Macroeconomic Policy Choices for Growth and Poverty Reduction

The Case of Tanzania

POLICY BRIEF

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Introduction

Tanzania is a poor country with per capita income of $290 (World Bank, 2004)[1]. The challenge of addressing the poverty problem has been high on the development agenda since early 1960s, soon after independence in 1961. The first independent government under the leadership of the President of Tanzania, Mwalimu Julius Nyerere, identified poverty as one of the three main challenges of development along with ignorance and disease. Therefore, early development efforts focused on addressing these challenges. This paper addresses the initiatives and approaches that Tanzania has taken to try to fight poverty.

The development strategy followed soon after independence adopted a mixed economy in which private investment was encouraged, including foreign direct investment. The disappointing shortfall in FDI inflows, coupled with political economic concerns those five years after independence when the economy was still largely in the hands of foreigners and Tanzanians of alien origin, led to changes of development strategy with a view to facilitating broader ownership of the major means of production and distribution. These concerns precipitated the Arusha Declaration of 1967 whereby Tanzania adopted the policy of socialism and self-reliance. This policy adopted nationalization as a way of putting the major means of production and distribution into the hands of the majority and, at the same time, the government adopted a development strategy which emphasized investment in human development consistent with a basic needs approach.

In fact, Tanzania made considerable achievements in human development during that period. However, that progress was interrupted by the economic crisis starting in the late 1970s and the early 1980s. In response, Tanzania adopted structural adjustment programs which were meant to focus on "getting prices right" with a view to achieving efficiency gains and growth acceleration. When these growth-oriented policies were found to be inadequate in terms of poverty reduction, Tanzania changed course and adopted policies, which sought to combine growth and social policy concerns. These three policy episodes are described in this paper.

It also describes the status of poverty in the country and proceeds to examine the relationship between growth and poverty, drawing from the literature on this subject. The relationship between macroeconomic policy and poverty reduction is examined, drawing on

1 World Bank. The Little Green Data Book. From the World development Indicators 2004. Washington, D.C. 2004.

some experiences on key macroeconomic policy issues and their relationship to concerns about growth and poverty reduction. It is argued that efforts can be directed to adapting macroeconomic policies with a view to making them more consistent with and supportive of poverty reduction initiatives. The paper examines the initiatives that are being taken to developing a sector in which the poor are actively engaged. It specifically addresses the case of agriculture-focused strategy for growth and poverty reduction in Tanzania. It highlights the major elements in the strategy, creating the complementarities between growth and redistribution. It addresses the challenges of generating an inequality-reducing pattern of growth on one hand and a growth-enhancing pattern of redistribution on the other.

Tanzania's Development Policy Experience: Three Policy Episodes

Since independence Tanzania has gone through distinct policy episodes that led to the development strategy packages with different focus and, subsequently, different poverty and growth outcomes.

In the context of the initiatives taken to fight poverty, three distinct policy episodes have been identified. First, Tanzania tried to reduce poverty by emphasizing social policy consistent with a basic needs approach (1967-1985). In the second policy episode, Tanzania switched to emphasizing orthodox growth policy consistent with the first generation of structural adjustment programs (1986-1995). Third episode initiatives have been directed towards combining social and growth policies culminating in the poverty reduction strategy paper (2000) and its revised version in 2004.

Social Policy Episode (1967-1985)

From 1967 Tanzania adopted a policy of socialism and self–reliance, which was promulgated in the Arusha Declaration. The implementation of the Arusha Declaration put the major means of production under the state through nationalization and a large part of subsequent investments occurred in the public sector with a large share going into the social sectors, which were deemed to be capable of contributing to human development within a short time. The development strategy was more in line with the basic needs strategy at the time. Major investments were made in basic social services such as education, health, water, and sanitation. This was done through central government investment programs underpinned by a basic needs approach and facilitated by considerable inflows of aid, especially in the 1970s. In fact, while Tanzania made considerable achievements in human development during this period, progress was stretched to its limits towards the end of the 1970s. In general, life expectance at birth rose from 41 years in 1960 to 52 years in 1980. Also, infant mortality declined from 146 per thousand live births in 1960 to 120 per thousand live births in 1980. Considerable achievements were recorded in school enrolment, adult education and health development. Perhaps the most remarkable achievement was the literacy rate, which was only about 33 per cent in 1970 and by 1985 had gone up to about

90 per cent, notably the result of Universal Primary Education, combined with adult education program. By the early 1980s, this development appeared to have been interrupted by the economic crisis, which deepened in the early 1980s.

