



SUPPORTING
ECONOMIC
TRANSFORMATION

SUPPORTING THE PREPARATION OF
TANZANIA'S SECOND FIVE YEAR
DEVELOPMENT PLAN (FYDP II) 2016/17
– 2020/21

SUMMARY

May 2016

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1. INTRODUCTION: INDUSTRIALISATION FOR ECONOMIC TRANSFORMATION AND HUMAN DEVELOPMENT

Tanzania has grown rapidly, at a rate of around 7% over the past decade, but it needs to overcome a range of economic and political constraints and engage in different ways of working if it is to industrialise more fully, transform the economy, create more good-quality jobs, reduce poverty faster, foster human development and improve resilience against shocks. Industrialisation has been one of the priorities in implementing Tanzania's Vision 2025, but the share of manufacturing in gross domestic product (GDP) is falling and currently below 7%. The Government of Tanzania, through the Planning Commission in the Ministry of Finance and Planning (MOFP), has begun the process of preparing the second Five-Year Development Plan (FYDP II) (2016/17-2021/22) focusing on the theme *Nurturing Industrialisation for Economic Transformation and Human Development*.

This study informs the preparation of FYDP II. It takes stock of Tanzania's industrialisation and economic transformation record, policies and strategies, identifies activities for nurturing a semi-industrialised economy, introduces a range of measurable targets that could be considered for the next FYDP, presents a resource mobilisation framework and considers new ways to make industrialisation and economic transformation a reality. We argue that Tanzania needs a radically different approach in the coming five years in order to seize the opportunities for industrialisation in a rapidly evolving environment.

Tanzania has long had a broad vision of becoming a diversified semi-industrialised economy with a substantial industrial sector. It has developed three five-year plans to guide this, with the first coming to an end this year and the second, aiming at nurturing an industrial economy for economic transformation and human development, being formulated with a view to starting later this year. A number of strategies have supported the implementation of these plans. These policy documents have highlighted desirable aspects, targets and factors behind industrialisation and economic transformation. Crucially, this paper argues it is essential to guide this process by tackling three questions:

- What should be the overall objective for the next FYDP: Undertake an economic transformation diagnostic which describes transformation so far, examines why this has happened and identifies appropriate sectors and targets for future economic transformation.
- What needs to be done to achieve the FYDP II: Formulate policies and a resource mobilisation strategy that remove constraints towards further economic transformation.
- How to make it happen: Introduce new ways of working to implement, monitor, learn lessons and adapt the FYDP II.

The issues facing FYDP II are at some level similar, but at another level very different, from those facing its predecessor. Looking backwards, this plan can learn lessons from the implementation of the first FYDP, asking why some targets have been met but not others. The new plan needs to continue with unfinished business and tackle the economic, political and institutional constraints that have emerged. However, looking forward, this plan faces a new international environment, with rapidly growing African markets and rising Asian wages, which offer opportunities for Africa's industrialisation. The discovery of offshore gas deposits, which, if commercially viable, could boost government revenue by the equivalent of 3% of non-gas GDP and bring in up to \$2 billion in export revenue (while also providing a source of fuel for the supply of electricity and cheaper energy), as well as other natural resources, provides further opportunities for industrialisation, although this also presents risks. Further, this plan relies more on the private sector to undertake much of the activity, with the government facilitating industrialisation rather than getting in the way. Domestic (public and private) financial resources are increasing in relative terms compared with international sources. A new government came to power at the end of 2015. It immediately began with a range of reforms. It should also respond to the challenges above and implement a new vision for economic transformation. It cannot afford to stand aloof and risk further deindustrialisation.

This summary is structured in five sections. Section 2 introduces the policy context around industrialisation in Tanzania and also considers links with human development and the Sustainable Development Goals (SDGs). Section 3 asks what has happened in terms of economic transformation in Tanzania in recent years, whether the previous FYDP targets have been met and why the situation has unrolled as it has. The economic transformation diagnostic presents a baseline of industrialisation and economic transformation, using the available data in an historical context; it benchmarks economic transformation and selected drivers in an international context; and it discusses the range of constraints impeding further progress, including economic and policy implementation constraints. Section 4 then considers what needs to be done to overcome these constraints. It uses a range of different criteria and data techniques to identify promising sectors for transformation and then considers which policies are needed to overcome constraints to developing these sectors. The final section then considers how to make this happen. It identifies preliminary targets for economic transformation, targets for supportive policies and targets for supportive ways of working to make these targets happen. These targets should be considered inputs into further discussions and wider consultation.

We conclude that there are some early signs of structural transformation in Tanzania. The country needs to build on these by addressing generally agreed policy options, but in a different way compared to the past. It can best do this in practical terms by considering a number of collaborative projects that would illustrate how it can nudge the economy further onto a more transformational path in the following areas: infrastructure development, human capital development, tax policy reform, investment climate reform and practical industrial policy. But this requires learning and adaptive development throughout the duration of the plan – a new approach that is appropriate given the new challenges.

2. THE POLICY CONTEXT OF INDUSTRIALISATION IN TANZANIA

It is important to set the FYDP II in the context of past attempts to develop the Tanzanian economy, because this shows how the policy stance changes over time and that past attempts of industrialisation have not always been successful. Development of the country's industrial sector can be viewed across four periods, each with a different ideological/development philosophy.

First, during the early years of independence (1961-1966), the industrial sector contributed only about 4% percent to GDP. The focus was on attracting investment and import substitution.

Second, in the socialist era (1967-1985), the major means of production were nationalised, with most major subsequent investments made in public enterprises under the National Development Corporation. The economic crisis in Tanzania that followed continued into the mid-1980s, and was associated with a difficult environment for industrial development characterised by excessive controls, including import licensing and exchange and price controls. These controls created a business environment that hampered the industrial sector and the building of capabilities to compete.

Third, in the structural adjustment and liberalisation phase (1986-1995), Tanzania opened up its economy, including through trade liberalisation and privatisation. State-controlled industrialisation gave way to market-led industrialisation. Imports increased and domestic production of manufactured goods declined. This was a period of deindustrialisation (e.g. by 1990, 22 out of 24 textile factories had closed).

Finally, in the return to the development agenda and industrialisation (1996-2015), the policy stance changed, bringing the question of industrial development back onto the development agenda in the context of market orientation and private sector-led development. The private sector was promoted to take the lead in industrialisation, with the government responsible for putting in place a conducive policy and regulatory environment and the requisite infrastructure.

The Tanzania Long-Term Perspective Plan (LTPP) (2011/12-2025/26) emphasised the transformation of the economy. It envisaged a major change in the growth path, with the contribution of the industrial sector

to GDP rising from the current (2010) 24.4% to 31% by 2025, and manufacturing specifically almost doubling, from 9.3% to 18%, as experienced in developing countries reaching middle-income status.

The LTTP is to be executed in greater detail through three FYDPs, with a view to achieving the targets of the Tanzania Development Vision. FYDP I (2011/12-2015/16) focuses on the removal of binding constraints to growth (hard and soft infrastructure, electricity and markets). It seeks to build a foundation for self-propelling industrialisation and export-led growth by encouraging agricultural processing and natural resource value addition – that is, resource-based industrialisation. It specifies five core priorities to unleash Tanzania's latent growth potential: (i) infrastructure (e.g. large investments in energy, transport infrastructure, water and sanitation and information and communication technology (ICT)); (ii) agriculture, focusing more on the transformation of agriculture to enable food self-sufficiency and on enhancing exports, irrigation and high-value crops; (iii) industrial development, particularly employing abundant labour and adding value to local raw materials, as well as the development of special economic zones (SEZs), which would also facilitate public-private partnerships (PPPs); (iv) human capital development that enhances skills with an emphasis on science, technology and innovation; and (v) promoting tourism, trade and financial services.

FYDP II (2016/17-2020/21) will focus on industrialisation as one of the pillars of socioeconomic and political development (intensified industrial development and promotion of structural change: light manufacturing and resource-based strategic industries). FYDP III (2021/22-2025/26) will focus on further promoting the competitiveness of the manufacturing sector and making substantial improvements in Tanzania's share in global and regional trade.

In 2015, the Government of Tanzania decided to merge the FYDP and National Strategy for Growth and Reduction of Poverty (NSGRP) planning frameworks (MKUKUTA). The current priority FYDP focus is on industrial development in economic transformation, but this also needs to be explained in terms of human development. Broad-based sectoral improvements (including in agriculture and services industries without smokestacks) remain important for economic transformation and human development, but, traditionally, industrial development has a special relationship with human development over the longer term. Industrial development leads to wealth creation and greater incomes throughout the economy. Innovation and productivity growth in manufacturing is faster than in other sectors, and faster technology adoption and innovation raises aggregate labour productivity and reduces prices, which raises real incomes and profits that allows faster investment.

The rapid promotion of exports of manufacturing is also one of a few proven routes to sustained job creation, with more, and higher-quality, jobs increasing aggregate incomes. When manufacturing is further linked with other sectors, for instance when it adds value by processing agricultural and other commodities, it creates multiplier linkages throughout the economy and, hence, induced effects on human development. Manufacturing growth further builds resilience against external shocks by diversification out of commodities, and manufacturing exports provide much-needed foreign exchange. Resilience to shocks protects the livelihoods of the poorest. Finally, industrial development based on broad-based private sector development often goes hand-in-hand with increased tax revenues, which helps provide the budget to promote human development.

