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**EQUITY AND GROWTH THROUGH ECONOMIC RESEARCH  
(EAGER)  
TRADE REGIMES AND GROWTH**

**TANZANIA TRIP REPORT  
August 9, 1995**

The AIRD Group team that visited Tanzania from August 2 through August 9, 1995 to initiate the EAGER/Trade project comprised the following: J. Dirck Stryker (Chief of Party), Lucie Colvin Phillips (Senior Advisor), and Daniel Ndlela (Regional Coordinator). The purpose of the visit was to work with USAID and Tanzanian decision makers, business leaders, and researchers to identify and prioritize the initial topics to be investigated during the project. The team was also to work, in collaboration with Tanzanian researchers, to develop proposals for specific research projects to be undertaken on these issues.

Our initial discussions with USAID made clear that the mission's priorities fit well with the EAGER project goal of developing the capacity of African researchers to respond to policy makers' needs with sound research related to economic policy issues. This capacity is already well advanced in Tanzania, where researchers from university faculties and research institutes have for many years contributed to the policy-making process. At no time, however, has this contribution been more important, given the current critical juncture in economic policy.

The EAGER/Trade team was able to identify two major areas of research for which there is strong demand within the Government of Tanzania and the private sector business community. The team agreed to work closely with the USAID program economist and private sector office in conducting this research. USAID/Dar es Salaam will be invited to participate in the selection of projects, to read draft reports, to attend conferences and workshops, and to help disseminate results.

During its stay in Tanzania the team visited with Tanzanian government officials, the central bank, business promotion organizations, private business leaders, officials of USAID, and researchers in universities, research centers, and consulting firms. A complete list of those contacted is contained in Annex A.

**POLICY MAKING AND THE RESEARCH COMMUNITY**

The EAGER project is meant to improve the use of top quality economic research by African policy makers. One step in this direction is to consult them in advance about their research priorities. Another is to structure research projects and teams so as to strengthen working relationships between policy makers and local economists. Our first step, therefore, was to consult with policy makers, business leaders, researchers, and USAID staff to obtain an overview of the existing dialogue between the research community and leaders in government and the business community. Policy makers were interviewed from the Planning Commission, the Ministry of Industries and Trade, the Ministry of Agriculture, and the Bank of Tanzania. Discussions were held with the Tanzania Exporters Association (TANEXA), the Chamber of Mines, The Business Center, and several mining companies. Researchers were consulted from the Economic Research Bureau, the Economic and Social Research Foundation, the Department of Economics at the University of

Dar es Salaam, and Mangesho and Company. Officials from the World Bank and UNDP, as well as from USAID, were interviewed.

Links between university research economists and policy makers are perhaps closer in Tanzania than in any other African country outside of South Africa. Both the Economic Research Bureau and the Economic and Social Research Foundation have Boards of Trustees that include leaders of government and the business community. The Principle Secretary of the Planning Commission chairs each of these Boards. In addition, individual researchers have their own close ties with the government, for which they often act as consultants.

## TRADE POLICY ISSUES IN TANZANIA

Tanzania today stands at an important crossroad in economic policy. For many years, the country sought to achieve economic growth and equity through a strategy that emphasized the public sector. This took the form of economic planning and regulation by the central administration, the production of goods and services by public enterprises, the collection and distribution of food and export crops by public marketing boards, and the organization of the rural sector into a system of centrally created cooperatives. Despite the best of intentions on the part of the country's leaders, the result was economic stagnation, mounting public debt, and macroeconomic imbalance leading to rapid inflation.

By the mid-1980s, the situation had deteriorated to the point that major reform was required. This took place in the form of two Economic Recovery Programmes designed to induce macroeconomic stabilization by increasing government revenue and lowering expenditures, reducing price controls, freeing up the internal marketing system, decreasing the importance of parastatals through privatization and liquidation, and reforming trade and exchange rate policy regimes. These reforms included devaluation of the exchange rate and movement towards a more flexible rate, elimination of direct controls on trade and foreign exchange, reduction of the complexity of the import tariff regime and some decrease in the average level of tariffs, and elimination of export taxes and the monopoly power of the marketing boards.

