



# Brief 1: The Status of Economic Growth and Poverty Reduction in Tanzania

Produced by the Research and Analysis Working Group of the MKUKUTA Monitoring System, Ministry of Finance and Economic Affairs

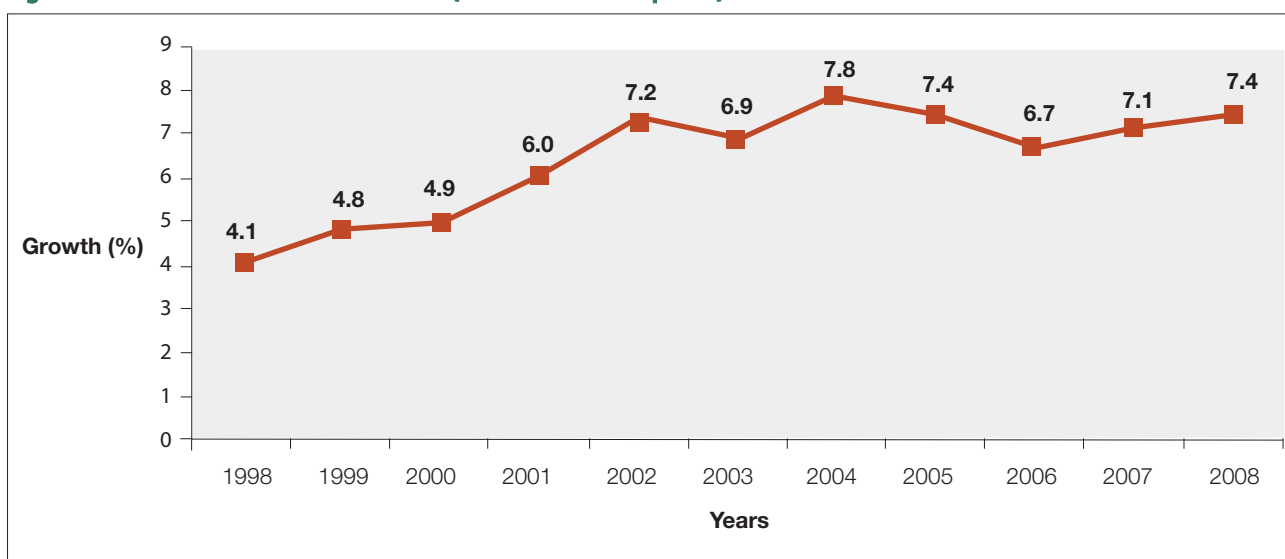
## POVERTY AND HUMAN DEVELOPMENT REPORT (PHDR) 2009

The core purpose of PHDR 2009 is to review progress towards Tanzania's development goals as set by the National Strategy for Growth and Reduction of Poverty 2005-2010 (MKUKUTA). This brief, the first of a series of five briefs on the report, presents a summary of trends and targets under MKUKUTA's Cluster I, which focuses on indicators of national economic growth and reduction of income poverty.

### Growth in Gross Domestic Product (GDP)

Since 2000, GDP growth has averaged approximately 7% per annum, which is historically high for Tanzania and comparable to the performance of the fastest growing economies in sub-Saharan Africa (Figure 1). GDP growth peaked in 2004 at 7.8%, but severe and prolonged drought during 2005/6 negatively affected the economy. Since then, GDP growth has recovered to reach 7.4% in 2008. However, due to the global economic and financial crisis, growth is projected to fall to 5% in 2009 before gradually increasing to 7.5% by 2012.