As there are strong linkages between industrial development, economic transformation and human development over the mid to long term, the FYDP also relates well to the SDGs, which, according to the previous government, would need to be implemented through the FYDP. Industrialisation and productivity change are directly linked to the economic and social SDGs. Furthermore, Tanzania's vision of natural resource-based industrialisation depends strongly on the sustainable management of natural resources (water, energy, land, etc.). The adoption of environmentally friendly techniques, such as renewable energy technology, could be a win-win for Tanzania.

3. ECONOMIC PERFORMANCE IN TANZANIA – WHAT HAS HAPPENED AND WHY

TANZANIA'S ECONOMIC TRANSFORMATION

We undertake an economic transformation diagnostic to understand recent progress on economic transformation. Tanzania is one of the fastest-growing countries in Africa, with growth at 6.6% annually over 2007-2013. However, the manufacturing share of GDP has remained stagnant since 2007 and was below 7% in 2013 and 2014, whereas the share of agriculture actually increased, going from 27% in 2007 to 32% in 2013. Tanzania revised its GDP data at the end of 2014, which resulted in a level shift in GDP in 2007 of 27.8% as well as a change in sectoral contributions. However, while the recent rebasing of GDP data suggests there is evidence of faster structural change than previously thought (e.g. an increase in the share of the tertiary sector in GDP by 3 percentage points), overall economic transformation looks to be very slow, at least at this aggregated level. This has also manifested itself in a high poverty rate (28% in 2012) which is slowly declining compared to Uganda and Ghana, for example.

When we look at some other aspects, however, we can see more evidence of economic transformation. For example, the share of agriculture in total employment fell from 76.5% in 2006 to 67.0% in 2014, that of manufacturing increased from 2.6% to 3.1%, that of wholesale and retail trade went from 7.6% to 12.6% and that of hotels and restaurants rose from 2.0% to 3.9% (see Table 1). When we look at the contribution sectors have made to productivity change over 2007-2013, we can see that manufacturing made the same contribution as agriculture, but the construction, transport and communication sectors have helped transform Tanzania significantly.

Table 1. Employment and labour productivity by sector in Tanzania

	Level of employment		Employment shares		Annual change in labour productivity (2007-2013)	Relative productivity 2013	Contribution of sector to aggregate labour productivity change 2007-2013
	2006	2014	2006	2014			
Agriculture/hunting, forestry and fishing	12,713,234	13,409,814	76.5%	67.0%	3.3%	0.4	8.9%
Mining and quarrying	84,325	218,023	0.5%	1.1%	-10.2%	3.0	2.3%
Manufacturing	434,206	615,323	2.6%	3.1%	1.0%	2.4	8.8%
Electricity, gas and water	17,005	32,983	0.1%	0.2%	-6.7%	9.6	0.6%
Construction	178,681	422,395	1.1%	2.1%	-4.8%	4.6	16.9%
Wholesale and retail trade	1,269,356	2,528,771	7.6%	12.6%	-4.9%	0.8	11.1%
Hotels and restaurants	327,433	787,038	2.0%	3.9%	-10.5%	0.4	0.3%
Transportation/storage and communication	244,227	521,697	1.5%	2.6%	-3.4%	3.8	17.1%
Financial intermediation	17,497	60,607	0.1%	0.3%	-9.1%	12.7	7.8%
Public admin and defence	184,749	189,939	1.1%	1.0%	2.7%	7.2	0.0%
Education	224,468	413,710	1.4%	2.1%	-3.3%	1.6	4.0%
Health and social service	100,482	167,243	0.6%	0.8%	-1.7%	2.0	2.0%
Other	831,470	659,594	5.0%	3.3%	10.3%	5.2	16.3%
Total	16,629,139	20,029,151	100.00%	100.00%	3.03%	1	100.0%

Note: Other includes real estate/renting and business activities, other community/social and personal service activities and private households with employed persons. Sources: Table 5.7: Distribution of Employed Population Aged 15 and above by Industry, Area and Sex, 2014 (from 2014 Labour Force Survey); Table B3: Employed Population by Sex, Area and Industry, 2006 (from 2006 Labour Force Survey). Employment data matched with rebased sector GDP data. Procedures to calculate changes and relative levels of productivity and the contribution of a sector to aggregate labour productivity change (both with and between sectors) are set out in the main report.

Related work for SET shows that females benefited from the sectoral employment shifts. Although more females than males continue to list agriculture (the lowest productivity sector) as their primary activity, growth in urban populations along with improved opportunities in the non-agricultural sectors brought many women into the trade sector – where they now have employment parity; the hotel and food service sector – where they dominate employment; and manufacturing – where female employment rose faster than male employment, even if it is still lower as a share of employment. As manufacturing has much higher productivity than the economy-wide average, this is good news. Shifting output shares did not bring women into the transport or construction sectors, however, which means that females lost out on high productivity employment opportunities in these large sectors.

While Tanzania ranked only 122 out of 180 on the Hausmann economic complexity index in 2012, it was among the top 10 countries with the largest increases over 2000-2012. Product space analysis further suggests Tanzania has moved over time from specialising in peripheral products that have very few products in the vicinity towards specialising in products that have more links to other products (i.e. are more in the middle related to machinery, electronics or garments), which indicates a better and more complex specialisation pattern. Manufacturing production doubled in real terms between 2005 and 2014. Using the World Development Indicators over 1997-2012, manufacturing production increased annually on average by 2.3% across the world, 3.4% in Sub-Saharan Africa and 7.9% in Tanzania.

And, perhaps surprisingly, the contribution of structural change (moving between sectors) to labour productivity change has increased in recent years (currently amounting to between 50% and 80% of the total labour productivity change):

- It contributed negatively to labour productivity change over 1990-2000, but was responsible for around half of the positive changes over 2000-2010 (pre-rebasing, Groningen database).
- It contributed 80% of labour productivity change over 2002-2012 (pre-rebasing, work by McMillan).
- It contributed two-thirds of labour productivity change over 2010-2013 (pre-rebasing, new UN/International Labour Organization (ILO) data, see Figure 1).
- It contributed three-quarters of labour productivity change over 2007-2013 (own analysis using Tanzania data sources, such as rebased GDP data and the 2006 and 2014 Labour Force Surveys).

Figure 1. Decomposition of labour productivity change, Tanzania, Kenya and Uganda (annual %)



Note: Combines UN data on sectoral GDP and ILO data on employment.
 Source: SET analysis <http://t.co/BboidifT8Z>.

We estimate that aggregate labour productivity grew by 3.0% annually over 2007-2013 (using new GDP data) and 3.5% over 2010-2013 (old data), more than twice as high as growth in Kenya and Uganda. Agricultural productivity rose fast, by 3.3% annually over 2007-2013, and manufacturing by 1.0% annually. The contribution of each of these sectors (within and between) to overall labour productivity change over the period was around 9%. Tanzania is on track to move its economy onto a more transformational path and manufacturing growth will further help aggregate productivity change. However, unless Tanzania can

continue to move into sectors with opportunities for learning and economies of scale such as manufacturing or productive services, it risks exhausting the gains from reallocation of resources from agriculture to other sectors in the near future and instead getting stuck in holding pattern growth associated with unproductive urban areas that contain low-productivity services that lack dynamic gains. A greater contribution from industry and high-productivity services is crucial.

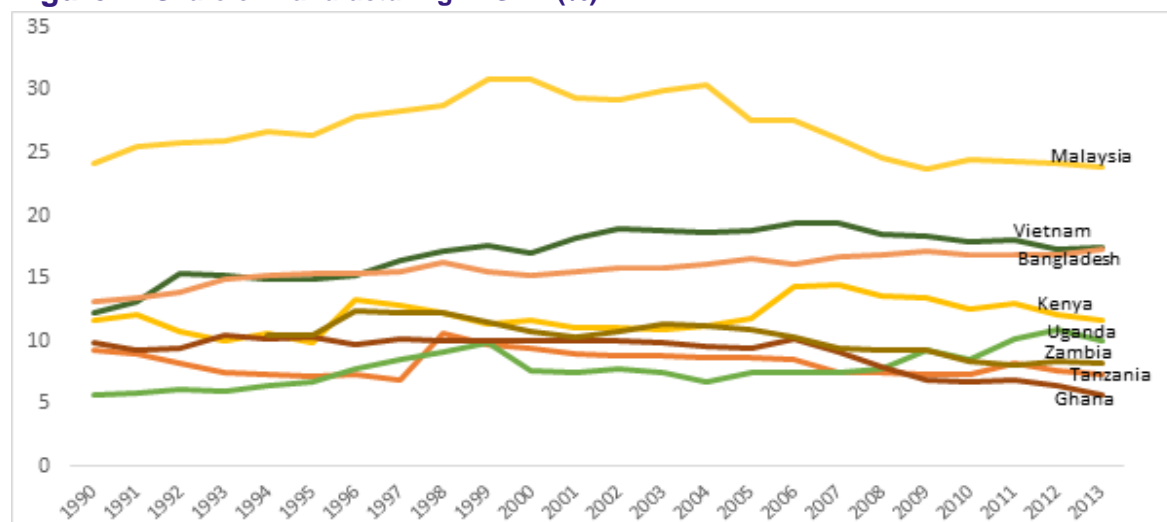
Trade and foreign direct investment (FDI) have also increased recently. Between 2005 and 2013, total FDI increased from \$936 million to \$1.87 billion – doubling in just under a decade. Imports of goods have risen to over \$12 billion in value, and exports have also increased, from just under \$2 billion in 2005 to approximately \$4 billion in 2013. Services exports (especially tourism) have grown fast in recent years, and now amount to \$3.2 billion, or 38% of total exports of goods and services. The value of manufacturing exports grew from \$106 million in 2005 to \$794 million in 2014. Intraregional exports to the rest of Africa accounted for approximately 72.4% of the total value of Tanzania's manufacturing exports in 2014, with the bulk of intra-African exports destined for markets in the East African Community (EAC) (46.6%) or the Southern African Development Community (47.1%). In value terms, intra-African exports of manufactures from Tanzania are dominated by textiles (29.4% of total exports of manufactures) and non-metal mineral manufactures (11.8%); but exports of various types of machinery and equipment (industry special machinery, telecommunications equipment, scientific and other instruments, photographic equipment and clocks, railway/tramway equipment and power generating equipment) feature prominently among Tanzania's fastest-growing manufacturing exports to Africa over the past decade. Moreover, since 2010, the share of Tanzania's medium- and high-tech manufacturing exports in total manufacturing exports has increased (although this is due to both growth in Tanzania's medium- and high-tech exports – at an average annual rate of 12% between 2010 and 2013 – and declining growth rates of exports of resource-based (by 10%) and low tech products (3%) over the same period). Even so, the majority of Tanzania's manufactured exports remain resource-based, especially those exported to destinations outside Africa.

