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Policy Reform and the Economic Development of Tanzania

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Abstract

This paper reviews the long-term economic performance of Tanzania since independence using long-term series of key economic and social indicators constructed from a variety of sources. The disastrous export performance for most of the period under consideration can be attributed partly to domestic policy failures and partly to a hostile external environment. However inconsistent donor support to a highly aid dependent economy at times exacerbated the constraints imposed by persistent foreign exchange shortages. Greater stability in funding and a more flexible policy dialogue are needed. The extent to which a small and poor economy with a weak indigenous private sector can rely on foreign private investment to finance investment in the early stages of adjustment is questioned. Investment in human capital beyond primary school level is also needed if growth is to be sustained.

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Introduction

In an address to the Tanzanian National Assembly on 8th June 1965, President Julius Nyerere stated:

> *"The amount of private investment which has taken place over the past year is, quite frankly a disappointment to us. We have special tax concessions to encourage new investment; we have investment guarantees for bringing capital into the country; and we have many other arrangements designed to encourage private investment of a character which will serve our nation. Yet the level of private investment does not appear to be as great as that provided for in the Plan."* (Nyerere 1968:35)

Thirty five years later a World Bank review of the Tanzanian economy stated:

> *"Private investment, currently at 14 percent of GDP, has not responded quickly to the reform measures undertaken since the late 1980s and has not compensated for the decline of public investment. …… The weak response of private investment to economic reforms may also be related to the decline in complementary public investment (in the form of the provision of basic infrastructure and human and institutional capital), that is necessary for raising the overall absorptive capacity of the economy."* (World Bank 2001a:xvi)

The former quotation eventually became an important part of the justification for the move towards the Tanzanian *ujamaa*[1] policy and the Arusha Declaration that resulted in the nationalisation of the *"major means of production and exchange"* (Nyerere 1968: 233-4).

The latter quotation is taken from a document in which it is later stated that:

[1] *Ujamaa* was a Tanzanian interpretation of African socialism associated with former President Julius Nyerere.

> *"One of the key lessons of Tanzania's post-independence experience is the importance of clearly separating areas of public and private investment. The principle source of investment has to be the private sector."* (World Bank 2001a:xxi)

Clearly the same issue (i.e. the perceived inadequacy of the investment response of the private sector) has led to very different policy conclusions by different people at different points of time.

This paper examines critically the Tanzanian experience with policy reform since independence[2] and considers the impact of the reforms instigated by both internal and external agents to try to uncover some explanations for the growth performance of the economy and changes in human welfare.

Tanzania is an important case when investigating long term development in Sub-Saharan Africa because it has shown remarkable political stability since independence and, apart from the war with Uganda in 1979 and a steady influx of refugees from less stable neighbours, has not been subject to the disruption associated with civil war or major natural disaster. National unity has been maintained and is reflected in the widespread use of Kiswahili as the national language. In principle therefore it appears to have had some of the most important non-economic attributes required for steady progress. Tanzania has also been a major recipient of aid from a wide variety of donors since the 1970s. Despite these positive characteristics, the economic performance of Tanzania for much of the last forty years has been disappointing, although in the last ten years there has been a significant improvement. It is therefore important to consider the factors explaining this performance, whether the recent improvement can be sustained and whether it can deliver significant benefits for the poorest members of the population.

[2] GDP data are also given for the period immediately before independence but all other data relate to the post independence period. For discussions of the pre-independence historical context to the Tanzanian economy see Coulson (1982) and Potts (2006).

Tanzania has undergone many policy changes since independence, first of all under the *ujamaa* policy and more recently through a steady process of liberalisation, which started in the early 1980s but is more commonly perceived as commencing with the agreement with the IMF in 1986. Available data (see Table 1, also Figure 1) indicate that per capita GDP in 2005 was approximately 36% above that of 1986 giving a real growth in per capita income of about 1.6% per annum over a 19 year period of liberalisation reforms, some improvement but hardly a spectacular success and nearly all of this growth has been achieved in the last ten years[3]. Given the tendency for liberalisation to widen income disparities in the initial stage it is possible that the impact on the poorest Tanzanians could have been very low or even negative, particularly in the early years of reform.

This paper examines the available data to determine the size and direction of changes in per capita income and broader indicators of welfare relating to poverty incidence and distribution over a long period. These changes are then related to major policy issues and external factors over the same period. Particular attention is given to the effect of policy changes on the agricultural sector and on export performance. Among the questions asked are:

- To what extent can changes in income and welfare be attributed to changes in policy and to what extent are external factors important?
- Which policy reforms have worked and which have not?
- Could the situation have improved if alternative strategies had been followed in the periods both before and after liberalisation?

Before answering any of the above questions it is necessary to look at the evidence on Tanzanian development over the last forty to fifty years.

[3] An alternative comparison could be that GDP per capita was only 19% higher than in 1979, a period of twenty six years since the first tentative steps towards liberalisation.

Long Term Growth and Development in Tanzania: The Evidence

The most easily available general indicator of development is the level of real GDP per capita. It was necessary to combine series from two different sources to get a series that would cover all the years since independence as well as the period immediately prior to independence[4]. The results give a reasonable overall impression of what has happened but the limitations of the data should be recognised. To make some sense of what has happened it is useful to divide the series into a number of periods, most of which are separated by significant events. The periods chosen were:

- 1954-1961 – the period immediately preceding independence
- 1961-1967 - the period immediately preceding the Arusha Declaration
- 1967-1973 - the period after the Arusha Declaration but preceding the second round of nationalisation and movement of the rural population into villages (villagisation)
- 1973-1979 – the period up to the war with Uganda including the impact of villagisation and further extension of the role of the state
- 1979-1986 – the period of economic crisis and dispute with the World Bank and IMF
- 1986-1995 – the first period of post-IMF agreement reform
- 1995- present – the current period of reform

Indices for per capita GDP and related annual equivalent growth rates for the above periods are shown in Table 1.

[4] An explanation of the sources and approach used in compiling the GDP series is given in Annex A

Table 1 Index of Real Per Capita GDP 1954-2004 (1961=100)

Year	1954	1961	1967	1973	1979	1986	1995	2005
Real GDP per capita	98.2	100.0	122.0	130.5	130.0	113.9	112.4	154.4
Annual growth in real per capita GDP[5]		0.3%	3.4%	1.1%	0.0%	-2.2%	-0.1%	2.8%

Sources: Compiled from:

World Development Indicators (WDI) (2006)

IMF International Financial Statistics (various issues)

World Bank (1994)

It can be seen that the only periods of rapid growth in per capita GDP were the initial period after independence and the last ten years. Some growth in real per capita GDP took place in the period following the Arusha Declaration up until 1976, but the growth from 1974-6 was associated with unusually high prices for sisal and coffee. Real per capita GDP (1992 prices) fell consistently from a peak of TSh. 57243 in 1976 to TSh. 47743 in 1986, a drop of over 16%. There was a slow recovery after 1986 up to 1990 with a decline of nearly 8% between 1991 and 1994 followed by a faster recovery from 1995 onwards. The net effect was a level of per capita GDP in 2005 that was about 26% above the level in 1967, about 54% above the level at independence and about 57% above the level fifty years previously.

Over a long period relatively small differences in performance can make a significant difference if maintained consistently. If the economic performance in the six years immediately following independence had been sustained, per capita GDP in Tanzania would be about three times the current level. Even if the performance in the period immediately after the Arusha declaration had been sustained, per capita GDP in 2005 would have been about 30% higher. The period between 1973 and 1985 can therefore be seen in many respects to have been one of lost opportunity.

[5] In this and other tables where growth rates are shown the figure given is the annualised compound rate of growth between the start and end years.

It is not just the growth of GDP per capita that is important. It is also important to assess the extent to which there has been structural change in Tanzania and the impact of changes on different segments of the population and on indicators of social development.

Assessment of changes in the composition of real GDP depends to some extent on the composition of the basket of goods used to deflate the GDP estimates as well as the approach used to measure subsistence output. Changes in both the composition of the goods produced and the relative prices of different goods can have a significant effect over a long time period and so judgements have to be made carefully. Nevertheless it is fairly clear that the relative size of the largest sector, agriculture, declined steadily from over 50% of GDP at independence to under 40% in the mid 1970s, increased back to just over 50% by 1987 and declined back to about 45% by 2004[6]. In other words, in terms of the structural transformation of an essentially agrarian economy the current situation is not very different from the situation at the time of the Arusha Declaration.

Overall the relative importance of agriculture has declined to about 83% of the level at independence implying that the real per capita value of agricultural production in 2005 was about 28% above the value at that time. Over the same period the proportion of the population living in the rural areas has declined from about 95% in 1964 to just under 76% in 2005 (WDI 2006). If all agricultural production were undertaken by the rural population this would imply that the real value of agricultural production per rural person had increased by about 60% since 1961, equivalent to about 1.1% per annum. However, since there is considerable agricultural production in some urban areas and there are significant contributions of agricultural labour made by the urban-based population, the actual growth in productivity has probably been lower than this.

[6] See Ellis and Mdoe (2003: 1369) for some observations on the reliability of estimates of the sector share of agriculture.

Agriculture has therefore not been a leading sector, rather a stabilising factor moderating the negative effects of periods of economic decline and declining in relative importance in periods of relatively faster growth. However, given the increase in the urban population it is clear that average urban productivity has declined quite considerably.

Per capita GDP is an imperfect indicator of welfare since it takes no account of factors that are not included in the measure and no account of distribution. Other relevant indicators of welfare include those that relate to levels of education and health and access to clean water. Indicators of inequality are also important, especially where the structural changes have differential effects on different segments of the population. Unfortunately reliable long time series are not always available for these indicators and so evidence is more impressionistic.

In the field of access to primary education, Tanzania made great strides in the 1970s with the policy of Education for Self Reliance[7]. However, as time went by, this progress became increasingly threatened by resource constraints and the quality of education for many deteriorated (World Bank 2001a: 32). Gross enrolment ratios rose rapidly from 32% in 1965 to a peak of 94% in 1981 but then fell back again to 66% in 1996 (Table 2, Figure 2). More recently primary school enrolment has risen again as a result of the abolition of primary education fees (URT 2002a: 19) and reached 87% in 2002 (WDI 2006). The gross enrolment rate exceeded 100% in 2005 and the net enrolment rate was over 90% (WDI 2006).

As a result of the massive expansion in primary education in the 1970s and early 1980s adult illiteracy fell rapidly from 63% in 1970 to 35% in 1991. Adult illiteracy continued to fall despite the fall in primary school enrolment and was down to about 31% in 2004 (WDI 2006). The gender gap in education has also narrowed with primary school enrolment rates for girls now being more or less the same as for boys, although the gender gap in illiteracy rates will take longer to disappear.

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[7] This policy was outlined in a speech made by Nyerere in 1967 (Nyerere 1968: 267-290).

