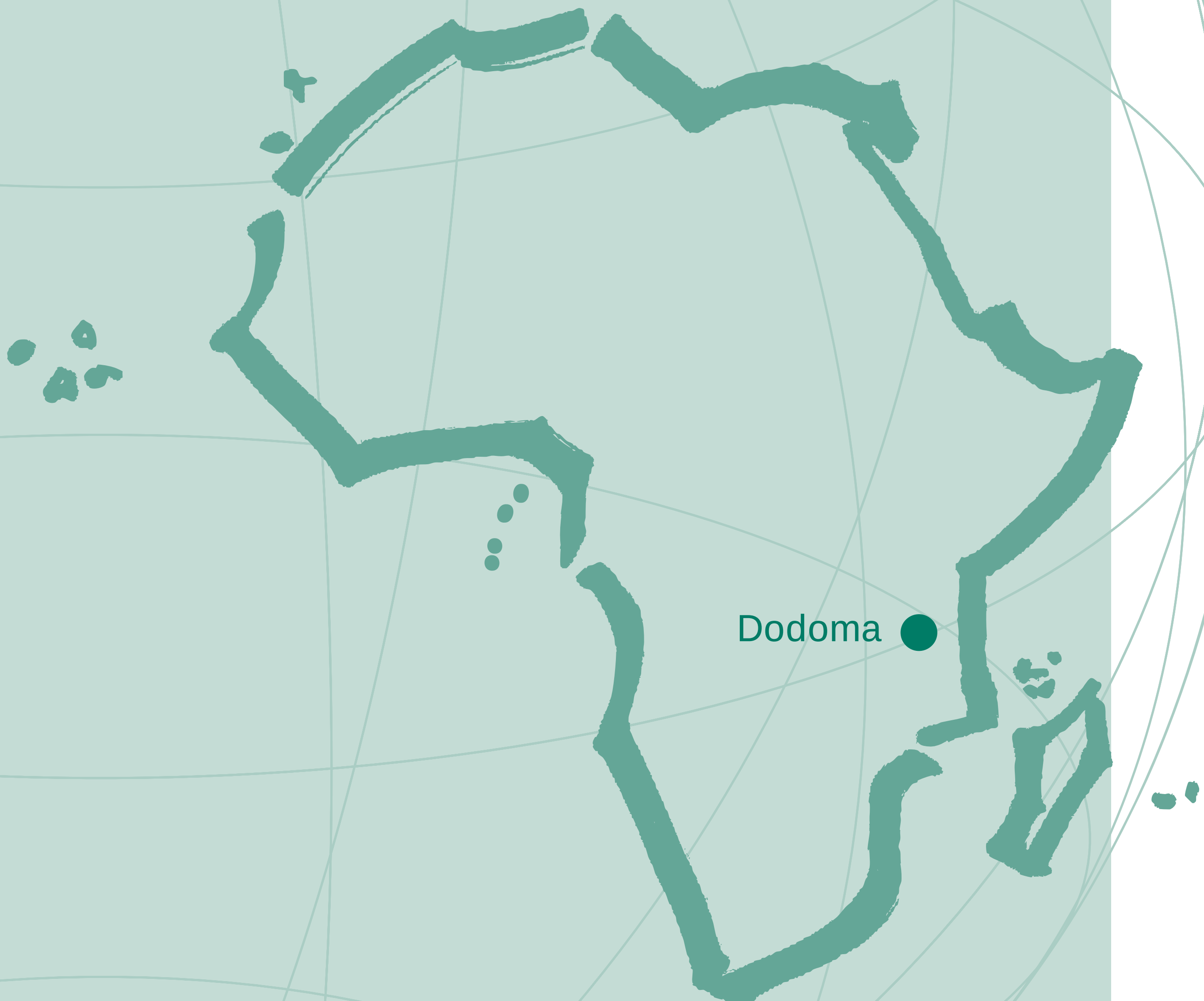
Tanzania



key figures

- Land area, thousands of km² 945
- Population, thousands (2004) 37 671
- GDP per capita, $ (2003) 278
- Life expectancy (2000-2005) 43.3
- Illiteracy rate (2004) 20.9

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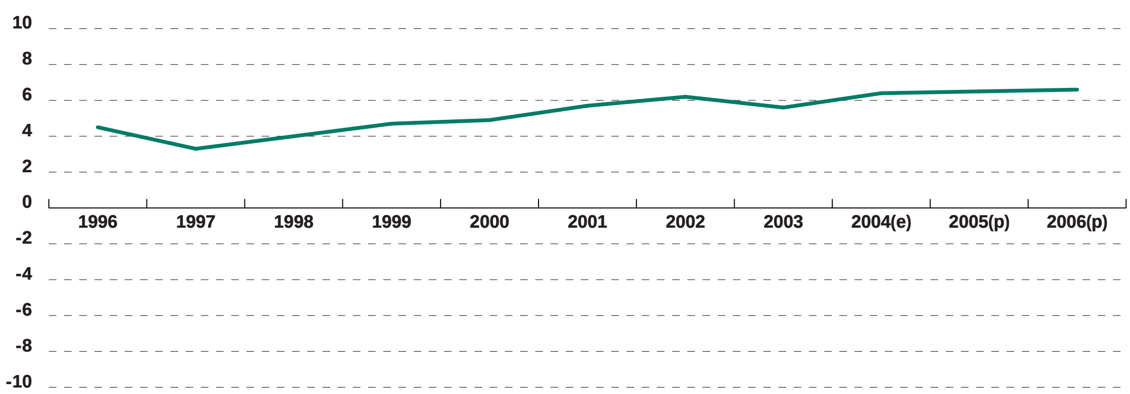
Tanzania

SINCE 1995, TANZANIA has successfully pursued economic reforms, resulting in accelerating economic growth and decelerating inflation. Strong growth and fiscal restraint in spite of a serious drought in 2003, demonstrates an impressive resilience. GDP growth has been 5.6 per cent in 2003 and is estimated at 6.4 per cent in 2004[1]. Yet, the share of manufacturing in GDP has only slightly increased from an average of 8.3 per cent during 1997-99 to an average of 8.4 per cent during 2001-03[2]. Growth in manufacturing is expected to take off soon due to various recent policy measures. Significant progress has been made in terms of increasing the share of exports in GDP which has increased from an average of 17.1 per cent during 1997-99 to 26.9 per cent during 2001-03. This progress in Tanzania's export growth along with reaching the Heavily Indebted Poor Country (HIPC) Initiative completion point in 2001 and an accelerated shift of donors from loans to grants, make Tanzania's external debt under current projections relatively sustainable. Yet, the current exploitation of natural resources, especially of gold, upon which most of Tanzania's export growth rests, will not be sustainable in the long term. As described in Tanzania's first Poverty Reduction Strategy Paper (PRSP), Tanzania has implemented an ambitious poverty reduction strategy during 2001-04, concentrating on primary education, roads, water and sanitation, the judiciary, health and agriculture. The PRSP has been updated via progress reports in August 2001, March 2003 and March 2004. In November 2004, the government of Tanzania (GoT) concluded its second PRSP, the *National Strategy for Growth and Reduction of Poverty (NSGRP)*. Tanzania's efforts have resulted in considerable progress in some social indicators, including increases in the net enrolment ratio for primary schooling (from 59 per cent in 2000 to 89 per cent in 2003), an increased ratio of the population with access to water (from 32 per cent in 1990 to 58.3 per cent in 2003), and a general decrease in poverty (measured in terms of consumption of basic goods and services). The country also enjoys political stability with elections set for 2005. Nonetheless, Tanzania remains one of the poorest countries of the

Sustained strong economic performance and high levels of donor support offer the opportunity to break out of the poverty cycle.