Figure 1: Real GDP Growth 1993 – 2008 (at 2001 constant prices)

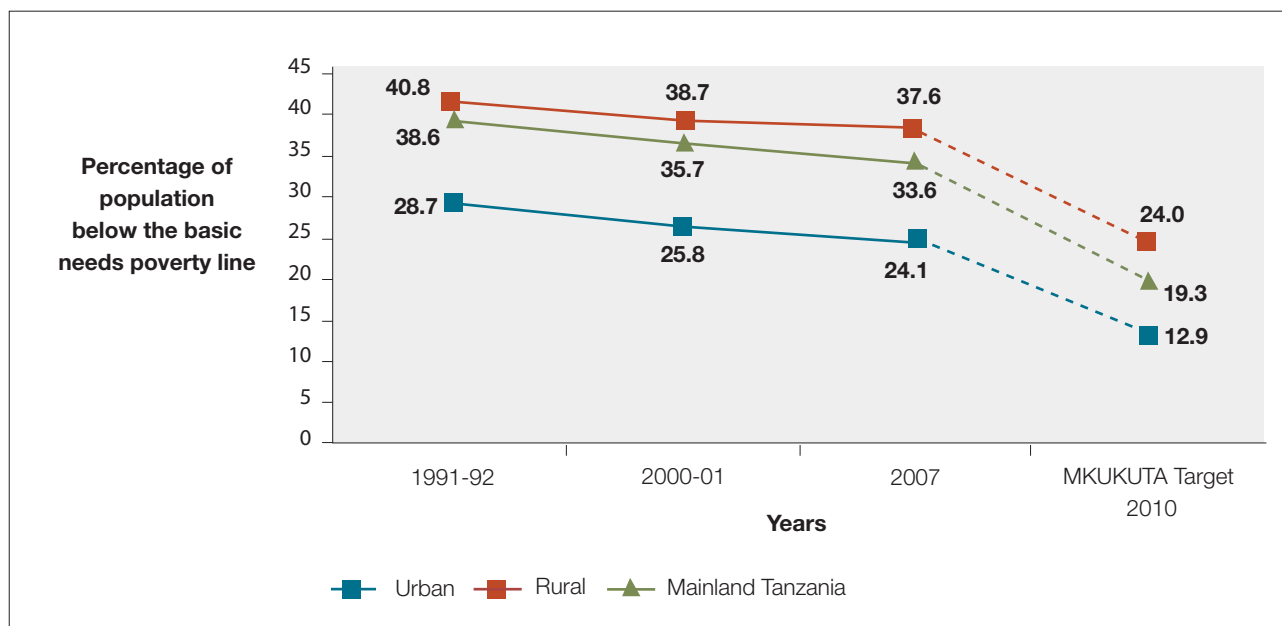


Source: Ministry of Finance and Economic Affairs (MoFEA), Economic Survey 2008

### Income Poverty Rates

Despite strong and sustained growth rates since 2000, only slight reductions in household income poverty have been achieved over the same period. Between 2000/01 and 2007, the percentage of households in Mainland Tanzania living below the basic needs poverty line declined by just over two percentage points from 35.7% to 33.6% (Figure 2). This small reduction means that MKUKUTA targets for poverty reduction by 2010 will not be met.

**Figure 2: Trends and Targets of Income Poverty Reduction, Urban-Rural, 1991-92 to 2010**



Note: Urban areas excludes Dar es Salaam

Sources: Household Budget Surveys (HBS) 1991/92, 2000/01 and 2007

Poverty rates remain highest in rural areas: 37.6% of rural households live below the basic needs poverty line, compared with 24.1% of households in other urban areas and 16.4% in Dar es Salaam. On a positive note, data from HBS 2007 indicate that ownership of consumer durables and productive assets as well as the quality of housing have improved for all wealth quintiles in both rural and urban areas. Rural residents have also especially benefited from increased public spending on education and health services, which is discussed in greater detail in Brief 2 of this series. Nonetheless, poverty remains anchored in the underdeveloped rural economy. Approximately 75% of the population depends on smallholder primary agricultural production, characterised by the use of hand tools and reliance upon traditional rain-fed cropping methods and animal husbandry.

The apparent contradiction between sustained economic growth and limited change in poverty rates may in part be explained by the increased share of public spending (i.e., government consumption) and capital investment in total GDP, which have accounted for much of the growth in GDP from 2000 to 2007, while household consumption as a percentage of GDP declined.