Table 2 Indicators of Educational Achievement 1965-2001

Year	1965	1970	1975	1980	1985	1990	1995	2004
Primary School Gross Enrolment Ratio (%)	32%	34%	53%	93%	75%	70%	67%	101%
Adult Illiteracy (%)	n.a.	64%	58%	51%	44%	37%	31%	31%

Sources: World Bank Africa Database (WBAD) 2004
WDI 2006

World Bank (2004) health indicators show a steady improvement in infant mortality rates until 1985 followed by a slight deterioration, partly as a consequence of HIV/AIDS (URT 2002a: 27), and a more recent improvement (WDI 2006). There is some evidence that the general improvement in infant mortality may not have been reflected in the infant mortality rate for the bottom income quintile (World Bank 2001a: 36), but evidence is mixed and all that is clear is that infant mortality is lowest for the highest income quintile. Evidence on malnutrition of children also suggests growing differentiation with a deterioration recorded for the lowest asset level groups (ibid). The deterioration in health indicators between 1987 and 1992 may be a reflection of the initial impact of the post 1986 adjustment policies on health expenditure but the decline in life expectancy since 1985 is a clear indication of the seriousness of the impact of HIV/AIDS.

Table 3 Indicators of Health Status 1965-1999

Year	1965	1970	1975	1980	1985	1990	1995	2004
Infant Mortality per 1000 live births	136	129	118	106	100	102	100	78
Average Life Expectancy at birth (years)	43	46	48	50	51	50	49	46

Source: WBAD 2004
WDI 2006

Reliable data on access to clean water are not readily available, but there is some evidence of a significant improvement from 46% of the population with access to improved water sources in 1990 increasing to 62% in 2004 (WDI 2006). In the rural areas most of this improvement is due to the increased use of protected wells and springs rather than access to piped water (URT 2002a: 39) and Tanzanian government figures suggest a lower figure (55%) for households with access to piped or protected drinking water (URT 2002b: 23). There has been no significant improvement in access to improved sanitation facilities.

Evidence on inequality is mixed. Standard measures of the Gini coefficient suggest an increase in inequality from 1969 to 1991. There was apparently a decrease in inequality between 1991 and 1993 followed by a subsequent increase (World Bank 2002: 35). A recent estimate of the Gini coefficient indicated that inequality in 2000/1 was greater than in 1991/2 (URT 2002a: 10). Although the evidence is not conclusive, it is likely that inequality has increased since per capita GDP reached a peak in 1976 that was only reached again in 2003. It is therefore quite likely that the incomes of the poorest part of the population are still lower than they were in 1976.

Unfortunately there are insufficient consistent and comparable data on poverty status to allow definitive judgements to be made about changes over time in poverty indicators (World Bank 2002: 89). According to the Poverty Reduction Strategy Paper (PRSP), incidence of poverty declined between 1983 and 1993 but increased from 1993 to 1998 (URT 2000: 7). Poverty headcount ratios for 1991/2 and 2000/1 indicate a slight decrease in poverty in relation to both food and basic needs (URT 2002a: 7). It is therefore probable (but not certain) that, despite some growth in inequality, the improvement in economic performance in the post reform period may have slightly reduced the extent of poverty although not necessarily the depth of poverty for the poorest part of the population.

Overall the evidence suggests that Tanzania has performed slightly better in terms of social provision than in general economic performance. This is reflected in positive changes in the Human Development Index during the 1990s (World Bank 2002: 92). However this improvement is threatened in a number of areas for the poorest section of the population because of inequality and inadequate funding of the social sectors and also because of the impact of HIV/AIDS.

A striking feature of Tanzania's economic performance has been the long-term decline of the real value of per capita foreign exchange earnings from both merchandise exports and invisible earnings (Table 4, Figure 3). Absolute values obscure the significance of the decline because the population in 2004 was more than three times the level at independence. Per capita merchandise exports reached a peak in 1966 and declined more or less continuously until 1988 by which time they were little more than 10% of the value in 1966. Although there has been some recovery since then, by 2004 they were still only just over 20% of the 1966 value. This picture is mirrored to some extent by the performance of invisible earnings, principally from tourism. In per capita terms these reached a peak in 1970, declined to a low of just under 13% of the 1970 level by 1986, but recovered more quickly to 47% of the peak level by 2004.

Until relatively recently, when exports of fish and minerals have increased substantially, there had been almost no structural change in the nature of Tanzanian exports. Despite negative trends in both production and prices, the six major export crops[8] accounted for over 50% of exports in nearly all years until 1999 (Table 4).

The capacity of Tanzanians to earn foreign exchange has therefore declined drastically leading to very heavy dependence on other sources, principally aid. It can be further surmised that the inability of Tanzania to generate export earnings was a major constraining factor on the growth of the economy. So why did this happen? In the analysis that follows issues have been divided into those that are primarily of external origin and those that primarily relate to internal policies and actions. Of course these issues cannot be entirely

[8] The six major crops are coffee, cotton, tea, tobacco, sisal and cashewnuts.

separated in reality but it is worth considering the relative importance of factors that were within the control either of the Tanzanian government or the donor community or both.

Table 4 Sources of Foreign Exchange 1961-2004
(period averages, constant 1961 prices, IUV deflator[9])

Year	1961-6	1967-72	1973-9	1980-5	1986-94	1995-04
Absolute Value ($ million)						
Merchandise exports	176.5	202.1	129.3	72.0	55.8	85.1
Services	28.8	62.8	41.7	31.2	29.4	63.5
Aid	35.3	37.0	82.5	109.5	151.9	122.0
Net FDI	n.a.	*3.7*[*]	1.2	1.5	1.2	28.1
Per Capita ($)						
Merchandise exports	15.8	15.1	7.9	3.6	2.1	2.4
Services	2.6	4.6	2.5	1.5	1.1	1.8
Aid	3.2	2.7	4.9	5.4	5.8	3.5
Net FDI	n.a.	*0.3*[a]	0.1	0.1	0.0	0.8
Per capita growth within period (% per annum)						
Merchandise exports	6.6%	-3.9%	-12.9%	-14.9%	0.4%	5.6%
Services	7.3%	8.3%	-12.0%	-4.6%	0.8%	1.1%
Aid	-10.2%	3.9%	13.1%	-7.5%	-0.2%	2.0%
Net FDI	n.a.	n.a.	-17.7%	5.5%	6.0%	12.9%
Traditional export crops as % of total exports	57.9%[b]	50.2%	61.4%	58.9%	58.4%	41.8%

Sources: Own estimates based on World Bank, IMF and Tanzanian government sources

[a] Figures from 1970-2 only[10].

[b] 1965-6

External Factors

A number of external factors have had an impact on the Tanzanian economy in the past forty years. The most important of these have been:

[9] Estimates of real values were derived by using an import unit value (IUV) index for Tanzania as a deflator. The IUV index was compiled from IMF and World Bank sources. Explanation of the compilation of the import and export unit value indices used in this paper is given in Annex B.

[10] Net FDI in 1961-8 was negative in most years (Coulson 1982: 174).

- Changes in the real prices of major export crops. In most periods this has been a negative external factor, but there have also been some periods of unusually high export prices (Table 5, Figures 4 and 5).
- Changes in oil prices. Tanzania does not produce oil and was therefore vulnerable to the oil price shocks of the 1970s. However the 1970s was also a period of relatively high prices for Tanzanian agricultural exports (Table 5, Figure 4).
- The debt crisis. As with all highly indebted developing countries Tanzania suffered significantly when the negative real rates of interest of the 1970s changed to positive real rates that were very high by historical standards in the 1980s.
- The break up of the East African Community (EAC). This reduced the potential for trade between the three East African countries and also tended to reinforce the concentration of foreign investment in Kenya, which was perceived to be a more attractive investment location during the 1970s and 1980s.
- The Ugandan war. It can be argued that this was in fact a conscious decision made by the Tanzanian government, but there was an unfulfilled hope that the removal of the Amin regime would be perceived externally as a public good and therefore that other countries would help with the estimated $500 million cost of the invasion (Avirgan and Honey 1983:196). Failure to secure such help drained Tanzania's foreign exchange reserves and helped precipitate the economic crisis of the early 1980s.
- The incidence of HIV/AIDS. Again this is not entirely outside the influence of the Tanzanian government and people but it has been a major negative factor since the1980s over which the government has had limited influence.
- Aid policy. Tanzania has received a relatively large amount of aid but has been subjected to changing policy priorities of the aid donors, increasing conditionality and

periods of policy driven aid cuts. Inappropriate aid programmes and inadequate aid co-ordination have also been seen as issues (Wangwe 1997, Booth 2003).

Not all of the above factors are readily amenable to quantitative analysis, but evidence on the impact of commodity price movements can be assessed. An index of unit values for traditional export crop prices was constructed based on a weighted average of the prices of the six main export crops. In order not to allow changing patterns of export crop production to distort the price index, a single set of volume weights based on the average volume of exports for each crop was applied to the unit value of each crop in each year in constant 1965 prices ($US). A summary of the evidence is shown in Table 5 (see also Figure 4). It can be seen that the price index declined in every period except 1973-9. Declining real values for Tanzanian traditional export commodities have therefore been an important negative factor for most of the period under study. By 2004 the real unit value of traditional export crop prices was less than half of the level at the beginning of the period. A unit volume index is also shown both in absolute and per capita terms. While the unit volume per capita declines steadily, it can be seen that the decline in unit volumes does not always follow the decline in export prices very closely. In particular the relatively favourable terms of trade in the mid 1970s were accompanied by a decline in both per capita and absolute export volume. Falling export prices therefore do not entirely explain the decline in export values.

Table 5 and Figure 5 also show more general measures of the movement of the terms of trade for all Tanzanian exports[11]. For most of the period the figures are very similar, but recently the declining relative importance of traditional export crops has caused some divergence between the unit value index for traditional export crops and the overall terms of trade. In

[11] This series was computed by joining together overlapping series for import and export unit values from World Bank and IMF sources. Inevitably there is a significant margin of error because of the different weights used in the different series. Nevertheless the orders of magnitude should give a reasonable indication of movements in the terms of trade over time (see Annex B).

particular favourable movements in the prices of mineral exports have had a significant positive effect on the terms of trade in the last five years.

Table 5 Indices of Real Unit Values and Volume for Traditional Export Crops and Commodity Terms of Trade 1965-2004 (period averages, 1965=100)

Period	1965-6	1967-72	1973-9	1980-85	1986-94	1995-04
Real Unit Value Index	99.1	90.3	93.6	74.0	61.0	40.0
Average Annual change		-1.8%	1.2%	-3.3%	-2.4%	-3.7%
Unit Volume Index (UVI)	112.9	113.7	88.6	63.4	60.6	77.7
UVI per capita	111.0	100.7	62.9	36.2	27.1	26.6
Average Annual change		-4.2%	-10.6%	-8.8%	0.6%	-2.0%
Terms of Trade (period average)	99.3	80.5	89.6	70.5	62.2	47.7
Average Annual change (period start to end)		-2.7%	2.7%	-3.9%	-2.7%	-1.2%

Source: Own estimates based on World Bank, IMF and Bank of Tanzania data.[12]

The economic impact of HIV/AIDS has been serious. Although such estimates are subject to a significant margin of error, it is estimated that the effect of HIV/AIDS on economic growth has been in the region of 0.7% per year (World Bank 2001a:xxv). This impact would have started at a relatively low level in the mid 1980s and increased steadily until the mid to late 1990s after which it has probably been fairly stable. The relatively good economic performance since 1995 has therefore been achieved despite the negative impact of HIV/AIDS.