While output growth was generally positive, averaging 3.5 per cent during the 1970s, this growth slackened during the second half of the 1970s. Growth of agriculture, which was the mainstay of the economy, was just modest, averaging about 2.1 per cent. This happened mainly because little attention was given to resource allocation to agriculture. During the 1966-70 period, agriculture received only nine per cent of fixed capital formation. Instead the agricultural sector was subjected to numerous administrative controls, including heavy taxes reflected in a low share of prices going to producers.

These achievements in the key social indicators could not be sustained, partly because there was not enough output growth to guarantee the sustainable flow of required resources that would sustain the social sectors in the economy. Towards the end of the 1970s and in the early 1980s, Tanzania experienced a deep economic crisis in which major macroeconomic variables were out of balance. Inflation was high, at around 30 per cent. The budget was in deficit. Balance of payments were in deficit, Shortages of goods were widespread and the productive capacities were underutilized following shortages of foreign exchange to finance imported inputs. As a result, access to and quality of basic social services declined.

Policy for Efficiency and Growth (1986-1995)

In response to the economic crisis of the late 1970s and early 1980s, Tanzania embarked on an economic recovery program under the IMF, as well as the World Bank sponsored Structural Adjustment Programs in 1986. Under the Economic Recovery Program (1986-89), Tanzania adopted stabilization measures, macroeconomic policy reforms and reforms in trade and the exchange rate regime. The outcome of these reforms is that access to additional external support was enhanced and the decline of the economy was halted with output growth recovering to about four per cent per annum. Towards the end of the 1980s, the economic recovery process began to address concerns about poverty reduction as a result of the social dimensions of structural adjustment in the late 1980s. The formulation of the Economic and Social Action Program (1989-92) was partly an attempt to take on board the social dimensions of adjustment. The social dimension, however, was introduced as an "add on" rather than being integrated in the policy making process. The fact that poverty is multidimensional and cross cutting was not appreciated at that time.

In general the shift in management of the economy towards market orientation and private sector development eased the otherwise tight control system and generated initial growth that way. However, the growth recovery could not be sustained as it soon came up against infrastructural bottlenecks and an institutional framework that was inappropriate for a market economy and private sector development. Institutional reforms were needed. In spite of liberalization, the past 15 years have seen the lives of ordinary people in villages being affected more by deeply established institutions and the way they function. It is well known that institutions change much more slowly than the structures in which they are contained.

Initiatives to Combine Growth and Social Policy (1996-2004)

By the mid-1990s, it became apparent that the adjustment and stabilization measures had resulted in erosion in the previous gains in social development in the country. Tanzania started to address poverty as a major policy concern. These initiatives coincided with the World Bank's introduction of the Comprehensive Development Framework, which essentially recognized that development had to be pursued in a comprehensive manner, taking into account economic as well as social and political processes. It is in this context that the international financial institutions (IFIs) came up with the concept of Poverty Reduction Strategy Papers (PRSP) tied to Highly Indebted Poor Countries (HIPC) debt relief funds. The Tanzania government responded quickly to the demand to prepare a PRSP in order to gain access to the HIPC debt relief resources.

The PRSP approach has brought poverty reduction policy in line with the fiscal framework, promoted a more participatory approach to public policy-making and helped the government to adopt a policy of eliminating primary school fees. The PRSP process has made the availability of resources for poverty reduction more predictable and, in general, there have been significant improvements in public expenditure management and the poverty reduction strategy has been subjected to reviews annually since 2000, giving room for improvements as lessons were learned in the process of implementation.

Drawing lessons from experience with PRSP, the preparation of the revised PRS known as the National Strategy for Growth and Reduction of Poverty (from end of 2003) has made at least three major departures from the earlier PRSP. First, the coverage has been expanded to include growth concerns along with the two other clusters: (1) human development and social well-being and (2) governance. The broadened coverage of PRSP has warranted the change of name of the document to the National Strategy for Growth and Reduction of Poverty. Second, the consultative process has been broadened and deepened in the sense that more time was allowed for consultations and all regions in the country managed to hold consultations. Third, the strategy has become based on outcomes and results rather than on identifying a few priority sectors. The priority of a sector is not as important as the contribution a sector makes to growth and poverty reduction.

Economic Growth and Poverty Reduction

The relationship between growth and poverty lies at the heart of development economics with recent empirical studies showing that that economic growth is important for poverty reduction. However, it has also been recognized that the distribution of assets, opportunities and incomes influences the effect of growth on poverty reduction. For poverty reduction to occur, the relevance of distribution and, as well, the importance of sources of growth has been underscored. The challenge is to influence the pattern of growth such that propoor growth is generated.