**Table 1: GDP and Expenditure (at constant 2001 prices) (TShs millions)**

Economic Activity	2000		2007	
	Expenditure	GDP Share (%)	Expenditure	GDP Share (%)
Household consumption	6,615,765	77	10,021,704	73
Government consumption	1,014,494	12	2,495,962	18
Investment	1,421,461	16	3,358,305	24
Net exports	-466,381	-5	-2,074,049	-15
<b>GDP at market prices</b>	<b>8,585,339</b>	<b>100</b>	<b>13,801,921</b>	<b>100</b>

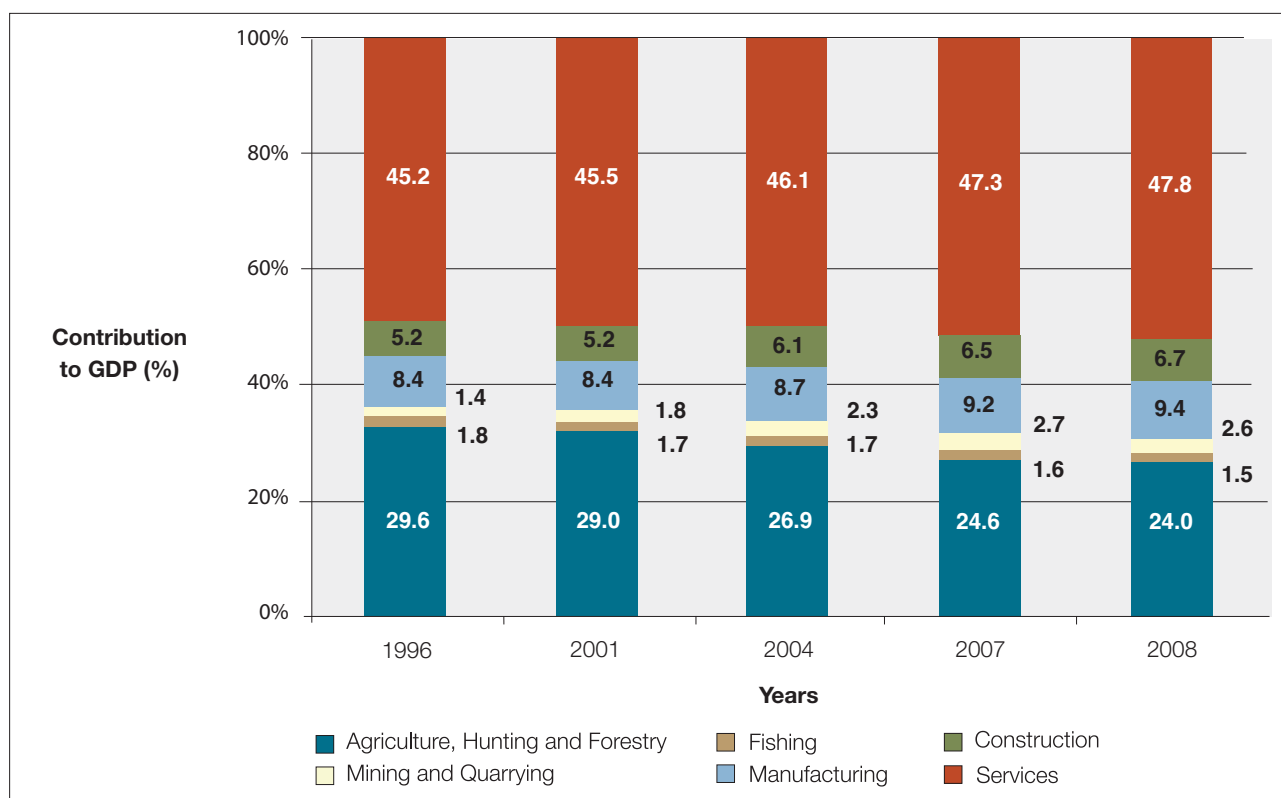
Source: MoFEA, Economic Surveys 2007 and 2008

Hence, while growth has not resulted in immediate income poverty reduction, the increased capital investment for structural change in the economy, improved productivity, and expansion in public spending in areas such as education and health services, may provide the foundation for future reductions in poverty.