Aid policy has been a significant factor in Tanzanian economic performance and is an important source of foreign exchange. Real per capita aid to Tanzania increased rapidly from independence, reaching a peak in 1979 (Figure 6). Due to disagreements between Tanzania

[12] It should be noted that during the crisis period recorded exports are a significant underestimate of actual exports because there were strong incentives to export through unofficial channels at parallel market prices. This is a relevant factor in the relative resilience of the Tanzanian economy during the crisis period but clearly the foreign exchange earned in this way was not available for use in the official economy.

and the major multilateral and bilateral donors over exchange rate policy, the real value of aid per capita then declined steadily during the crisis period until 1985. Real per capita aid increased following the 1986 agreement with the IMF reaching another peak in 1988 but fell significantly after further disagreement and only recovered slowly after renewed agreement (Table 6, Figure 6).

Table 6 Index and Growth of Real Value of Aid per Capita 1961-2004

(Indices 1961=100)

Period	1961-72	1973-79	1980-85	1986-92	1993-97	1998-04
Start	100.0	94.1	164.9	143.5	97.7	60.4
End	73.2	173.8	108.9	174.9	53.0	129.7
Period Average	79.2	130.5	143.0	169.7	83.4	98.1
Aid as % of Exports (period average)	19.1%	63.9%	152.0%	294.8%	148.8%	155.7%

Source: Own estimates derived from World Development Indicators (2006)[13].

Given that the value of aid has been more than the value of exports in every year since 1979 and that it has been a major source of fixed capital formation it can be argued that fluctuation in aid flows has been an important contributory factor to instability in Tanzanian economic performance, significantly exacerbating the declines in real per capita income experienced in 1981-5 and 1992-5.

In terms of the periods under consideration, the initial post independence period was marked by a slow but steady decline in unit export values compensated for by a steady increase in aid – a broadly neutral external environment, although aid flows were influenced in some years by political disagreements with Germany and the UK over the recognition of the GDR and the response to UDI in Rhodesia respectively.

[13] The figures in Table 6 are very sensitive to the deflator used (in this case a linked series for the Import Unit Value (IUV) Index for Tanzania). The IUV index is very sensitive to changes in oil prices because of the relative importance of oil imports and this has a significant effect on the estimates of the real value of aid.

The period between 1973 and 1979 was one in which the external environment was generally favourable. Per capita aid increased and was accompanied by generally favourable export prices. Real interest rates for much of this period were negative giving rise to cheap loans for borrower countries. The oil price shocks at the beginning and end of the period had some negative effects but these would have been less important if export volumes had responded to the positive price changes for sisal and coffee. The break up of the EAC may have had some negative effect on inward investment, but it could be argued that internal factors were more important in discouraging investors and that inward foreign investment was very low before the break up.

The period from 1980 to 1985 was one in which external factors played a significant negative role. The Uganda war exhausted Tanzania's foreign exchange reserves, export prices were in steep decline and from 1981 onwards there was a rapid decline in per capita aid provision[14]. Added to this Tanzania was affected like other indebted developing countries by the impact of the rising real cost of servicing debt[15]. The external environment was therefore very hostile. Given these negative factors what is surprising is not that the economy declined but that it did not decline by more[16].

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[14] The decline in aid volume came about because aid donors were becoming disenchanted with Tanzania's internal policies, in part because the political climate in the donor countries shifted significantly to the right and the external perception of Tanzania's socialist policies had changed from one of support for its egalitarian principles to one of hostility to its antipathy to market led solutions. See Bigsten et al. (2001: 294-5)

[15] This problem was caused by the failure of interest rates to fall in line with the fall in inflation rates in lending countries. The real cost of servicing a given debt is determined by the real value of payments of interest and loan principal. In periods of high inflation of lender currencies the real value of these payments for any loan declines rapidly during the lifetime of the loan. This does not happen when inflation of the lender currency is low.

[16] Bevan et al (1988) provide evidence from household budget surveys using parallel market prices suggesting that the decline in real incomes may have been significantly greater than the official data suggest.

From 1986 to 1991 Tanzania continued to face low real export prices, but this was partly compensated by a substantial increase in aid. The real value of aid fell between 1993 and 1997, although this was partly offset by improved coffee prices in 1994 and 1995. Export prices then fell again while aid levels recovered. For most of the period following the 1986 agreement the external environment was fairly hostile in relation to export prices and the real cost of debt service but improved in relation to aid apart from the period 1993-7. More recently the external environment in relation to debt service has improved significantly with the HIPC initiative. Foreign direct investment finally began to make a significant net contribution to foreign exchange inflows from 1995 onwards but was still only 23% of the value of aid and 33% of the value of merchandise exports in the period 1995-2004 (WDI 2006).

Overall the impact of external factors has been mixed but mostly either neutral or negative apart from the mid 1970s when it might be said to have been positive. External factors were therefore important, but the economic performance of Tanzania cannot be explained solely in these terms. It is also necessary to look at the impact of the policies followed by the Tanzanian government, particularly in the period prior to the 1980s when it might be argued that the Tanzanian government had greater room for manoeuvre.

Internal Policy Changes

The period immediately following independence was one in which the Tanzanian government followed a conventional import substitution policy relying largely on private investors in the industrial sector and a combination of smallholder farmers and large scale private farms in the agricultural sector. There was a significant increase in the level of investment rising to 18.9% of GDP in 1967 (Bigsten et al 2001: 313) but this was still regarded as insufficient by the political leadership. In particular there was disappointment at the lack of investment by the private sector in areas regarded as priorities in the First Tanzanian Five Year Plan.

Table 7 and Figure 7 show gross fixed investment as a proportion of GDP along with the average growth rate of GDP in the corresponding period. Paradoxically the two periods of highest growth have the lowest rates of investment, a clear indication that the productivity of investment in the period 1973-85 was very low (World Bank 2001a: 24-5)[17].

Table 7 Gross Fixed Investment as % of GDP and Real GDP Growth 1961-2004 (period averages)

Period	1961-6	1967-72	1973-9	1980-85	1986-95	1996-04
GFI (% of GDP)	12.8%	21.2%	27.3%	25.6%.	22.5%	16.7%
Real GDP Growth Rate	6.5%	4.4%	3.3%	1.1%	3.2%	5.1%

Source: Own estimates based on World Bank sources.

Major changes were introduced with the Arusha Declaration in 1967, which provided a blueprint for the development of Tanzanian socialism. The initial changes extended the role of the state to cover the 'commanding heights' of the economy. These were interpreted to include the main elements of the financial sector, most large-scale industries and a significant proportion of the large-scale agricultural sector (Nyerere 1968: 251-256).

The initial impact of these changes on economic growth was not particularly great. Investment continued to grow and exceeded 20% of GDP from 1970 onwards, but the relative importance of public sector investment in total investment increased dramatically from 31.6% in 1965 to 63.8% in 1970 (World Bank 2002: 125). Two other interrelated factors came into play that had implications for subsequent developments. In 1969 Tanzania achieved a current account surplus on the balance of payments for the last time. From 1970

[17] For some revealing cases of poor investments see Coulson ed. (1979: 175-190) and Coulson (1982: 279-282).

onwards foreign exchange shortages were a regular feature[18] and Tanzania started on the road towards dependence on aid to finance the gap between export earnings and import requirements. Tanzania also maintained a fixed exchange rate pegged to the dollar until 1974 at a time when internal inflation, although not particularly high, was higher than that of her major trading partners. Although the problem of appreciation of the real exchange rate (RER) is more commonly associated with the early 1980s, the shilling appreciated by about 50% in the late 1960s thereby initiating the process of erosion of the competitiveness of export crops (Table 8, Figure 8).

Table 8 Index of Real Exchange Rate 1961-2004
(period averages, 1961=100)

Period	1961-6	1967-72	1973-9	1980-85	1986-95	1996-04
Real Exchange Rate	97.8	142.3	142.8	227.8.	85.6	76.5
Average Annual change	0.8%	2.7%	0.0%	15.1%	-15.0%	-0.7%

Source: Own estimates based on World Bank and IMF sources.
A positive sign indicates appreciation of the real exchange rate

Further major policy changes were introduced in 1973 and the subsequent few years. The most important change was the process of villagisation[19], justified partly by the desire to provide social services to the villages and partly by the aim to create more communal forms of production in the rural areas. The impact of this change varied from location to location with the most severe disruption to production occurring in areas with scattered settlement patterns where farmers were unable to maintain perennial crops that were located too far from

[18] Green et al. (1980) provide a review of the factors affecting the balance of payments situation in Tanzania during the 1970s that is sympathetic to the Tanzanian government policies at the time. A more critical review of Tanzanian policy during this period can be found in Bevan et al. (1990 Appendix 6).

[19] Villagisation was the process of bringing farmers who lived in scattered settlements together into villages. At first this was seen as a voluntary policy but impatience with slow progress led to compulsory resettlement of a large proportion of the rural population in the period 1973-5. Useful accounts can be seen in von Freyhold (1979), Coulson (1982 Ch. 22) and Hyden (Ch. 4 and 5).

their new homes. Production of cashewnuts was particularly badly affected and declined from 143,300 tonnes in 1973/4 to 57,100 tonnes in 1978/9 (URT 1984:8).

Agricultural production was also affected by the abolition of the regional co-operative unions in 1976 and their replacement by parastatal marketing boards. This change affected the delivery of services to farmers, particularly for export crops, and also contributed to high marketing costs thereby reducing the prices paid to farmers below what they otherwise might have been[20]. The inefficiency of the parastatals, combined in some cases with mixed priorities and unclear objectives[21], therefore contributed to the poor supply response of the export sector to the relatively favourable external environment of the 1970s.

During the period 1973-9 international inflation rates were generally as high as those in Tanzania and the RER did not change very much. However this period saw a rapid extension of price controls over a wide range of products as well as a foreign exchange allocation process to cope with periodic foreign exchange shortages. These shortages occurred despite this being the only period in which the terms of trade were generally favourable.

The widening of controls over prices and resource allocation contributed significantly to a number of problems. First of all the process increased the demand for skilled labour to administer the expanding role of the public sector. This was problematic because, while Tanzanian education policy had concentrated resources on expansion of primary education for reasons of equity, the proportions of the population receiving secondary and tertiary education were among the lowest in the world and had actually declined since independence (World Bank 2001a: x). Tanzania therefore did not have the human resources needed to administer the system it had adopted, resulting in low levels of technical and managerial

[20] Ellis (1983) estimated that the proportion of the world price of the six major export crops obtained by farmers fell from 70.3% to 41.7% between 1970 and 1980.

efficiency (Van Arkadie 2005: 123-4). Secondly the shortages created by these controls led to rising levels of rent seeking behaviour. These were reflected in the increasing importance of parallel markets for essential commodities and foreign exchange[22]. Essentially the state had taken on responsibilities beyond its capacity for effective implementation. This led to several policy reversals in cases where the impact was clearly negative from the outset[23].