By mid-1995, almost all of the reforms related to trade and exchange rate policy, as well as those associated with price controls and internal market regulation, had been announced. Problems remain, however, with effective implementation. Some success had been achieved in privatization, but much more remained to be done. Macroeconomic stabilization was far from having been achieved, with inflation running at close to 40% per annum. Part of this was due to the inability of the government to control public expenditures and part of it was because of widespread tax avoidance and evasion. This rapid rate of inflation was having a serious impact on decisions regarding investment.

### Trade Policy Reform

During the first two decades of independence, emphasis was placed on modernizing the economy and achieving structural transformation aimed at decreasing reliance on the external economy. This was achieved through import protection resulting from high tariffs, quantitative restrictions on imports, and exchange controls. At first, rapid growth was achieved as production

by local firms substituted for imports. The limits of market size were soon exhausted, however, often before economies of scale had been achieved. Furthermore, policies designed to promote import substitution resulted in overvaluation of the currency and a strong bias against exports. This was strengthened by the failure of the export marketing boards to offer adequate incentives to producers. As a result, exports declined and firms had difficulty in obtaining the foreign exchange necessary to purchase capital equipment, raw materials, intermediate goods, and spare parts. This led to large losses due to substantial underutilization of capacity.

With the trade and exchange rate policy reforms that have recently been undertaken, there is now an enormous opportunity to reorient the economy once more towards the external sector. This not only will permit Tanzania to exploit its static comparative advantage in international trade but also will allow it to benefit from some of the dynamic effects associated with growing exports.<sup>1</sup> However, although exports have responded to the recent reforms, the response has not been as great as had been hoped. Most of it has occurred among traditional exports such as coffee and cotton. Although the percentage growth rate of nontraditional exports has been relatively high, this rate starts from a small base and, in any case, has tended to level off recently. One reason may be that nontraditional exporters benefitted more when they could obtain imported inputs at the official exchange rate and converted their export proceeds to local currency at the parallel rate of exchange. Now that the exchange rate has been unified, they no longer have this incentive.

A Task Force has recently been created to develop an export strategy for Tanzania. Included on this Task Force are representatives from government, private business, and professional associations such as the Tanzania Exporters Association. A draft report has been prepared and is being discussed by the various parties involved. When it has been agreed upon, it will be disseminated throughout the country through workshops and other mechanisms. Following this, it is expected that the World Bank will fund an export promotion project, which will try to address the constraints on export growth.

In the meantime, there is the danger that some of the recent trade policy reforms may be reversed. As an example, the *Daily News* recently reported on a ban that has been placed on scrap metal exports in order to protect domestic users of scrap metal. This use of discretionary authority over trade policy can wreak havoc with all the accomplishments of the past few years designed to promote export growth. It is vital that both the government and the private sector understand the advantages that trade can bring and the dangers of intervening arbitrarily in the trade regime environment.

### Mineral Exports

The mining sector in Tanzania appears to have an immediate potential for rapid growth. In the two years since it was freed from the dominance of inefficient parastatal monopolies, private exploration activity has increased dramatically. Tanzania's major nickel deposits and strong potential

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<sup>1</sup>These are discussed in detail in J. Dirck Stryker, *et al*, *Costs and Benefits of Eliminating Institutional Constraints on the Expansion of Nontraditional Exports*, Cambridge, Massachusetts: AIRD, October 1994.

for gold, diamond, and semi-precious gems have been documented both by UNDP-sponsored studies and private mining companies. The intragovernmental Export Strategy Task Force estimates that the mining sector has the largest potential of any sector for contributing to GDP growth in the next five years. Its contribution to employment and income growth should also be greater than the other potential growth sectors, such as tourism and nontraditional exports of agricultural and manufactured products.

One large diamond mine is currently in production (Williamson Diamond Mine) and an estimated 300,000 small-scale miners are prospecting for and mining gold and diamonds. They are one of four interested groups: (1) major mining conglomerates (dominated by such companies as DeBeers and Anglo-American), (2) middle-sized international companies, including Canadian, U.K., Australian, and potentially U.S.-based firms, (3) joint-venture and Tanzanian businesses that have filed small formal claims (often the Tanzanian partner filed the original claim, but lacked the capital and technology to exploit it, and thus allied with a small or medium-size expatriate business), (4) small-scale miners, often young to middle-aged men from local farming communities.

