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The Bank of Tanzania Research Newsletter is an annual publication aimed at disseminating research results of recent studies conducted by the BoT Staff and those presented at BOT seminar series by non-BOT staff.

The views expressed in this Newsletter are solely those of the authors and do not necessarily reflect the official position of the Bank of Tanzania or its management.

Inclusive Growth in Tanzania: Ideas from Elsewhere

Stefan Dercon

Globally, achievement has been recorded in poverty reduction from 36 percent in 1990 to 14.5 percent in 2011. In addition, progress has been made in human development particularly on health and education. While Sub Saharan Africa (SSA) recorded strong progress in health and education, relative income remained low although it rebounded marginally since 2001. Per capita GDP in SSA remains persistently low for most countries. The lessons learnt from a successful growth leading to poverty reduction suggest two key ingredients. One is a growth process

that succeeds in being inclusive of poorer groups via labor absorption into better, higher productivity jobs and activities. Two, is a functioning social system, delivering basic health, education, security and basic safety nets for the poorest.

The paper highlights important ingredients for bringing about growth. These include investment, macroeconomic stability, political stability, and an effective state. In particular, investment should bring about structural change from lower to higher productive activities, within

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and across sectors. While it is important for growth to start with agriculture, especially smallholder-based, it is critical to enhance productivity to enable reallocation to more productive activities including commercial, export, and high value crops.

Tanzania has recorded impressive annual average GDP growth of 6.2 percent in the last nine years. Contributing to this were export-led sectors including tourism, manufacturing, and transportation. Equally important is an improvement in macroeconomic stability. These achievements cushioned the Tanzanian economy from the negative effects of the economic and financial crises of 2008/09 and 2011/12.

Tanzania has opportunities which can be utilized to further boost growth. These include strategic geographical location which facilitates transit trade; attracting manufacturing activities from Asia through labor relocation; tourism; and agriculture. This is in

addition to increasingly diversification of exports as well as the scope for FDIs in all sectors. Furthermore, Tanzania has politically committed to fiscal discipline in terms of revenue collection and prioritization of government spending. The government has also committed to combating corruption as well as putting in place development infrastructure.

Investment should bring about structural change from lower to higher productive activities, within and across sectors. While it is important for growth to start with agriculture, especially smallholder-based, it is critical to enhance productivity to enable reallocation to more productive activities including commercial, export, and high value crops.

[This paper was presented at BOT Seminar Series, Dar es Salaam, 4th May 2016]

Beyond Aid and Concessional Borrowing: New Ways of Financing Development in Africa

Justin Yifu Lin

Most developing countries have been trapped in low-income or middle-income status since WWII. Africa is poor as it has not diversified from agriculture and natural resources. For example Africa's exports of primary commodities are more than 80 percent of its total export, which is the highest in the world. Not only that, but also, primary commodity exports represents greater share of Africa's GDP compared to other regions, implying low value addition due to lack of manufacturing industries. In almost all oil exporting countries, crude oil exports alone account for at

least 50 percent of GDP and more than 70 percent of national budget.

Most primary commodities are subjected to low price in the world markets. This has resulted to insufficient resources to finance development activities, making Africa dependent on foreign assistance. Theoretically, the development aid and concessional loans increase the capital available for investment and should contribute to development in developing countries but this has not worked in Africa due to little transformation

of economies to improve manufacturing and export-led growth. As a result, these countries remained trapped in poverty and inability to finance development activities. This paper seeks to provide alternative source of financing development in Africa.

The paper argues that the sustainable way of financing development is through domestic resource mobilization, which should be preceded by domestic investment. Investment is essential for successful structural transformation. A country with a strategy to develop its economy according to its comparative advantages will generate abundant savings to support domestic investment. Africa needs to focus on domestic capital mobilization for investment so that FDIs can only complement what is already available. Development aid and concessional loans should be used just to boost domestic capital. For example, some of the successful economies including Korea and China relied mostly on domestic capital mobilization for investment.

Africa needs to focus on domestic capital mobilization for investment so that development aid and concessional loans are used just to boost domestic capital.

Evidences from successful catching-up economies indicate that their governments played a facilitating role to capture the window of opportunities arising from the relocation of light manufacturing in the world to jumpstart their industrialization and structural transformation. Good examples are Japan in the post WWII, the four East Asian Tigers in the 1960s, and China in the 1980s. In these countries development assistance was helpful for development as they used it for expanding the government's resources to facilitate structural transformation.

It is urged that Africa needs to invest heavily on "hard and soft" infrastructure in order to make a step-forward towards industrialization. Also a dynamic structural change in technology and industries is a key step for industrial upgrading and diversification, which in turn will improve well-being of the people and sustaining economic growth. There is a strategic need to balance between light and heavy manufacturing industries in order to be able to compete globally and accommodate the available labour supply. There is a window of opportunity for industrialization and structural transformation arising from the pending relocation of light manufacturing from China and other emerging market economies due to their rising wages.

A decline in conventional development assistance from the northern countries necessitates the need for Africa to go beyond conventional development aid and concessional loans by including other official flows (OOF)—like loans and investments from emerging market economies—in the definition of development assistance.