The 1979 Uganda war ushered in a period of acute economic crisis, which lasted until an agreement was reached with the IMF in 1986. During this period the Tanzanian government attempted to introduce a number of reforms, but these were regarded by most of the donor community as too little and too late. The principle issue of dispute was the exchange rate. While the government did devalue the Shilling in 1982, 1983 and 1984 by 10%, 20% and 26% respectively, it was only the third devaluation that was sufficiently large to prevent continued appreciation of the RER. Part of the reason for this was the high level of internal inflation, but another major reason was the deflationary policies followed by major developed economies, which caused their inflation rates to fall very rapidly. It is possible that the Tanzanian government was rather slow to realise the significance of the diversion in inflation rates for the competitive position of exporters, but there was also a view that the exchange rate was an issue of national sovereignty and that the devaluation demands of the IMF and the World Bank were excessive.[24].

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[21] Examples of these are the investments of the Sisal Authority in sisal processing capacity and diversification schemes at a time when production of sisal fibre was falling. Similarly the Cashewnut Authority invested with World Bank support in cashew processing factories at a time when cashewnut production was falling.

[22] The ratio of the parallel market price for foreign exchange to the official rate increased steadily from 2.2 in 1979 to 3.8 in 1985 (World Bank Africa database 2004). Other sources indicate that the rate was sometimes even higher during this period (e.g. Kimei cited in Bevan et al 1990: 328, Lofchie cited in Hyden and Karlstrom 1993: 1398).

[23] A notorious example was 'Operation Maduka' in 1976, a failed attempt to close down private retailers and replace them with co-operative shops (Hyden 1980: 132-3).

[24] Bigsten et al. (2001: 316-320) provide an interesting discussion of the debates going on at this time. The view expressed suggests that prime responsibility for intransigence lay with the Tanzanian government.

The Tanzanian Government produced a National Economic Survival Programme (NESP) in 1981, which removed export taxes, but otherwise did not go much further than exhortation (Morrissey 1995: 642, Bigsten et al. 2001: 317). A more comprehensive process of reform was initiated with a home-grown Structural Adjustment Programme (1982-4) which proposed a strategy based on the revival of traditional export crops. This was followed, in 1983, by the Agricultural Policy of Tanzania, in which the role of the private sector and the need for security of land tenure were explicitly recognised and a policy decision was made for the co-operative unions to be reintroduced.

Efforts were made to draw up programmes defining the requirements for investment and recurrent resources for the traditional export crops (URT 1984[25]) but they depended on support from the donor community, which was not forthcoming without agreement with the IMF, and investment by the private sector, which was unwilling to invest in what was perceived to be a risky environment[26]. Nevertheless these programmes did embody a number of significant reforms including some proposals for the sale of non-performing public sector estates to the private sector. There were also reductions in the number of products subject to

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Other useful discussions of the debates include Biermann and Wagao (1986), Hyden and Karlstrom (1993) and Holtom (2005). A common theme was the critical role of President Nyerere and some of his closest advisors in resisting the perceived 'take it or leave it' attitude of the IMF in negotiation. Another theme was the failure of Nyerere and his advisors to fully understand the economic implications both of devaluation and of failure to devalue. My own personal experience was that there was significant internal pressure for reform but the task of the reformers was made more difficult by the refusal of the IMF and the World Bank to compromise on hard line positions. The size and speed of exchange rate adjustment demanded was not even viewed as particularly helpful by some private sector exporters, who argued for a steady depreciation. The view expressed by some was that a very rapid change would make it more difficult to finance the foreign exchange costs of the rehabilitation needed to restore production and take advantage of exchange rate changes (personal communications during fieldwork collecting information for the Ministry of Agriculture on private sector requirements in 1984-5).

25 The original document covering the six major export crops as well as pyrethrum and cocoa was followed up by more detailed programmes and investment proposals for each crop.

price control and the beginnings of liberalisation of the foreign exchange allocation system. Some attempts were made to reverse the deterioration in the real value of producer prices to farmers, but deteriorating terms of trade and an appreciating RER meant that these measures worsened the deficits of the parastatals and exacerbated the problem of controlling government expenditure[27].

In terms of policy measures the reforms of the early 1980s were significant in that they signalled a reversal of the trend of the previous decade towards public sector dominance of all major economic functions. An indication of this change was that the share of public investment in total fixed capital formation fell back to about 40% in 1980 and 35% in 1985 (World Bank 2002: 125). Given the crisis state of the economy, the proportion of investment to GDP remained surprisingly high but the productivity of that investment was clearly constrained by the economic conditions. With the progressive withdrawal of support from the donor community the economic crisis continued. In 1985 there was no devaluation and the reform process was stalled, partly because this was the final year of Nyerere's presidency. By this time the RER had appreciated to over three times the level of 1961, a position that was clearly unsustainable in the long run, especially when the terms of trade had also moved against Tanzania.

By 1985 the economic crisis had caused severe strains on the physical and social infrastructure of the country. While adult literacy was still improving as a result of past efforts, schools and health centres were unable to deliver effective services. Primary school enrolment started to decline and the improvement in health indicators slowed down. The

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[26] It is nevertheless interesting to note that real net foreign direct investment was actually higher in the period 1980-1985 than it was in the period from the IMF agreement up to 1994 (see Table 4).

[27] Between 1981 and 1984 government transfers to the crop authorities increased from 3.3% to nearly 9% of government recurrent expenditure (World Bank 1996: Vol. 2: 36).

physical infrastructure also suffered and this was reflected in a rapidly deteriorating road system and inability to expand provision of utilities in line with demand.

In 1986 the new government under President Mwinyi reached agreement with the IMF under the Economic Recovery Programme (ERP). The agreed package involved an initial massive 63% devaluation[28] followed by a steady depreciation to eliminate exchange rate overvaluation by 1988. By that time the RER had already fallen below the 1961 level. Measures were to be taken to control public expenditure, raise interest rates and liberalise both internal and external trade.

Growth of the economy resumed, but after a temporary boom in 1986, real exports continued to decline until 1993 and did not recover to 1984 levels until 1994. Fixed capital formation declined as a proportion of GDP, mainly as a result of the effects of restrictions on public expenditure, but also because the private sector response to reform was disappointing. Aid levels recovered but Tanzania was even more aid dependent than before. The hoped-for inflow of foreign investment failed to materialise. Some privatisation measures were taken but it was not until 1991 that pressure to reform the financial sector was embodied in the Financial Sector Adjustment Programme. External pressure for more rapid privatisation in this area was at least partly responsible for the breakdown in the agreement with donors in 1992. Bigsten et al (2001: 323-4) argue that lack of fiscal discipline and resistance to measures to control tax evasion and other rent seeking behaviour caused a breakdown in donor confidence. From the Tanzanian point of view the breakdown was perceived to be due to excessive donor demands and failure to deliver on promises (Helleiner 2002: 251).

From 1991 to 1994 per capita income growth was negative and was associated with declining support from aid donors culminating in the cancellation of the adjustment programme by the IMF. Nevertheless the reform process continued. Freedom of entry and exit in the financial

[28] The exchange rate in relation to the US$ was devalued from TSh. 17 to TSh. 46 in 1986.

sector was allowed after two acts in 1991 and 1992 and the process of restructuring and privatising the major banks commenced. Liberalisation of the agricultural sector involved opening up marketing to the private sector, removing fertiliser subsidies and scaling down the activities of the crop marketing parastatals. By 1994, eight years after the 1986 agreement with the IMF, the first clear signs of a significant positive response from foreign investors could be seen with Net FDI increasing to $50 million.

Liberalisation of the financial and agricultural sectors had some negative impacts. Although liberalisation of marketing had some positive impacts on the producers' share of export prices, the costs of inputs rose sharply and access to credit deteriorated. This process led to varied outcomes (Winter-Nelson and Temu 2002) but it is likely that it exacerbated inequality because poorer farmers are less likely to be able to finance the cost of their inputs and less likely to be able to negotiate favourable prices for their outputs (World Bank 1996: 65). Banda (1997: 173) suggested that the market reforms created problems because of the withdrawal of public sector and co-operative institutions before sufficient time had elapsed to allow the development of private sector institutions[29]. Participants in the 1995 participatory poverty assessment (PPA) undertaken for the World Bank (1996) mentioned input supply problems and lack of credit as important constraints (ibid: 85-7). While the state owned banking system did not provide a good service to its customers, the liberalisation process led to closure of loss-making branches and switches in sectoral lending away from agricultural marketing (Nyagatera and Tarimo 1997: 75, 88). The result has been greater concentration of financial services in the large towns while more remote areas now get no service at all.

[29] On the other hand Cooksey (2003) argues that the remnants of the parastatal and co-operative based marketing systems restricted the space for the development of private sector provision of marketing and input supply services. Either way the transition was not a smooth one and the experience reinforces the point that how institutional change is introduced can be as important as the decision to make such a change.

In 1995 a new government was elected and negotiations with the IMF resumed culminating in a new enhanced structural adjustment facility (ESAF) in 1996. The process of agreement was enhanced by the appointment of an independent group to review the relationship between the Tanzanian government and donors in order to improve the efficiency, relevance and effectiveness of aid programmes. The group proposed measures to ensure that agreements could be set out clearly in such a way that the performance of both the Tanzanian government and the donors could be monitored against agreed statements. It was hoped that this would enhance the 'ownership' of the reforms by the Tanzanian government. Their report (the Helleiner Report) contributed to the development of a number of policy documents including the Tanzania National Development Vision 2025 (1997) and the National Poverty Eradication Strategy (1998). Relations with donors were defined in the Tanzania Assistance Strategy (TAS) (2000) in line with the newly required Poverty Reduction Strategy Paper (PRSP). Although some of the original proposals of the consultative group have been eroded to some extent it appears that the TAS has helped to establish a more genuine dialogue between the donors and the Tanzanian government backed up by a renewed level of aid support.

The economic performance of Tanzania started to improve in 1995 and this improvement has accelerated since 2000. Exports per capita are rising thanks to considerable growth of exports of minerals and fish. Government recognition of the importance of exports and the need for diversification is reflected in a new National Trade Policy (2003). Invisible earnings from tourism have risen and FDI is finally becoming a significant factor. In the social field primary school enrolment rates have started to rise again (Table 2, Figure 2), partly due to abolition of school fees in 2000. The proportion of the population proceeding to secondary and tertiary education is also now rising, albeit from a very low base. HIV/AIDS remains a serious problem and as yet there is no indication of any significant improvement in the situation, but in most other respects it appears that Tanzania is on the road to sustained economic growth with some positive impact in the proportion of the population in absolute poverty[30].

However, while the overall picture is generally positive, there are some doubts about sustainability. Tanzania is still very aid dependent and a long way from current account balance. Growth in foreign exchange earnings is mainly from minerals and fish exports and tourism and there are some concerns that these industries have relatively weak internal linkages as well as fairly high levels of outward leakage. Recent moves to strengthen economic cooperation with neighbouring countries have not yet resulted in substantial trade flows. A more general issue is the question of the whether market driven reforms can deliver poverty reduction to the poorest groups or whether they actually make the position of these groups worse.