Figure 1 - Real GDP Growth



Source: IMF and domestic authorities' data; estimates (e) and projections (p) based on authors' calculations.

1. There are considerable differences in Tanzania between real GDP growth rates based on GDP at market prices and GDP at factor costs, with the latter lower than the former. For reasons of consistency with some other low-income countries as well as last year's AEO, real GDP growth rates are reported here based on GDP at factor costs.
2. Three-year averages are provided to minimise the impact of temporary fluctuations.

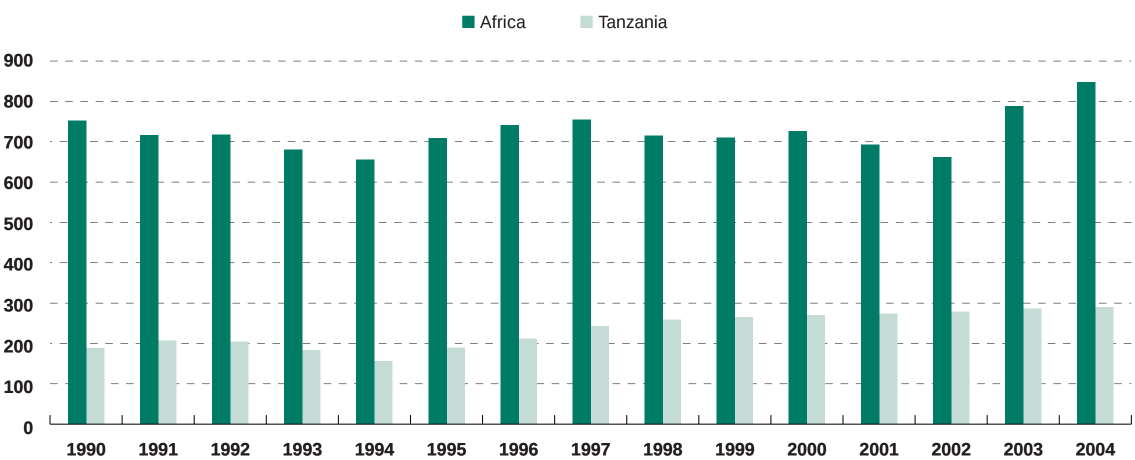
world and is highly dependent on foreign aid. In addition to maintaining macroeconomic stability, sustainable growth and poverty reduction require further structural reforms, especially in areas such as agriculture, infrastructure and the legal system. Tanzania has been identified as a likely candidate for the Millennium Development Goal (MDG) fast-tracking which, if realized, would give Tanzania a considerable boost in terms of poverty reduction and growth[3].

Recent Economic Developments

Building on the macroeconomic stability achieved since the mid-1990s, the economy is enjoying growing resilience against adverse shocks. This became apparent in 2003, as the economy grew at 5.6 per cent in real terms despite a drought, following 6.2 per cent growth in 2002. Based on resurgent agricultural growth, real GDP growth in 2004 is projected to reach 6.4 per cent. Assuming that currently favourable developments in the manufacturing and mining sectors will continue, the authorities target an average real GDP growth rate of nearly 7 per cent over the medium term. Reflecting the unfavourable weather conditions in 2003, the share of agriculture fell slightly from 47.5 per cent in 2002 to 46.7 per cent in 2003, while strong growth in the industry sector has resulted in its increase from 22.1 per cent to 22.8 per cent of GDP. The share of the service sector decreased marginally from 35.1 per cent to 35 per cent of GDP[4] as industrial production grew stronger than the service sector.

Over the last few years, Tanzania has made progress in growing drought-resistant crops, of which a few are traditional crops in some areas. The drought resistant crops have maintained real agricultural growth at a respectable 4.1 per cent during the 2003 drought year. Yet, the effects of the drought would have been mitigated even further if distribution channels across regions within Tanzania, especially from surplus to deficit regions, were further developed. Given the lack of such channels and the preference to move some food crops across borders (aided by the Cross Border Trade Initiative), food security remains a critical issue in Tanzania. Furthermore, the agricultural sector remains constrained by weather conditions, the small size of farms, and inadequate use of technology. The GoT continues to support sustainable growth in the agricultural sector through efforts to attract large-scale

Figure 2 - GDP Per Capita in Tanzania and in Africa (current $)

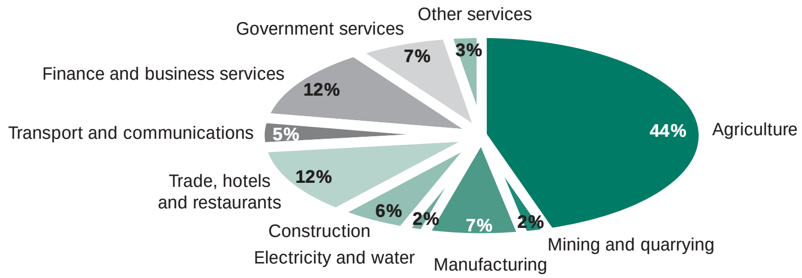


Source: IMF.

3. See the Millennium Project's Report to the UN Secretary-*General Investing in Development – A Practical Plan to Achieve the Millennium Development Goals*, January 2005.

