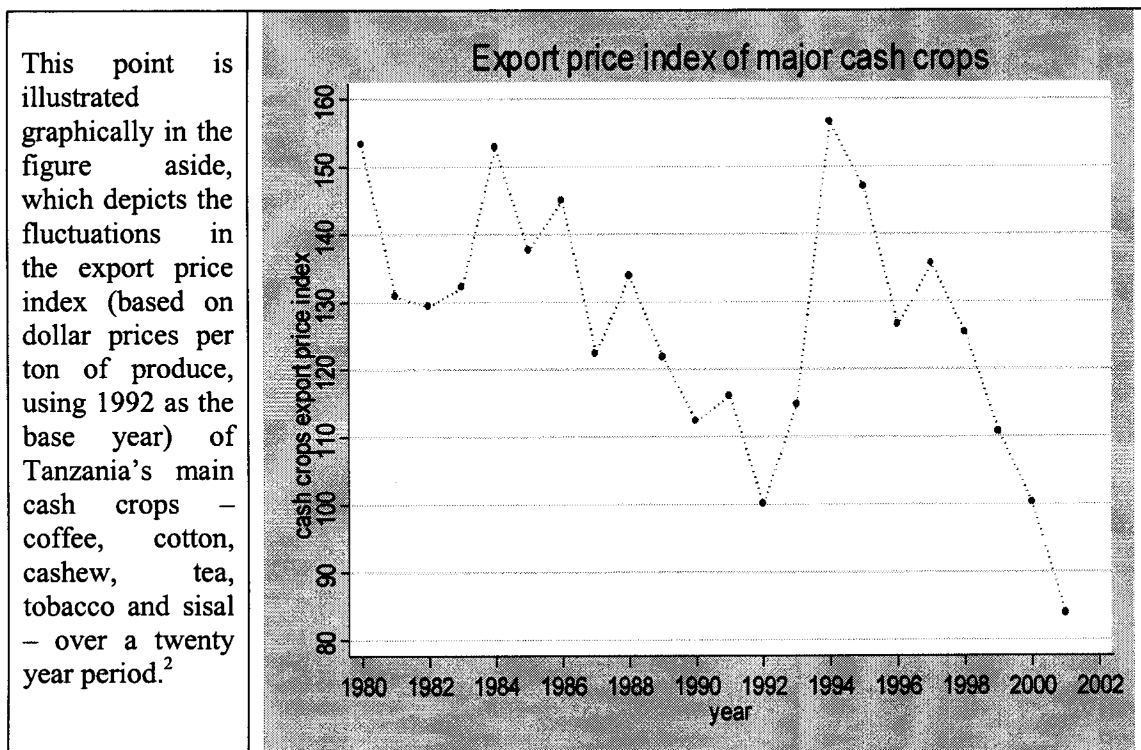
But the export of goods is only part of the total exports of a country. We also need to take account of the exports of services such as, for example, tourism or transport. Traditionally, the share of services in total export earnings was rather low – around 20%, but, especially from the mid-1990s onwards, it rose remarkably fast such that, at the turn of the century, the share of services (especially tourism) constituted in between 43 to 48% of total export earnings.

In fact, a recent World Bank report identified mining and tourism as 'the new pacemakers for growth' in Tanzania (World Bank, 2002: 8). Interestingly, agriculture, which the Berg Report not only sought to stimulate in particular, but also identified as the main pacemaker of economic development, no longer featured in this list. And the figures above do indeed provide supportive evidence that the economy has been diversifying in recent years under the impulse of economic reforms, particularly from the latter half of the 1990s onwards. This is particularly manifested in the growth in tourism. Also, as primary export producer, the country is clearly diversifying away from its near exclusive reliance on agricultural commodities under the impulse of the growth of its nascent mining industry, much of it propelled by foreign investment.

But this does not yet imply that Tanzania has ceased to be a predominantly agrarian economy. The larger part of its population still remains heavily dependent on agriculture, including cash cropping for exports, to secure its livelihoods. Moreover, as shown below, the degree of differentiation suggested by these figures need to be *revisited* in the light of what happened to the evolution of the prices of agricultural export crops in particular.

Unlike prices of manufactured goods, the prices of primary commodities in general, and of agricultural commodities in particular, tend to fluctuate much more violently from year to year. Countries relying on primary exports, therefore, are not just poorer, but also more vulnerable due to the often sharp year-to-year fluctuations in the prices of the few commodities upon which they rely [UNCTAD, 2002].

