Tanzania:
Thinking About Diversification

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Gas and Diversification

- Gas is not likely to transform Tanzania into a resource dependent economy.
- But revenues are certainly large enough to shape the non-oil economy.
- It will take some time for the full impact of gas revenues to be felt
- To make the most of gas, the focus needs to be on the quality of policy and investments for the *non-gas* economy.
- It is important to begin thinking about options for the non-gas economy now

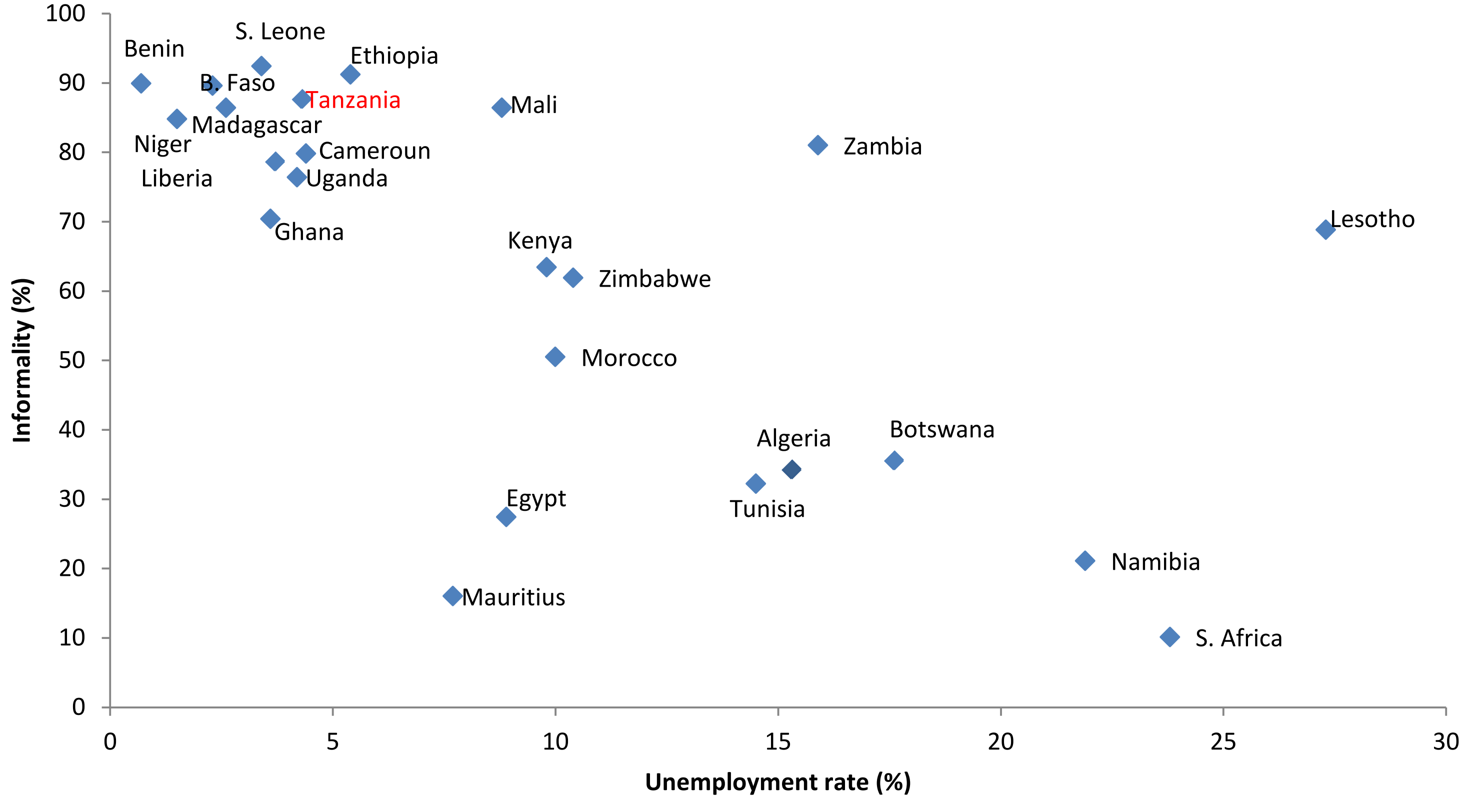
Tanzania's Structural Challenge

	Share of value-added of:				Share of labour force in:				Relative productivity of:			
	Agric.	Ind.	Man.	Serv.	Agric.	Ind.	Man.	Serv.	Agric.	Ind.	Man.	Serv.
Benchmark Middle-income country	21.7	12.2	21.9	44.2	45.2	6.6	11.6	36.6	0.48	1.85	1.89	1.21
Africa Low-income Country	27.8	11.8	11.1	49.3	63.1	5.1	6.6	25.2	0.44	2.31	1.68	1.96
Tanzania	**28.4**	**24.0**	**9.4**	**47.6**	**69.4**	**3.0**	**4.3**	**23.3**	**0.41**	**8.0**	**2.19**	**2.04**
Africa: Resource-rich country	17.8	29.6	8.3	21.1	45.4	4.8	6.5	43.4	0.39	6.17	1.28	0.49

Why Worry about Diversification?