TANZANIA'S ECONOMIC DEVELOPMENT IN A COMPARATIVE CONTEXT

We compared Tanzania with its neighbours (Kenya and Uganda), other African countries (Ghana and Zambia) and three Asian countries (Bangladesh, Malaysia and Vietnam) on the basis of production structures and a range of determinants of economic transformation, including trade, skills, finance and infrastructure.

Tanzania's GDP per capita performed well compared with Kenya over 1990-2013, and it maintained its relative position with respect to Ghana and Zambia. Interestingly, whereas Tanzania and Vietnam had the same GDP per capita in 1990, Vietnam's level was twice as high by 2013. Tanzania's share of manufactures in GDP remained flat and at a comparatively low level over 1990-2013. On the one hand, this is better than in Ghana and Zambia, which saw a sharp *decrease* in their share, particularly from 2006. On the other hand, it is much worse than in Bangladesh and Vietnam, which observed increases in the share of manufactures. Malaysia's manufacturing share has reached a peak and is now declining during a shift towards services.

Food and beverages are responsible for more than 40% of manufacturing output in Tanzania. This is similar to the share in Kenya but substantially greater than that observed in Bangladesh, Malaysia and Vietnam. Malaysia has a high share in office, accounting and communication equipment that is compatible with its high share in exports of high-technology products. Bangladeshi textiles and wearing apparel represent more than 50% of its manufacturing output. Other sectors in which Tanzania has high production shares include furniture, rubber and plastic, and non-metallic mineral products.

Figure 2. Share of manufacturing in GDP (%)

Source: World Development Indicators (2015)

Investment is a primary determinant of productivity growth and economic transformation. Malaysia, for example, invested almost 40% of its GDP before the Asian crisis. Vietnam seems to be following the same path. In the case of Tanzania, investment has averaged around 25% of GDP – still a little low given its level of development. Moreover, the situation has been unstable, with several years in which the ratio has fallen. In the past few years, the investment ratio has been rising again.

Tanzania has low-quality transport infrastructure, even when compared with its African peers (Table 2). Kenya and Ghana, for example, have a substantially higher quality of transport infrastructure.

Table 2. World rankings on transport infrastructure (2015)

	Quality of infrastructure			Average rank across infrastructure
	Railway	Road	Port	
Malaysia	12	19	19	17
Kenya	71	59	61	64
Ghana	66	79	92	79
Vietnam	52	104	88	81
Bangladesh	75	117	93	95
Zambia	87	86	124	99
Tanzania	88	112	106	102
Uganda	101	105	118	108

Source: World Economic Forum World Competitiveness Rankings

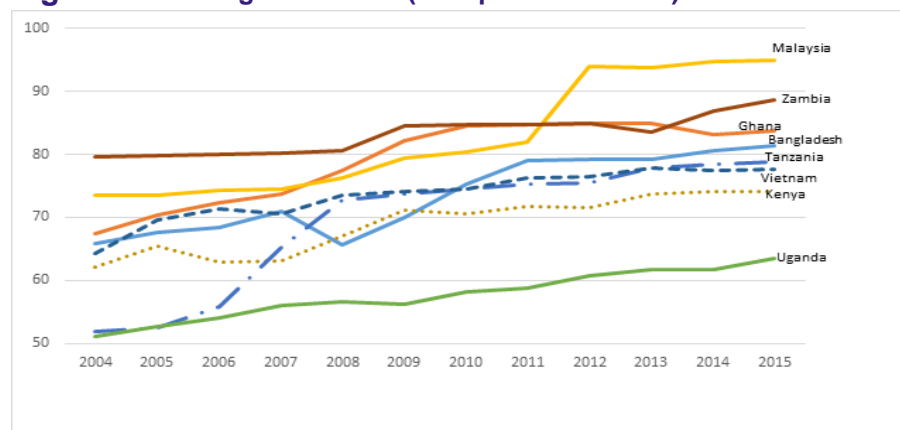
African countries, particularly Kenya, Tanzania and Uganda, have low levels of tertiary education enrolment, although the figure for Tanzania has increased recently. Ghana has higher levels and compares well with the levels observed in Bangladesh. Vietnam has much higher levels of tertiary education enrolment.

In terms of credit available to the private sector (expressed as a share of GDP), Kenya has higher levels and Tanzania lower levels. This ratio has increased substantially in both Tanzania and Vietnam. However, whereas Vietnam has reached high levels of financial deepening, close to those seen in Malaysia, Tanzania has levels similar to those seen in the rest of Africa.

Tanzania has made improvements with respect to the business environment. Between 2006 and 2007, Tanzania made substantial reforms that allowed it to position itself closer to the group of other African countries and Bangladesh and Vietnam. For example, as Figure 3 shows in the case of starting a business,

Tanzania caught up with other countries over this period, but the pace of reforms has since slowed. In addition, there remain a number of other problematic issues related to Tanzania's business environment, including inefficient customs procedures, poor quality road, rail and port infrastructure, inefficiencies in the tax system and a high number of nuisance taxes, high energy costs and unreliable electricity supply.

Figure 3. Starting a business (best performer =100)



Source: World Development Indicators (2015)

HAVE FYDP I TARGETS BEEN MET?

The first FYDP included a range of quantifiable indicators. Some targets have been met (tertiary enrolment rate, government expenditure as share of GDP) or even exceeded (total manufacturing employment, manufacturing share in total exports, budget deficit (excluding grants) as a share of GDP, mineral sector share in GDP), while others have not although good progress has been made towards the targets (e.g. average annual GDP growth). That said, some of the targets that were achieved may have been too easy to attain or mask fiscal management problems (such as the target on overall government expenditure as a share of GDP). Moreover, many targets have turned out to be too ambitious, such as targets on the share of manufacturing in GDP, share of Tanzania in world trade, rank on the World Bank Doing Business indicators and tax revenues. More generally, there is a sense that the budgeting and revenue targets have not been realistic, and there is a need for future budgets to be more realistically linked to actual revenues. This needs to be considered when designing the next FYDP.

Table 3. FYDP I (2011/12-2015/16): targets and progress, illustrative examples

Target area in FYDP I	Target in FYDP I (2011/12-2015/16)	Experience since 2011	Assessment of progress
Average annual GDP growth	8%	7.2% over 2011-2013	Progress towards the target but fell short
Global rank of Tanzania in World Bank Doing Business survey	Decreasing below 100	131 in 2015 and 130 in 2014	Progress towards the target but fell short
Manufacturing sector GDP contribution	Increasing to 12.9% by 2015/16	Constant at 7% over 2007-2013 (rebased data) 9% old data	No progress
Total manufacturing employment	Growing from 120,000 people presently to over 221,000 people by 2015/16	615,323 in 2014 (Labour Force Survey)	Target exceeded
Tertiary enrolment rate	Increased from 1.5% to 4%	4% in 2012	Target met
Manufacturing share in total country's export	Accounting for 19.1% by 2015/16	25.1% in 2013	Target exceeded
Mineral sector in GDP	3.7%	4.3% in 2013	Target exceeded
Fisheries in GDP	5% in 2015/16	2.4% in 2013	Got worse
Increase share of Tanzania in world trade	From current 0.022% to 0.1% by 2015/16	0.016% in 2014	Got worse
Increase contribution of trade to GDP	From current 16% to 20% by 2015/16	19% (exports/GDP) in 2014	On track to achieve target

Target area in FYDP I	Target in FYDP I (2011/12-2015/16)	Experience since 2011	Assessment of progress
Budget deficit	Restrict the budget deficit (excluding grants) to 10% of GDP	Budget balance to GDP ratio (excluding grants) of -5.1% in 2014/15 (provisional data)	On track to exceed target
Tax revenues	Increase revenue-to-GDP ratio to 19%	Tax revenue to GDP ratio of 12% in 2014/15 (revised data). Current revenue to GDP ratio of 14% in 2014/15.	Got worse. Tanzania's revenue to GDP ratio remains low compared with most EAC counterparts.
Tax exemptions	Reduce tax exemptions to 1% of domestic revenue	Tax exemptions projected to amount to equivalent of 1.5% of GDP for whole of 2015/16 financial year (1.4% of GDP for period from July 2014 to April 2015). This is down from 2.5% of GDP in 2013/14.	Progress towards the target (particularly since the passing of the new VAT Act in 2014) but fell short
Government expenditure	Overall government expenditure not to exceed 28% of GDP	Projected to be 20.6% at the end of 2015/16	Target met

Source: Main report

WHAT HAVE BEEN THE ECONOMIC CONSTRAINTS?