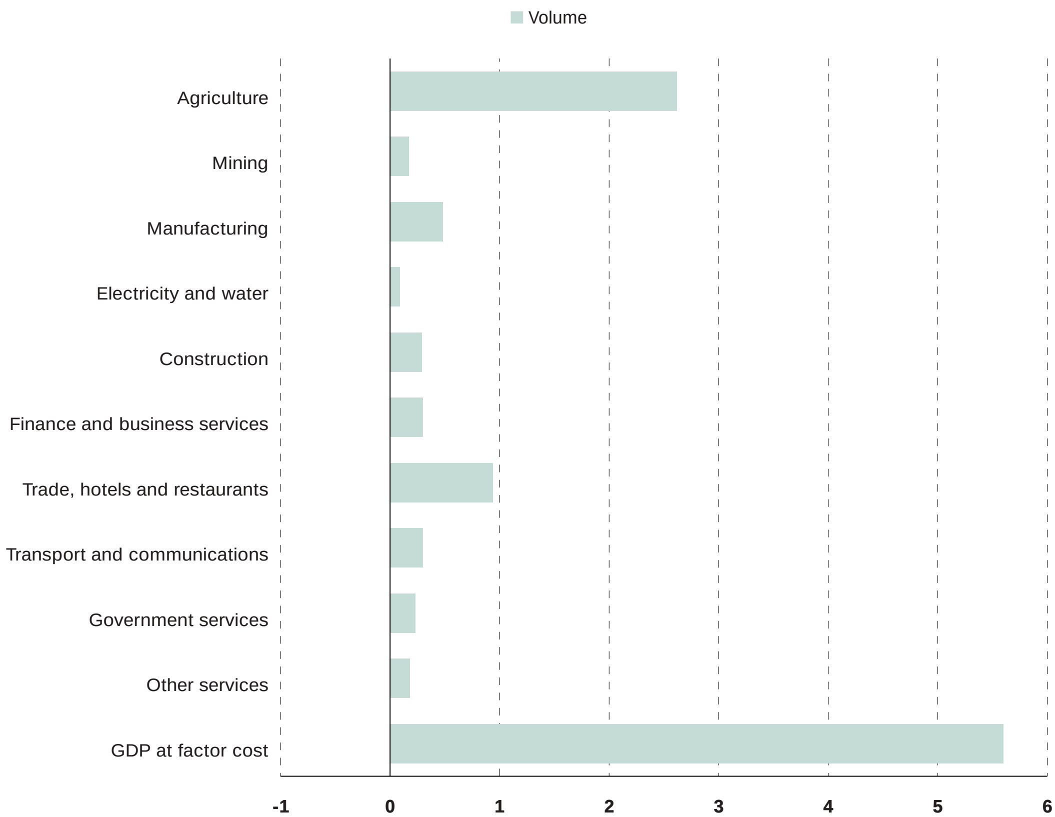
4. The shares of agriculture, industry and services add up to more than 100 per cent as imputed bank service charges, amounting to about -4.7 per cent of GDP in both years, are not allocated to the various sectors.

Figure 3 - GDP by Sector in 2003 (percentage)



Source: Authors' estimates based on IMF and domestic authorities' data.

Figure 4 - Sectoral Contribution to GDP Growth in 2003 (percentage)



Source: Authors' estimates based on IMF and domestic authorities' data.

investments, subsidies to the transportation of fertiliser in the main cereal producing regions, increased funding for agricultural research and extension services, and the strengthening and rationalisation of the export credit guarantee scheme.

The industrial sector's rapid growth is mainly due to strong performances in manufacturing, construction, and especially in mining and quarrying. For the fourth year running, mining and quarrying output grew more than 13 per cent in real terms, reaching a growth rate of 17 per cent in 2003. Real growth in construction had reached 12 per cent in both 2002 and 2003, while real growth in manufacturing was 8 per cent in 2002 and 8.6 per cent in 2003. Electricity and water are the weakest growing subsectors, yet have each grown at about 5 per cent in 2003. While industrial sector growth is unlikely to maintain these exceptional rates in the long run, preliminary estimates for 2004 indicate that the industrial sector boom is continuing, at least in the near term.

Within the service sector, the hotels and restaurants subsector continues to exhibit the fastest growth, notwithstanding a slight decline from 7 per cent in 2002 to 6.5 per cent in 2003. Transportation and communications growth fell to 5.1 per cent in 2003 from 6.4 per cent in the previous year, partly due to the rise in fuel prices and the slowdown in the agricultural sector. Public administration is the most stagnant sub-sector within the service sector, growing at 3.8 per cent during 2003 (the same as in 2002). Financial and other services continued to grow at around 5 per cent in real terms. Preliminary estimates for 2004 indicate healthy growth in the service sector, with the strongest growth in the transportation and communications subsectors.

The expenditure composition of GDP reveals an increase in the shares of both private and public consumption, and a decrease in the shares of investment and domestic savings in 2003. The share of private consumption in GDP increased from 80.7 per cent in 2002 to 83.8 per cent in 2003 (partly due to changes in consumption patterns moving towards quality education and improved health services), while the share of public consumption in GDP increased from 6.3 per cent in 2002 to 6.5 per cent in 2003. While the shares of investment and savings in GDP decreased from 19.1 per cent and 12.9 per cent in 2002 to 18.6 per cent and 9.7 per cent in 2003 respectively, real investment grew, while savings fell even in nominal terms. In response to measures taken in fiscal year (FY) 2004/05 to boost savings and investment, preliminary results for 2004 indicate a recovery in savings and a significant increase in investment (see Table 1). As will be described in more detail below, the new measures include the creation of collective investment schemes, the establishment of a credit reference bureau, and improvements in the operations of credit guarantee schemes that aim at encouraging financial institutions to lend.

Table 1 - Demand Composition (percentage of GDP)

	1996	2001	2002	2003	2004(e)	2005(p)	2006(p)
Gross capital formation	**16.6**	**17.0**	**19.1**	**18.6**	**21.4**	**21.2**	**22.4**
Public	3.5	5.6	7.6	7.4	8.9	9.2	8.7
Private	13.2	11.4	11.6	11.2	12.4	12.0	13.7
Consumption	**95.4**	**91.2**	**87.1**	**90.3**	**89.2**	**91.1**	**90.1**
Public	11.6	6.2	6.3	6.5	7.1	7.8	7.5
Private	83.8	85.0	80.7	83.8	82.1	83.3	82.6
External sector	**-12.0**	**-8.2**	**-6.2**	**-9.0**	**-10.6**	**-12.3**	**-12.6**
Exports	19.9	15.5	16.1	17.8	17.9	18.1	17.6
Imports	-31.9	-23.7	-22.3	-26.7	-28.5	-30.4	-30.2

Source: IMF and domestic authorities' data; estimates (e) and projections (p) based on authors' calculations.

Macroeconomic Policies

Fiscal and Monetary Policy

Developments in fiscal policies have been satisfactory despite the drought, which necessitated the provision of additional financial resources to purchase and distribute food as well as to import oil to substitute for the loss in hydropower. Despite a limited increase in the overall fiscal deficit excluding grants from 7.8 per cent of GDP in 2002/03 to an estimated 9.6 per cent of GDP in 2003/04, and a further increase to a projected 12.5 per cent of GDP for 2004/05, longer-term projections show a decreasing deficit. The same applies to the overall fiscal deficit including grants which, under cautious assumptions about foreign aid, is expected to increase from 2.9 per cent of GDP in 2003/04 to 5.1 per cent of GDP in 2004/05. The widening deficit reflects increasing expenditures, especially for poverty reduction measures and the expenses related to the upcoming election, rather than falling revenues. The 2003/04 deficit is estimated to be smaller than previously projected, due to improved domestic revenue collection, frontloading of external budget support, and relative expenditure restraint. The GoT has ensured that expenditures on priority sectors for poverty reduction, namely health, education, water, roads, agriculture, judiciary and legal departments, are fully funded as planned, regardless of the extra expenditures on food and electricity associated with the drought.