This point is illustrated graphically in the figure aside, which depicts the fluctuations in the export price index (based on dollar prices per ton of produce, using 1992 as the base year) of Tanzania's main cash crops – coffee, cotton, cashew, tea, tobacco and sisal – over a twenty year period.[2]



[2] A World Bank / IFPRI report (2000: xiv, *my italics*) states that:

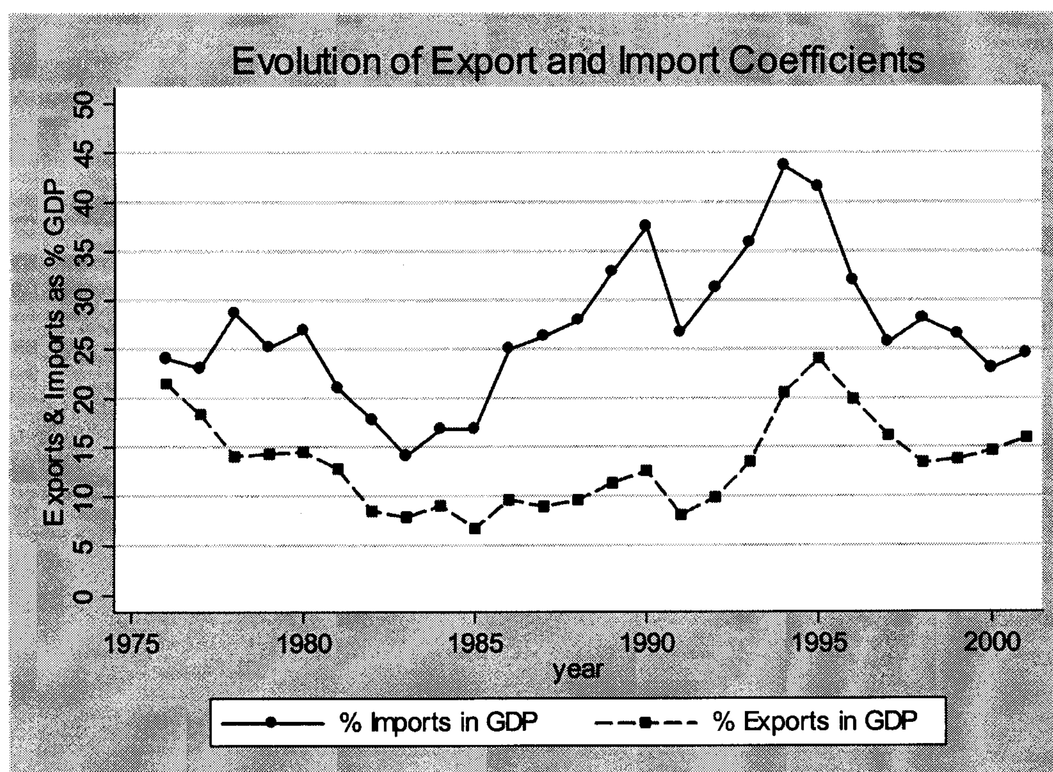
> Since 1993, real producer prices for all major export crops have fallen 25 and 70 percent. This has occurred in spite of some reduction in marketing margins due to privatization and *in spite of stable world prices*. The main explanation for the falling producer prices is the appreciation of the real exchange rate since 1993.

This is puzzling. Price movements were in fact exceptionally volatile and adverse in this period!

The year-to-year variations in the price index are remarkably pronounced in both directions – up as well as down, implying high vulnerability of the country at large, and of its rural producers in particular, to the shocks transmitted through the volatility of externally determined prices. Particularly noticeable is the sharp decline in the price index of agricultural commodity exports from the mid-1990s onwards – by 2001 the price index of cash crops stood at about 54% of its level in 1994.

The rapid fall in the share of cash crops in the value of exports of goods, therefore, reflects in part this dramatic fall in its prices. This suggests that the diversification of exports – as noted earlier by the changes in the *shares* of different sectors in total exports – may not just be the result of the fast growth in mining and tourism, but also a reflection of the slump in agricultural export prices during the late 1990s.

With respect to the level of trade integration, the reform years witnessed an initial rapid rise in both the export and import coefficients, followed by a subsequent decline towards historically middling levels. The behaviour patterns of these coefficients over time do not only depend on volume changes in exports and imports, but also on the movements of the real exchange rate and of the terms of trade.