The economic transformation diagnostic has noted the lack of transformation in Tanzania, although there have been some good signs recently. There are a range of economic challenges in meeting several targets. The main report examines why certain industries that could help in economic transformation in Tanzania have not developed so far. It undertakes document and data review and analysis, augmented by qualitative in-depth interviews. We do not emphasise one view but bring together a large body of evidence. Our main conclusion is that a number of constraints are common across a large range of sectors. We divide constraints into two categories: economic fundamentals (skills, infrastructure such as energy and transport, finance and technology) and policies and institutions (including trade policy, corruption and effective coordination). There are a number of special constraints to small and medium sized firms such as finance, tax compliance and access to land.

Consultations with the private sector suggested that constraints that require urgent and robust solutions as prerequisites for rapid industrialisation include the following:

- Low levels of availability and reliability of low-cost energy and transport infrastructure;
- Lack of innovation and access to information;
- Lack of skills;
- Lack of policy coherence and predictability, which is a serious impediment to capital formation and industrialisation;
- Many uncoordinated policies, legislations and taxes, hindering competitiveness;
- Limited and extremely expensive land for industrial projects;
- Low levels of productivity and fragmentation in agriculture.

In addition to our own stakeholder analysis, we reviewed a range of relevant studies that examined the constraints to sectoral growth and economic transformation. Some studies (WEF) are based on internationally comparable data and interviews, some based on in-depth interviews with key firms (Sutton), and others based on in-depth sectoral studies (Dinh and Monga). Table 4 brings the information together by summarising the broad constraints identified in the strategy documents (the details are in the main report). The review identifies three major binding economic constraints that are common across most studies i.e. limited infrastructure, low worker skills and little access to finance. Policy and institutional constraints also limit growth and the reviewed studies all agree on one aspect – the impact on energy generation, although other examples are given, such as the policy bias towards imports (distorting export production costs) or the cumbersome bureaucracy that limits access to land for industrial purposes. There is, therefore, a reasonable consensus on the type of policies required.

Table 4. Broad constraints to sector growth

	Infrastructure	Skills	Finance	Tariffs and taxes	Land policy	Energy policy	Corruption	Coordination
Dinh and Monga (2014)	Yes	Yes		Yes	Yes	Yes		
UNIDO (2012)	Yes	Yes						Yes
World Bank Enterprise Survey (2013)	Yes		Yes					
Global Competitiveness Index (2014-2015)	Yes	Yes	Yes	Yes			Yes	Yes
Sutton and Olomi (2012), Enterprise Map	Yes	Yes	Yes	Yes	Yes			
Stakeholder consultations	Yes	Yes		Yes	Yes			Yes

Source: See references in the main report

WHAT HAVE BEEN THE CONSTRAINTS ON POLICY IMPLEMENTATION AND WAYS OF WORKING?

Unfortunately, it is not the lack of sensible policies but ineffective implementation that has often been a major constraint in Tanzania. As our review indicates, significant industrialisation has been a failure in Tanzania so far despite different policy approaches. It is unrealistic to nurture an industrial economy without taking into account the failures of the past and the political economy challenges of the present. For example, industrialisation targets for the past five years have been missed. On the other hand, recent performance in the economy (strong agricultural labour productivity and structural change into, for instance, ICT and communication activities) suggests better performance than could be anticipated given experience in the past or in other countries.

There are a range of country-specific characteristics for effective economic transformation policy, as well as characteristics of the institutions behind good policy: trust, leadership, collaborative working and policy consistency. A review of these issues suggests Tanzania may not have had all these benign characteristics in the past. Our analysis is not exhaustive, but we highlight a number of indicative areas. We are not suggesting these issues are pervasive all the time and everywhere, or differ significantly from neighbouring countries, but they are examples showing a lack of policy preparedness in Tanzania. The current global environment – particularly in relation to the rebalancing in China, regional growth, and the potential for offshoring manufacturing jobs away from China – provides an opportunity for African countries to gain manufacturing market share, and competitors such as Ethiopia have been proactive in looking to seize the opportunity. It remains to be seen whether this will occur in the case of Tanzania.

Trust among stakeholders is essential but has sometimes been lacking. The consultations as well as historical considerations presented in the report suggest distrust and a lack of reciprocity still exist between the public and the private sectors in Tanzania. It will be important to build this trust and to institutionalise effective state–business relations. There are challenges with the President’s Advisory Council in Tanzania, which is seen as less effective in leading reforms than similar structures in Ghana, Senegal and Uganda. Many proposed investment and policy changes at sector level have not been undertaken or have been delayed. There needs to be a fundamental change whereby the state and private sector do not compete with each other, or work in silos, but instead work together, with the state playing a facilitatory role. This is especially important in the context of the next FYDP, which relies heavily on private sector investment.

Leadership is crucial. Although economic transformation has been embedded in the language of the speeches of top officials, implementation has involved multiple initiatives (Big Results Now (BRN), among others) and different private sector associations at different times (the Tanzania Private Sector Foundation,

the National Business Council, etc.). It is important that ensure that clear lines of responsibility are assigned and that agencies stay focused and see projects through.

Inter-agency/ministerial coordination within government: Policy coherence is not always achieved. For example, in the past, value-added tax (VAT) and import duty exemptions granted by the Ministry of Finance through the Tanzania Investment Centre were not always honoured by the Tanzania Revenue Authority (TRA) or Customs, and, vice versa, duty on rice imports were lowered discretely, suggesting a lack of coherence in implementation. This is not to suggest incentives as such are the magic solution (in fact a comprehensive resource mobilisation framework is required), but rather incoherent implementation fails to deliver intended benefits and creates uncertainty for potential investors.

Tanzania lacks enough demonstration examples of good **collaborative projects** between relevant stakeholders, perhaps because state–business relations are not sufficiently institutionalised. A task force to deal with the financial crisis in 2008-2010 and the past TRA process to raise tax to GDP ratios have been suggested as good examples, but there are many examples of failed collaborations. For example, one stakeholder suggested the FYDP I was to involve specific PPPs in energy distribution but these never materialised, whereas corruption has affected other infrastructure projects. Other instances include a lack of collaborative action on the part of government to support horticulture in seeking adequate transport arrangements (unlike in, for example, Kenya), land and water rights, taxation and credit. In the area of industrialisation, recent examples of Chinese investment in Ethiopian shoes and Rwandan garments show that hard and collaborative work to attract investment in light manufacturing can lead to results. The absence of an emphasis on implementing such collaborations represents a missed opportunity and needs to be rectified in the approach to the next FYDP. This requires active leadership from the top.

Policy inconsistency is an issue in Tanzania. In broad terms, this impacts negatively on the delivery of public services which, in turn, can influence the potential for transformation via the labour supply and, more generally, undermine human development. Policy inconsistency may also have more specific sectoral impacts. For example, the gold sector featured regulations that were seen as international best practice at first, but a more recent act and problems around mining rights have dampened interest in the mining sector (the point here is the lack of consistency, not the appropriate level of taxes). Furthermore, according to stakeholders, the TRA does not always adhere to conditions in agreements. As a further example, after the business environment improved (see analysis above), recent years seem to have seen some reform fatigue. It is therefore important that the new FYDP includes a renewed emphasis on business environment reforms.

There remain **vested interests**, which sometimes run out of control. There are widely discussed problems associated with energy governance (TANESCO), port management (Ports Authority) and tax revenue management (TRA) in Tanzania, and these will dampen attempts to industrialise if they are present at a large scale. In fact, one of the priority areas that requires urgent attention is the energy sector ahead of the expected oil and gas boom. It will also be important to address the high levels of concentration in certain manufacturing sectors (e.g. leather and leather products, apparel, textiles, wood products). In many cases this is the product of the dominance of large firms in these sectors (with small firms finding it difficult to enter the market) and weak competition (compared to other East African countries) among these large enterprises. Higher levels of competition in Tanzania's manufacturing sectors can promote greater productivity growth.

A strong political economy literature exists on Tanzania which argues that these implementation failures are systemic, and thus present severe challenges. The new Government has admirably begun to tackle problems at the port and revenue authorities, but lasting solutions will require ongoing political commitment and ingenuity.

4. LOOKING AHEAD: WHAT NEEDS TO BE DONE?

Despite strong growth, Tanzania has not yet achieved a sufficient level of economic transformation, and it has faced a range of constraints to doing so. Growth has the potential to be much higher and more inclusive. But much can be done to come out of this impasse. We look ahead by:

- Identifying **promising sectors** for Tanzania's future economic transformation;
- Reviewing **desirable policy options** to address constraints to the development of these sectors; and
- Designing a **resource mobilisation framework** that considers the new financing environment (less aid, more domestic public and private resources).

