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TOPIC: THE GLOBAL FINANCIAL CRISIS AND
ECONOMIC IMPLICATIONS FOR TANZANIA

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ABSTRACT

The worsening in 2008 of the global financial crisis has had major negative effects on global economic performance, trade, and private capital flows. There has been a major global downturn, adversely affecting incomes and employment, but individual countries have been affected differently - both in terms of aggregate impacts and transmission channels of the crisis. This paper looks at the specific case of Tanzania. In respect of the channels of transmission, focus is placed on the more significant ones which are largely indirect, impacting through: slower export growth, weak growth or decline in tourism receipts, reduced remittances, reduced foreign direct investment (FDI), and possibly reduced official development assistance. The paper also relates these and associated economic problems to the important issue of employment opportunities. Some possible approaches to mitigating the effects of the global economic slowdown are then presented, in the context of protecting domestic demand and employment in the short-term, while ensuring, in the medium-term, that the economy's underlying growth dynamic does not get compromised. It is indicated that for implementing such a strategy, a combination of supply-side and external-sector management policies would be needed.

I. INTRODUCTION

The worsening in 2008 of the financial crisis, which originated from sub-prime mortgage lending difficulties in the United States, has had major negative effects on global economic performance, trade, and private capital flows. As will be seen below, projections in early 2009 indicate that world growth this year will be at its slowest since World War II, and that the volume of world trade will decline for the first time since 1982. This will clearly be a major global downturn, adversely affecting incomes and employment, but individual countries will be affected differently – both in terms of aggregate impacts and transmission channels of the crisis.

The country differences imply that, at one level, appropriate policy responses should in part be based on a thorough understanding of the crisis transmission channels and the gauged consequences. At another level, the responses should also be shaped by the global nature of the crisis, requiring international coordination and cooperation. This paper looks at the specific case of Tanzania. After briefly summarizing the origins and spread of the crisis in section II, the paper examines in section III the transmission channels in typically low-income countries like Tanzania. The following section IV relates the emerging economic problems to the all important issue of employment opportunities. The subsequent section V presents some possible approaches to mitigating

the effects of the global economic slowdown, before making an overall conclusion.

II. THE ORIGINS AND SPREAD OF THE CRISIS

As the Bank of Tanzania (BOT) simply put it, the recent turmoil in global financial markets has resulted in lack of confidence in financial markets that has severely curtailed credit in global markets¹ (the credit crunch). The source of the crisis was sub-prime mortgages offered by financial institutions in the United States, and the effects of those mortgages quickly spread across the West and other parts of the world.

National policy actions in the industrial countries have been implemented to address the root causes of financial stress and to support demand, including programmes to purchase distressed assets, use of public funds to recapitalize banks and provide guarantees, and a coordinated reduction in policy rates by major central banks. But the results of these initiatives will take time to be realized.

The credit crunch and the resulting fall in consumer and producer confidence especially in the Western World have undermined global growth and its prospects. In advanced economies, the growth rate in

¹ Bank of Tanzania, "Recent Global Financial Crisis and Implications to the Tanzanian Economy", (Press Statement, October 22, 2008)

2008 according to IMF data², dropped by more than 60 percent of its level in 2007, and is projected to contract significantly on a full-year basis in 2009 – the first such fall in the post-war period. For Sub-Saharan Africa, economic growth³ is projected to drop from an annual average of 6.6 percent in 2006-07 to 3.5 percent over 2008-09. And, according to World Bank data⁴, the volume of world trade in 2009 will shrink for the first time since 1982, while net private capital flows to emerging countries will likely be significantly less than half the record US\$ 1 trillion of 2007. Commodity prices, which declined sharply since July 2008, are projected to continue that decline.

Global stock markets experienced record falls⁵ in 2008 as the financial turmoil and economic slowdown ended the boom in share prices. For instance, the FTSE 100 index in London declined by over 30 percent – its worst year on record – with larger falls in Frankfurt and Paris. There were also larger falls in New York (the Dow Jones), Tokyo (the Nikkei index), and Hong Kong (the Hong Seng index).