Thanks to various reforms in tax administration and tax structure as well as higher petroleum taxes, the GoT exceeded its goal for domestic revenue collection in fiscal year 2003/04 by about 4 per cent, implying a 20 per cent increase in collections compared to the previous fiscal year. The tax reforms undertaken aimed at expanding the tax base, increasing accountability of tax collectors and tax payers, eliminating nuisance taxes, improving the business environment, and increasing the efficiency of the Tanzania Revenue Authority (TRA). Furthermore, a new Income Tax Act was passed by Parliament in April 2004, aiming at expanding the tax base and introducing a new culture of voluntary compliance in paying income taxes. Expenditure performance for fiscal year 2003/04 was broadly in line with budget estimates, reaching 97 per cent execution in recurrent expenditure excluding debt service, and 92 per cent of the budget for development expenditure. Full allocation for priority sectors was made at the beginning of each quarter and total actual expenditure was 98 per cent of estimates. Actual expenditure in the category *Other Charges* registered a 94 per cent performance level.

Table 2 - Public Finances[a] (percentage of GDP)

	1995/96	2000/01	2001/02	2002/03	2003/04	2004/05(p)	2005/06(p)
Total revenue and grants[b]	**14.6**	**15.7**	**16.2**	**18.3**	**19.7**	**20.4**	**20.9**
Tax revenue	11.3	10.7	10.6	11.0	11.8	11.9	12.0
Grants	1.4	3.7	4.4	6.2	6.8	7.4	7.8
Total expenditure and net lending[b]	**14.7**	**16.8**	**16.6**	**19.9**	**22.6**	**25.5**	**25.8**
Current expenditure	13.8	13.1	13.3	14.9	16.8	18.7	19.1
Excluding Interest	*10.4*	*11.4*	*11.9*	*13.9*	*15.7*	*17.4*	*17.9*
Wage and salaries	5.5	4.0	3.9	4.0	4.1	4.3	4.3
Interest	3.4	1.7	1.4	1.0	1.1	1.3	1.3
Capital expenditure	0.9	3.7	3.3	5.0	5.7	6.8	6.7
Primary balance	**3.2**	**0.6**	**1.0**	**-0.6**	**-1.8**	**-3.8**	**-3.6**
Overall balance	**-0.1**	**-1.1**	**-0.4**	**-1.6**	**-2.9**	**-5.1**	**-4.9**

a: Fiscal year begins 1 July.
b: Only major items are reported.
Source: IMF and domestic authorities' data; projections (p) based on authors' calculations.

During fiscal year 2004/05, the GoT plans to increase revenue from domestic sources to the equivalent of nearly 14 per cent of GDP, up 20 per cent from the government's revenue projections for 2003/04. The GoT's short- and medium-term fiscal policy objectives are to enhance domestic revenue, lower aid dependency, allocate higher expenditures for poverty reduction, and ensure that debt remains sustainable. Given that the planned expenditures will be about 26 per cent of GDP, the 2004/05 budget would have a financing gap of about 12 per cent of GDP which is expected to be covered largely by grant aid from bilateral donors and the European Union and by concessional loans and grants from multilateral institutions, specifically the World Bank and the African Development Bank. A remaining financing gap of about 2 per cent of GDP is expected to be met by drawing down government reserves with the Bank of Tanzania (BoT) and through domestic sale of government securities.

Monetary policy has also shown remarkable progress, although the BoT remains confronted by the challenge of sterilising large inflows of foreign aid. Money supply was tightened, with its growth rate decelerating to 18.7 per cent at end-March 2004 from 22.7 per cent at end-June 2003. Credit to the private sector in domestic currency increased by 41.8 per cent between July 2003 and March 2004, fuelled in part by large corporations switching from borrowing abroad to borrowing domestically. The two major factors driving this switching were the need to avoid exchange rate risks and the lower borrowing costs stemming from increased competition among commercial banks. The interest rate spread between lending and deposit rates has declined from 13.1 percentage points in 2002, to 11.4 percentage points in 2003, and is estimated to have declined to about 10 percentage points in 2004.

The inflation rate increased slightly from 4 per cent in July 2003 to 4.6 per cent at end-March 2004. The increase in the inflation rate resulted from pressure on food prices following the drought and from the sharp increase in oil prices. Inflation is targeted at 4 per cent by end-June 2005 and is expected to stabilise at that level in the medium term. The government introduced a new and more appropriate weighting system for the consumer price index in September 2004 which will make inflation less sensitive to changes in food prices.

External Position

There has been a substantial increase in both imports and non-traditional exports. Imports have increased by 26.6 per cent in nominal terms in 2003, or in relative terms, from 15.5 per cent of GDP in 2002 to 18.8 per cent in 2003, largely due to sharp increases in imports of fuel and food. The increase in food imports was an obvious consequence of the drought. The sharp increase in fuel is also attributable to the drought as hydroelectricity was replaced by thermal power produced with petroleum. While there are some concerns about the impact of high oil prices on the balance of payments, the value and volume of petroleum imports are actually estimated to have fallen in 2004, due to resumption of hydroelectricity production as well as due to the introduction of natural gas as a substitute for petroleum[5].

Non-traditional exports increased by 16 per cent in 2003, mostly attributable to gold and manufactured products. Gold, though considered a non-traditional export, is now Tanzania's largest export. Traditional exports (coffee, cotton, tea, cashew nuts, cloves, sisal and tobacco) remained depressed despite some signs of recovery in the prices of coffee, cotton, tea and cashew nuts on the world market. Overall goods exports increased from 9.2 per cent of GDP in 2002 to 11 per cent of GDP in 2003. Receipts from tourism also rose during 2003. While the current account deficit increased slightly from 3.3 per cent of GDP in 2002 to 4.1 per cent of GDP in 2003, the increase in the capital account balance surpassed that of the current account balance, and for the first time since 2000, the balance of payments recorded a surplus of $243.9 million, equivalent to about 1 per cent of GDP. The Tanzanian Shilling remained relatively stable to the US dollar during 2004, though it first depreciated slightly during the first half and then appreciated slightly during the second half of 2004.