PROMISING SECTORS FOR TANZANIA'S FUTURE ECONOMIC TRANSFORMATION

A range of methods exists to examine promising sectors for Tanzania's future economic transformation as part of FYDP II. We divide these into single criteria, such as employment potential, current production or productivity or availability of natural resources, and mixed criteria, which combine objectives. We have reviewed relevant documents, undertaken a range of new statistical analyses and consulted the private sector. Our analysis assumes sectors have good potential to contribute to economic transformation in Tanzania when they make use of the country's resources, raise productivity and diversification or support other sectors. We look at the body of evidence, rather than being guided by one particular study or method.

We observe a number of patterns when considering the range of available evidence. Important sectors that use Tanzania's resources include traditional products such as sisal, fish and gold and future promising products such as natural gas, vegetables, iron and uranium. Some generate jobs and others bring export revenues. Key sectors that help Tanzania move up on value-added through agri-processing and manufacturing include processing of cashews, leather, fruit and nuts and production of wood and paper products, with machinery and chemicals as strategic bets. Some of these help increase Tanzania's value addition; others help raise its productivity and productive capacity. Finally, services such as tourism, logistics and finance are fast-growing sectors, with tourism creating foreign exchange and jobs and logistics and finance supporting other industries. Table 5 summarises these different types of sectors (in Section 5 we present these as three types of sectors).

Table 5. Selecting promising sectors

Criteria for inclusion of sector	Techniques used	Identified sectors	Source
<i>Single objective</i>			
Resource endowments (geography and availability of natural resources)	Qualitative	Agriculture and agro-processing (sugar cane, rice, livestock, horticulture, fruit and nut processing), tourism, natural gas, mineral and metal-based industries, energy, transport	SET analysis
(Low-skilled) employment potential	Input-output models/ employment multiplier	Agricultural products such as cashews, pulses, sorghum, sisal and fish	SET analysis in Appendix
Domestic value-added contribution to exports	Eora database calculations	Telecommunications, chemical and mineral products, electrical machinery, wood and paper, metal products, hotels and restaurants	SET analysis in Appendix
Past export specialisation (revealed comparative advantage, RCA)	Compute RCA, broad product categories	Precious stones, vegetable products, prepared foodstuffs, live animals, textiles	SET analysis in Appendix
	Compute RCA for specific product categories	Mineral goods, brazil nuts, oil seeds, leather products, furniture paper, cement, fish, tobacco and coffee	World Bank Country Economic Memorandum (CEM) 2014

Criteria for inclusion of sector	Techniques used	Identified sectors	Source
Concentration in manufacturing production (share and compared with other countries)	Manufacturing production shares	Food and beverages, furniture, rubber and plastic and non-metallic mineral products	SET analysis
Relative firm-level productivity (compared with other sectors and other countries)	Calculate total factor productivity using World Bank Enterprise Survey	Plastics, chemicals and food in Tanzania have, on average, higher productivity compared with other sectors and countries	SET analysis in Appendix
Products in which world demand is growing and Tanzania is specialising	Trade data analysis	Cashew nuts, gold, coconuts, oil cake residues, precious stones, sesamum seeds, oil seeds, cocoa beans, cereal	SET analysis in Appendix
Products in which world demand is growing and Tanzania is decreasing its specialisation	Trade data analysis	Sunflower seed, beer hides and skins, boxes, footwear, palm kernel, vegetable fats and oils	SET analysis in Appendix
Mixed objectives			
Market size, value chain length, availability of resources and comparative advantage	Qualitative	Fertiliser, textiles, edible oils, cashew nuts, fruits, dairy, leather products, light machinery, iron and steel, tourism	Tanzania Integrated Industrial Development Strategy (2011)
Strategic bets combining product complexity, distance (how far is certain product from current revealed capabilities?) and opportunity gain (how strategic is that product in terms of its proximity/connectedness to other complex products?)	Hausmann-Hidalgo product space analysis	Machinery and transport equipment (e.g. specialist industrial machinery), chemicals and related products (e.g. organo sulphur compounds), manufactured goods classified chiefly by material (e.g. glass sheets), miscellaneous manufactured articles (e.g. microscopes)	SET analysis in Appendix
Products Tanzania does not export but that are 'close' to the one it is already exporting	Hausmann-Hidalgo product space analysis	<i>Agriculture:</i> rice, nuts, vegetables (cucumbers and lettuce), <i>agri-business:</i> preserved fruits and processed meat, <i>manufacturing:</i> sheepskins, rubber tires, wool, silk, paper and pulp products, hand-woven tapestries	World Bank CEM (2014)
Employment potential, growth capacity and capacity to produce	RCA, Hausmann-Hidalgo	High-value vegetables and fruits, processed grains and wheat, processed meat, wood products, paper products, leather processing, tourism	World Bank CEM (2014)
Growth potential; shifting from low- to high-productivity sectors; employment creation	RCA, Hausmann-Hidalgo and Justin Lin's Growth Identification Framework	Tourism, wood, leather, agro-processing	Dinh and Monga (2013)
Natural resource and ability to boost labour-intensive industrialisation path	Qualitative	Natural gas, iron and steel, agro-processing, minerals	UNIDO (2012)
Stakeholder views			
Employment intensity of industries given structure of the labour force and intensive use of local raw materials	Private sector stakeholder analysis	Pulp and paper, cashew processing, leather industries, textiles, mineral beneficiation	SET stakeholder workshop

Source: See references in the main report

DESIRABLE POLICY OPTIONS TO BOOST TANZANIA'S ECONOMIC TRANSFORMATION

In principle, governments play a crucial role in alleviating constraints to economic transformation, but they can also accentuate them. A temptation for many countries in search of industrialisation is to plan large-scale industrialisation behind protected borders, but experience suggests this is doomed to fail in the end. Indeed, the literature clearly suggests that opportunities for effective interventions are limited and specific, and need pragmatism rather than unbridled ideological ambition. Not all constraints relate to market failures, as governments can fail too. Instead, there is a more nuanced role for the state in promoting industrialisation, which is not to pick or replace winners but to create the conditions for winners. This role

is one whereby the state puts in place the right framework, incentivises the private sector to build industrial capabilities and nudges the economy into the right direction through collaborative action and effective state–business relations.

The consultations and reviews of policy documents suggest there is no lack of policy suggestions on how Tanzania can promote industrialisation and economic transformation. One challenge is to bring together policy suggestions from a range of different sources into a compelling framework around economic transformation. We previously identified sectors with the potential to make significant contributions to economic transformation when they raise Tanzania's productivity or diversify its export and production structures.

Accordingly, we classify policies into those intended to promote (i) *structural change*: public actions to accelerate the movement of resources from lower- to higher-productivity sectors by reducing the economic costs of resource flows into modern economic activities and/or by increasing the rate of growth of modern activities relative to the rest of the economy; and (ii) *within-sector productivity growth*: public actions to generate sustained productivity growth across the economy, by increasing the productivity of firms in modern economic activities and/or by promoting productivity growth across the entire range of economic activities, including agriculture, manufacturing and services.

In an effort to provide some further structure, we distinguish within each of these policy sets between (a) policies that are 'horizontal' and improve fundamentals (skills, infrastructure, financial sector development or investment climate) and (b) policies that are more targeted and display some measure of selectivity (e.g. they are aimed at specific economic activities (SEZs, FDI policy or targeted technical assistance). The evidence suggests that countries that have transformed substantially have used a combination of policies from all cells but also that countries struggle to effectively implement selective transformation policies because such policies require an appropriate institutional context. Table 6 synthesises policy suggestions for Tanzania.