² International Monetary Fund, World Economic Outlook Database (2009)

³ The sub-region's 2009 current account deficit (including grants) is projected to widen by over 6% of GDP (due to projected decline in world trade), and the overall fiscal balance (including grants) to deteriorate to a deficit of nearly 5% of GDP (the slowdown in trade would reduce government revenues). Short-term prospects for international capital market access would be reduced, specifically for some 8 countries of the sub-region (apart from South Africa).

⁴ IBRD, Global Economic Prospects, (Washington, D.C., 2009).

⁵ Reported in writing by the British Broadcasting Corporation (BBC), December 31, 2008

III. TRANSMISSION CHANNELS FOR LOW-INCOME COUNTRIES (LIC)

As has been variously argued, most low-income countries, including Tanzania, have to a large extent not been directly affected by the on-going crisis because their financial sectors are much less integrated into global financial markets⁶. As well, the foreign banks that operate in most of low-income African countries do so under respective national laws and regulations, and their financial relationships with parent institutions require approval of the host countries.

The significant channels of transmission of the crisis are, therefore, largely indirect, impacting through: slower export growth; weak growth or decline in tourism receipts; reduced remittances; reduced foreign direct investment (FDI); and possibly reduced official development assistance (ODA).

i. Exports

As has been indicated, weakening global demand will continue depressing commodity prices over 2009-2010, with projected average decline of nearly 14 percent over the two-year period. In

⁶ See, for instance, IBRD, "Global Financial Crisis and Implications for Developing Countries", (G-20 Finance Ministers' Meeting, Sao Paulo, Brazil, November, 2008); and Bank of Tanzania, "Recent Global Financial Crisis..." op cit

the more specific case of Tanzania, the price falls for the major traditional exports were already quite significant⁷ in 2008: between August and November, the world prices of Robusta coffee declined by 19.4 percent, of tea (average price) by 27.7 percent, of cotton ("A" Index) by 29.7 percent, and of cloves by 27.3 percent. The weakening global demand will, therefore strain Tanzania's trade account of the balance of payments, especially in 2009 when the drop in non-oil commodity prices is expected to exceed 20 percent.

ii. Tourism and Transportation

Receipts from tourism are a major source of foreign exchange earnings in Tanzania, constituting close to 30 percent⁸ of total exports of goods and services over 2007-08. Another important single source on the receipt side (exports of services) is transportation, mainly related to the passage of cargo through the port of Dar es Salaam. This item constituted about 8.5 percent of goods and services receipts over the same two year period (with the receipts having more than doubled in US dollar terms over 2004-08)

⁷ See Bank of Tanzania, Monthly Economic Review, (Dar es Salaam: November and December 2008 issues)

⁸ For the two years 2007-08 (years ending in November), the estimate is 27.9 percent, based on data in the Bank of Tanzania Monthly Economic Review (December, 2008). For transportation receipts, the proportion is 8.55 percent.

By November 2008, the effects of the economic slowdown in the industrial countries were not easily discernible from reported aggregate tourism receipts⁹ for the year. However, some hoteliers and other agents have estimated the decline in the number of visits in the order of 10 percent and higher during the year. Similarly, transportation receipts continued to grow reasonably in 2008 in part reflecting the obvious – that the indirect effects of the global slowdown could not be so quickly translated into import reduction for the neighbouring countries using the Dar es Salaam port. It can be concluded therefore, that the more significant effects on aggregate service receipts – coming mainly from the tourism side -- may likely be registered in 2009 and perhaps 2010.

iii. Remittances

Internationally comparable estimates indicate that yearly remittances for Tanzania are quite small – certainly compared to larger numbers in neighbouring Uganda and Kenya. For the period 2003-2006, the annual average was estimated¹⁰ at U.S. \$13 million in Tanzania compared to \$ 479 million and \$ 494 million for Uganda