Taking into account the lower debt service payments due to debt relief, and an increase in official programme grants and loans, gross international reserves reached $1.97 billion in 2003, and continue to rise. As of end-March 2004, official foreign exchange reserves had

5. As of October 2004, the production of clean, reliable, efficient electricity generated from Tanzania's indigenous gas reserves extracted from SongoSongo Island in Kilwa (and transported through a 225 km long pipeline to the Ubungo Power Station) had reached 115 megawatts. Due to agreements finalised in November 2004, the total capacity of electricity generated from Tanzanian natural gas will increase to 180 megawatts by April 2005, which is enough to meet over one third of Tanzania's peak demand and the whole of Dar es Salaam's power requirements.

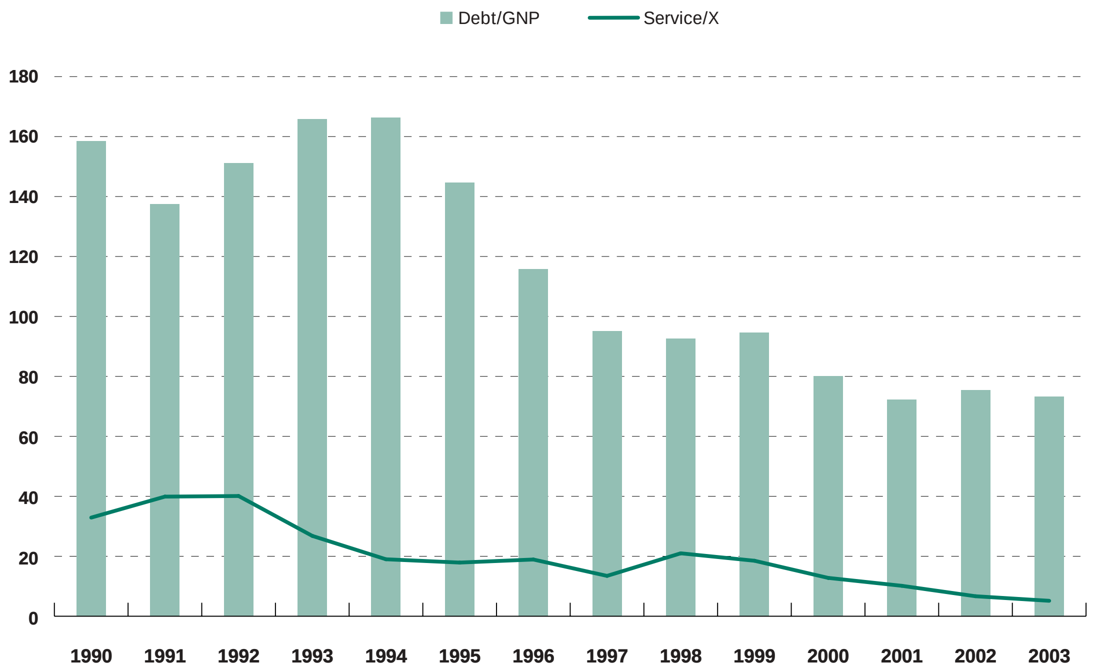
Table 3 - Current Account (percentage of GDP)

	1996	2001	2002	2003	2004(e)	2005(p)	2006(p)
Trade balance	-6.9	-8.3	-6.2	-7.8	-9.2	-10.5	-10.5
Exports of goods (f.o.b.)	11.8	8.2	9.2	11.0	11.1	11.2	11.0
Imports of goods (f.o.b.)	-18.7	-16.5	-15.5	-18.8	-20.3	-21.8	-21.5
Services	-4.3	-0.1	-0.5	-0.9			
Factor income	-1.1	-0.9	-0.9	-0.5			
Current transfers	5.2	4.2	4.3	5.1			
Current account balance	**-7.1**	**-5.1**	**-3.3**	**-4.1**			

Source: IMF and domestic authorities' data; estimates (e) and projections (p) based on authors' calculations.

reached a comfortable level, equivalent to eight months of imports of goods and services. The GoT intends to draw down its reserves with the BoT and to borrow domestically by issuing short- and long-term securities to the amount of about $231 million. While it is expected that a small portion of these securities will be used to fund the export credit guarantee scheme, the majority is intended to settle maturing obligations. The GoT has continued to seek debt relief from the Paris Club and non-Paris Club creditors under the HIPC Initiative. Tanzania reached the enhanced completion point in November 2001. All Paris Club Creditors except Brazil offered Tanzania between 90-100 per cent debt relief on all bilateral debt. Steps have been taken to initiate and conclude negotiations with the Brazilian government. Within the group of non-Paris Club creditors, India has cancelled all intergovernmental loans, Bulgaria cancelled $15.1 million of bilateral debt, a preliminary agreement has been negotiated with Iran, and negotiations with the Abu Dhabi Fund are well underway. The GoT continues with its effort to negotiate debt relief with the remaining creditors at terms consistent with the enhanced HIPC framework. Negotiations with some

Figure 5 - Stock of Total External Debt (percentage of GNP) and Debt Service (percentage of exports)



Source: World Bank.

non-Paris Club creditors and most commercial creditors have been difficult and protracted, as these creditors seem unwilling to participate in the HIPC Initiative. Although the drought complicated Tanzania's macroeconomic situation, it is notable that neither external borrowing nor domestic financing exceeded their respective ceilings.

While the GoT intends to reduce its aid dependency, it also recognises that large amounts of foreign aid will still be needed over the foreseeable future in order to reach the MDGs. Based on Tanzania's satisfactory track record, its development partners are willing to provide their support increasingly through direct budget support as well as in the form of grants. Foreign assistance is co-ordinated through the Tanzania Assistance Strategy (TAS) that provides a framework to increase effectiveness of aid, through harmonisation and simplification of procedures to reduce transaction costs and bureaucracy. During 2003/04, donors including international financial institutions have contributed 45 per cent of the government budget, compared to 47 per cent during 2002/03. Based on agreements reached between the GoT and the development partners, Tanzania expects to receive grants and concessional loans equivalent to about 41 per cent of total expenditures during 2004/05 (of which about $510 million are for budget support and about $860 million are for development projects). While falling as a share of expenditures, this level of grants and loans represents an increase in nominal terms of close to $200 million (16 per cent) over fiscal year 2003/04. Given the open dialogue and consultative process as well as the successful past co-operation between the GoT and its development partners (including the achievements of the TAS and of Tanzania's annual public expenditure reviews), the GoT is confident that its development partners will maintain their support and fully implement their commitments under the Monterrey Consensus to enable Tanzania's attainment of the MDGs.