Backwardness in technological innovation, industrial upgrading, institutional innovation together with the available resources, provide a room for developing countries to grow faster than advanced countries, and achieve convergence. Therefore, Tanzania and other African countries can grow as dynamically as any successful countries in East Asia and other parts of the world, if they have an enabling government to facilitate private firms to capture the window of opportunity.

[The paper was presented during the Symposium to Mark the 50th Anniversary of the Bank of Tanzania, Dar es Salaam, 22nd June 2016]

Tanzanite Processing in Tanzania: Challenges and Opportunities

Wilfred E.N. Mbowe, Nicas Yabu, Moto Lugobi

Tanzania is endowed with huge natural resources. The country's proven mineral reserves include more than 2,000 tons of gold, 50.9 million carats of diamond, 12.6 million grams of tanzanite, 209 million tons of Nickel, 13.6 million tons of copper, and 880 billion cubic feet of natural gas deposits. The liberal and private-sector friendly policies pursued particularly since 1991, and for the mining sector from 1998, have encouraged private sector investment including in mining of gold and gemstones. As a result, the mining sector has been growing at about 10.2 percent since 2000 and accounts for about 45 percent of Tanzania's total merchandise exports. Despite the high growth, the sector's contribution to GDP is still low at 3.3 percent in 2011 and absorbs only one percent of the labour force.

In 2010, the government banned export of rough tanzanite weighing more than one gram, for them to be processed before export. The aim is to create employment for Tanzanians, recoup profits and thus boost the economy. Despite this measure, over 80 percent of rough tanzanite still finds its way to the export market unprocessed.

Factors hindering processing of tanzanite locally include unpredictable supply of rough tanzanite, which is constrained by the use of poor mining technology, high competition for the rough tanzanite, and small size of recovered stones. With low processing activities, the contribution of the subsector to employment and revenue is still low.

This study seeks to evaluate factors that hinder processing¹ of rough tanzanite in Tanzania with greater

emphasis on availability of raw materials, financial resources, skills and market. In addition, the study examines contribution of tanzanite processing activities to employment and revenue. Structured questionnaire was used to collect information from tanzanite miners, brokers and dealers. Information was also collected from the Ministry of Energy and Minerals; Tanzania Minerals Audit Agency; and the State Minerals Company on the opportunities and challenges facing the industry.

The findings suggest that contribution of Tanzanite processing activities to employment and revenue in the country is not significant. Factors hindering processing of tanzanite locally are diverse, and include unpredictable supply of rough tanzanite constrained by the use of poor mining technology, high demand for the rough tanzanite, and small size of recovered stones. Other challenges are related to accessibility to financial resources, tanzanite processing technology and skills, as well as unreliable markets for cut and polished tanzanite.

The study recommends that the government could consider the need to establish a tanzanite cutting and polishing export zone at Mirelani area, where tanzanite is mined. This would serve as marketing centre for rough tanzanite. The efforts to establish a special economic zone in the area could be hastened to enable ease access to market information, and promote processing activities locally facilitated by predictable supply of rough tanzanite. In addition, the government might provide tax incentives by reducing multiplicity of taxes payable to central and local governments as well as waive import duties on equipment for both mining and processing activities.

[Full paper is available in the Journal of Applied Economics and Finance; Vol. 3, No. 3]

¹ Tanzanite processing entails cutting and polishing of rough tanzanite for domestic or export markets.

Price Adjustment Behavior of Manufacturing and Services Sector Firms in Tanzania. A Survey Evidence of Price Stickiness

Deogratius Kimolo

Price stickiness is one of the key assumptions of New Keynesian Macroeconomic Models used to support monetary policy analysis and medium term macroeconomic forecasting by central banks. While studies on the subject abound, there has been little micro level evidence to back this assumption in developing countries. This study attempts to bridge this gap. It investigates the existence and extent of nominal price rigidities among firms in Tanzania particularly those in manufacturing and services activities. The study also investigates shocks that trigger firms to change or do nothing with the prices of the main product or service they produce, as well as the magnitude and direction of price changes. Finally, it assesses the relative price adjustment behavior of firms to costs and demand shocks.

Overall, manufacturing and services prices in Tanzania are sticky. Firms are prompted to change prices by shocks that lead to profit losses than those which lead to profit gains

A survey method was used to collect information on pricing behavior among selected companies in Dar es Salaam, Tanzania. Results of the study indicate that majority of the surveyed firms change prices of their products and services at least yearly, indicating that overall prices are sticky. However, the observed price rigidity is lesser than that in developed countries. Also increase in prices is more prevalent than decrease in prices, implying that prices are generally sticky downwards. It was also found that price adjustments are asymmetrical; companies are more prompted by shocks that lead to profit losses than those that lead to profit gains.

The findings of the study support the modeling of inflation dynamics in Tanzania based on the assumption of price stickiness as it is grounded on a new Keynesian assumptions. These support forward looking monetary and exchange rate policy analysis as well as medium term forecasting.

[This paper will be available in BOT's Working Paper Series]



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