⁹ See trends from Bank of Tanzania, Monthly Economic Review, *ibid*, Chart 4.5

¹⁰ World Bank data, cited in Gupta, S, C. Pattillo and S.Wagh, “ Impact of Remittances on Poverty and Financial Development in Sub-Saharan Africa”, Working Paper WP/07/38, (Washington, D.C.: International Monetary Fund, 2007), Appendix Table 1. The estimates are for a broad category defined as: workers’ remittances, compensation of employees, and migrant transfers.

and Kenya respectively. As a proportion of foreign direct-investment, for instance, remittances to Tanzania stood at about 3 percent, over the same period, and were much smaller compared to ODA inflows in the country. There is of course a caveat to the data especially for Sub-Saharan Africa, where informal channels are significantly used for remittances, and where intra-regional transfers may not be accurately captured in the balance of payments statistics.

However small, remittances are quite important to families that are beneficiaries. The available evidence from empirical surveys point to poverty-reducing effects of remittances – through smoothing household consumption and supporting expenses for education, health care, and nutrition.¹¹ Reduced remittances¹² that would result from lower global growth and reduced employment opportunities abroad would therefore impact negatively on poverty.

¹¹ See Gupta, S, C. Patillo, and S. Wagh, “Making Remittances Work for Africa”, Finance and Development, Vol. 44 No. 2 (June 2007)

¹² The World Bank is forecasting a decline of 7-10% in remittances to developing countries in 2009; cited in The Economist magazine of August 1, 2009.

iv. Foreign Direct Investment (FDI)

Foreign direct investment in Tanzania has increased quite rapidly¹³, registering almost a four-fold increase between 1995/96 and 2006 (estimated to reach US\$ 597 in the latter year). It has thus become an important source of investment financing, constituting an average of about 20 percent of private capital formation in the two years 2006-2007. And according to the last survey¹⁴ of foreign private investment into Tanzania, the investment has been associated with relatively fast expansion in (FDI-generated) employment -- that has risen by about 42 percent between 2002 and 2005, led by job creations in manufacturing, wholesale trade, and agriculture in that order.

For 2008, The Tanzania Investment Centre (TIC) had initially projected FDI at US\$ 750 million. TIC has, however, recognised that the tightening of global credit conditions is likely to lower FDI flows and also reduce or reverse portfolio inflows, as investors flee to more liquid or safer assets. This is over and above the effects of

¹³ See, for instance, Bank of Tanzania, Economic Bulletin (June 2008), which presents (Tables 4.1 and 4.2) the latest consistent data in the context of balance of payments statistics. On the basis of this source, FDI increased from US\$ 387.6 million in 2002 to a provisional estimate of US\$ 647 million in 2007. Another source is United Republic of Tanzania, The Economic Survey (Dar es Salaam, various issues).

¹⁴ Tanzania Investment Report, (Dar es Salaam: Bank of Tanzania, 2006); Chapter 4

the general financial uncertainties created by the global economic recession - leading to investment delays or cancellations. Accordingly, at end-2008, TIC revised the projected FDI figure downwards by 10 percent.

Given the poor economic prospects in 2009, FDI will remain highly constrained and may indeed fall in line with the World Bank's projected significant decline in net private capital flows to emerging countries.¹⁵ Under the latter scenario, Tanzania would experience negative effects on investment and employment creation.

v. Official Development Assistance

For the last three fiscal years (2005/06 to 2007/08), external sources of finance averaged about 40 percent of total government expenditures¹⁶. For the fiscal year 2008/09, the government had planned to lower this figure to 34 percent from 42 percent in 2007/08 in the interest of reduced aid dependency. Nevertheless, external resources will continue to constitute a major financing source of government and development expenditures, and therefore, an important support of public investment, growth, and

¹⁵ IBRD, Global Economic Prospects, 2009, op cit

¹⁶ United Republic of Tanzania, The Economic Survey, 2007 (Dar es Salaam, June 2008).

employment. Strained public finances in the donor countries, resulting from the global financial crisis, could constrain aid growth, contrary to internationally agreed targets related to the financing of MDGs.