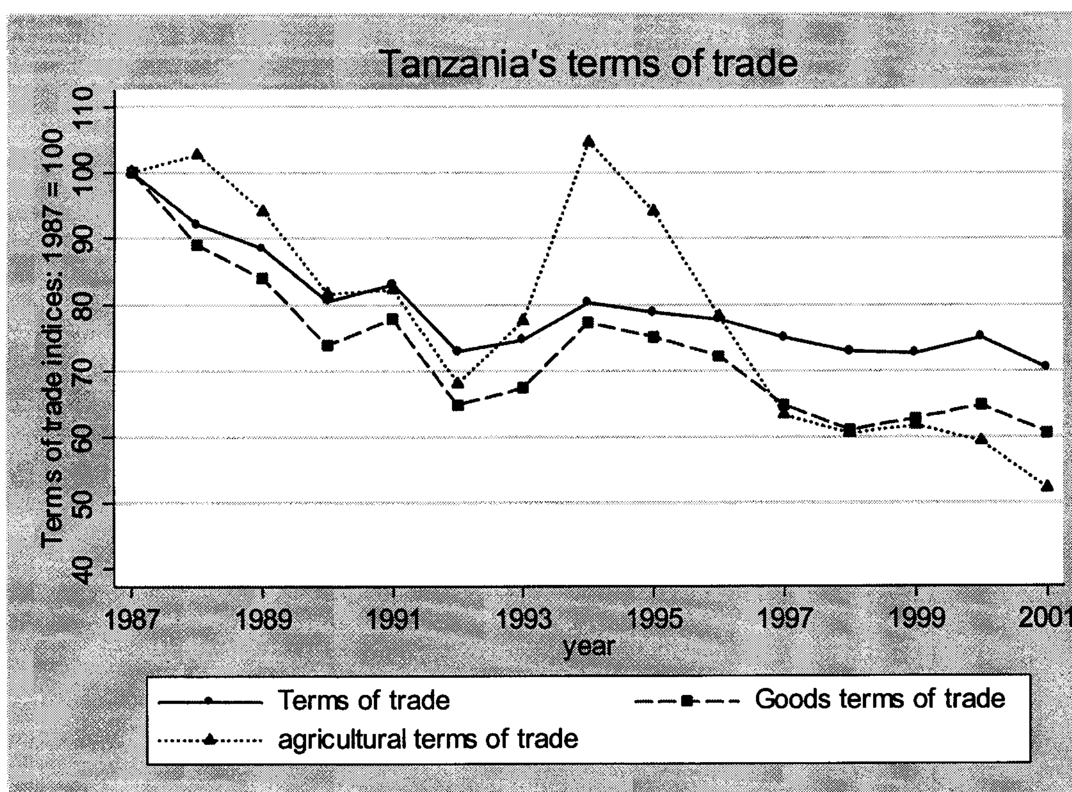


As pointed out elsewhere (see, for example, World Bank / IFPRI, 2000 and World Bank, 2002), the real exchange rate depreciated markedly during the second half of the 1980s and early 1990s, after which it appreciated again, but not to the same extent as to offset the initial depreciation.

5. *Export volume and the purchasing power of exports*

The national accounts data of Tanzania, at least from 1987 onwards, give us consistent series of export and import values, both at current and at constant 1992 prices, respectively for goods and for services. By dividing, for each year, the value of a series in current prices by that of the corresponding series in constant prices, we obtain the implicit *price deflator*.

The figure below shows the evolution of Tanzania's terms of trade, respectively, between all exports and all imports, between the exports and imports of goods only, and between agriculture exports (using the price index mentioned above) and goods imports. The overall picture is one of a rather dramatic decline over the period since the economic reforms under structural adjustment, indicating that Tanzania gets less and less for its exports relatively to the prices of its imports. Over the period as a whole, from 1987 to 2001, the overall terms of trade dropped by nearly 30%, while the terms of trade for goods dropped by nearly 40%. The agricultural terms of trade shows much greater volatility in its year to year fluctuations and dropped by about 50% over the period as a whole.