### Signs of Structural Changes in the National Economy: GDP Growth by Sector

Over the last decade, the economy has shown signs of structural transformation with steadily increasing shares of total GDP from the services sector (48%), from manufacturing (9%) and from construction (7%) (Figure 3). Communications is the fastest growing services sub-sector, averaging 14% growth per annum since 2000. In contrast, the share of the agricultural sector in total GDP has fallen from around 30% in 1998 to 24% in 2008.

Figure 3: Sectoral Contribution to GDP (2001 constant prices)



Source: Economic Survey 2008

However, the decline in agriculture's contribution to GDP and increasing levels of off-farm employment are not associated with productivity growth but rather with continued low returns in the sector and limited incentives for increased production and trade, especially in food crops. Farming households continue to be the poorest. These are not positive developments. The majority of smallholders remain effectively cut off from the national growth story with little access to technological improvements and inputs that enhance productivity. The country looks to the recently announced *Kilimo Kwanza* ('Agriculture First') policy to sustainably boost farmers' productivity and incomes. *Kilimo Kwanza* aims to achieve a green revolution in agriculture through improved institutional arrangements, land use and financing as well as implementation of an industrialisation strategy geared to the transformation of agriculture in Tanzania.

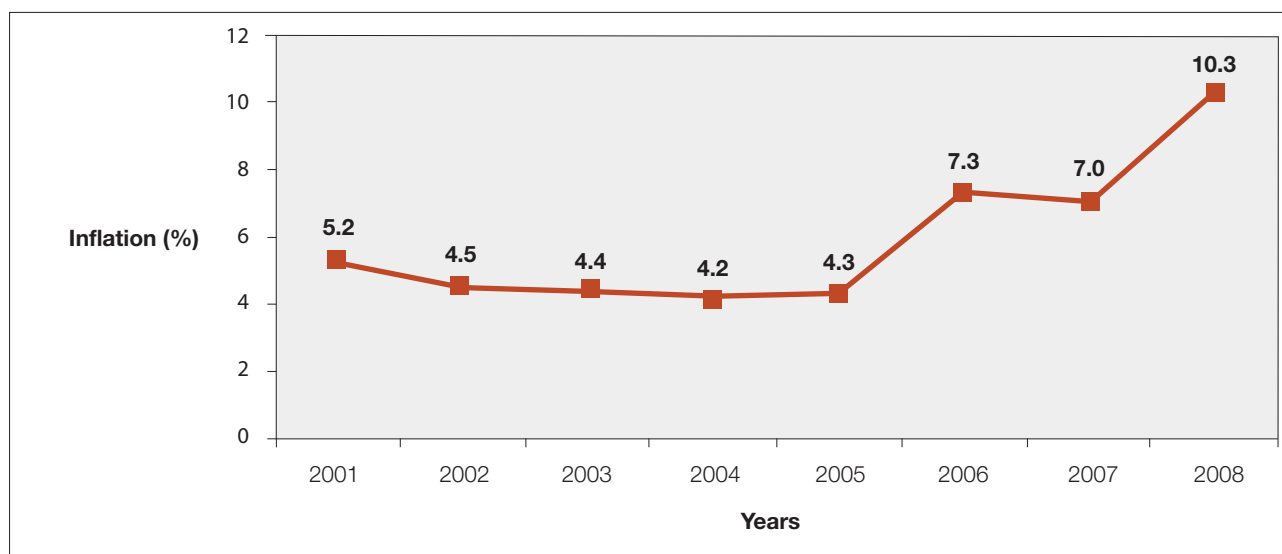
## Key Macro-economic Indicators

The global financial and economic turmoil in 2008 and 2009 added to the macro-economic management challenge. The banking system in Tanzania has weathered the global financial crisis, but other aspects of the economy have been clearly affected.