Aggregate Growth

The overall impact of the foregoing and related factors on the Tanzanian economy will be a reduction in the pace of economic expansion. The government estimates that GDP growth in 2008 will be below the original projection of 7.8 percent, and for 2009-10, the drop¹⁷ is projected to be more significant – to around 5-6 percent from an earlier projection of about 8 percent. These projections assume that, especially in 2009, efforts will be made to protect levels of domestic investment and activity, and to defend levels of earlier envisaged external resources.

IV. POTENTIAL IMPACT ON EMPLOYMENT AND DECENT WORK OPPORTUNITIES

With regard to employment, a starting point is to note that labour statistics in low-income countries are quite unreliable and measures of underemployment rather problematic, but the consensus is that Tanzania has a serious problem of unemployment and

¹⁷ As indicated, for instance, in the 2009/10 Budget Statement to Parliament by the Minister of Finance and Economic Affairs (June 2009).

underemployment. The integrated Labour Force Surveys (ILFS) of 2000/01 and 2005/06 indicate, among other things, that¹⁸:

- unemployment was nearly 13 percent in 2001, and 11 percent in 2006
- in Dar es Salaam city, unemployment was 31.3 percent in 2006 compared to 46.5 percent in 2001; in other urban centres the comparable figures were 16.3 percent and 24.9 percent.
- in rural areas, unemployment was 7.1 percent in 2006, having declined from 8.4 percent in 2001
- unemployment for the youth (aged between 15 and 35 years) was 13 percent in 2006, declining from 16 percent in 2001.

Thus, over the five year period (2001-2006), overall unemployment has declined very slowly -- by only 2 percentage points; and youth unemployment by only 3 percentage points. These results are consistent with the slow reduction in the overall incidence of poverty, which according to the provisional results of the 2007 Household Budget Survey stood at 33.3 percent in 2007 from 35.7 percent in 2001.

The sectoral distribution of employment indicates that agriculture is by far the largest employer with nearly 77 percent of the total in 2006 (from

¹⁸ See summary in Tanzania, The Economic Survey, 2007, op cit, Chapter 6

84 percent in 2001). The most dynamic sectors in terms of employment creation are the informal sector, which raised its share of the total from 5.7 percent in 2001 to 9.3 percent in 2006, and a combination of other sectors (excluding agriculture, the public sector, and domestic work), which together represented 8 percent of total employment in 2006, from 4.4 percent in 2001.

In respect of safeguarding employment and decent work opportunities in the wake of the global economic slowdown it would, therefore, be very important to bear in mind, the sectoral distribution of and dynamism for employment creation in the Tanzanian economy.

V. APPROACHES TO MITIGATING THE EFFECTS

The overall impact of the severe recession in the industrial countries will be a reduction in resources – reflected in balance of payments flows – that are needed to support domestic economic expansion and employment in Tanzania. Countercyclical and medium- to long-term policy measures will, therefore, be required to cushion aggregate activity and protect the economy's underlying growth dynamic. The measures may be discussed under four broad headings: macroeconomic and institutional strategies; supply-side measures and related employment; external resource mobilisation; and international coordination.

Macroeconomic and Institutional Strategies

As the likely reduction or slowdown in resource flows to Tanzania would be rooted in external aggregate demand weakness or decline, it would be appropriate to cushion the domestic economy against the likely adverse impacts, at least in the short-term. This should be done through the pursuit of non-inflationary macroeconomic policies – notably monetary and fiscal – that are supportive of domestic demand. This is all the more viable because the country has a relatively strong foreign exchange position.¹⁹ But even if this was not the case, it would still be prudent to mobilise appropriate external resources (concessional borrowing or otherwise) to protect the economy from demand compression and further unemployment. Domestic credit policy in particular should aim at supporting continued production expansion. Fiscal policy, on the other hand, while also supportive of aggregate activity²⁰ would, at the same time, need to strive for sustainability.