Small-scale miners currently have no legal buyer for their ore and stones since the Bank of Tanzania withdrew from purchasing gold after incurring substantial trading losses. These miners mainly mine illegally, as well, since the diamond and gold exploration concessions are generally held by medium and large-scale companies. Health and environmental hazards associated with the mining are substantial. They include:

- subminimal temporary living conditions;
- less than a living income for most miners most of the time (sustained by the gamble inherent in the enterprise and the possibility of mining as a secondary occupation);
- child labor (cheap and mobilizable);
- conflict between small-scale miners and concession holders;
- work in dark, wet, hand-dug tunnels that occasionally collapse;
- mercury poisoning during manual purification.

Because the entire operation is extra-legal and takes place in isolated rural areas, there has been no way to address the social and environmental problems associated with small-scale mining.

A substantial portion of the sales of gold and diamonds have traditionally passed via Burundi, Rwanda, and other neighboring countries. The result is that Tanzania forgoes potentially substantial royalties on gold (3% of the value of production) and gem production. Moreover, the foreign exchange that is earned stays outside the formal banking system. The Export Strategy Task Force has identified this as a major issue to be studied.

## TOPICS FOR RESEARCH

This initial team visit revealed widespread interest in at least two broad topics that should lead to fundable research projects. These include (1) a study of small-scale mining and (2) an assessment of Tanzania's comparative advantage in a number of industrial and agro-industrial sub-sectors.

### Small-Scale Mining

Tanzania would benefit substantially from bringing small-scale mining under a viable legal and regulatory framework, covering prospection, processing, and marketing. The benefits would include

- enhanced government revenues;
- foreign exchange circulating through official channels;
- growth in employment;
- growth in rural incomes, improving both incomes and equity;
- opportunities for the introduction of schools and health services in mining communities currently lacking them;
- reduced conflict between the small miners and formal-sector mining companies;
- healthier relations between the Tanzanian government, Tanzanian public opinion, and the mining sector as a whole, contributing to a more stable investment climate.

### Prospection

Both gold and gemstones occur in dispersed deposits over a wide area. They are high-value, low-weight products, easily transportable across borders. For this reason small-scale mining requires a finely tuned legal framework and marketing system. These must be competitive with those of neighboring countries in order to capture a significant portion of production, as smuggling is virtually impossible to control by force. A viable marketing system in Tanzania would also tend to attract substantial gold and diamond trade across Lake Tanganyika from Eastern Zaire, where small-scale mining is liberalized but not well served by markets.

The prospection component of the study will look at means of facilitating the registration of small claims by artisanal miners. The optimal localization and sizing of claims should be studied, as should procedures for filing and enforcing the legal status of claims. This is expected to contribute substantially to reducing tensions between larger mining interests and small miners. It should also give Tanzanian public opinion a vision of mining that includes Tanzanians benefiting

directly from it, not just expatriates. This is an important factor in stable working relations for the sector as a whole.

### Processing

The study will examine existing and alternative means for concentrating and processing ore. There is a niche for small-scale appropriate technology in the processing of gold ore and possibly gemstones. This can open opportunities for Tanzanian entrepreneurs able to take advantage of slightly more capital and technology than artisanal miners. In gold processing, for example, what are called stamp batteries have been used successfully in Western Australia in similar artisanal mining situations. The stamp battery purifies the ore of individual miners, who receive their purified ore at a saleable standard concentration and a small recompense for the value of the tailings. The owner-operator of the stamp battery can be an independent entrepreneur, or possibly a licensed gold buyer. Another small device, called a retorquer, allows one to recover the mercury from gold tailings without handling it. This is a potential source of income, saves the cost of the mercury, and reduces the health hazard. Currently some processors handle mercury without gloves while purifying ore, resulting in serious poisoning.

Cutting of gemstones in the field should also be explored. It is risky, as high quality gemstones may be poorly cut, resulting in reduced rather than increased value added. For this reason, we hypothesize that it would only be viable on lesser value gems. Nevertheless, it can result in a valuable secondary market in Tanzania and the region that would complement the tourist trade nicely.

### Marketing

The biggest lack in current arrangements is a viable marketing system. As both Tanzania and neighboring countries have liberalized their markets, this will most likely be a form of licensed buying. Viable, competitive conditions and procedures for obtaining and exercising buyers' licenses must be established. For this purpose, existing marketing systems in Tanzania will be examined and comparisons will be made with marketing systems in other countries such as Kenya, Burundi, Rwanda, Uganda, Zaire, Botswana, Ghana, and Mali. The last two countries are considered to have established viable marketing systems; others on the list are potential competitors and/or suppliers for the regional market.