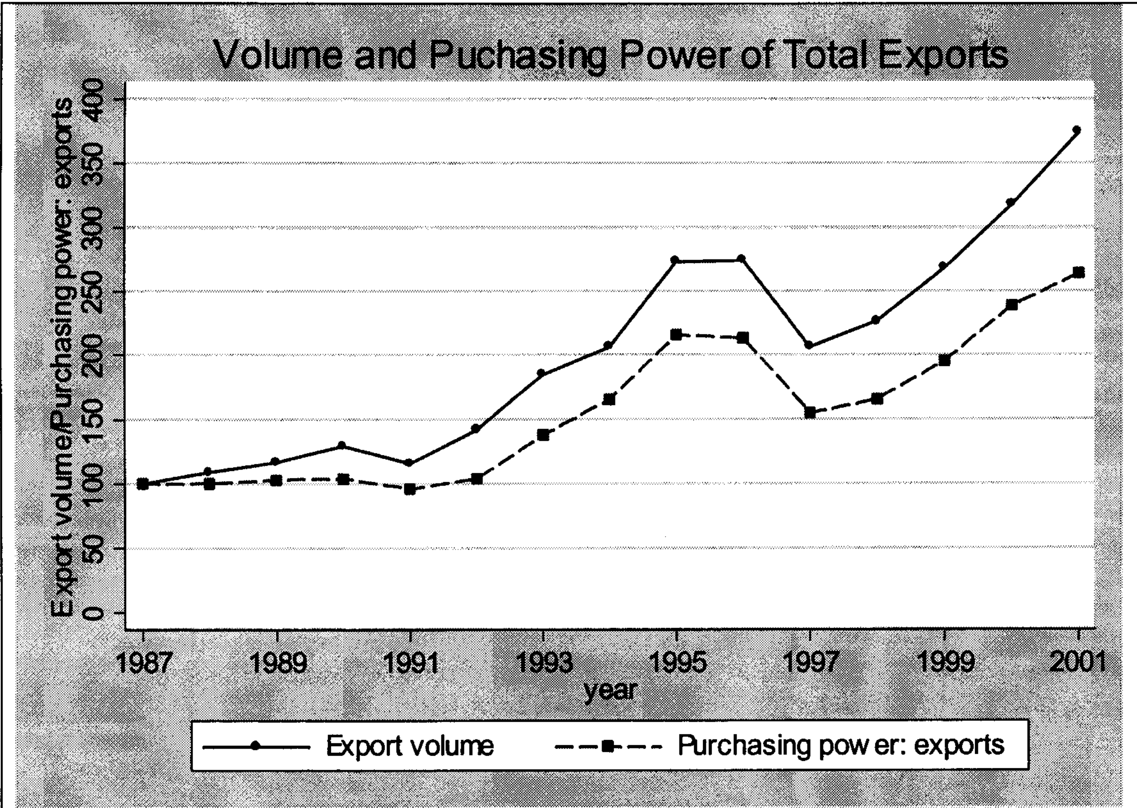


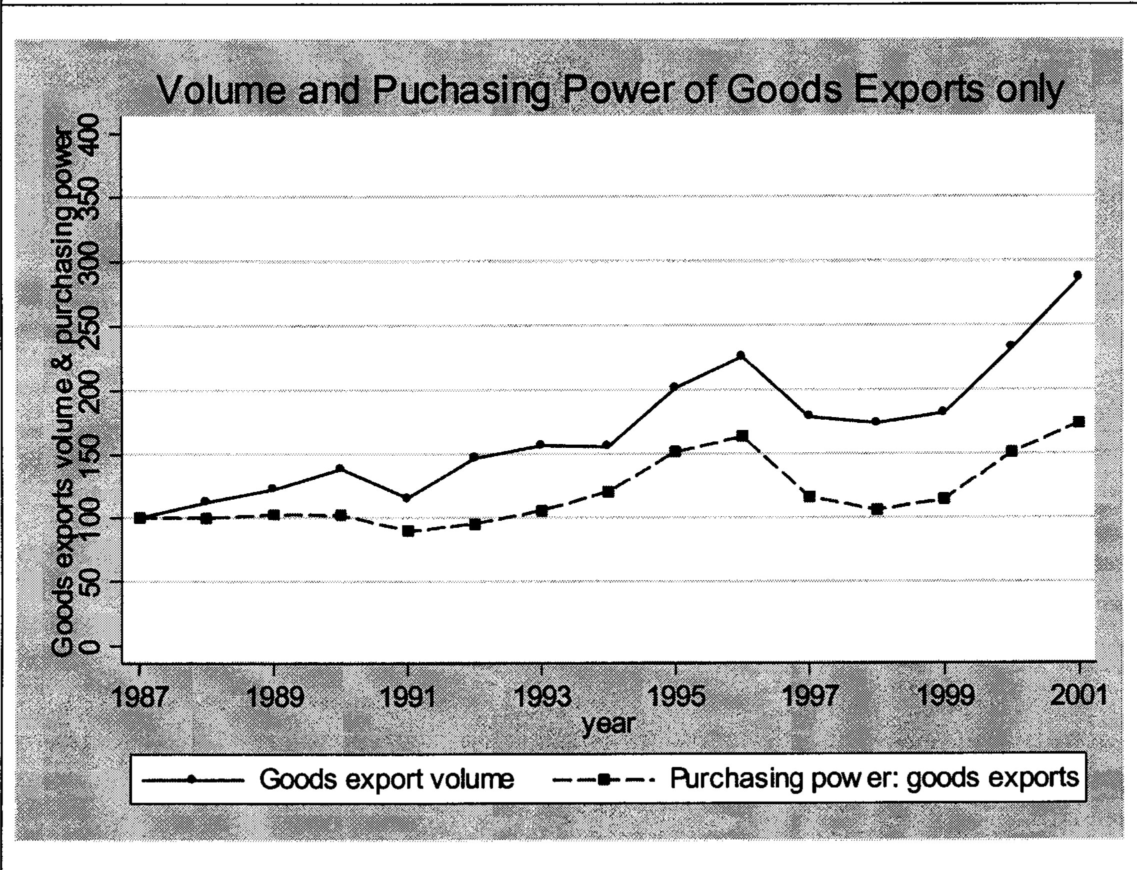
In volume terms, it is useful to make a clear distinction between two concepts: the *volume of exports* and the *purchasing power of exports*. Empirically, we measure the *volume of exports* by calculating exports over time at constant prices of a given base year, normally expressed as an index. This index measures whether a greater or lesser volume of exports is produced over time – more coffee, more cotton, more gold, and so on. The *purchasing power of exports* instead measures the *volume* of imports the exports can buy, which depends not only on the volume of exports, but also on the prevailing terms of trade. It tells us whether the country's exports allow it to buy more manufactured consumer goods, more equipment, more agricultural inputs, and so on, from abroad.

More precisely,

PURCHASING POWER OF EXPORTS = TERMS OF TRADE · VOLUME OF EXPORTS

The two figures below show the evolution of the volume and the purchasing power of (a) Tanzanian total exports and (b) goods exports only, over the period of the recent economic reforms under structural adjustment. For purpose of comparison, the vertical axes in both graphs feature the same range.





Three patterns are particularly noticeable:

- First, in both cases, by and large, the volume of exports increased quite substantially over the period as a whole (despite some fluctuations). The economic reforms, therefore, appear to have had the desired effect of stimulating export production.

- But, second, also in both cases, the rate of increase in export volume was by no means matched to the same extent by the rate of increase in the purchasing power of exports.