### Inflation

In 2008, the economy was subjected to further inflationary pressure as domestic oil and food prices continued to climb. Inflation reached 10.3% (Figure 4). Although global oil and food prices declined sharply in the last quarter of 2008, local pump prices did not decline commensurately, and food shortages in neighbouring countries put pressure on local food prices.

**Figure 4: Rate of Inflation 2000 – 2008**



Source: Economic Survey 2008

### Domestic Revenue and Fiscal Deficit

Domestic revenue collection as a percentage of GDP has been increasing steadily from 11.8% in 2004/05 to 16% in 2007/08. Initial budget estimates indicated that revenue receipts would climb to 17.9% in 2008/09, but declining tax receipts due to the global economic slowdown has necessitated revisions. Revenues in 2008/09 are expected to be 15.9% of GDP, increasing to 16.4% in 2009/10 and to 18.3% by 2011/12.

Increased collections in recent years can be largely attributed to strengthened tax administration. Further improvements in tax administration will be required, including more effective enforcement in under-taxed areas like natural resources. However, the tax structure remains narrowly based, and depends more on indirect taxes (such as VAT, and customs and excise duties) than on direct taxes (income and corporate taxes). The key challenge is to increase tax revenue without increasing the tax rate. In the medium to long run, domestic resource mobilization should focus primarily on expanding the revenue base through sustained economic growth.

As government revenues have increased, so too has public expenditure – from approximately 15.1% of GDP in 2000/01 to 22.8% in 2007/08. Expenditure is estimated to reach 26.6% in 2008/09. The gap between domestic revenue and expenditure has also grown over time; the fiscal deficit after grants was provisionally estimated at 4.7% of GDP for 2008/09, compared with 0.4% in 2001/02, having increased sharply in 2005/06 to about 5.1% of GDP.

To facilitate a higher rate of growth, maintain fiscal balances, and control inflation, the Government must direct expenditure efficiently, controlling wastage of resources in current and development outlays. In order to maintain macro-economic stability, public expenditure must balance outlays to strengthen capabilities and increase future productivity with outlays directed at satisfying current household needs for goods and services.

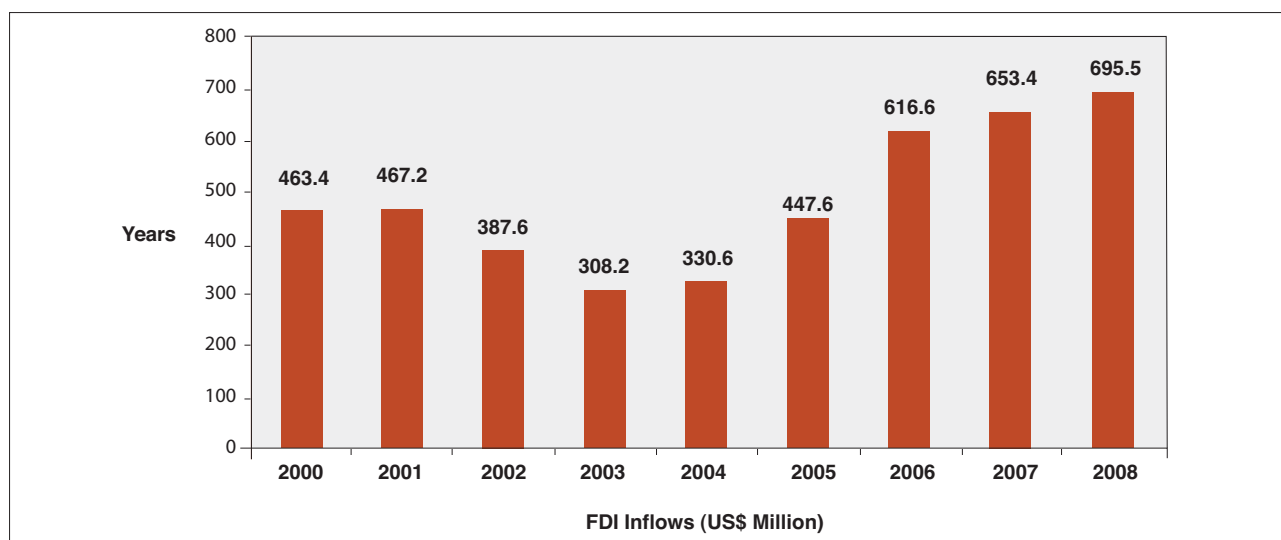
### Exports, Imports and Foreign Direct Investment