Structural Issues

Strong macroeconomic policies and sustained implementation of a broad range of structural reforms laid the foundations of Tanzania's economic growth. Reforms undertaken by the GoT to create a conducive environment for private sector investment include trade liberalisation, export promotion, maintaining a competitive exchange rate, streamlining of the exchange and payment system, financial sector liberalisation, fiscal policy reform, and liberalisation of the domestic market. Prior to these reforms, Tanzania's business environment was unfavourable to private investors, with an inadequate infrastructure, notably for transport, obsolete regulations and a heavy-handed administration. However, in recent years, the GoT has made significant progress in enhancing the business environment, especially through the implementation of a programme called the Business Environment Strengthening in Tanzania (BEST). Another significant step was the establishment of the Tanzania Investment Centre (TIC) in 1997 as a one-stop-centre promoting investment. More recently, the Banking and Financial Institutions Act was amended in 2003 to empower the BoT to regulate and supervise the activities of all savings and credit associations as well as to facilitate the provision of long-term finance to the productive sector, e.g. by allowing housing finance companies. The Tanzania Bankers Association has also improved access to credit through the establishment of a credit bureau. The Land Act of 1999 has been amended to accelerate land surveys and to modernise the land registry in order to enable the commercialisation of land leases and to facilitate their use as collateral for bank loans. Further initiatives are underway to formalise personal property rights with the overall aim of creating a comprehensive and inclusive property system that links with Tanzania's traditional norms and creates an institutional bridge that overcomes registration obstacles. In addition, measures to facilitate the speedy and effective enforcement of commercial contracts will be undertaken. Finally, the Income Tax Act of 2004 has been considered to be friendlier to private sector growth than previous income tax laws.

As in many developing countries, small firms predominate in the domestic private sector, with a particularly important role in employment creation. Based on the Central Register of Establishments (CRE) of October 2003, there were 13 442 enterprises with at least five employees, of which 5 905 enterprises (43.9 per cent of the total) employed five to nine persons, 5 559 enterprises (41.4 per cent of the total) had 10-49 employees, 936 enterprises (7 per cent of the total) had 50-99 employees, 339 enterprises (2.5 per cent) employed 100-199 people, 512 enterprises (3.8 per cent of the total) had 200-499 employees, and 191 enterprises (1.4 per cent of the total) employed more than 500 persons[6]. It is estimated that about a third of Tanzania's GDP originates from SMEs.

The promotion of SMEs has a long history in Tanzania. The first major attempt to promote SMEs was undertaken in 1966, when the National Small Industries Corporation (NSIC) was formed under the National Development Corporation (NDC). The NSIC set up small industrial clusters which were basically training-cum-production workshops. In 1973, the Small Industries Development Organisation (SIDO) was established by an Act of Parliament to plan, co-ordinate, promote and offer every form of service to small industries. Currently, SIDO remains the main government arm for promoting SMEs in Tanzania. Some of the key measures employed by SIDO included: *a)* the construction of 16 industrial estates with more than 140 sheds at regional headquarters; *b)* the establishment of 10 training-cum-production centres that offered simple rural-based technologies; *c)* the introduction of lease-purchase programmes through which more than 2 000 entrepreneurs were assisted with machines and working tools; and *d)* the setting-up of feasibility studies. In collaboration with other stakeholders, SIDO supported the establishment of SME associations to empower the private sector, whereby the Tanzania Food Processors Association (TAFOPA) and the Tanzania Small Industries Organisation (TASISO) are likely the two most prominent associations.

In April 2003, after a five-year preparation process involving extensive participation of the private sector, the GoT adopted, under the leadership of the Ministry of Industry and Trade, a comprehensive SME Development Policy. The SME Development Policy focuses on three main areas: *a)* the creation of a supportive business environment; *b)* development of an financial and non-financial services; and *c)* creation of an appropriate institutional infrastructure. The SME Development Policy takes into account the special constraints and opportunities faced by SMEs and aims to strengthen institutions that will address these constraints.

In addition, the government has adopted a variety of tax reforms to improve the business climate and to create a propitious environment for the growth of small- and medium-size enterprises. Currently, SMEs with an annual sales turnover of less than about $20 000 pay two types of taxes to the Tanzania Revenue Authority (TRA): a stamp duty on receipts and a presumptive income tax. These taxes are assessed on the basis of value of sales. In order to reduce compliance costs for such businesses, it is proposed to abolish the stamp duty on receipts, and increase the presumptive income tax rates to compensate partly for the resulting loss of revenue. The proposed new presumptive income tax is progressive with five rates, distinguishing between enterprises that keep and do not keep sufficient records to demonstrate turnover. Apart from reducing the overall tax burden, this system will provide incentives for better record keeping among small businesses, thereby improving their access to credit. Furthermore, if the small individual businesses keep records on income and expenses to a standard satisfactory to TRA, they will file returns and be assessed on their profits rather than their turnover. A variety of nuisance taxes such as license fees have been abolished, while other taxes have been harmonised.

The GoT has set up a variety of funding mechanisms for SMEs. Such funds include SIDO's traditional regional revolving fund (ERRF), the National

5. Based on Tanzania's classification, small enterprises are categorised as enterprises that employ between five and 49 employees or with capital investment from Tsh5 million ($5 000) to Tsh200 million ($200 000). Excluding micro-enterprises, the share of small enterprises in total enterprises is 85 per cent. Medium enterprises are categorised as companies employing between 50 and 99 employees or with capital investment from about $200 000 to $800 000. Though more than 10 years old, the latest Informal Sector Survey estimated that there existed about 2 million micro-enterprises (i.e. enterprises with fewer than five employees), employing about 3 million people (mostly family members) in the informal sector.

Entrepreneurship Development Fund (NEDF), the Youth Development Fund (YDF), and the Women's Development Fund (WDF). Related programmes established through joint GoT-donor efforts include the Small Entrepreneurs Loan Facility (SELF), the National Income Generating Programme (NIGP), the Presidential Trust Fund (PTF), and the Community Development Trust Fund (CDTF). The establishment of the National Microfinance Bank (NMB) was another key initiative, meant to cater specifically for microenterprises. Last but not least, a SME's Credit Guarantee Scheme has recently been established. Box 1 provides more details on the key initiatives supporting the financing of SMEs in Tanzania. Based on a recent survey, micro-credit accounts for almost 5 per cent of all bank credit. The main providers were savings and credit co-operatives and associations, microfinance NGOs, and a few commercial banks. The reforms of the banking sector, especially the amendments to the Land Act, the strengthening of the Commercial Court, the establishment of credit guarantee schemes, and improvements in infrastructure, are expected to further increase competition and access to credit, including for SMEs.