### Tanzania's Comparative Advantage in Industry and Agro-Industry

In assessing Tanzania's comparative advantage in production of industrial and agro-industrial products for export, whether to neighboring countries or to the world market, and for the domestic market, numerous factors must be considered:

- the long-run equilibrium rate of exchange after taking into account further reduction of import barriers, the long-term prospects for agricultural and mineral exports, and projected capital inflows;
- the functioning of the labor market and, in particular, the opportunity cost of labor;

- the important role that transportation costs play given long distances to overseas markets and the fact that many of Tanzania's trading partners are landlocked;
- the obsolete nature of much of Tanzania's technology, resulting from low levels of investment for many years and the possibilities that exist for upgrading that technology through new investment;
- the problems that Tanzania accrues because of its poorly developed transportation and telecommunications infrastructure, financial and insurance markets, and the other institutions important to international trade;
- the impact that Tanzania's adherence to various schemes for regional integration would have on the incentives facing its producers.

There is a particular need to assess where Tanzania's future comparative advantage lies with respect to exports to neighboring countries and to the world market. Once this is understood, the analysis must identify the factors that stand in the way of the realization of this advantage, whether these be related to trade and exchange rate policy, transportation and telecommunications policy and infrastructure, mobilization of investment finance, establishment of training programs, or participation in regional schemes for economic integration.

#### FUTURE ACTION

The team recommends that at least two research topics be selected for Tanzania and that research proposals be prepared as described below. The first of these topics on the small-scale mining sector has already been highlighted by the Export Strategy Task Force and has widespread acceptance within government and the private mining sector. This proposal will be prepared with pre-project financing during the fall and will be submitted to the Technical Committee shortly after the first of the year. The second proposal will involve greater interaction with policy makers and is probably best postponed until after the elections are over and the new government is in place.

#### Small-Scale Mining

The Small-Scale Mining Sector study will be divided into two phases: (1) a proposal development phase and (2) the study proper. The proposal development phase could be funded by September 1995, and the study proper take place in 1996.

The Business Center in Dar es Salaam, which initially mentioned the need for work in this area, is interested in helping to develop the proposal. This will involve: (1) coordinating with the World Bank, which is undertaking a major project in support of the mining sector, (2) hiring a Tanzanian to do a review of the literature on the subject and interviews with major actors in the sector, and (3) participating in drafting the proposal.

Both TANEXA and the Chamber of Mines (a member of TANEXA) have expressed interest in sponsoring the study, participating in it, and using the results. Several Tanzanian researchers have

already conducted work in this area, but composition of the final team will be decided during the proposal development phase.

Lucie Phillips, Senior Advisor for EAGER/Trade, is proposed as Principal Investigator for the project. She is well qualified to lead this study, being familiar with mining and marketing of gold and diamonds in Burundi, Zaire, and Congo. Her firm, AMEX International, has consulted on the status of gold purification firms in Burundi, and is implementing two export promotion projects in Ghana. She is therefore in a position to provide comparative perspective and oversight for the field study.

### Tanzania's Comparative Advantage in Industry and Agro-Industry

The Ministry of Trade and Industry has indicated an interest in a study of Tanzania's Comparative Advantage in Industry and Agro-Industry. This study is seen as filling an important gap in the information available to policy makers when they make important decisions regarding trade policy. The topic has also been discussed with the Economic Research Bureau and the Economic and Social Research Foundation, the Directors of each of which feel that such a study would be important for policy and would fit in well with their research programs.

It is generally felt that the study should concentrate on a few sub-sector industry chains. One of those suggested is the cotton-textile-clothing chain. In this chain, there is a danger that efforts to shelter the vulnerable textile firms by artificially lowering the price of domestically grown cotton would decrease the incomes of cotton farmers. At the same time, furnishing this protection by imposing high tariffs on textile imports would raise the prices of inputs into the clothing industry, which might otherwise be competitive for export. This study would be particularly appropriate given the investment that Cargill has made in cotton ginning and exports in Tanzania.

It is anticipated that this research project will be prepared after the first of the year. A useful occasion for deciding whether and how to proceed might be the EAGER conference to be held in Nairobi at that time.

# List of Persons Contacted

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