There has been an increase in exports as a percentage of GDP since 2000/01, from 14.6% to 22% in 2007/08. The increase in goods exported has been largely due to increased exploitation of natural resources, especially minerals. More recently, exports of manufactured goods have also increased. However, the demand and prices for some traditional agricultural exports, such as cotton, coffee, cloves and cashew nuts, declined in 2008 and early 2009. Fortunately, the demand for gold, which accounted for 34.7% of the value of Tanzania's exports in 2008, increased following loss of confidence in the hard currencies of developed countries. Tanzania's tourism sector has expanded rapidly in recent years, and is currently the leading source of foreign exchange earnings. However, tourist operators indicated a drop in cash flows up to 20%, with tourist cancellations of 30-50% for the season starting January 2009.

Imports have also continued to increase, and at a faster rate than exports, resulting in high trade deficits. However, a higher level of imports for investment is essential to support higher rates of growth.

Foreign direct investment in Tanzania has increased every year since 2003 reaching USD 695.5 million in 2008 (Figure 5). However, inflows have been concentrated largely in mining and tourism, and growth in the mining sector has yet to incorporate domestic processing and service systems in its value chains. The credit squeeze resulting from the global financial crisis forced some capital intensive development projects to be postponed or shelved, but the scale of the slide in foreign investment should not be overstated. Its impact is expected to be muted because of the concentration of FDI in the natural resources sector, where new investment may be delayed but current projects are likely to continue.

**Figure 5: FDI Inflows 2000-2008 (USD millions)**



Source: Economic Survey 2008

Note: 2008 figure is the budget estimate

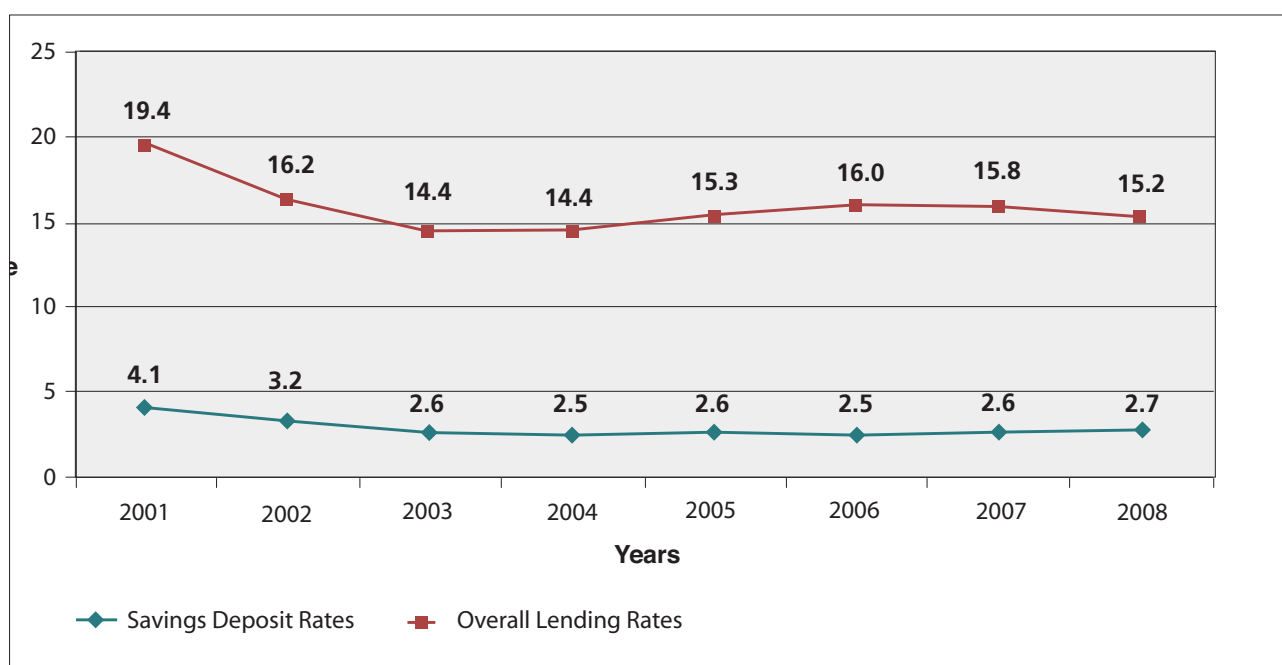
FDI inflows, while growing steadily, fell significantly short of the overall level of interest registered by potential investors, reflecting in part continued difficulties of doing business locally. Investment, domestic and foreign, continues to be hampered by control and ownership rights of production resources (especially land), non-tariff barriers such as customs and administrative procedures, regulations and licenses. The lack of physical infrastructure is an ongoing constraint which will take time to address.