Conclusions

Tanzania has been through a range of reforms over the last forty to fifty years with mixed but generally disappointing results between two short periods of rapid growth. It easy to dismiss Tanzania's 'socialist experiment' as an expensive mistake but it is worth considering what were the critical factors and to what extent the current reforms are addressing the most important issues for the future.

The most problematic period from a policy point of view was the period from 1973-9. It is necessary to recognise the significant changes in the political context that took place in this period. In this period Tanzania received increasing amounts of aid at a time when the terms of trade were generally favourable. The Tanzanian government had adopted a form of state socialism in which the ideologically driven extension of the role of the state went well

[30] The basic needs poverty headcount ratio for Tanzania fell from 38.6 to 35.7 between 1991/2 and 2000/1 (URT 2002a: 7)

beyond the operational capacity for administration. The control of prices, marketing and resources and widespread resort to rationing led initially to inefficiency and as shortages became more acute it created opportunities for patronage and rent seeking by parastatal managers and government officials. Bevan et al. (1990: 306) point out that the windfall gain from the coffee boom of the mid 1970s merely postponed the consequences of an increasingly unsustainable policy. The irony is that this extension of the role of the state was actively supported by the same institutions that changed their tune following the demise of Robert McNamara's basic needs agenda and the advent of structural adjustment (Holtom 2005: 558). As Van Arkadie (2003: 3) argues in relation to both structural adjustment and subsequent 'development fashions':

> "*Unpredictable shifts in donor fashions have become one powerful source of exogenous instability affecting policy making in heavily aid-dependent economies…….For a country such as Tanzania it may seem somewhat ironic that officials are now lectured on the need to emphasise poverty alleviation, long the established priority of Tanzanian policy by the same institutions that had pushed policies that had led to downgrading of basic needs priorities in the not too distant past*."

From an economic point of view the most problematic period was 1979-85, but this would almost certainly have been difficult whatever the circumstances because of the hostile external environment with rapidly deteriorating terms of trade, declining levels of aid and rising problems with debt service derived from high real rates of interest in the developed world. The relationship between Tanzania and the donor agencies was confrontational, not only because the Tanzanian leadership was intransigent on the exchange rate issue but also because the donors were reluctant to compromise. A more sympathetic encouragement of the domestically driven reform programme or at least willingness to compromise on some issues might have strengthened the position of the reformers in Tanzania and led to a more realistic response in relation to exchange rate adjustment.

Opposition to reform was not only an issue of national sovereignty. It also involved defence of vested interests for the ‘bureaucratic bourgeoisie’ who benefited from access to resources in a period of scarcity. While the political leadership may have taken a stand on the principle of national sovereignty they were supported by groups who were potential losers from market driven reforms. It is therefore scarcely surprising that issues of economic mismanagement or governance arose in the post reform era.

In general the reforms since 1986 seem to have worked, but it took nearly ten years before there was any significant progress in terms of per capita income and export performance. Meanwhile some social indicators actually deteriorated while others remained more or less unchanged despite rising incomes[31]. While the general direction of the reforms is widely accepted there are issues about the speed, the order of their introduction and how far they have to go to ensure an environment that is conducive to pro-poor growth.

It is clear that the overvaluation of the Tanzanian exchange rate in the 1980s was a serious problem and that a process of adjustment was needed. What is not clear is whether a ‘big bang’ approach involving an immediate 63% devaluation was the most appropriate way to start the adjustment process. While there was an immediate export boom in 1986, real exports did not return to the 1986 real value until 1995. Part of the reason may have been that the export industries were in such a parlous state that the rapid devaluation made the local currency cost of investing in rehabilitation prohibitively expensive. The local currency cost of borrowing in foreign currency is also significantly increased by rapid devaluation.

[31] Gross primary school enrolment did not stop falling until 1998. Infant mortality rates increased for a period after 1985, although it could be argued that this was associated with the rise in HIV/AIDS, a factor that cannot be attributed to the reforms (RAWG 2002: 26-7). Indicators of child malnourishment have seen little change (ibid: 36-7).

Very rapid change in exchange rates is also destabilising in that it increases uncertainty. A very rapid depreciation leads to potential overshooting and the possibility that the process might be reversed, thereby reducing incentives to exporters at a time when maintaining profitability could be crucial. This happened in Tanzania from 1992 to 1998 when the RER appreciated after falling to its lowest ever level. Evidence from Uganda suggests that while exports are negatively correlated with the RER, uncertainty associated with exchange rate variability also has a negative effect on exports (Cameron, Kihangire and Potts 2005). This would suggest that a more careful exchange rate strategy might be required than simply removing overvaluation at the earliest possible opportunity.

A second example where questions can be asked about the speed of change relates to the liberalisation of financial and agricultural markets. While it was clear that the introduction of the private sector in these areas could eventually bring improvements in efficiency it is not so clear that the rapid withdrawal of public sector institutional structures was the most effective way to achieve such a transition. It takes time for farmers to adapt to new institutional structures as well as for a poorly developed private sector to extend its role[32].

The issue of speed relates also to the issue of the order in which things are done. Morrissey (1995: 647) pointed out the need to "identify the policy environment first, then assess which reforms are appropriate to that environment, notably building institutional capacity….. Countries with greater capacity and/or commitment can move faster." While he argued that the majority of reforms were basically successful, he pointed to problems in tax administration and in the capacity for privatisation and the reform of the parastatals, in part due to the weakness of the private sector. In any reform process it is important to be aware of the status and perceived legitimacy of local institutions and their capacity to deliver.

[32] "A crop parastatal can be privatised at the stroke of a pen, but it will take a lot longer than this to establish an energetic, competitive, efficient and responsive private marketing system." (Ellis and Mdoe 2003: 1379)

The weakness of the private sector in Tanzania leads us back to the quotations at the beginning of this paper. A major stated reason for the Arusha Declaration was the perceived failure of the private sector to deliver the investment the government was looking for. In hindsight the impatience of the Tanzanian government may be considered unjustified, but an equally significant factor was probably the issue of ownership. The private sector was predominantly owned by foreigners and relatively privileged ethnic minorities. The indigenous population owned relatively little. After nearly thirty years of socialist oriented policies it is hardly surprising that local private sector capacity was weak or that Tanzania was regarded with suspicion by foreign investors. For the World Bank to place too much expectation on the private sector to deliver a substantial increase in investment even in the medium term, as is implied in the third quotation, was just as unrealistic as Nyerere's implicit assumption that the role of the state could be massively extended without major investment in human capital.

The ideological drive to downsize the state by privatising wherever possible and as soon as possible makes an implicit assumption that the supply of private sector funds is highly elastic. This was certainly not the case for the indigenous private sector in the early years of reform because savings rates were relatively low, the banking system was not well developed and the stock exchange was non-existent. It is also clear that the interest of foreign investors was not particularly strong and has tended to be concentrated in a small number of areas such as mining and tourism where the prospect of repatriating funds is relatively good.

The questions of what to privatise and when are therefore important and should be driven primarily by practical considerations related to the maximisation of overall efficiency in the use of scarce resources. A relevant factor in this respect is the fact that the most attractive state enterprises from the point of view of private investors are those that are performing relatively well and have guaranteed markets. While there is no doubt that many Tanzanian parastatals were badly managed and inefficient, there was considerable variation in their performance[33]. From the point of view of the government it is the enterprises that are failing and operating in an uncertain environment that are the ones most in need of external investment. The implications of the inherent contradiction between what is most helpful to the government and what is most attractive to the private sector need careful consideration, especially if the supply of private sector capital is regarded as limited rather than infinitely elastic[34].

The word 'ownership' can be used in two ways. One is in the sense of 'ownership' of the reform process. It appears that the process instigated by the Helleiner Report has gone some way to increasing the extent to which policy is now being driven by the Tanzanian government (Killick 2004: 233). For this to be effective it is important that there should be some genuine policy options. While it is legitimate for the donor community to be concerned with the standard of overall macroeconomic management and the effectiveness with which funds are being used, there should be greater scope for the government to decide on issues such as how to raise revenue and what roles should remain within the public sector. Ensuring the coherence and effectiveness of state intervention is more important than minimising the role of the state.

The second use of the word 'ownership' relates to the ownership of assets. There is growing evidence that lack of ownership of (or entitlement to) assets, in particular land, is an important factor underlying the poverty of the poorest Tanzanians (Ellis and Mdoe 2003: 1379). There is some evidence that the liberalisation process has increased rather than reduced inequality and that in the agricultural sector it is the richest farmers who have gained

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[33] Some examples of such variation in agricultural parastatals are described in Potts (1995).

[34] An early example of this issue (1986) was the pressure to privatise the most efficient public sector tea estate at a time when there were other public sector estates in much greater need of rehabilitation. A compromise was reached by including a run down estate in the package.

most. This is likely to exacerbate the process of concentration of land, especially in those areas where land is becoming increasingly scarce.

The proportion of the population living in the urban areas has increased dramatically from 5.2% in 1960 to 24.2% in 2005 with a concomitant increase in the importance of the urban informal sector (WDI 2006). The proportion of the population living in the urban areas grew most rapidly from 6.4% in 1966 to 14.6% in 1980 and more slowly thereafter. A major issue for the future is the extent to which the industrial and service sectors can provide gainful employment for this rising population. It is quite possible that the increasing proportion of productive capacity in the hands of foreign companies will re-emerge as a political issue if there are no signs of 'trickle down' to the wider population.

An important factor in the assessment of the limitations of the Tanzanian economy throughout has been the limited development of human capital. Tanzania has been praised for the achievements of a very poor country in terms of primary education and literacy. However this has to some extent been at the expense of secondary and tertiary education where participation rates are among the lowest in the world. A successful transformation of the Tanzanian economy cannot take place without a substantial increase in the proportion of the labour force with education beyond primary level.

Overall the outlook is quite encouraging but the current rate of growth cannot be sustained without consistent support from the donor community combined with rather than as a substitute for continued revival and diversification of foreign exchange earnings. Perhaps the most important single conclusion is that drastic changes in the policies of both host country and donors accompanied in the latter case by rapid in changes in the level of support are disruptive to aid-dependent economies.

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Annex A Construction of the GDP Series

The data used for the period 1967 to 2002 are taken from the IMF International Financial Statistics (various issues from 1985) and therefore should be internally consistent. However it should be noted that there are some inconsistencies. The series were joined at points where there appeared to be reasonable consistency in terms of growth from one year to the next with more recent estimates taking precedence. They were updated to 2005 using the World Development Indicators (2006). The data used for 1954 to 1967 are taken from World Bank (1994) and are not entirely consistent with the IMF series. The series were joined using a consistency check for the overlapping years (1965-7). Inevitably given the length of time covered the margin of error in all such figures should be recognised. A particular issue for the period 1961-7 is the union with Zanzibar in 1964, which makes comparison between 1961-3 and 1964-7 potentially problematic. By concentrating on per capita rather than absolute estimates of GDP the margin of error is reduced sufficiently to allow general conclusions to be drawn. Another issue is the upward adjustment of the series that took place in the 1990s. By utilising what should be a consistent series from 1967 onwards and working backwards using growth rates rather than absolute values while checking for consistency in overlapping years, the series should be reasonably consistent. Useful discussions of the issues arising in compiling long series for Tanzania can be found in Bigsten and Danielsson 1999:8 and Ellis and Mdoe 2003. A significant margin of error must be accepted in figures covering such a long time period but it is argued that the orders of magnitude are sufficiently accurate to make judgements about trends during the periods identified.