Tanzania has also made progress in restructuring and privatising public enterprises, even though the expected privatisation revenues to the amount of about $17 million were not fully realised during FY 2003/04. The GoT projects revenues of about $10 million in FY 2004/05 from the sale of government shares. The delays in the sale of publicly-owned companies were mainly due to a change in strategy. The new strategy is to restructure and reorganise the publicly-owned enterprises in order to make them more profitable and more sustainable before selling them, as well as to set up regulatory authorities and amend laws establishing the newly privatised enterprises. Such steps are essential given that Tanzania is now privatising large public utilities. In 2003, a total of 101 enterprises were concerned, with the sale of 26 whole enterprises and 75 non-core assets, bringing the cumulative total of the privatisation programme in December 2003 to 289 whole enterprises privatised and 328 non-core assets sold. The GoT also: *a)* completed the leasing arrangement of Dar es Salaam Water and Sewerage Authority (DAWASA); *b)* reached tendering stage of the leasing procedures of the Tanzania Railway Corporation (TRC); and *c)* finalised the two studies for unbundling the Tanzania Electric Supply Company (TANESCO), including the completion of preparations for a new electricity and energy marketing system as well as supervising the implementation of management contracts. The privatisation process has also begun for the National Insurance Company (NIC), the National Microfinance Bank (NMB), and commercial units of the Tanzania Harbours Authority (THA). Furthermore, the GoT initiated preparations for the privatisation of large farms such as the National Agricultural and Food Corporation (NAFCO), a variety of national ranches, and 12 cashew nut processing factories. The GoT continued to encounter challenges in the implementation of the privatisation programme. In particular, some public enterprises had excess workers requiring labour shedding, and some of the investors failed to restructure or delayed restructuring of the acquired enterprises. The GoT has taken the following measures to deal with the problems encountered: *a)* follow-up of the performance of the privatised enterprises in collaboration with the respective ministries and Parliamentary Committees; *b)* engagement of debt collectors to deal with chronic debtors; *c)* continuation of education of various stakeholders on the privatisation policy through workshops, media, leaflets and advertisements; *d)* establishment of a procedure of securing bank guarantees for the purpose of regulating brokers and investors who are not genuine; *e)* opening up of cases against investors who have failed to abide by the privatisation sale agreements; *f)* engagement of lawyers to deal with ongoing court cases; and *g)* employment of a land expert to deal with problematic title deeds.

The GoT continues to adhere to the objectives of the National Debt Strategy in the management of debt and continues to comply with the requirements of the Loans, Grants and Guarantees Act of 1974 which was amended in 2003. At present, loans are solicited from concessional sources only and directed to support priority sector spending for economic growth and poverty reduction. The issuance of government guarantees for contracting external loans has been

Key Initiatives Supporting the Financing of SMEs in Tanzania

There are three key initiatives in Tanzania aimed at financing SMEs: the Small Industries Development Organization (SIDO), the National Microfinance Bank (NMB), and the newly-established SME Credit Guarantee Scheme.

***a)* Small Industries Development Organisation (SIDO)**

Established in 1974, SIDO remains the main government arm for promoting SMEs in Tanzania. In addition to broad-based support for SMEs, including the establishment of training-cum-production centres and SMEs associations, SIDO also extends loans to SMEs through a regional revolving fund and the National Entrepreneurship Development Fund (NEDF). Group lending has been a major reason for the NEDF's success. The programme started with about $0.5 million of capital in 1994/95 and an additional 0.3 million in 1997/98, but has grown over the years and was able to expand its capital base to well over $1 million by early 2004, due to a reasonable repayment record. SIDO loans under the NDEF range between $50 and $500. The repayment period for individual borrowers is usually a minimum of one year and a maximum of two years. Repayments by small borrowers are usually on a monthly basis, though microenterprises are often required to pay through their groups on a weekly or fortnightly basis. It should be mentioned that there are a few other government established funds, including the Women Development Fund (WDF) managed by the Ministry of Community Development, the Gender Affairs and Children and the Youth Development Fund (YDF) under the Ministry of Youth Development and Sports, and the Small Entrepreneurs Loan Facility (SELF) under the Vice President's Office, Poverty Eradication Department (which is funded by a variety of donors), though they are much smaller than the NEDF.

***b)* National Microfinance Bank (NMB)**

The government-owned NMB was formed in October 1997, after splitting from the former National Bank of Commerce, in order to provide banking services to poor individuals, micro-enterprises, savings and credit co-operative societies and associations, and community banks. In 2004, it provided a variety of micro and personal loans as well as savings, deposit, and payment services to more than 131 000 clients through 108 branch locations countrywide. The NMB maintained an outstanding loan portfolio of about $61.3 million in 2004. It has been under private management since 1999, and is on track to be privatised in 2005. It should be mentioned that a few other commercial banks (such as CRDB Bank, Akiba Commercial Bank, and the Tanzania Investment Bank) have also been extending loans to SMEs through savings and credit co-operative societies and associations, though their portfolio for SMEs is much smaller than that of the NMB.

***c)* SME Credit Guarantee Scheme (SME-CGS)**

The objective of the SME Credit Guarantee Scheme (SME-CGS) is to kick-start financing to SMEs by the banking sector, while complementing and strengthening existing banking facilities. Participating financial institutions will maintain responsibility of credit scoring, approval, monitoring and recovery. The Bank of Tanzania will initially manage the scheme. Guarantee will be limited to 50 per cent of any loan. The size of the Fund is modest to start (Tsh2 billion, equivalent to $2 million). Loans have a maturity of one to five years and a maximum size of about $0.2 million. Though funds for the scheme had already been provided in the budget of FY 2003/04, it is expected to be launched and operational in the first half of 2005.

stopped and it is now prohibited for any official or government agency to either borrow on behalf of the GoT or to enter into any arrangement of a financial nature without first obtaining the approval of the Minister for Finance, who in turn must consult with the National Debt Management Committee established under the Act.

Finally, while agricultural implements and inputs such as tractors, pesticides and fertilisers are exempted from customs duties, the remaining customs tariff structure has been changed following the coming into force of the East African Customs Union (EACU) on 1 January 2005. These changes include elimination of customs tariffs on goods originating from East African Community (EAC) states on a phased basis and introduction of a common external tariff on goods originating outside the EAC. Principles and procedures relating to customs will be harmonised across EAC states, although each member state will continue to administer and collect the customs duty. Tanzania is expected to earn new revenues of about $6 million in 2004/05 from the adoption of the EACU, while the abolition of duties due to the adoption of the EACU is expected to reduce other revenues by about $4.8 million in FY 2004/05.

Political and Social Context

Though some political unrest occurred towards the end of 2004 (related to local government elections in November 2004 and the upcoming national elections scheduled in October 2005), Tanzania continues to be one of the most politically stable countries in Africa. However, Zanzibar harbours a potential source of political unrest. In line with the PRSP and the National Anti Corruption Strategy and Action Plan (NACSAP) for 2003-05, the GoT continued with its efforts to promote good governance in the public service delivery, to strengthen the judicial system, and to curb corruption. Progress in the fight against corruption is being publicised in quarterly progress reports. Human and financial resource capacities to co-ordinate and implement the NACSAP are being addressed under the Public Service Reform Programme (RSRP). A Good Governance Co-ordination Unit (GGCU) has been established in the President's Office. The unit commissions studies on public procurement, public finance, as well as legal and judicial operations. The GoT continues to implement its salary payment reform policy for civil servants, which will permit it to reach the budgetary target limit of 4.8 per cent of GDP for wages. Furthermore, the GoT is expected to finalise soon a specific framework for processing salary adjustment arrears, including those for teachers. Payment of these arrears was suspended on account of fraud that was uncovered a year ago involving a few dishonest civil servants. Investigation has been almost completed and legal action is underway against the perpetrators. Moreover, the Large Taxpayers Department under the Tanzania Revenue Authority has been strengthened, leading to greater efficiency and a substantial reduction in complaints from such taxpayers.