At the institutional level, government and the central bank would need to devote special attention to maintaining the stability of the financial

¹⁹ Equivalent to 5 months of imports in late October 2008, according to the Bank of Tanzania Press Statement on the Recent Global Financial Crisis..., op cit

²⁰ In June 2009, President Jakaya Kikwete unveiled a TSh. 1.7 trillion (about US \$1.3 bn) fiscal support package to compensate some exporters for losses, guarantee debt rescheduling, and to boost loans to farmers; see the President's statement in Dodoma on 10 June 2009. Relatedly, the Bank of Tanzania set a target of nearly 29% annual private sector credit expansion (by June 2010); see Bank of Tanzania, Monetary Policy Statement, (Dar es Salaam, June 2009)

sector, given the global nature of the crisis and the consequent financial uncertainties. This would call not only for ensuring continued interbank lending but also reinforcement in the oversight of domestic financial institutions – to ensure the maintenance of sound financial indicators.

Supply-side Measures and Related Employment

In the efforts to minimise the impact of a severe global recession on domestic activity and employment, particular attention ought to be given to the agricultural or rural sectors, where almost 75 percent of the Tanzanian population lives. As already seen, that sector is also, by far, the largest employer. In the short- to medium-term, productivity-enhancing strategies relying on known technologies²¹ -- related to greater use of better or improved seed varieties, extended fertiliser applications, extended irrigation, and improved extension services -- could make significant differences to outputs (domestic and industrial raw materials), incomes and employment. The key to success in such efforts is the setting of monitorable and time-bound targets in the indicated directions (in contrast to the usual ‘lip-service’ by government functionaries).

²¹ This aspect of agricultural improvement is, for instance, emphasized in President J. Kikwete’s End-of-Year National Address (December 31, 2008).

Relatedly, there is need for reinforcement of national efforts for greater value addition in agriculture – through more agricultural processing and the improvement or establishment of agro-based industries – to increase the supply of processed foods and other agro-products for domestic and export markets. These activities would also be relatively more labour-intensive, supporting faster employment expansion. A key challenge on this effort will be the gaining of market competitiveness in terms of product quality and pricing. It has to be said, for instance, that Tanzania’s continued import-dependence on relatively simple products, like fruit juices, is clearly inconsistent with the objectives of maximizing domestic incomes and employment.

Beyond agriculture, greater efforts are also needed to expand and diversify exports on a broad front. This requires, among other things, continued improvement of price-related incentives, the provision of better and more reliable infrastructure and energy, and other ways of enhancing overall international competitiveness. The approach is also relevant for promoting tourism to make it more attractive, and therefore, more competitive in favour of Tanzanian destinations. In addition, Tanzania’s potential for much enhanced transportation receipts, through greatly improving the port of Dar es Salaam (and other ports) and the connecting infrastructure services to the many neighbouring countries, should be fully exploited. This may require large investments in

infrastructure and related services by the public and private sectors (including foreign investments) to address the growing demands. Both quantity and quality will matter in this rather strategic area for Tanzania; capital expansion without significantly visible improvements in the way of 'doing business' would fail to make Tanzanian ports and related infrastructural services competitive.

The informal sector, as one of the more dynamic employment-creating sub-category and which produces quite varied outputs (some of them exported), also needs special attention. Expansion of appropriate financing mechanisms (saving and credit cooperative societies, micro-finance, etc.), infrastructure and energy, and other support would be particularly helpful in maximizing opportunities for self-employment and poverty-reducing growth.

Mobilising External Resources

Given the rapidly evolving global economic situation, short- and medium-term balance of payments (BOP) projections would need to be made under various scenarios, and on an on-going basis, to ascertain the adequacy (or otherwise) of the foreign exchange reserves over time – in light of the demand-supporting macroeconomic approach. If found necessary, appropriate external financing should be mobilised – perhaps

from suitable facilities of the IMF, like the exogenous shocks facility²². Such BOP projections may also indicate the need for expediting the flow of envisaged programme and project finance from both bilateral and multilateral sources – through the illustration of the financing gaps and related policy consultations.

Through the BOP exercise, it would be important to fully take into account the fact that the global financial crisis would tend to undercut aid effort by development partners. Thus, all envisaged aid levels would need to be carefully reconsidered. In terms of actions going forward on this front, national and international dialogue will need to be sharpened and refocused to protect Tanzania's pace of approaching the multilateral development goals (MDGs). Relatedly, domestic fiscal revenue efforts should be continued to raise Tanzania's tax-GDP ratios closer to the best performers in Sub-Saharan Africa. Revenue efforts should, of course, be complemented by serious public expenditure prioritisation and monitoring to maximise poverty reducing expenditures in the overall budgetary envelopes, and to avoid negative public perceptions of 'wasteful' government.