Annex B Compilation of the Import (IUV) and Export (XUV) Unit Value Series

To obtain a single series for the IUV and XUV to cover the whole period it was necessary to join different series together. The limitations of joining series together when there are changes in the patterns of both expenditure on imports and export composition are recognised and clearly there are implications for the margin of error in the results indicated. There are many series covering different periods but none that cover the whole period in question. Reference was made to the IMF International Financial Statistics (1976) and to various editions of the World Bank Tables, World Development Indicators and African Development Indicators. The level of inconsistency in the various series is remarkable but not entirely surprising given changes in trade composition over such a long period. The series finally adopted was assembled on the basis of some general principles. These were:

i) There should not be too many joints in the series.

ii) There should not be too much inconsistency between the series at the points where joints are made.

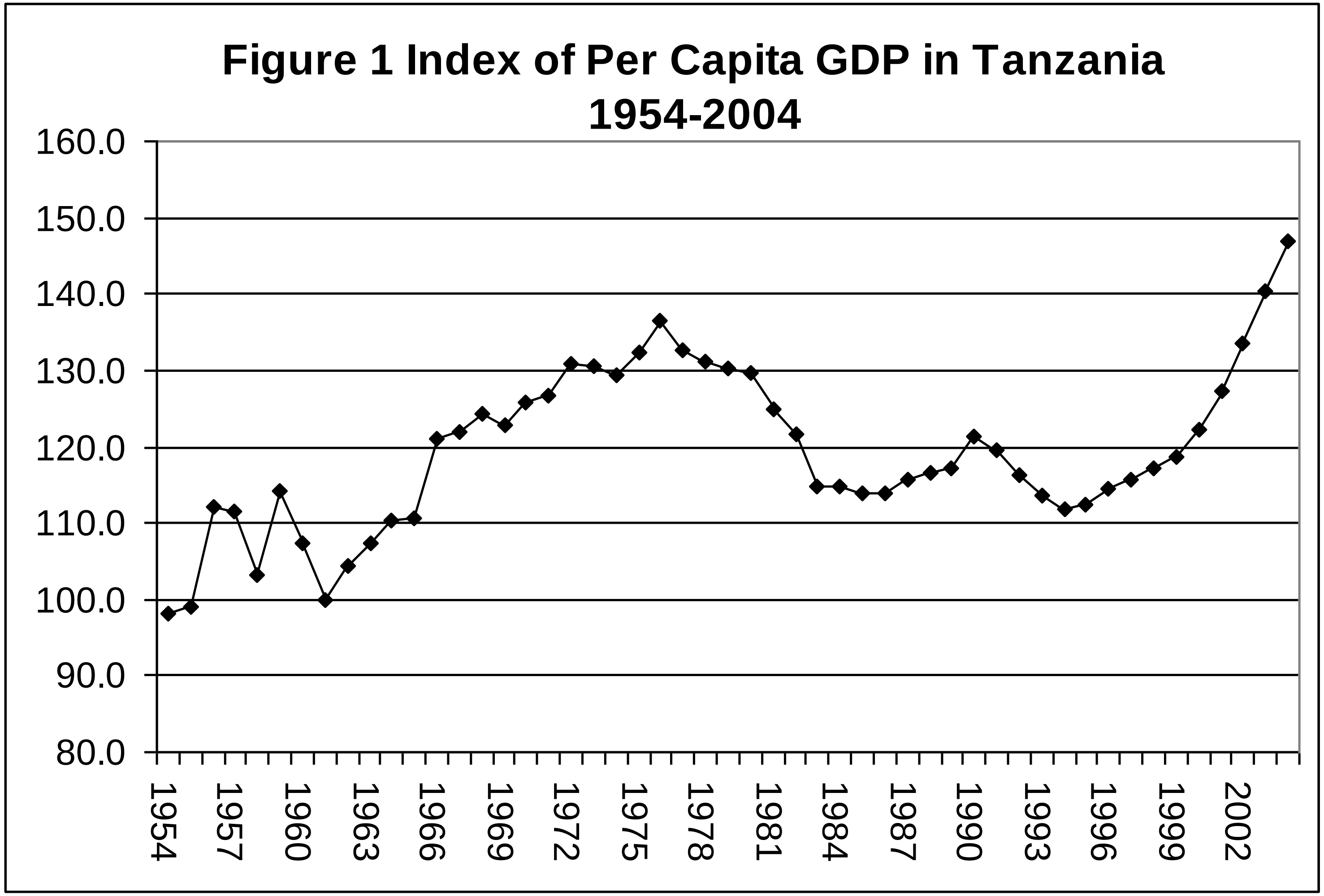
iii) The most recent and the oldest values in the series are likely to be the least reliable in the former case because of subsequent statistical revisions and in the latter case because of changes in trade composition.

iv) For consistency the joints should be made in the same years for both IUV and XUV series.

The series adopted was based on IMF (1976) for the period 1961-70, World Tables (1987, 1993 and 1995) for the period 1971-1990 and derived from World Development Indicators (2006) for the period from 1991 onwards. The margin of error for the most recent period is particularly great because of significant changes in trade structure, particularly for exports.

Annex C Compilation of the Real Exchange Rate Series

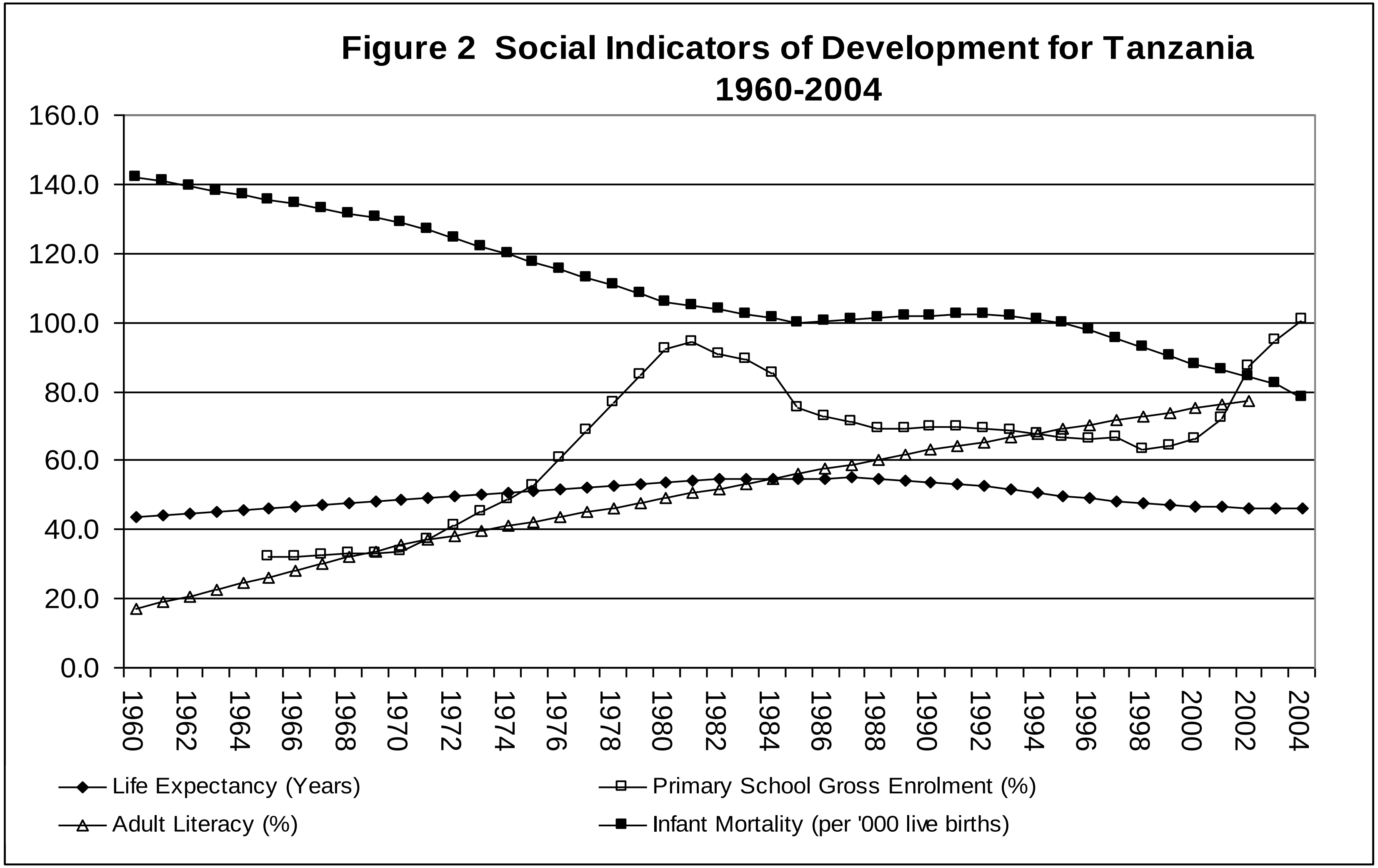
As with other series it was necessary to join a number of series together. Data for the period from 1961 to 1980 were derived from Krumm (1993), which in turn is based on IMF data. Data for the period 1981 to 1991 were derived from the World Bank African Development Indicators (1992 and 1998/9). Data for the period from 1992 to 2002 were derived from the World Bank Africa Database (2004). The final two years were derived from IMF (2005). Data from World Bank (1994) were referred to for cross-checking.