Table 6. Public actions for economic transformation in Tanzania

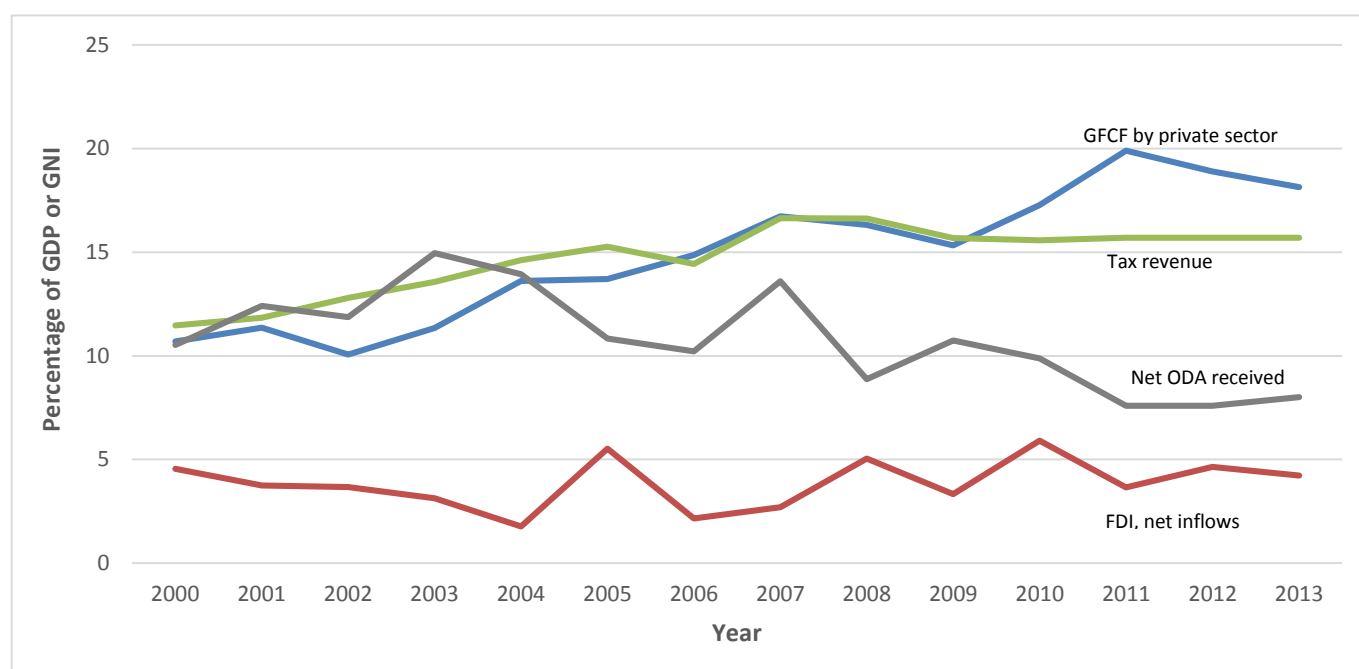
	Improving fundamentals (cross-sectoral)	Targeted interventions (sector-specific)
Public actions to support structural change	<ul style="list-style-type: none"> Investment climate reform (e.g. improved customs procedures, lower export taxes and lower tariffs on inputs) Financial sector development leading to public–private partnerships (PPPs) Better public–private coordination 	<ul style="list-style-type: none"> (Regional) export push policies Coordinated and coherent industrial policy Industrial parks and SEZs for sectors such as textiles, leather, building materials, plastic cards, equipment, electronics assembly, cashew, confectionary, coffee Attracting FDI in light manufacturing (e.g. leather, wood and garments)
Public actions to support within-sector productivity growth	<ul style="list-style-type: none"> Energy, transport and irrigation infrastructure (especially local) Skills and innovation policies, e.g. to address lack of tertiary education through vocation and training centres and addressing science, technology, engineering and maths skills 	<ul style="list-style-type: none"> Value chain development and transport corridors (e.g. long-term finance to facilitate entry of small and medium enterprises into regional and global value chains; PPPs; contract farming and cluster formation for agriculture productivity) Technical assistance to the leather sector Kaizen projects for the wood sector

RESOURCE MOBILISATION STRATEGY

The implementation of the policy suggestions will require the mobilisation of substantial financial resources from both domestic and international sources. It will also require policies that ensure these financial resources are used effectively to achieve the goals set out in FYDP II. We contextualise the discussion on mobilising finance by summarising recent trends in the flows of different sources of finance in Tanzania, presenting the central tenets of a general finance and policy framework to mobilise finance and use it effectively in Tanzania, and adopting a more focused approach that places the discussion on resource mobilisation within the context of the theme of nurturing industrialisation for economic transformation and human development.

Figure 4 provides a broad overview of trends in Tanzania in different types of financial flows by comparing flows of tax revenue (domestic public finance), net official development assistance (ODA) (international public finance), gross fixed capital formation (GFCF) (domestic private finance) and FDI (international private finance) for the period from 2000 to 2013. This clearly illustrates the declining influence of international sources of finance relative to domestic sources in Tanzania. While aid flows (net ODA) have declined as a proportion of gross national income (GNI), and FDI flows have been relatively stagnant (when measured as a percentage of GDP), GFCF by the private sector has increased sharply as a share of GDP, and there has been some growth in tax revenues (as a percentage of GDP) over the period. However, despite gradual growth in domestic revenue collections through taxation, Tanzania's tax-revenue-to-GDP ratio remains relatively low – at around 12% – compared with most of its regional counterparts in the EAC (especially Kenya and Rwanda). Tanzania has historically relied on aid from donors to make up for deficiencies in domestic revenue collection and to finance shortfalls in the budget. In recent years, however, there has been a steady decline in general budget support from donors.

Figure 4. Comparison of trends in specific types of domestic public, international public, domestic private and international private finance flows in Tanzania, 2000-2013



Note: Net ODA received is expressed as a percentage of GNI (not GDP); tax revenue flows are old (pre re-based) data as these are available for the full 2000-2013 period (see discussion in the text).

Sources: World Bank World Development Indicators (for FDI and net ODA); IMF World Revenue Longitudinal Data (for tax revenue to GDP); Tanzania National Bureau of Statistics Statistical Abstracts (for GFCF by the private sector)

To date, the role of the private sector in financing development has been relatively muted. Aside from steady increases in GFCF by the private sector, other measures of private sector investment in Tanzania have been slow to take off. The level of domestic credit provided to the private sector by banks as a percentage of GDP remains well below the average levels among low-income countries (LICs) and in Sub-Saharan Africa (SSA) and does not reach the right sectors. Similarly, while market capitalisation of listed companies has increased as a share of GDP since 2006, it remains lower than the average across SSA. Portfolio and private lending flows also remain comparatively limited (and well below the averages in SSA and LICs when expressed as a percentage of GDP). This suggests that much still needs to be done to bolster private investment and boost access to private credit. Trends in FDI flows have been notably more positive, although FDI flows into manufacturing have stagnated in recent years.

The main report includes an analysis of a general finance and policy framework to mobilise finance and use it effectively in Tanzania in the context of FYDP II, focusing on sources of domestic public, international public, domestic private and international private finance. Based on this analysis, Table 7 provides a

summary matrix of a range of desirable policies (related to four categories of financial flows) that could be employed in Tanzania to boost the mobilisation of financial resources and ensure they are utilised effectively for economic transformation and human development. We also include specific proposals (highlighted in bold font) on mechanisms and policies to mobilise finance for economic transformation and value chain development in light manufacturing (one of the priority sectors behind industrialisation).

Table 7. Summary of proposals to mobilise finance and use it effectively, by category of financial flows
(proposals in bold font have been assessed in the context of industrialisation specifically)

Category	Policies to mobilise finance	Policies to use finance effectively
Domestic public finance	<ul style="list-style-type: none"> • Reform tax system and administration to boost tax collections: <ul style="list-style-type: none"> - Build on new initiatives to boost tax compliance, combat tax evasion - Minimise tax exemptions to maximum value of 1% of GDP (currently around 1.5%), building on existing reforms (e.g. new VAT Act) - Broaden geographic distribution of tax base and diversify sectoral contributions (e.g. better taxation of property) - More effective taxation of informal sector by effectively identifying taxpayers • Carefully consider fiscal risks associated with a sovereign bond issue • Leverage natural gas revenues to grow non-resource sectors of economy 	<ul style="list-style-type: none"> • Ensure the tax system supports, rather than hinders, industrialisation: <ul style="list-style-type: none"> - Review tax incentives and design a programme of targeted tax breaks combined with support measures and complementary policies (e.g. improvements to the business climate) that support light manufacturing - Simplify the tax system by reducing number of tax payments, and streamline tax compliance processes to make it easier to pay taxes (especially for small and medium enterprises) - Eliminate nuisance taxes and prepare clearer guidelines on what should/should not be taxed by local government authorities (LGAs) - Tax labour less heavily by reducing the skills and development levy to 1-2% to lower the effective tax rate to be more comparable with regional neighbours • Enhance public financial management (PFM) systems to achieve more realistic revenue projections and budgets (e.g. through guidelines to prevent accumulation of arrears; reduction of existing debt stock; less use of expenditure floats at fiscal year end; and timely fiscal outturn data), especially at local level • Greater transparency and equity in the allocation of domestic revenues from the central government to LGAs based on objective measures of relative need • Local development finance institutes working together with regional and international development banks to assist in designing and structuring development projects, and linking projects to funding opportunities • Direct financial resources to eliminate binding constraints (e.g. infrastructure, chronic electricity and skills shortages) to light manufacturing: <ul style="list-style-type: none"> - Utilise natural gas as a source of fuel for the supply of reliable and affordable electricity - Invest in natural gas distribution infrastructure in major industrial cities/clusters - Efficient infrastructure and lower import barriers to support access to intermediate inputs • Strategies to manage potential negative exchange rate effects of future natural gas revenue flows on the competitiveness of other export sectors; settle the debate on the gas price for domestic users