Poverty can be categorized into income poverty and non-income poverty, reflecting human development attributes. Poverty in Tanzania is pervasive with some 18.7 per cent of Tanzanians living below the food poverty line and 35.7 per cent living below the basic needs poverty line. Poverty is largely a rural phenomenon, as 87 per cent of all the poor live in rural areas. Primary schools with gross enrolment reached 98.6 per cent in 2002 compared to 77.6 per cent in 1990, with net enrolment rising from 58.8 per cent in 1990 to 80.7 per cent in 2002. The illiteracy rate is still high at 28.6 per cent. Access to health services has shown modest improvement with 70 per cent of the sick visiting health facilities. Access to health facilities is generally limited by the system of user charges (cost sharing) coupled with a weak screening system for identifying deserving cases for exemptions. Distance to health facilities is another factor hindering access. The population that has access to clean water is 53 per cent in rural areas and 73 per cent in urban areas.

In the early 1990s, economic performance was extremely weak, with growth in GDP often less than the growth in population. Growth appears to have increased steadily since the mid-1990s when greater effort was put into institutional reforms. By 2002, the growth rate had reached 6.2 per cent, although it declined somewhat to 5.7 per cent in 2003, following the effects of drought. The most recent information on poverty trends in Tanzania shows that, in spite of the rising rate of economic growth, the declines in income poverty for the last decade were very modest. The key challenge is whether, and to what extent, growth will translate into poverty reduction over the coming years. Two crucial issues have been raised regarding these achievements. The first issue relates to the sustainability of economic growth itself – whether such growth rates, high by historical standards, will continue and reach eight per cent as envisaged in Vision 2025. The second issue relates to whether this growth will be translated into poverty reduction, contrary to the experience of the last decade. This will depend on the sources of growth and how the gains from growth will be distributed among households.

Macroeconomic Policies and Poverty Reduction

The poverty focus of macroeconomic policies calls for a new framework that can capture some of the tradeoffs and distributional implications of traditional macroeconomic policies and shocks. Macroeconomic polices that are meant to achieve pro-poor growth need to have the elements to address the distributional impact of growth. Growth is pro-poor if it uses assets that the poor own, if it favours sectors in which the poor work and if it occurs in the areas where the poor live. These points, however, are rarely decoded into detailed reforms to make policies pro-poor in practice. Pro-poor policies imply that the social and economic indicators of poor people improve more rapidly than those of the rest of society.

Macroeconomic policies are likely to stimulate pro-poor growth by addressing two main issues. First, macroeconomic policies may be designed to contribute to enhancing the basic human capabilities of the poor. It has been argued that universal coverage of basic social services of good quality is key for ensuring equitable growth. Second, macroeconomic policies may be designed to contribute to fostering the concentration of growth in economic sectors that can directly benefit the poor. Different sources of growth affect poverty and inequality differently because they affect factor returns differently, and because the poor and the non-poor own factors in different proportions. Poverty reduction is more likely to be achieved when a significant share of growth originates from sectors in which the poor are active. The major challenge to researchers is, therefore, to identify policies or a combination of policies that generate growth without adverse distributional effects or, even better, generate pro-poor growth with improving distributional effects.

In the context of Tanzania, recent experience has shown that in the macroeconomic policy area, two main areas deserve special attention if macroeconomic policy is to be more supportive of pro-poor growth.

First is fiscal policy whereby tax policy issues regarding effort, efficiency and equity are still on the agenda. Tax reforms have been driven by the need to broaden the tax base and rationalize the tax system. Tax measures that have been taken recently have been directed to stimulate investment and production in general. However, large-scale investors have been given greater tax relief through Tanzania Investment Centre (TIC) certificates, which are only available to investors above a specified investment threshold. Small investors in the SME sector rarely hold TIC certificates.

On the public expenditure side, the challenge of making expenditures pro-poor lends itself to setting priorities, targeting and allocating expenditures according to priorities and targeted programs. The recent opportunity to enhance allocations to social sectors, following HIPC debt relief, has improved allocations to these sectors.