Sources: Compiled from: World Development Indicators (2006)

IMF International Financial Statistics (various issues)

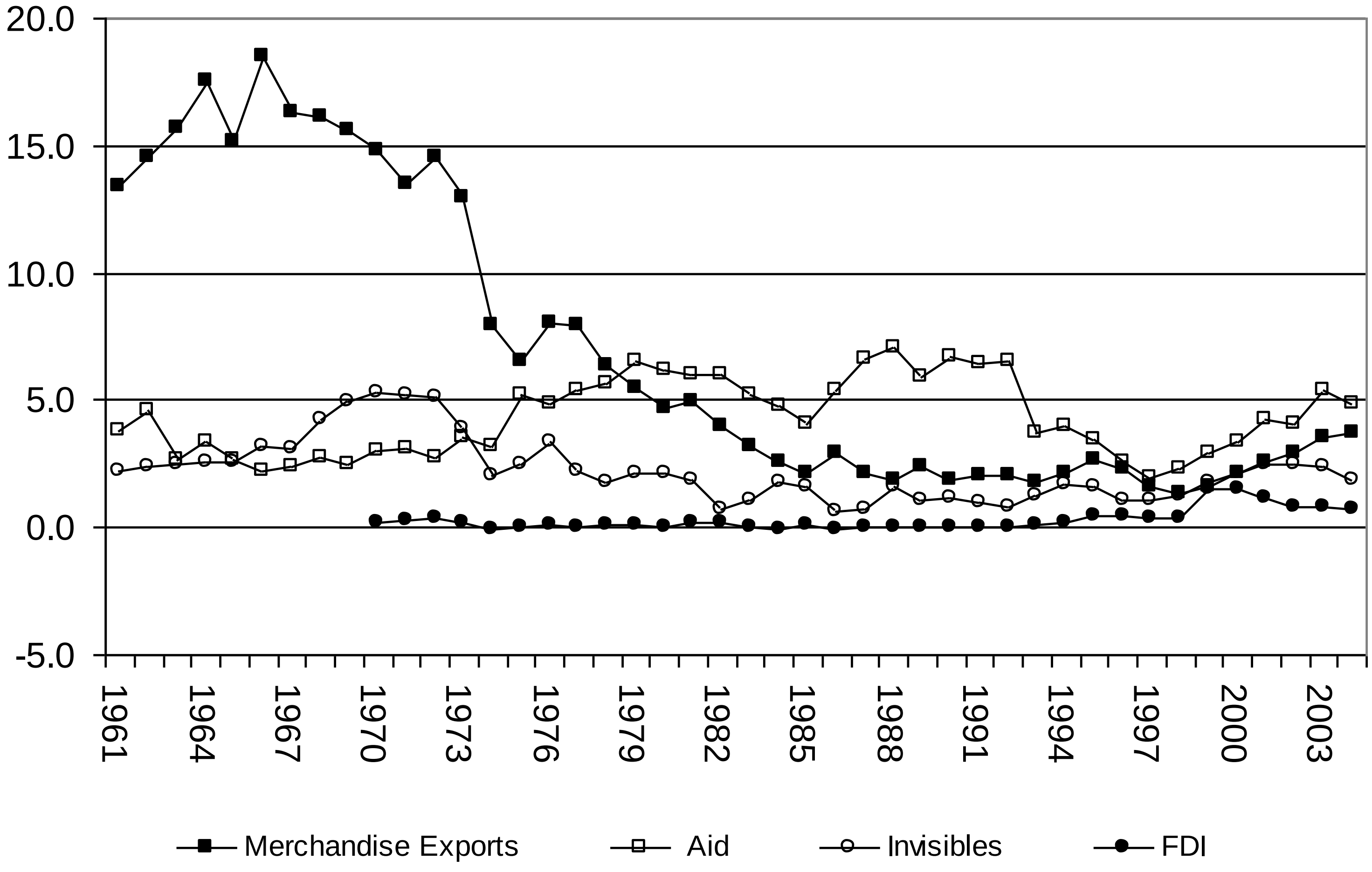
World Bank (1994)



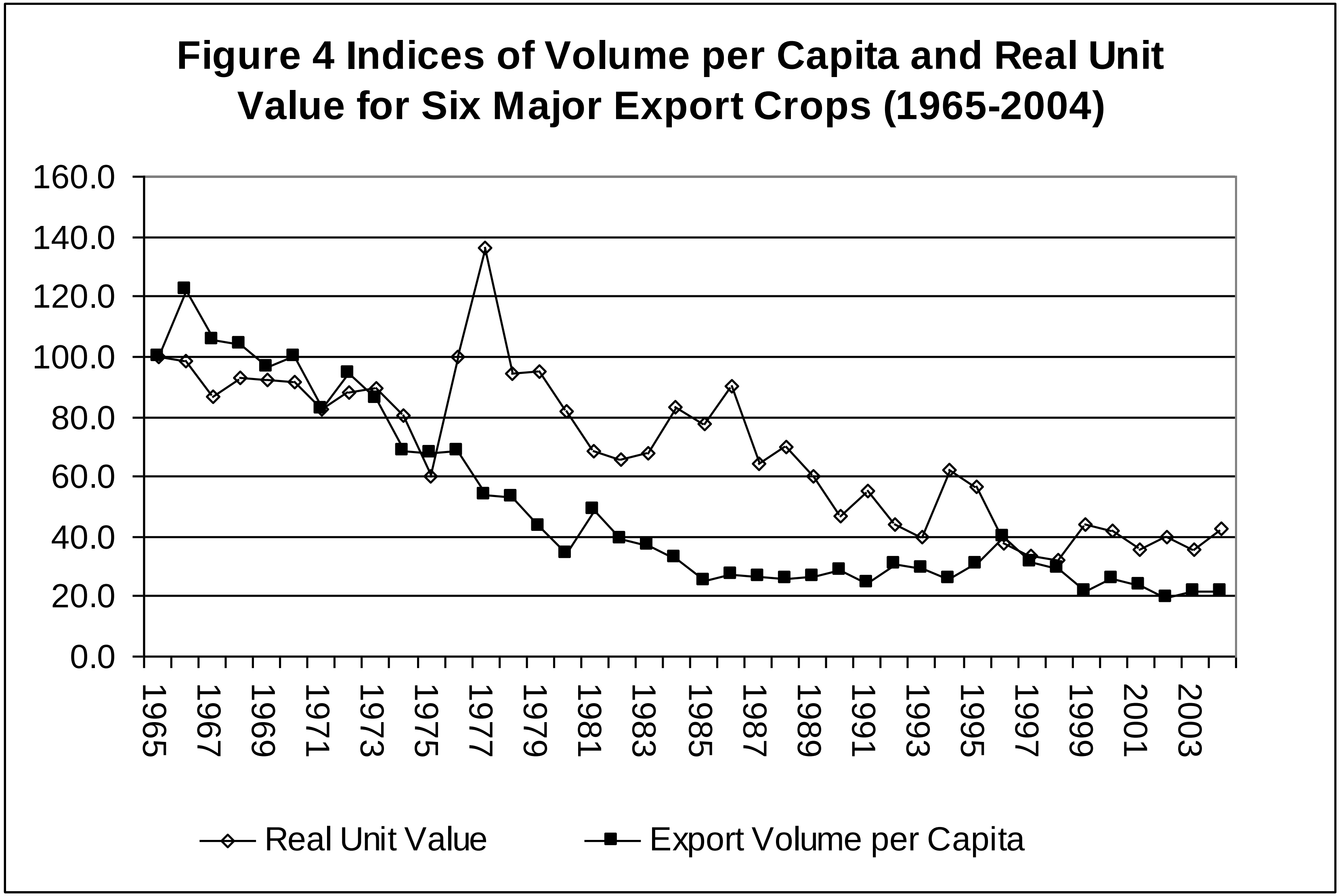
Sources: World Bank Africa Database 2004
World Development Indicators 2005 and 2006

Note: All series have missing years, which have been included by extrapolation between data points

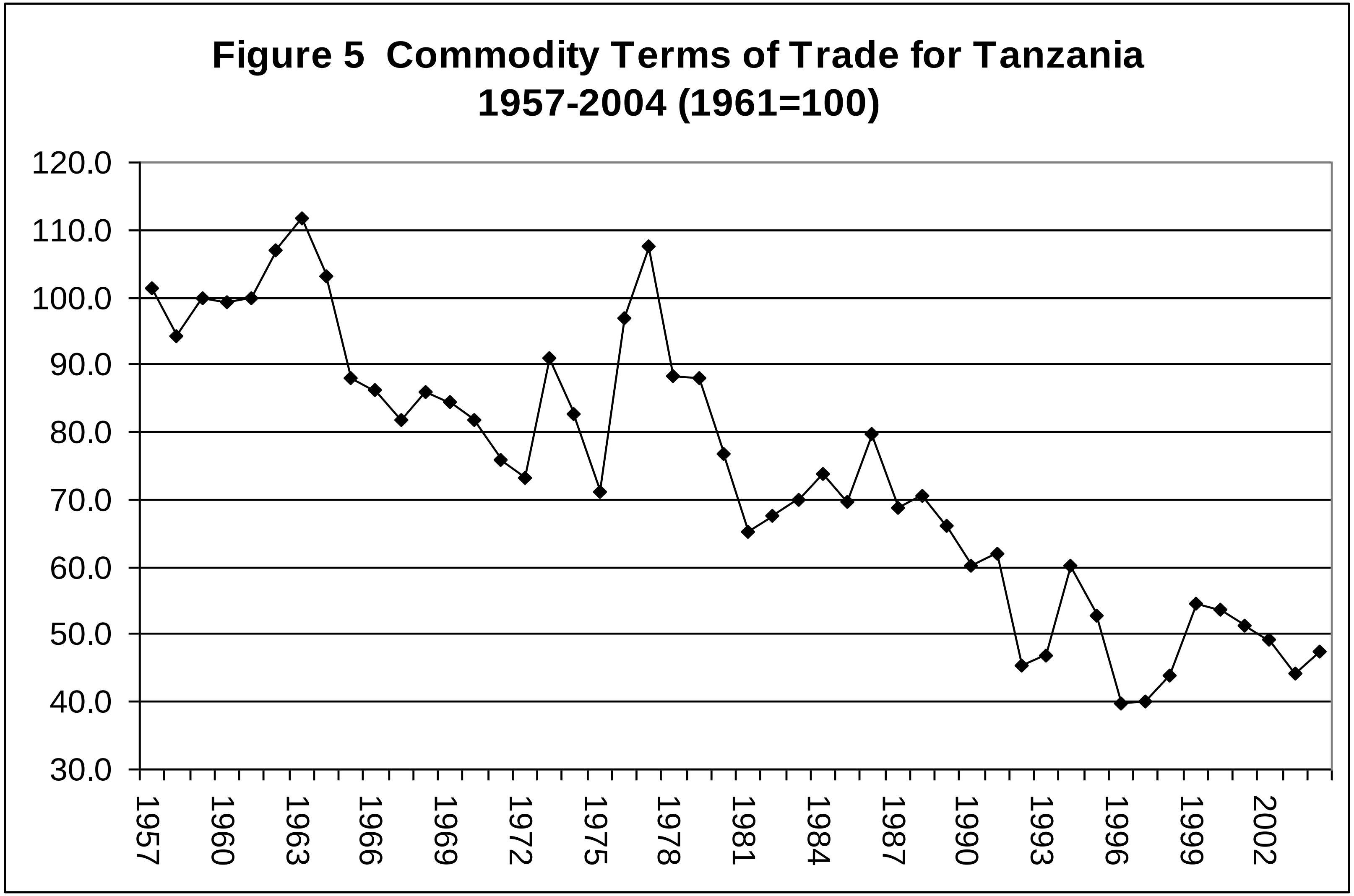
Figure 3 Per Capita Sources of Foreign Exchange 1961-2004 ($US constant 1961 prices)