## Domestic Credit and Interest Rates

Faster economic growth will not be possible without a deepening of the financial system. Banks are still not providing sufficient support to domestic initiatives, especially small- and medium-scale enterprises (SMEs) and the agricultural sector. While credit to the private sector has maintained an upward trend from 4.6% of GDP in 2001 to 13.8% in 2007, it remains low compared to other developing countries. Banks remain highly liquid and reluctant to expand credit except to the most creditworthy borrowers. Structural weaknesses in the financial system also persist. Underdeveloped and inefficient legal and regulatory systems and information frameworks, particularly with respect to property rights, result in weak collateralisation of claims and inadequate contract enforcement mechanisms.

The spread between overall lending and savings deposit rates decreased from 13.5 percentage points in 2006 to 12.5 percentage points in 2008 (Figure 6), but there is wide concern that the spread remains too high. The high lending rates will continue to deter investments especially by SMEs, and the low deposit rates will discourage domestic savings.

**Figure 6: Overall Lending and Saving Rates of Commercial Banks, 2001 – 2008**



Source: Calculations based on Bank of Tanzania (BoT), Quarterly Economic Bulletins (various years)

## Employment

Productive employment is the principal route out of poverty, and job creation must be placed at the heart of the national development agenda. Tanzania's labour market is characterised by high participation compared with other sub-Saharan countries and low unemployment: 90% of the population aged 15-64 years are working, and unemployment is 3.7% in urban areas and 0.7% in rural areas (Table 2). In other words, almost all people 15 years and older in Tanzania are working, and the central issue is not unemployment but the reliability, quality and productivity of employment. The unemployment rate is highest among youth aged 15 to 24 years, especially in urban areas.

**Table 2: Current Unemployment Rate by Age Group and Residence (International Definition)<sup>1</sup>**

Residence	Age Group				
	15-24 years	25-34 years	35-64 years	65+ years	Total
Urban areas (including Dar es Salaam)	9.3	3.0	1.0	1.1	3.7
Rural	1.2	0.9	0.3	0.3	0.7
<b>Total</b>	<b>3.1</b>	<b>1.5</b>	<b>0.5</b>	<b>0.4</b>	<b>1.5</b>

