

Fiscal Policy Issues for Tanzania

Country-level research opportunities

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Background

Tanzania began serious efforts at economic reform more than twenty years ago, but only in the last decade have sustained improvements in economic performance and wellbeing been registered. From 2001 to the eve of the global economic crisis, growth in GDP averaged around 7% per annum compared to less than 3% per annum in the previous decade.

Though good luck and a well-designed macroeconomic policy response ensured that Tanzania weathered the worst of the global economic recession of the last two years, the economy has still been hit hard. Growth is projected to be around 5% in 2009/10 while revenue mobilization has fallen back sharply. Even with good macroeconomic management, the economy faces significant challenges as it seeks to return to the high growth path of the first decade of the century.

This challenge is heightened by the fact that many of the early growth-supporting gains from exchange rate liberalization, the removal of domestic price controls and the decompression of the previously highly constrained economy, have probably run their course. Neither the rapid pace of credit expansion to the private sector, nor the impressive increase in domestic revenue mobilization – both of which grew substantially relative to (a rapidly growing) GDP over the first decade of the 2000s – are likely to be sustained. Even with continued sound macroeconomic stewardship, credit conditions are likely to remain tight.

Thus, as the 'catch up' growth phase passes and Tanzania comes to increasingly resemble its comparators, more conventional fiscal and growth challenges are beginning to emerge, challenges where the trade-offs are drawn more starkly than before.

These all relate ultimately to the need to raise investment above current levels. Tanzania has a long history of low productivity investment: sustaining growth in the future requires much higher and much more productive private investment. Critically, however, it also requires much higher investment in infrastructure and public goods.

Issues of congestion in infrastructure capital, in power generation and distribution, in the transport and communications networks and, in particular, in the gateway infrastructure of the port of Dar es Salaam, now figure largely as constraints on growth. These concerns necessarily focus attention on fiscal policy and the role of the state both in supporting the

substantial increase in the level and quality of investment, and in providing the institutional framework for increased investment to translate into sustained growth.

Research Issues

The recent paper by David Bevan, *Fiscal Policy Issues for Tanzania*, provides a detailed discussion of these and emerging fiscal issues in Tanzania. Part 2 of that paper identifies a number of areas where further research by IGC may be useful. These may be grouped around two broad but inter-related themes, within which we have grouped some possible topics. This list is illustrative rather than prescriptive and is certainly not exhaustive:

Networks, infrastructure provision and growth

Tanzania occupies a pivotal geographic location. Apart from its own long coastline, it also borders three major lakes, and shares borders with eight countries of which five are landlocked, and one “quasi-landlocked”.¹ There has been much discussion about the possibility of greatly increasing the exploitation of this favourable location.

Realizing this potential will require not only a massive increase in infrastructure provision, but a radical improvement in Tanzania’s logistical capabilities more generally.

Possible Topics

- Economic geography: agglomeration dynamics and the development of Tanzania as a regional hub
- Growth and infrastructure: are the infrastructure requirements of a ‘regional hub economy’ consistent with those of a ‘coastal manufacturing’ economy?
- Urbanization and urban infrastructure requirements
- Institutional reforms, political economy and the management of public infrastructure.
- Infrastructure financing: PPPs, BOTs and private financing.

¹ The maritime states – and hence competitors for the role of regional hub – are Kenya and Mozambique. The landlocked ones are Uganda, Rwanda, Burundi, Zambia and Malawi. The quasi-landlocked country is DRC, which has its own short coastline on the Atlantic coast but which has the bulk of its economic activity very remote from that location, much of it nearer the Indian Ocean via Tanzania.

Government size and the boundaries of the state

In recent years, the government has been focused on trying, and eventually succeeding, in engineering a recovery from the very low levels to which revenue collections had fallen. These have now reached a share of GDP which is not out of line with other low-income countries. It is also clear that it is harder to achieve high revenues in low-income countries because of the large relative size of the difficult-to-tax informal sector. Attempting too ambitious a revenue target can have an adverse impact on the functioning of this type of economy, by raising the marginal effective tax rate of enterprises or individuals in the formal sector to excessive and incentive-sapping levels. Second, and in consequence, it may retard the shift from informal to formal activities as the economy grows, retarding productivity growth, and inhibiting the whole growth process generally. There is clearly a balance to be struck between these risks and those of inadequate public good provision, which may also inhibit growth and reduce welfare. There should be scope for research devoted to these issues.

Possible Topics

- The desirable/feasible size of government and the associated revenue effort
- Public vs private financing I: estimating the marginal cost of public funds in Tanzania
- Public vs. private financing II: infrastructure investment, crowding out and debt policy