Sources: Own estimates based on World Bank, IMF and Tanzanian government sources



Source: Own estimates based on World Bank, IMF and Bank of Tanzania data



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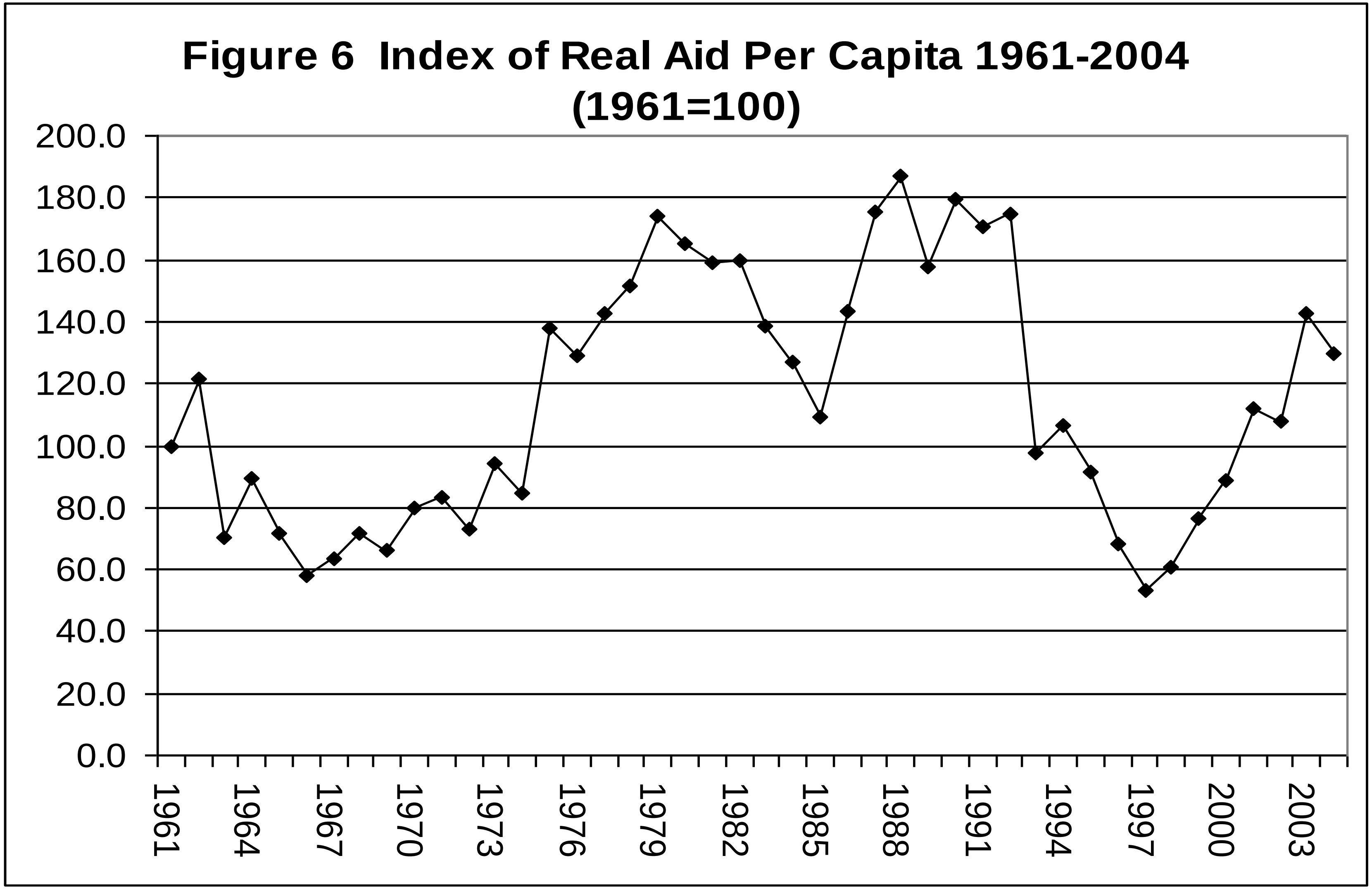
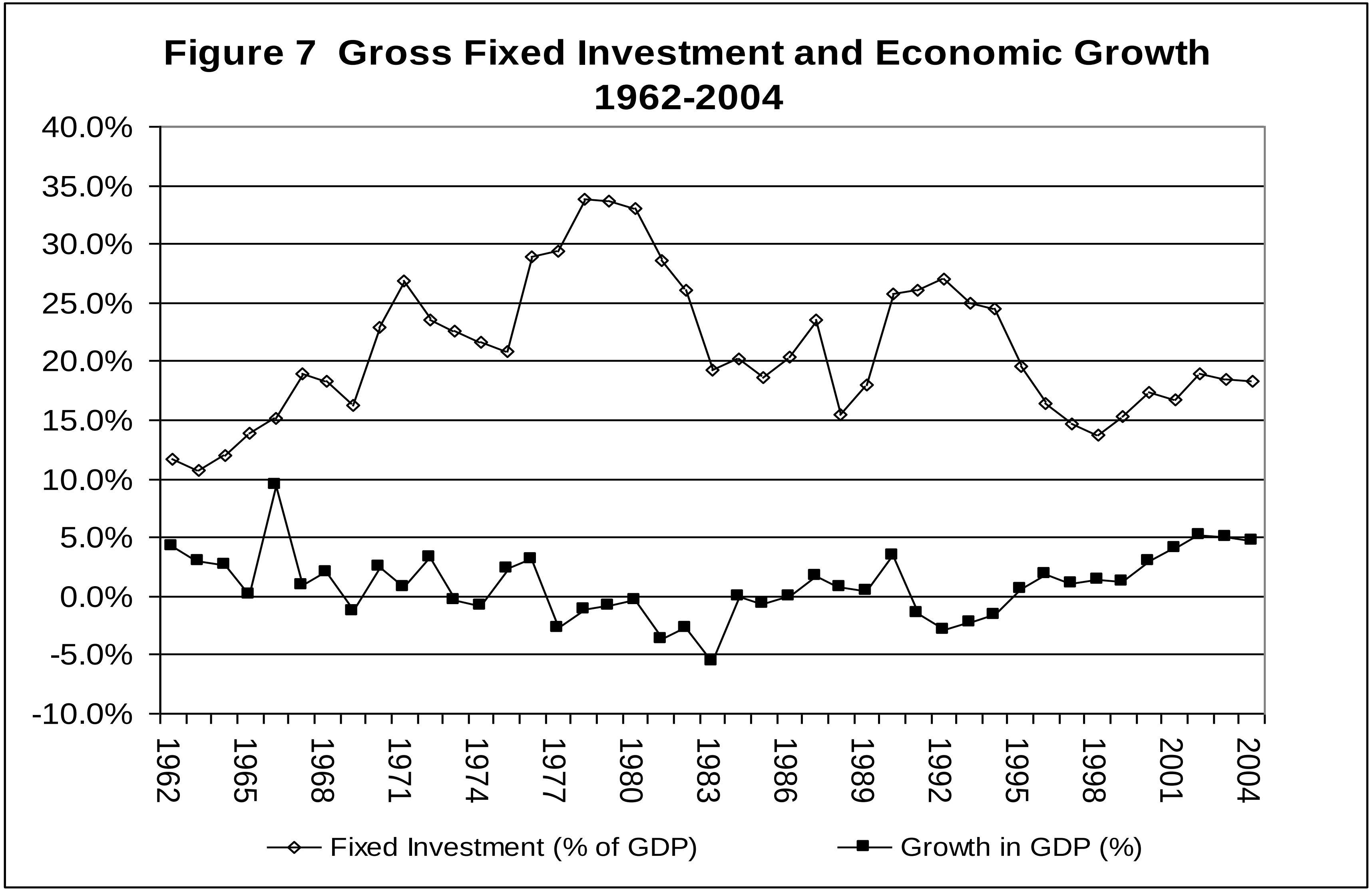
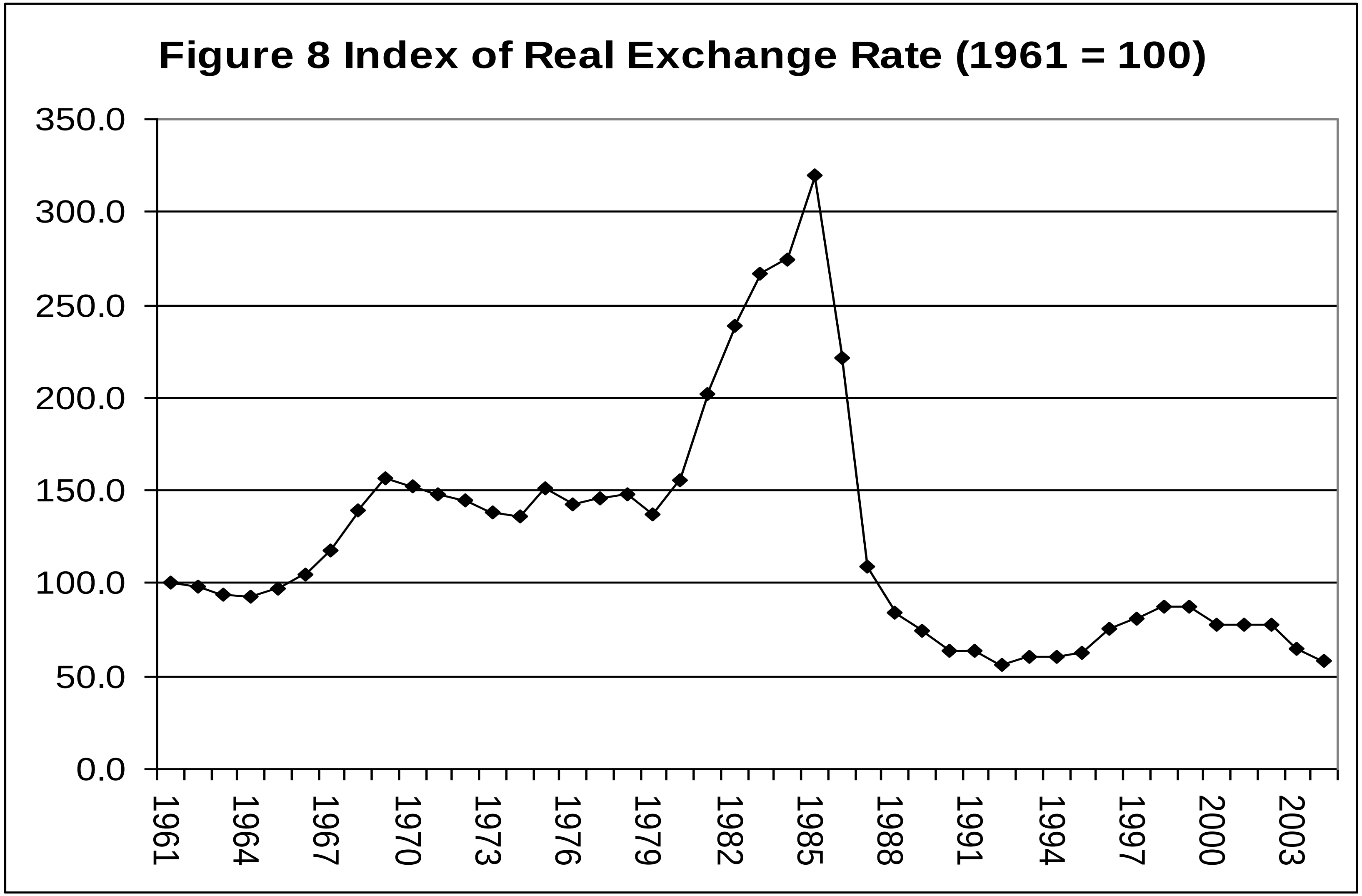


Source: Own estimates derived from World Development Indicators (2006)



Source: Own estimates based on World Bank sources



Source: Own estimates based on World Bank and IMF sources