The GoT has also taken a number of measures to improve the accountability of public funds and to strengthen the internal auditing function. Also, as part of the Public Financial Management Reform Programme (PFMRP), amendments to the Public Procurement Act No. 3 of 2001 are underway, with a view to improving efficiency in the implementation of the government budget, especially the execution of development projects. Due to all these efforts, Tanzania made considerable progress in reducing the perception of corruption. The October 2004 Report by Transparency International ranked Tanzania 90 (out of 146 countries), a better ranking than its neighbours (including Kenya and Uganda) and most other countries with similar GDP per capita levels.

Previously established specialised government agencies, such as the Ethics Secretariat, the Commission of Human Rights and Good Governance, and the Prevention of Corruption Bureau (PCB), continue to report quarterly on matters brought to their attention. The Commission for Human Rights and Good Governance has also conducted meetings with government officials to enlighten them on the workings of the Commission and met with civil society organisations that are engaged in the promotion of human rights. The PCB has been strengthened by increasing its budget and by decentralising from administrative zones to regional and district offices. Yet, it has become clear that there is need for further action to ensure efficiency, transparency and accountability in law enforcement institutions. The 2004 USAID Country Report notes that Tanzania's democracy remains fragile. While there are clear policy statements and enabling legislation has been enacted to move forward with the local government reform programme, implementation of the reforms to date has been slower than anticipated, largely due to an over-ambitious mid-term plan with overlapping implementation phases.

Tanzania has completed three years of implementing its first Poverty Reduction Strategy Paper (PRSP-I) and has concluded a revised PRSP, the *National Strategy for Growth and Reduction of Poverty (NSGRP)* in November 2004, focusing on poverty reduction measures which aim at attaining three pillars of success: good governance and accountability; growth and reduction of income poverty; and improved quality and social well-being[7]. Yet, Tanzania remains one of the poorest countries in the world. Per capita income in 2004 is estimated to be about $290 and, owing to AIDS/HIV, life expectancy at birth has dropped from 50 years in 1990 to 43 years in 2002. There is some indication that outside Dar es Salaam, there has been little progress in the reduction of the proportion of households below national poverty lines. The picture is the same for food poverty. While considerable progress has been made in terms of increasing the shares of budget allocations for poverty reduction measures, actual outputs, especially in terms of life expectancy and child mortality are disappointing. Comparing the progress made in reducing poverty with other countries in terms of Tanzania's ranking in the United Nations Development Programme (UNDP) Human Development Index (HDI), Tanzania has experienced a slight deterioration in its rank, going from a ranking of 140 (out of 162 countries) in 2001, to a ranking of 162 (out of 177 countries) in 2002[8]. Given the incomplete transition from macroeconomic achievements to the micro-level reforms, it is recognised that there is need for closer analytical work on growth-poverty linkages and how growth could better benefit the poor. HIV/AIDS and malaria have also contributed to the disappointing outcomes. Malaria continues to be the number one killer disease, accounting for 17 per cent of all deaths and approximately 30 per cent of all hospital visits. The HIV/AIDS adult prevalence rate has increased slightly from 7.8 per cent in 2001 to 8.8 per cent in 2003. The GoT continues to fight the spread of HIV through the recently developed National Multi-Sectoral Strategic Framework (NMSF) which intends to address HIV in a comprehensive manner to overcome some of the previous weaknesses in efforts against HIV.

The UNDP 2004 has ranked Tanzania 131 out of 144 countries in its Gender Development Index (GDI) quantifying the status, treatment and participation of women, roughly as poor as the HDI ranking. Yet, in terms of women's participation in economic and political life, Tanzania fares relatively well. For example, looking at the percentage of seats in parliament held by women, Tanzania ranks 34 (out of 163 countries) with 21.4 per cent of seats held by women. With regards to the ratio of female-earned-income to male-earned-income, at 71 per cent Tanzania ranks 8 out of 153 countries. While life expectancy decreased drastically during the last 10 years (owing to HIV/AIDS), life expectancy has decreased more for women than for men. Tanzanian women still live about one year longer than Tanzanian men, however.

The current health sector reform plan aims to improve primary health care delivery through decentralisation of responsibilities to the district level, thus favouring rural areas. Decentralisation is intended to improve service quality, availability, and accessibility. According to the latest Household Budget Survey (2000/01), 91.4 per cent of the population are less than 10 km from a health facility and 75.4 per cent are less than 6 km away. The GoT is using User Satisfaction Questionnaires to monitor the perceived quality of the health services provided. For public

7. More information on poverty reduction initiatives in Tanzania can be obtained at: www.povertymonitoring.go.tz

8. See UNDP (2002), and UNDP (2004), *Human Development Report*, New York respectively.

facilities, some two-thirds of respondents did not report a problem, while one third did. The most common complaints were about long waiting times and a shortage of drugs. With immunization rates for tuberculosis, diphtheria and measles around 90 per cent, Tanzania compares favourably to other sub-Saharan countries and continues to make progress towards universal coverage. More quantitative data on progress made in the health sector is expected from the analysis of the recent Population and Housing Census.

After a period of virtually stagnant enrolment ratios in the late 1990s, there have been large gains in primary enrolment in the past three years. Based on the Ministry of Education and Culture's (MoEC's) Basic Education Statistics, the gross enrolment ratio for primary education has increased from 78 per cent in 2000 to 85 per cent in 2001, to 99 per cent in 2002, and to 105 per cent in 2003. Similarly, net enrolment ratios have increased from 59 per cent in 2000, to 66 per cent in 2001, to 81 per cent in 2002, and to 89 per cent in 2003. While the gap between primary school enrolment ratios between boys and girls has been widening over the last four years, amounting to about 3 per cent for the net enrolment ratios of 2002 and 2003, it is anticipated that this gender gap will disappear in the next few years. The largest increase in overall enrolment ratios has come with the abolition of education fees in 2002 and the launch of the Primary Education Development Plan (PEDP) 2002-06. Yet, pass rates in the Primary School Leaving Examination (PSLE) taken in Standard 7 remain low, though transition rates from primary to secondary school have increased from 16 per cent in the late 1990s to about 20 per cent in 2002/03