Category	Policies to mobilise finance	Policies to use finance effectively
International public finance	<ul style="list-style-type: none"> • Broaden the donor base by expanding relations with large southern donors; maximise grants from existing donors • Tie development objectives to climate change targets to tap into new sources of climate-related funding 	<ul style="list-style-type: none"> • More inclusive consultation with donors to explain FYDP II objectives and plans and suggest ways donors can support; facilitate greater coordination between donors • More strategic use of aid allocations to support PFM and improve institutional capacity (e.g. TRA) • Raise speed of disbursement of donor funds and ensure smooth flow of donor resources through the various levels of government (especially to decentralised units)
Domestic private finance	<ul style="list-style-type: none"> • Leverage finance from private sector through PPPs to address development-focused investment shortfalls (e.g. in transport and energy infrastructure investments) • Improve the quality of the business climate (combat corruption, clear government policy stance on macroeconomic management, consistency in policy messages) to attract more private investment • Improve financial intermediation and develop local financial markets to bolster access to private credit by supporting the development of Tanzania's capital market; developing a liquid and well-functioning local currency bond market; removing obstacles to lending; supporting greater competition and innovation and improved product offerings in the banking system; and taking a sectoral approach to loosening constraints in accessing credit (e.g. in agriculture) 	<ul style="list-style-type: none"> • Enhance government capacity for evaluating, negotiating and executing PPP projects • Encourage local governments and government agencies to utilise stock market to mobilise finance, particularly for infrastructure development projects • Improve access to finance for light manufacturing firms: <ul style="list-style-type: none"> - Encourage greater flexibility in the way commercial banks and other financial institutions apply collateral requirements - Assist light manufacturing firms to prepare effective business and financial plans - Incentivise commercial banks and other financial institutions to offer finance to purchase or upgrade machinery and equipment - Establish a fund to facilitate increased lending to small and medium enterprises from sources other than banks, with the fund matching money from private sector investors, and the total funds invested on fully commercial terms - Boost capitalisation of Tanzania's development banks to fund projects to support value chain development
International private finance	<ul style="list-style-type: none"> • Improve business climate with a focus on creating a more competitive production environment that is conducive to attracting high-quality FDI • Greater consistency in the approach to conceptualising, locating and developing SEZs to attract FDI (and local investment) into light manufacturing, informed by an assessment of what has and has not worked with existing SEZs <ul style="list-style-type: none"> - Start small by committing to develop one SEZ effectively as a way to demonstrate potential • Explore options for additional non-concessional borrowing and borrowing on commercial terms (obtain a credit rating) 	<ul style="list-style-type: none"> • Encourage FDI in cooperation with local companies or through joint ventures to foster backward and forward linkages and promote spillover effects • Review policies for foreign participation in domestic bond markets

5. MAKING IT HAPPEN: TARGETS, POLICY PRIORITIES, MONITORING AND LEARNING/ADAPTIVE DEVELOPMENT

For the FYDP II to nurture an industrial economy, it must contain measurable and realistic targets that are followed up by joint action. It will also require real leadership and clear lines of accountability for delivery and non-delivery. In this report, we provide an initial discussion of these targets, which of course should be discussed further. We articulate three areas of work to make it happen:

- **Formulate targets** on relevant aspects of industrialisation and economic transformation;
- **Prioritise realistic policies** that remove constraints to further economic transformation;
- **Introduce new ways of working:** monitoring, learning and adaptive development.

This means the plan should consider not only targets on economic transformation but also short- to medium-term targets for action to achieve them, including to improve policy preparedness and ways of working. Furthermore, as past targets were sometimes overambitious, the targets for the next FYDP should be more realistic, backed up by realistic planning and realistic implementation procedures.

FORMULATE TARGETS FOR ECONOMIC TRANSFORMATION

The analysis in the paper suggests we consider the following **targets for economic transformation**:

- Labour productivity (by sector), value addition per employee;
- Shares of manufacturing and high-productivity services in the economy;
- Gross fixed capital formation;
- Percentage of goods within a particular sector that are exported in a raw, semi-processed and wholly processed state;
- Value addition percentage;
- High-technology exports (as a percentage of total exports);
- Export diversification.

Table 8 provides an initial discussion of these targets. It focuses mostly on economic transformation at the aggregate level (apart from the target on manufacturing). In the previous section, we suggested a three-pronged approach towards prioritising sectors:

1. Activities that use Tanzania's resources: traditional activities such as sisal, fish and gold; and promising activities such as natural gas, vegetables and uranium. Some sectors generate significant jobs, others export revenues;
2. Activities that increase value-added through agro-processing and manufacturing, such as processing of cashew, leather, fruit and nuts and the production of wood and paper products, with machinery and chemicals as strategic bets. Some of these help increase Tanzania's value-addition; others help raise its productivity and productive capacity;
3. Fast-growing services sector activities such as tourism and trade, with tourism creating foreign exchange and jobs and trade supporting other industries.

Table 8. Possible targets for FYDP II

Target areas of economic transformation	Base/recent progress	Indicative range of future opportunities during 2016-2021
Labour productivity value addition per employee (aggregate)	Aggregate labour productivity growth of annual 3-4% 2000-2013, with structural change the largest component	Continuation of aggregated annual productivity growth of 3-4%
Labour productivity value addition per employee (agriculture and manufacturing)	Annual growth of agriculture productivity growth 2007-2013 of 3.3%. Annual growth of manufacturing productivity growth 2007-2013 of 1.0%.	Annual growth of agriculture productivity growth 2007-2013 of 3-4%. Annual growth of manufacturing productivity growth 2007-2013 of 2-3%.
Shares of manufacturing and high-productivity services in economy	Share of manufacturing in value addition constant over 2007-2013 (around 7%); it has been decreasing in comparator African countries	Manufacturing share of between 8% and 12% at end of period (consistent with trends in successful country examples elsewhere)
High technology exports (as % of total exports)	Share was 5.4% in 2011 but growing	Following growth of others and Tanzania in the past, a target of 10%-15% may be feasible
Export diversification (number of export targets and products) and economic complexity index (Hausmann/Hidalgo)	Tanzania among the top increases (2000-2012) in economic complexity, ranked 10th of all countries	Among top 5-10 ranked countries on the complexity change index
GFCF, especially for manufacturing and agriculture sectors (% of sector GDP)	Ratio increased from 25% in 2009 to 29% in 2013	Maintain an approximately 30% level; increase investment share to manufacturing

PRIORITISE REALISTIC POLICIES

The policy analysis of the broader policy suggestions and the policy suggestions around mobilising and using finance for nurturing an industrial economy for economic transformation and human development clearly suggest a number of common priority themes. In order to nurture an industrial economy, the reviewed studies and consultations suggest Tanzania will need to prioritise the following five areas:

- **Infrastructure development** by developing all the infrastructure elements of transport corridors for agriculture and agri-processing; getting the energy infrastructure (both soft and hard) right seems an absolute priority for industrialisation in the coming five years when the offshore gas sector is also going to be developed. This would also involve settling the debate on what should be the gas price for domestic users. But it could also include electrification, paving of roads and development of the main port. It makes sense here to use a corridor approach, where infrastructure, finance and regulation could be combined for value chain development. It could also help foster clusters formed around secondary cities. A significant immediate bottleneck is institutional development in energy and port infrastructure, which needs to be tackled. Some of the energy infrastructure could be low-carbon and based on renewable energy sources, as long as the access to the grid is working properly (in addition to the small scale off-grid solutions) and, hence, addresses climate change concerns. Focus on improving the soft and hard port infrastructure around Dar es Salaam, so that the relative position versus Mombasa Port does not worsen.
- **Human capital development** by working together with the private sector to promote appropriate skill (including skills to participate and innovate in industrial employment and management skills to lead and manage industrial firms) levels and technology development in target sectors. Skills development could increase the percentage of skilled labour within a sector or sub-sector (dependent on the sector and sub-sector). Some could be linked to specific sectors such as wood products or garments. Tertiary education (as a percentage of the population at the eligible age for tertiary education) increasing to around 12-13% could be a feasible goal by 2021, according to historical analysis in comparator countries where such an increase (1% increase per annum) was attained in a comparable timeframe.
- **Finance** by improving domestic resource mobilisation for industrialisation, preparing more realistic budgets and ensuring that financial resources are utilised effectively to promote industrial development. This will require raising tax revenues while encouraging industrialisation and developing capital markets by raising capital for productive activities. The details of these finance-related proposals are listed in Table 7. For example, a target could involve increasing domestic

credit to the private sector (measured as a percentage of GDP) to approximately 20% by 2021. It is particularly urgent to consider progress on tax revenues and make that a priority for follow-up, as we suggest below.

- **Investment climate.** Stepping up efforts to reform the regulatory framework around targeted areas such as energy markets; non-income taxes on labour (reducing the skills and development levy, currently at 5%, to between 1% and 2% so it is more in line with the global average; bringing the effective tax rate down from 34% to a level comparable with regional neighbours (e.g. 26% in Kenya and approximately 30% in Rwanda and Uganda)); and port efficiency. A desired rank (or change in ranking) on the Doing Business indicators or rankings in relation to other countries could be a target, although it may be better to have a target for individual indicators. For example, given Tanzania's identified binding constraints on transportation, the following indicators could be best targeted:
 - Time to export: potential feasible target between 12 and 15 days;
 - Cost to export: reduce cost from \$1,009 to \$600-800 in line with more competitive comparator countries;
 - Documents to export: reduce required documents from 11 to eight in line with more competitive comparator countries.
- **Industrial and FDI policy.** Developing a limited set of SEZs and cluster formation for attracting FDI that can build human and technological capabilities and produce higher-quality manufacturing products (e.g. through developing SEZs and promoting clusters of firms). A target could include clustering and building SEZs (around certain products and regions). There could be a target on the percentage of planned SEZs in operation by 2021, for example 80%. Below, we suggest it is important to have a debate on what has worked and what has not and then to focus on doing one SEZ really well.