- The structure of a resource-rich economy matters for long run growth.
  - What an economy makes matters for its long term growth. Natural resource exporters tend to make the "wrong things".
  - Countries whose exports are concentrated in natural resources are exposed to significant risks of declining commodity prices and volatility.
- Natural gas alone will not meet the twin challenges of :
  - Employment growth
  - Shared growth
- For these reasons Tanzania needs to think now about how to use the gas boom to reshape its economic structure.

A Natural Gas Boom Carries Risks of "Jobless Growth"



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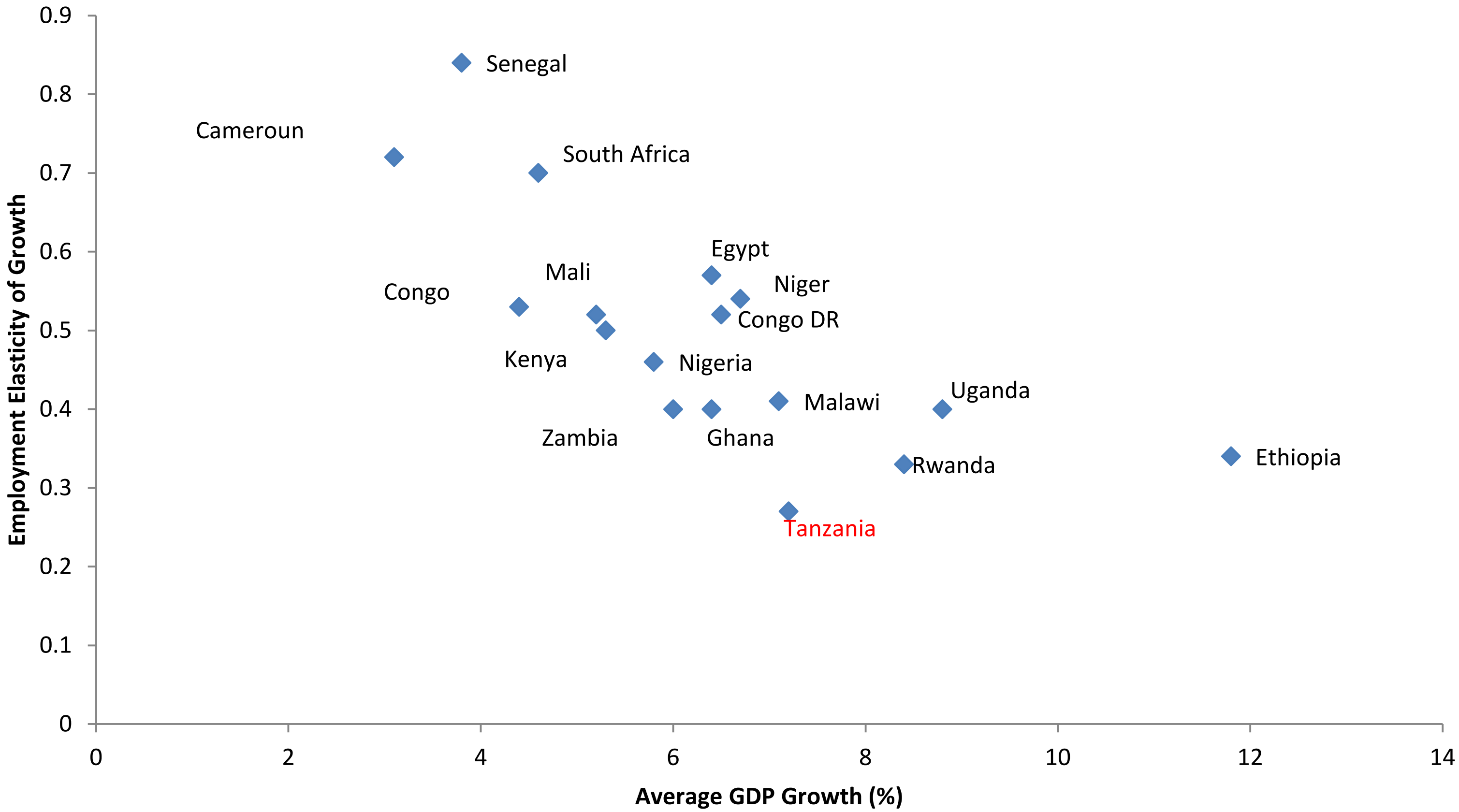
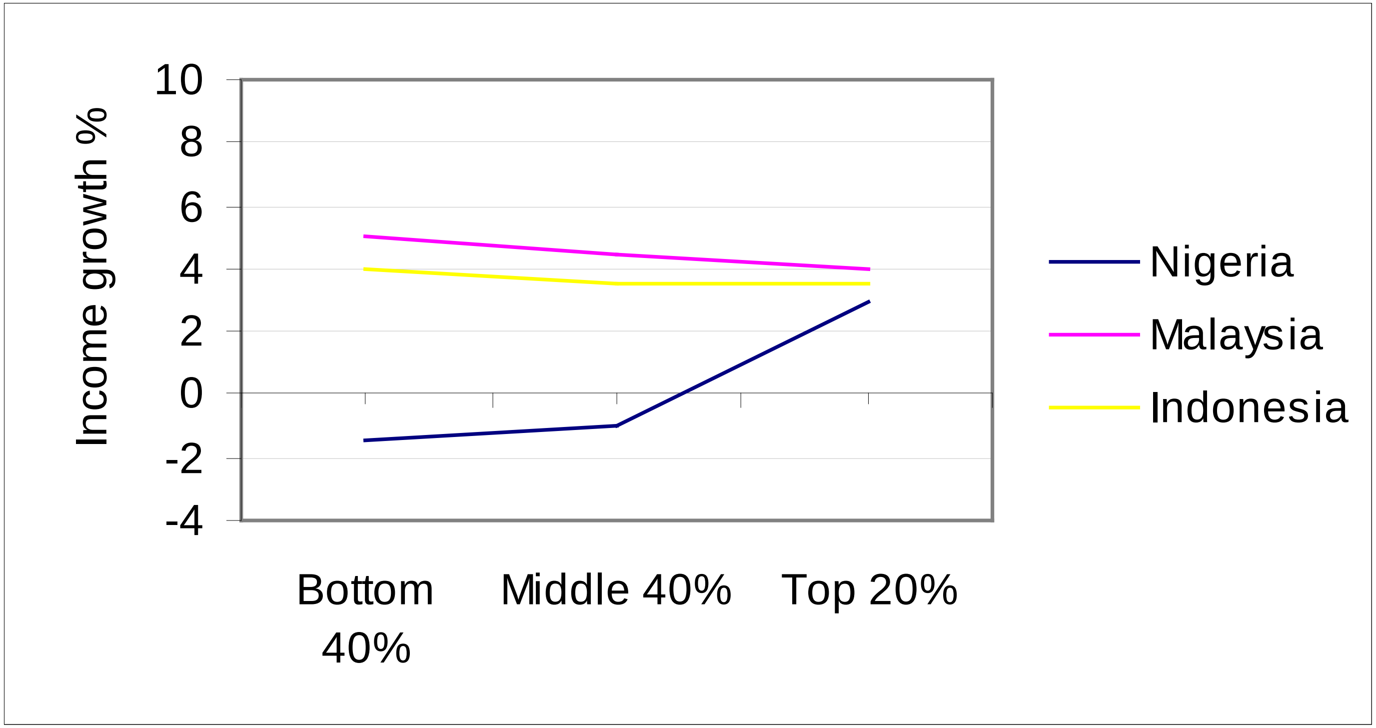