²²Indeed on May 29, 2009, the IMF approved about US\$ 336Mn loan to Tanzania under the Exogenous Shocks Facility, citing the balance of payments difficulties that would arise from a 26% fall in cotton export prices and a severe downturn in tourism and foreign direct investment (IMF Press Release No. 09/190; May 29, 2009)

In respect of foreign direct investment (FDI), greater effort in improving Tanzania's business environment will be necessary for attracting increased investment flows as well as private domestic capital formation. Specifically, Tanzania has to become more competitive, in a sustained manner, in terms of doing business. In a World Bank report, Doing Business, 2009, Tanzania was downgraded to 127th (out of 181 countries) in respect of the "ease of doing business", from 124 in the 2008 ranking. The management of the Tanzania Investment Centre (TIC) has cited various reasons²³ for the downgrade, including weak land legislation laws and procedures, delays in port clearance, and bureaucratic hurdles and delays. President J. Kikwete's envisaged establishment of an "Investors Complaints Bureau" aimed at directly addressing some of these hurdles and obstacles could be helpful in this broad area. Other related efforts for enhancing FDI inflows pertain to the need for investment source diversification²⁴, and for strengthening infrastructure and energy supplies.

²³ The reasons were cited in The Guardian (Tanzania; January 19,2009)

²⁴ According to the Tanzania Investment Report 2006, over 80 percent of the stock of FDI by 2005 originated from only 10 countries, with South Africa, Canada, and UK together contributing close to 50 percent.

International Cooperation

Given the global nature of the current economic crisis, Tanzania will clearly need to look beyond its own BOP financing concerns and join the broader international efforts aimed at addressing the crisis. Two areas in this regard should be pointed out: the Group of Twenty (G-20) process that began in November 2008 in Washington, D.C., and the stalled discussion on the Doha Round.

As may be known, South Africa is the only African country-member of the G-20 -- a group of the largest industrial and emerging market economies ("systematically significant economies") that meet, in the framework of the Bretton Woods Institutional system, to discuss key economic and policy issues relating mainly to the promotion of a stable and sustainable world growth. For the first time since the formation of the Group in 1999, it met at the leaders' level (heads-of-state and government) in November 2008 to enhance cooperation and work together to restore global growth and achieve needed reforms in the world's financial system²⁵. In the context of the latter, focus would be placed on strengthening financial market transparency and accountability, enhancing sound regulation, promoting integrity in financial markets, reinforcing international cooperation among financial

²⁵ As expressed in the "Declaration of the Summit on Financial Markets and the World Economy" , (Washington, D.C.: The White House, November 15,2008)

regulators, and reforming international financial institutions (principally the Bretton Woods Institutions and related fora). Although not members of the Group, low-income countries, including Tanzania, have much to gain by working indirectly with some members (notably South Africa in Tanzania's case, but also with other members) to promote global financial stability and reform the international financial institutions.

In respect of the stalled Doha Round, Tanzania remains a deeply interested party in a timely conclusion, given the country's dependence on an international (and agricultural) trade and related resource flows. Both directly and through relevant country groupings, Tanzania should, therefore, actively continue to support the negotiation processes on both the outstanding substance and modalities.

VI. CONCLUSION

Given the externally generated global recession, an appropriate policy response is one that, in the short term, protects domestic demand and employment, while ensuring, in the medium term, that the economy's underlying growth dynamic does not get compromised. Fortunately, Tanzania currently has a comfortable foreign reserve position and an overall macroeconomic stability to move on this strategy. A combination of supply-side and external sector management policies will be needed to implement the strategy. As well, Tanzania will need to cooperate

actively with its bilateral and multilateral development partners in addressing the underlying causes of the global financial crisis and in reforming the global trading framework.