Source: HBS 2007

Tanzania has done well to keep the employment rate relatively constant during this decade. However, maintaining this rate will require that the economy is able to generate employment for approximately 720,000 new entrants to the labour market annually. This is feasible given that the number of Tanzanians employed grew by an average of 630,000 per year between 2001 and 2006. However, employment creation has been primarily in small informal businesses, which typically have low earnings and productivity. Many farmers are underemployed. Earnings are low and hours are long for most Tanzanians. The ILFS 2006 found that 75% of employed people earn less than Tshs 100,000 per month, and the majority of self-employed workers earn less than 50,000 per month. Business surveys commonly report that the lack of adequately skilled workers is a major constraint to development. A growth strategy must, therefore, prioritise investment in quality secondary and higher education and skills training so that new entrants to the labour market are equipped with the knowledge and skills in demand.

## Infrastructure

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Transport and energy infrastructure are also commonly cited as constraints to investment and economic growth. The proportion of national and regional roads in good and fair condition has risen to 85% in 2007, though a high proportion of district and feeder roads remain in poor condition. Further investment in roads, port facilities and transport services are needed to realise Tanzania's comparative advantage as a trade and transport hub for neighbouring landlocked countries.

A reliable and affordable power supply for producers and consumers underpins economic growth, facilitates productive employment and contributes to quality of life. Electrification however, is still low and unreliable in Tanzania with electricity provision still subject to outages caused by inadequate maintenance and investment in infrastructure. The national grid is the mainstay of power transmission in the country but it has limited coverage. Household connections to the electricity grid, predominantly serving the urban population, have increased only slightly overall, from 10% of all households in 2000/01 to 12% in 2007.

<sup>1</sup> The **international definition** of unemployment is 'persons with no work but actively seeking work'. Higher rates of unemployment are reported by the Integrated Labour Force Survey (ILFS) 2006 – 11.7% for the population aged 15 years and above. The ILFS uses a **national definition** for unemployment which includes people who are **not** actively looking for work but are available for work and persons with marginal attachment to employment (not sure of availability and income of employment the next day).

## Key Policy Implications

To sustain and accelerate economic growth and reach national poverty reduction targets, continued investment, both domestic and foreign, is needed to enable Tanzania to fully exploit its comparative advantages and propel domestic productivity and income. A focused growth strategy with disciplined public spending, together with an enabling regulatory environment for the private sector will be essential in the decade ahead. The reduction of poverty will critically depend on stronger support for productivity gains for small-scale agricultural producers.

Agricultural transformation – and consequently economic structural transformation – can only be realised if key actors in technology generation, institution building and policy formulation work collaboratively. Policies are needed that go beyond liberalisation to include incentives for smallholder farmers to engage in new productive patterns of investment and exchange. This implies a major role for future research in identifying organisational arrangements that can facilitate smallholders' access to technical and management know-how, capital and financing, and connections to local and international markets.

## Recommendations for Improved Monitoring

Further strengthening of monitoring systems for Cluster I is recommended to more reliably capture national economic trends. For example, GDP figures have sometimes been insensitive to major shocks in the economy, such as drought, suggesting possible shortfalls in the compilation of National Accounts. Many reasons may contribute to this, including capacity constraints in techniques of sampling and data processing, outdated business registers, infrequent data collection and low response rates. Some economic sectors are also not adequately covered in surveys. In addition, institutional constraints – including lack of resources at the NBS and insufficient collaboration of key institutions – need to be addressed.

Lastly, rationalisation of indicators across major national surveys will facilitate analysis of trends. One clear example is unemployment. Household budget surveys adopt an international definition, while labour force surveys use a national definition. The national definition is more inclusive of those who are not actively looking for work but are available for work, and those with marginal attachment to their employment.

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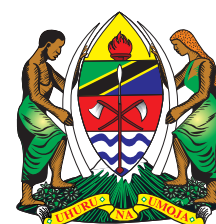
The Poverty and Human Development Report 2009 and accompanying brief series are available in electronic copy, and the printed report can be obtained from: The Poverty Eradication and Empowerment Division, Ministry of Finance and Economic Affairs, Dar es Salaam.

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