Second is monetary policy and financial sector reform. Monetary policy that has been adopted in Tanzania has been driven by the goal of price stability. The target has been low inflation. Overall, it can be observed that high inflation rates hurt the poor most. Therefore, reducing inflation rates that has been done so far can be regarded as a pro-poor policy move. However, there is concern that the narrow focus on price stability is not sufficient for poverty reduction to be realized. There is need to make monetary and fiscal policy consistent with and supportive of poverty reducing objectives such as growth and employment. On the side of financial sector reform, the opportunity for these reforms to be pro-poor has largely been missed to the extent the sectors which have least access to financial services are groups which are associated with poor people, such as SMEs and rural activities.

Agricultural Growth for Poverty Reduction

Poverty in Tanzania is predominantly a rural phenomenon. Therefore, to the extent the majority of the poor derive their livelihood in agriculture, an agriculture-focused growth strategy stands out to be the best option for sustainable economic growth and poverty reduction in Tanzania. The challenge is to influence the internal growth of agriculture in a way that will not exclude the majority of the poor within that sector.

Following the identification of agriculture as a sector in which the majority of the poor derive their livelihood, the government has prepared an agricultural development strategy as an integral component of macroeconomic reforms and structural reforms. Modernization of agriculture and raising productivity in that sector is given high priority in Tanzania's Development Vision 2025 (1998) and in PRSP (2000), as well as in the revised poverty reduction strategy, MKUKUTA (2004). The development of agriculture is seen as an effective strategy for poverty reduction, addressing food security and contributing to growth of the economy. The strategy is to make the macroeconomic policy environment favourable for private investment in agriculture and to put in place sector-specific policies that have important bearing on agricultural productivity and profitability.

The agricultural sector development strategy is accompanied by the Rural Development Strategy (RDS), which provides a strategic framework that will facilitate the coordinated implementation of sector policies and strategies for the development of rural communities. RDS has several dimensions, such as attaining high quality livelihood, creating an enabling environment for people's empowerment, attaining self-reliance and self-sustenance and trade and international competitiveness. It is recognized that diversification in the rural economy can be promoted through diversification within agriculture, promotion of agro-processing and agribusiness in general and support for the development of other non-farm activities in rural areas.

Conclusion

While Tanzania declared as a priority poverty reduction right from the early post-independence years, the linkage between growth and poverty reduction is a relatively recent phenomenon. Notwithstanding early and impressive gains, particularly in the areas of basic health, education and social infrastructure, expanding government social programs without attention to policies for economic growth and strengthening capacity and participation at the local level proved ill-fated. One obvious observation is that pre-reform efforts to reduce poverty in Tanzania failed partly because of lack of sound macroeconomic policies to ensure robust growth and stability. Little attention was paid to the fact that economic growth and stability were also important in creating the capacity to effectively address poverty reduction. The shift from concerns about human development in the first policy episode (1967-1985) to concerns about growth and efficiency in the second policy episode (1986-1995) went to the other extreme where poverty concerns were neglected. The outcome was not favourable for poverty reduction either. These experiences suggest that there is a need to strike a balance between growth and poverty concerns and face the challenge of pursuing poverty reducing growth.

The experience with the macroeconomic stabilization packages that have been implemented so far shows that they have not been accompanied by a rigorous assessment of poverty and social impact. Effort has not been put into ensuring that macroeconomic policy is consistent with pro-poor growth. The major challenge, therefore, is to identify policies or a combination of policies that generate pro-poor growth. It has been shown that policy reforms supervised by the IFIs have been implemented largely with little attention to the type of growth that should be generated. In many respects the macroeconomic policies that were followed did not facilitate supply response from the poor or from the sectors in which the poor are active.

Recent initiatives have been directed to the agricultural-led development strategy in order to benefit the majority of the poor who are active in that sector. Agriculture is now regarded not only as an important source of growth due to its large share in the economy but also as an important contributor to poverty reduction to the extent the majority of the poor are active in that sector. It is too early to assess the outcome of this new policy stance but the strategy is to make the macroeconomic policy environment favourable for private investment in agriculture and to put in place sector-specific policies that have important bearing on agricultural productivity and profitability. The challenge is to influence the internal growth of agriculture in a way that will be more inclusive of the majority of the poor within that sector. However, it is also recognized that linkages between agriculture and other sectors in the economy provide a better opportunity for ensuring that agricultural growth stimulates the kind of growth that is effective in terms of poverty reduction. This suggests that poverty reduction can be best realized if priority in resource allocation is extended to investments outside agriculture, notably rural infrastructure, rural finance and investment in complementary economic activities, such as agro-processing and other agribusiness activities. In the past, institutional problems frustrated agricultural development. The current strategy has correctly placed emphasis on strengthening the institutional framework for managing agricultural development in the country, covering both public and private institutions.