INTRODUCE NEW WAYS OF WORKING

Although there is quite a consensus on what needs to happen in Tanzania for it to be able to sustain growth and ignite meaningful economic transformation, it is much less clear *how* to make it happen. This needs to be informed by explanations (including those offered above) of why there has been so little transformation. History has shown that doing industrial policy effectively in Tanzania is very difficult, and it has also provided some reasons for *why* it is difficult. We know that in order to implement industrial policy effectively, the political will to do so needs to be strengthened. The mechanisms that will translate that political will into action also need to be strengthened. This will doubtless involve fighting ongoing battles against vested political and economic interests, unhelpful ideologies and bureaucratic inertia. An effective industrial policy in Tanzania will create winners and losers. Any solution, therefore, must be *politically smart*. Moreover, old-style planning for success will not do. Old-style planning works where the context is stable and the problem and the intervention are simple; and where leaders have sufficient control over resource allocation decisions. In other words, when we understand the political and operational context, know how to influence it and, moreover, understand the problem and how to solve it.

In Tanzania, as in many countries, it is hard to know exactly how to increase the legitimacy of private sector-led economic growth, especially when some of the most obvious beneficiaries of that growth will be foreign firms and investors. There will be a range of vested interests surrounding particular economic sectors; even when these are known, it is not easy to imagine a way forward. Further, there is no blueprint for getting ministries to work together better, or getting lower-level civil servants to do their jobs more effectively. Moreover, there is no perfect foresight on all the problems and obstacles of a technical or logistical nature that will affect attempts to promote a particular sector. Consequently, it is important to transition from a more conventional notion of development planning according to blueprints to one of searching for solutions.

Another way of saying this is that industrial policy in Tanzania needs to become more problem-driven, iterative and adaptive. If the problem is that Tanzania needs to be able to build a world-class SEZ, it is not sufficient to have a plan to solve that problem and then expect everything to fall into place. One may start with a loose plan, but the plan should change as the implementers come to understand more about the

problem, as new problems arise and as new solutions present themselves. Implementers need to be empowered to be creative at the same time as being accountable.

Much has been written recently about what a problem-driven, iterative development approach (PDIA) looks like. An effective monitoring and evaluation strategy that is fit for the 21st century complements a set of targets and monitoring for compliance (which are also essential, and this study provides examples of quantifiable targets) with experimenting. For example, it would experiment within the parameters of the programme design, evaluate feedback at frequent intervals and scale up or down approaches accordingly. In other words, policy-makers make a number of small bets on what will work, and then follow signs of success with bigger bets, in much the same way as economic entrepreneurs do. This is not to say that all bets should be in safe areas. Sometimes, if the potential rewards are high enough, it will be worth placing a bet in a risky area – that is, an area where the challenges appear large and the probability of success small. However, a prudent approach is to adopt a mixed portfolio, with some safer and some more risky bets.

In addition, since many of the problems implementers encounter will have a political as well as a technical dimension, they must be politically savvy. Problem-driven political economy analysis should be embedded as part of the FYDP programme methodology – not as something to be done at the outset of a programme and then left on the shelf, as often happens but something that is done and updated on an ongoing basis. Implementers need to know who stands to gain or lose from a particular policy or programme, what their political strengths are, how potential spoilers can be brought on board or circumvented, how alliances between potential winners can be forged and so on. And they need to be aware that the factions in favour of, or in opposition to, a policy may be constantly shifting, so strategy needs to be revised and updated in real time. They also need to know that first-best technical solutions may simply be unfeasible in the current political context, and that second or third best solutions may have to be found.

There is already a programme in the Tanzanian government that is working in a self-consciously problem-driven, adaptive way: BRN. Consultations with BRN staff suggest it has performed best when implementing projects with a strong lead ministry and a minister who has fully internalised the methodology. Water is regarded as one of the most successful National Key Results Areas (NKRAs) precisely for those reasons. BRN has apparently had less impressive results in areas that require more extensive inter-ministerial coordination, with unclear accountability lines arguably part of the problem. It has had even less success in areas that involve PPPs. Thus, while BRN appears exactly the kind of approach Tanzania needs to implement some priority areas within FYDP II, certain aspects of its operation will need to be adapted or improved if it is to be a credible delivery system for the MOFP, especially in dealing with the private sector. More forceful support from the top; timely disbursement from the MOFP; more vigorous inter-ministerial coordination; and a more innovative approach to PPPs seem essential.

As suggested above, with some adaptation, the BRN would appear to be a potential vehicle for supporting the implementation of some key areas of FYDP II. The next FYDP will need to be implemented with coherence and leadership. The main report suggests that the MOFP needs to be in charge of coordination of the planning process. As other ministries (e.g. trade and industry, or the TRA) also have a stake, it is therefore important that the president and the MOFP have the power to discipline other agencies.

We can apply these important principles in the case of the priority policy areas. For each policy area, Table 9 presents potential projects and possible technical and political economy issues that might arise in their implementation, and suggestions on potential responses and ways of working to deal with these issues. The table also suggests a range of new NKRAs. Tanzania is on the cusp of significant economic transformation if it embraces a new way of implementation. In doing so, it can raise the quality of growth, improve human development and reduce poverty more successfully into the future.

A crucial first step is to design a number of feasible collaborative projects which can demonstrate the potential for economic transformation. This needs to be matched by a commitment from the leadership to ensure that there is one ministry or agency responsible for overall implementation, that other agencies are co-ordinated and assigned responsibilities effectively, and that these agencies stay focused and see projects through. As alluded to in the introduction, this is an exciting time for Tanzania (e.g. rebalancing in

China, regional growth, offshore gas discovery, governance changes), but effective leadership is required to seize the opportunities for transformation. Now is the time to act.

Table 9. Analysis of implementing possible FYDP priority areas

Policy area	Possible projects	Possible technical issues	Possible implementation issues	Possible responses
Infrastructure development	A corridor approach to energy, transport and logistics development. Focus in particular on getting the energy sector ready to support large-scale industrialisation.	Shortages of finance and human resources, plus numerous as yet unforeseen technical issues. Inadequate soft infrastructure and institutional weaknesses around energy utilities.	Coordination issues between different ministries, e.g. land, energy, transport. Procurement and management in infrastructure sector has suffered in the past from corruption (e.g. energy, port). In energy, need to agree a gas price that can (i) attract finance into the sector; (ii) raise government revenues; and (iii) incentivise industrialisation.	BRN makes good on its existing commitments to energy, transport and ports, and merges the three areas into a dedicated corridor NKRA. Kickstart a national debate on the appropriate gas prices.
Human capital development	Skills development around particular economic sectors or sub-sectors. Focus, in particular, on improving managerial and organisational skills in light manufacturing sectors, as well as technical skills in the oil and gas sector (and its suppliers).	Inadequacy of current technical and vocational education and training (TVET) infrastructure, curriculum and human resources. There are particular skill gaps at tertiary level. And a lack of organisational skills for manufacturing.	Acquiring financial and human capital for improved TVET system. Confronting vested interests/reluctance to change among current staff. Ensuring greater buy-in from the private sector. Creating openness to outside talent and ideas. Preventing brain drain to other East African countries and facilitating imports of skills.	MoFP/BRN tasked with research into capacity of existing TVET system, especially around technical and organisational skills, study tours to other relevant countries with more successful systems, working groups/labs with private sector to assess private sector needs/potential engagement.
Finance	Tax reforms to boost domestic resource mobilisation. Arrangements for granting access to concessional and non-concessional finance, private sector credit, etc.	Lack of institutional development in the TRA. Ability to repay non-concessional finance or sovereign bonds.	Opposition from political elites to reductions in tax exemptions and efforts to clamp down on tax evasion; misappropriation in the tax revenue function. Concessional finance attracts unproductive rent-seekers; facilities for export finance have in the past been a target for corruption; lack of interest from banks in terms of finance for agriculture, manufacturing and SMEs.	New NRKA focused on tax administration and revenues (replacing the previous NRKA that was more broadly focused on resource mobilisation). Balancing tax revenue function with ability to incentivise private sector.
Investment climate	Targets for improvement on overall or individual Doing Business Indicators. Focus on improving energy governance, lowering labour taxes, lowering trade taxes (including import duties), making it easier to start a business and developing PPP units.	Vertical and horizontal coordination required to streamline business bureaucracy.	Business-related red tape a major source of petty rent-scraping for lower-level officials, a key support base for the ruling party. Past corruption around energy governance and port management.	BRN makes good on existing commitments and deals with unfinished business (skills levy, PPPs, access to energy grid) in a new way.
Industrial and FDI policy	Upgrading existing SEZs or creating new SEZs to high standards. Targets for attracting FDI in light manufacturing, e.g. agro-processing, wood, leather, tourism, pulp and paper, cashew, textiles.	Finding land and creating high-quality infrastructure and bureaucratic support and logistics systems; finding high-quality human capital to staff managerial and technical positions.	Coordination among multiple ministries; challenges of delivering high-quality low-cost infrastructure given grand corruption problems; challenges of supplying efficient bureaucracy given petty rent-seeking problems; challenges of supply of high-quality human capital given deficiencies of education system, restrictive labour and immigration laws, history of economic nationalism, etc.; challenges of holding firms to their production and export commitments.	New NKRA around SEZs/FDI in light manufacturing, focusing on one or a limited set of SEZs. Review the pros and cons of SEZs in Tanzania so far.