- Finally, total exports grew faster than goods exports only, indicating the faster growth of services during the 1990s.

Over the period as a whole, from 1987 to 2001, the aggregate export volume rose by 274% (implying a growth rate of *9.9%* per annum, on average), while its purchasing power rose by 164% (*7.2%* per annum, on average). Similarly, but more modestly, aggregate goods export volume increased by 187% (*7.8%* per annum, on average), while the purchasing power only rose by 74% (*4.0%* per annum, on average)! Additional efforts in boasting exports, therefore, did not pay off proportionally in terms of its additional ability to pay for imports and debt servicing. This was also true for agricultural exports which grew in volume terms by about 3.6% per annum over the period concerned. The loss in purchasing power must have eroded this gain in output even further.

In contrast to export performance, the growth in import volume was particularly modest, even when compared with the growth in the purchasing power of exports. Total imports rose by 39% (2.4% per annum, on average) over the period 1987 to 2001. Over the same period, imports of goods increased in volume terms by only 24% (1.6% per annum, on average). Both growth rates, therefore, were well below those of GDP – a point worth looking further into.

6. *By way of conclusion: a brief summary of points*

There is no doubt that the brief descriptive analysis presented above is no more than a rough sketch of a few macro features of Tanzania's growth experience. It would be presumptuous to try to draw any firm conclusions from this analysis. Tentatively, however, these features point towards the following issues for policy analysis which, undoubtedly, would require far more research than is presented above.