And Risks to Shared Growth

- Recent growth in Tanzania is not perceived to have been broadly shared.
  – 36 out of every 100 Tanzanians were poor in 2000/01 compared to 34 in 2007. (MKUKUTA II)
  – Growth of the agricultural sector was about 4.5 percent on average. Contrasted with the national population growth rate of 2.9 percent, the change in rural per capita income becomes small.” (MKUKUTA II)
- Mineral dependent economies in Africa tend to have:
  – Higher poverty rates
  – Greatly income inequality
  – Less spending on health care
  – Higher child malnutrition
  – Lower literacy and school enrollments

Some Mineral Exporters Have Achieved Shared Growth….

Growth Incidence Curves, 1995-2005



…Through Successful Diversification: Indonesia and Malaysia

- Indonesia and Malaysia – show quite different but successful patterns of diversification and growth based on natural resources.
- The diversification pattern of each country reflects the types of public policies pursued by their governments.
- Malaysia: spatial and industrial policies for manufactured exports
- Indonesia: investments in rural infrastructure and connections to markets

The Challenge of Diversification

- Resource-rich economies in Africa show little evidence of structural change
- Tanzania will face the same economic pressures that have shaped the region's current resource rich economies.
- Policy can offset the worst effects of Dutch Disease by Increasing the productivity of private investment
- Two areas for action:
  - Boosting overall competitiveness
  - A strategy for diversification

Boosting Competitiveness: Two priorities for public policy

- Accelerate Investment Climate reforms
  - Institutional and regulatory reform
  - Infrastructure
  - Skills
- "Investing to Invest"
  - Containing construction costs
  - Gauging the pace of public investment

The Investment Climate: Regulatory Reforms

- An unfinished agenda of reforms:
  - Tanzania ranked 134 (of 187) on the *Doing Business* indicators
  - Starting and closing a business in Tanzania costs about 200% of GNI per capita (China: 14%, India 62%)
  - Port and customs delays are considerably longer in Tanzania than in comparator countries.
- But don’t simply use *Doing Business*
  - *Doing Business* is a “league table” not a diagnostic tool
  - Close communication with the private sector is needed
- Focus on building accountability

The Investment Climate: Infrastructure and Skills

- Closing the infrastructure gap
  - Firm-level surveys in Tanzania highlight infrastructure deficiencies:
    - 59 percent of firms reported that electricity was a major or very severe obstacle to enterprise operations and growth
    - Tanzania's transport infrastructure ranks well below the average of other sub-Saharan African and low-income countries
    - The port of Dar es Salaam presents a major bottleneck
  - Annual spending required is about US$ 3 billion per annum over ten-years.
- Closing the skills gap
  - Skills constrain firms in more sophisticated activities
  - Increases in access and quality at the post-primary level will be needed.
    - Most secondary schools do not meet the infrastructure, teacher, and grant requirements necessary for a productive learning environment
    - The tertiary enrollment rate (3.7 percent in 2008) is lower than the regional average.
  - There is an important role for the private sector and public-private partnerships

“Investing to Invest”

- Construction costs determine the ability to transform “investment effort” into “investment outcomes”.
- Construction costs have been rising (relative to non-food non-tradables)
- The pace of public investment should be governed by construction costs
- Policies will be needed to shift down and flatten the supply curve of construction.

Linkages to Gas

- Downstream projects are tempting but warrant careful analysis
  - Are they viable at the border price of gas?
  - Do they create significant employment (either directly or indirectly)?
  - How do output prices vary with gas prices?
- Upstream projects must build on existing capabilities and create new ones
  - Construction and civil engineering will require investing to invest
  - Services suppliers will need to build capabilities
  - Sector specific knowledge can be used to develop ancillary industries – Qatar and pollution

Building a Diversified Economy

- Tanzania is unlikely to succeed with an East Asian mass manufacturing model.
- Rather it must seek to build a broader range of high value added per worker activities.
- This suggests a strategy built on three components:
  - Investing in agriculture
  - Transforming manufacturing
  - Building “industries without smokestacks”

Creating a Diversified Economy: Investing in Agriculture

- Important for both efficiency and equity
  - Agriculture employs nearly 70 % of the labour force, and accounts for more than a quarter of GDP.
  - Past growth has come mainly from area expansion.
  - Recent growth has favoured urban populations.
  - “agriculture is central to poverty reduction in general and hunger/food poverty in particular” (MKUKUTA II)
- Three areas for public action
  - Development and dissemination of new agricultural techniques
    - There is substantial room for growth through yield increases
    - Innovation systems need to be strengthened
  - Improving rural infrastructure and market access
    - Reduce costs from the farm gate to primary and secondary markets
    - Investments in irrigation
  - Support efforts to enter global value chains

Creating a Diversified Economy: Transforming Manufacturing

- Manufacturing has experienced a recent recovery
- Location provides opportunities in both African and global markets
  - Improved trade logistics are critical
- In addition to investment climate reforms effective spatial industrial policies will be needed. (EPZs are not performing to global best practice)
- And a more effective strategy to attract non-gas FDI.

Creating a Diversified Economy: "Industries without Smokestacks"

- Agro-related value chains and tradable services offer the potential to create "good jobs" where geography or other endowments provide a comparative advantage
  - Globally these activities are growing faster than manufacturing
- Physical investment in trade logistics and ICT infrastructure is essential
- So is generating new knowledge relevant to new exports in agriculture or services, such as tourism.

Conclusions

- To make the most of gas, the primary focus needs to be on the quality of policy and investments for the *non-gas* economy.
- Tanzania needs to think now about how to use the gas boom to reshape its economic structure
  - The structure of a resource-rich economy matters for long run growth.
  - Natural gas alone will not meet the twin challenges of employment growth and shared growth

Conclusions

- Relative prices will work against diversification
- Policy can offset Dutch Disease by:
  - Boosting Competitiveness
    - Accelerate Investment Climate reforms
    - “Investing to Invest”
  - Building a more diversified range of higher value added per worker activities
    - Investing in agriculture
    - Transforming manufacturing
    - Building “industries without smokestacks”

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