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Policy Brief

POLICY RESEARCH REPOA FOR DEVELOPMENT

A Diagnostic Manufacturing Competitiveness Study: Challenges, Prospects and Policy Options for Tanzania

Assessing competitiveness of such a dynamic sector as Manufacturing can be a daunting task, not least because of the various issues that need to be taken into consideration in its definition, measurement and profiles. This study has attempted to define and measure competitiveness of Tanzanian Manufacturing sector within a small set of indicators, and informed by the context of the study based on its Terms of reference. Overall, we find that the level of Tanzania's manufacturing competitiveness has been improving gradually since 2007 in two ways. First, based on the Global Competitiveness Index (GCI), Tanzania has been performing strongly in areas of macroeconomic environment and institutions. Second and more importantly, productivity within the industrial manufacturing sector has been improving, albeit at a small extent. However, in both of these aspects, our analysis identified areas where Tanzania has continued to perform poorly. Tanzania scores low in innovation and sophistication factors, higher education and training. Furthermore, reflecting low export capacity, Tanzania is among the bottom countries in the export competitiveness. Assessment of competitiveness indices also show that, although Manufacturing is the most competitive of all the industrial sectors, the wage rate has recently been increasing rapidly, suggesting that the manufacturing subsector might have been losing its competitive edge. While this general trend may be worrisome, some firms' characteristics are more revealing. In particular, we observed that exporting firms have lower unit costs and higher value added per worker compared to non-exporting firms. Similarly, foreign ownership is associated with lower unit costs than domestic ownership. More generally, private owned firms had the lowest unit cost compared to public owned firms. We complemented these results with those obtained from our productivity analysis where firm characteristics such as exporting, foreign ownership, size (large firms) and training appears to have higher levels of productivity over time. In addition, by controlling for time invariant firm characteristics, we found that management experience and business culture enhance productivity performance.

Apparently, trends and levels of productivity have differed across sub-sectors. Our findings show that computer, electronic and optical products, beverages and apparel industry were observed to have performed well in terms of unit labor costs and value added per worker, hence better candidate for targeted policy initiatives to further improve development of the manufacturing sector. Furthermore, productivity growth appears to be driven largely by the formal manufacturing sector compared to the informal sector where employment is rapidly growing and outpacing growth in value added.

Using Computable General Equilibrium (CGE) analysis, the last part of the study focused on identifying priority reforms and sectors that are best suited to promoting manufacturing competitiveness. Findings show that, increased investment in infrastructure to reduce energy costs, improve transport services and harness innovation through ICT will have significant effects on competitiveness compared to reducing tax rates. In particular, increasing investment in ICT yields a multiplier of three, meaning that, for every shilling investment in ICT it generates 3 shillings in economic return. Furthermore, a 10 percent increase in ICT investment increases manufacturing value added by 0.41%. Second, increasing labour productivity through investment in skills generates the largest positive effects on competitiveness compared to the impact of investment in ICT or reduction in tax rates. Finally, while reduction in tax rates is generally good for competitiveness, the Government is likely to reap much larger positive impact on competitiveness through reducing corporate tax. The findings show that for every Tsh the government lost in terms of corporation tax revenue, it generates 77 cents of additional GDP, compared to 13 cents and 42 cents for VAT and income tax rate cut respectively. This result is not surprising, as the literature is clear that corporation tax is more damaging to the economy than VAT since it is a tax on capital stock.

The policy options for promoting manufacturing competitiveness also include strategic decision on which sector/sub-sector to select for priority Government support. Our results show that, Textile and Garments, Food products and Tobacco are the top three sectors with most potential for Tanzania to gain dramatic improvement in her manufacturing competitiveness. Others in the top ten include Quicklime, Chemicals, Fertilizers, Metal products, Fish, plastics and rubber.

Based on the above findings, the study makes several broad conclusions and recommendations. **First,** as the economy begins to achieve some structural transformation, market failures becomes more significant, requiring substantial government interventions. In the context of low income country such as Tanzania, such intervention would involve dramatic policy measures to reduce costs of production, improve productivity, and adopt business environment reforms that will support broader private sector development. **Second,** owing to the fact that competitiveness will require policy actions in myriad of areas and sectors; the current analysis has identified priorities for Government policy actions:

(i) *Avoid taxing inputs and investments by reducing corporate income tax rate and simplifying the tax structure to reduce cost of production for productive sectors;*

(ii) Increase investment in transport, power and ICT infrastructure to spur growth of value added (production) and innovation;

(iii) Select 2-3 sectors for active Government support through investment promotion, and direct support in their supply/value chain development. These include: Textile and garments, food processing, tobacco products, fabricated metal, rubber and plastics; and

(iv) Build business consensus (partnership) with industry actors on mutual commitment to promote competitiveness.

Third, as competiveness is getting tougher across countries, constant learning from what works (or doesn't) elsewhere and what worked or didn't in the past is critical for informing policy response to competitiveness. The study recommended Botswana, Mauritius and Ethiopia as potential countries for providing useful lessons for Tanzania.

In particular, a set of lessons include building quality institutions to support the process of transformation, leveraging openness to attract FDI and harness opportunities from trade agreements, safeguarding independence in decision making, and the importance of learning by doing.

Fourth and finally, the policies and strategies to support future improvement of manufacturing competitiveness will depend on the extent to which the state and business builds mutual relationship, based on affirmative actions aimed at addressing key bottlenecks, harnessing comparative advantages and fostering the incipient structural transformation. Going forward, REPOA will organize a brief survey to seek specific feedback and recommendations for enhancing competitiveness. Furthermore, a few areas for further research can be identified to include analysis of (i) sources and drivers of competitiveness at product level including assessment of supply/value chain development; and (ii) identifying type of political and economic institutions for enhancing competitiveness.

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