First, it is clear that the economic reforms had quite a significant impact in terms of stimulating export performance, particularly in terms of volume expansion. This is manifested in the average annual growth rates of nearly 10% per annum for all exports and 7.8% for goods exports, although the exports of agricultural crops – perhaps contrary to the expectations of the Berg report – lagged behind with 3.6% per annum.

Second, these gains did not, however, translate themselves in a similar growth in the purchasing power of exports, respectively 7.2% per annum for all exports and only 4% for goods exports. The old worries about adverse terms of trade movements cannot, therefore, be too easily dismissed. Over the period of economic reforms, the economy has been running up a steeper slope in terms of production efforts than the slope it benefited from in terms of the expansion of its capacity to pay for imports or debt servicing.

Third, the growth rate in export production is by no means matched by that of GDP and, hence, by that of non-tradables. This raises some doubts whether the often quoted favourable multiplier effects of export sectors in terms of stimulating the demand for non-tradables (including employment) are not too optimistic or are based on assumptions which fail to come to terms with the precise mechanisms at work. The rather sluggish growth in import volume is

perhaps another manifestation of this issue, which, undoubtedly, would require further investigation into the workings of macro-micro linkages within the economy at large.

Fourth, the growth of tourism and of mining has led to the greater diversification of Tanzania's integration within the world economy, but the extent of this diversification might appear greater than it is due to the adverse effects of the external terms of trade confronting agriculture (upon which the livelihoods of the majority of rural producers still depend). The drop in the share of cash crops in export earnings, therefore, is not only a reflection of the rapid expansion of alternative employment, but also of the increasingly dire straights in which the agricultural sector found itself within international markets. The balance between the possible employment and income effects emanating from the growth sectors and the depressing effect of the evolution of the terms of trade on rural incomes is difficult to assess, but might be one reason why no significant poverty reduction took place within rural areas over the last decade, notwithstanding strong export growth and a reasonable GDP growth performance since the second half of the 1990s.

Fifth, the drastic fall in the share of manufacturing exports during the 1990s may well be a cause of concern and cannot perhaps wholly be accounted for by the growth in mining.

Finally, I would like to turn back to the question of macro-micro linkages raised earlier. There I argued that the importance of this issue cannot be deduced from merely contrasting the favourable growth performance of GDP in recent years with the lack of any significant reduction in the incidence of poverty (with the exception of Dar es Salaam) during the 1990s. Indeed, as shown above, the growth in GDP per capita has been too modest to warrant drawing strong conclusions in terms of its possible effects on poverty reduction.

But, as shown above, export growth performance has been much stronger and, hence, the relevant question appears to me to be:

- Why the rapid growth in exports did not translate itself into comparable broader GDP growth as a result of income and employment effects generated by the export sectors within the wider economy?

- In other words, how do macro context and policy affect the myriad ways in which export growth translates itself into household income diversification and employment generation patterns, thereby structuring household-based livelihoods?

Part of the answer is of course provided in the PHDR report (2002: 68-74) which argues that cash crop production has much more widespread roots within people's livelihoods than either mining or tourism. It follows, therefore, that the effects generated by the buoyancy of the latter cannot fully match those provoked by adverse developments in the latter. In other words, the butter may be spread thinner in agriculture than in mining or in tourism, but it is definitely spread more widely across the population at large in agriculture than in the other two sectors.

It is not inconceivable, for example, that during the early 1990s, when non-agricultural growth and, hence, GDP growth slackened considerably, but agricultural prices were favourable, the resulting effects on poverty reduction may have been more favourable than during the second half of the 1990s, when GDP growth was stronger, but agriculture was facing rapidly falling export prices, thereby eroding rural incomes.

Agriculture, therefore, still holds much of the key to poverty reduction. And so is the character of employment relations likely to matter a great deal as well. The emphasis placed on employment by the PHDR (2002: pp. 12- 17) is particularly to be welcomed,

notwithstanding the fact that the PRS does not have employment policy among its explicit targets.

It is not surprising that, as found in a recent (2001) household survey undertaken by REPOA in collaboration with ILO, rural households which relied only on agricultural activities have significantly lower incomes on average than those who combine farm with non-farm activities. Somewhat more surprising may be that the prevalence of wage work within rural areas proved to be more widespread than might be expected and its effect on household earnings quite significant. In the regions surveyed, about one in four households relied, among other activities, on income from wage labour, and, furthermore, households relying on wage labour had significantly higher average incomes than those who did not.

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