AFRICAN DEVELOPMENT BANK GROUP
GROUPE DE LA BANQUE AFRICAINE DE DÉVELOPPEMENT

COUNTRY FOCUS REPORT 2024

TANZANIA

Driving Tanzania's Transformation

The Reform of the Global Financial Architecture

AFRICAN DEVELOPMENT BANK GROUP
GROUPE DE LA BANQUE AFRICAINE DE DÉVELOPPEMENT

COUNTRY FOCUS REPORT 2024

TANZANIA

Driving Tanzania's Transformation

The Reform of the Global Financial Architecture

ACKNOWLEDGEMENT

The 2024 Country Focus Report for Tanzania was prepared in the Chief Economist and Vice-Presidency for Economic Governance and Knowledge Management Complex (ECVP), under the direction and supervision of Prof. Kevin C. Urama, Chief Economist and Vice-President, with support from Amadou Boly (Chief Assistant to the Chief Economist), and Amah Marie-Aude Ezanin Koffi (Executive Assistant).

The preparation of this report was led by Désiré Vencatachellum, Senior Director, Country Economics Department (ECCE), with Marcellin Ndong Ntah (Lead Economist, ECCE) as the project management Lead, IT support from Abir Bdioui (Consultant, ECCE), and administrative support from Tricia Effe Baidoo (Team Assistant, ECCE). Tanzania report was prepared by Prosper Charle, Senior Macroeconomist, under the guidance of Edward Sennoga, Lead Economist for East Region.

The team thanks (i) the Tanzania Country Team led by Nnenna Nwabufo, Director General, East Africa Region, Leandre Bassole, Deputy Director General, East Africa Region; and Patricia Laverley, Country Manager, Tanzania Country Office; (ii) the Macroeconomics Policy, Forecasting and Research led by Abdoulaye Coulibaly, Director, Officer-in-Charge; (iii) the Transition States Department (RDTS) led by Yero Baldeh, Director, (iv) the African Natural Resource Center (ECNR) led by Désiré Vencatachellum, Director, Officer-in-Charge; and (v) the Macroeconomics Policy and Debt Sustainability Division led by Anthony Simpasa, Division Manager, for their contributions.

The data in the report was compiled by the Department of Statistics led by Babatunde Samson Omotosho, Director, with significant contributions from Louis Kouakou (Manager of Socio-Economic Statistics Division, Department of Statistics), Ben Paul Mungyereza (Manager of the Statistical Capacity Building Division, Statistics Department), Anouar Chaouch (Senior Statistician, Division 1 of the Statistics Department) and Momar Kouta (Senior Statistical Information Systems Officer, Division 1 of the Statistics Department).

Peer-review comments were received from Iyad Dhaoui, Principal Policy Economist, Country Economics Department, Duncan Ouma, Senior Country Economist, and Edward Sennoga, Lead Economist, East Africa Region. Dr Joseph Atta-Mensah, Senior Fellow from Africa Centre for Economic Transformation acted an external reviewer.

The cover of the report is based on a general design by Laetitia Yattien-Amiguet and Justin Kabasele of the Bank's External Relations and Communications. Copy-editing was done by the Bank's Language Services Department and layout was done by Eighth Wonder.

TABLE OF CONTENTS

LIST OF FIGURES

LIST OF TABLES

LIST OF BOXES

ACRONYMS AND ABBREVIATIONS

AEO	African Economic Outlook
AfDB	African Development Bank
EAC	East African Community
ECF	Extended Credit Facility
ECI	Economic complexity index
FDI	foreign direct investment
FYDP III	Third Five Year Development Plan
GDP	Gross domestic product
GW	Gigawatt
HBS	Household Budget Survey
HCI	Human capital index
HIPC	Heavily Indebted Poor Countries
ICT	Information and communication technologies
ILFS	Integrated Labour Force Survey
IMF	International Monetary Fund
MDB	Multilateral Development Bank
MW	Megawatt
ODA	Official development assistance
PV	Present value
SADC	Southern African Development Community
SDG	Sustainable Development Goal
TCF	Trillion cubic feet
USD	United States dollars
VAT	Value-added tax

EXECUTIVE SUMMARY

Tanzania's real gross domestic product (GDP) grew by 5.1% in 2023, up from 4.7% in 2022, driven by agriculture, financial services, mining, trade, construction and manufacturing on the supply side, and by private investment on the demand side. Prudent monetary policy, together with moderation in food and energy prices, helped to reduce inflation from 4.3% in 2022 to 3.8% in 2023. The Tanzanian Shilling depreciated by 8% against the US Dollar in 2023, explained by foreign exchange shortages. The fiscal deficit declined to 3.5% of GDP in 2022/23 from 3.6% in 2021/22 due to expenditure controls and was financed by external and domestic borrowing. The primary deficit stabilised at 1.8% of GDP in 2021/22 and 2022/23 and is projected to moderate to 1.4% of GDP in 2023/24. Public debt increased from 43.6% in 2021/22 to 45.5% of GDP in 2022/23 due to an increase in loans to finance infrastructure projects. The current account deficit narrowed from 7.3% of GDP in 2022 to 3.8% in 2023, explained by higher tourism receipts, and was financed by external commercial debt and official flows. Reserves declined to 4.5 months of import cover in 2023 from 4.7 months in 2022, explained by the authorities' response to the foreign exchange shortage.

The outlook is positive, with real GDP growth projected at 5.7% and 6% in 2024 and 2025 respectively, driven by agriculture, manufacturing, and tourism, and supported by public investment and reforms to improve the business environment. Inflation is projected to decline to 3.3% in 2024 and 3.4% in 2025, helped by stability in food and energy prices. The fiscal deficit is expected to decline to 2.5% of GDP in 2023/24, and to stabilise at this level in 2024/25, supported by improvements in revenue performance, and will be financed by domestic and external borrowing. The current account deficit is projected at 4.0% and 4.2% of GDP in 2024 and 2025 respectively, supported by mineral export performance and tourism receipts, and will be financed by external borrowing. The major downside risks to the outlook include spillovers from geopolitical tensions and regional conflicts, sluggish global growth, a narrow tax base and climate shocks.

The transformation of Tanzania's economy is demonstrated by the reallocation of labour from low-productivity agriculture to services and industry. The employment share of agriculture declined, while employment in industry and service increased. The share of agriculture in GDP declined from 42% in the early 1990s to 26% in 2022. However, transformation has been slow and held back by structural challenges, including declining industrial productivity and competitiveness, and shallow financial markets.

Key actions to expedite structural transformation include enhancing the regulatory framework to improve the business environment and boost private investment in manufacturing; addressing infrastructure bottlenecks; and investing in human capital. Financing Tanzania's transformation requires deepening financial markets, including through an expansion of digital financial solutions; undertaking domestic revenue mobilisation reforms, notably expanding the tax base; and strengthening capacity for negotiation of natural resources contracts. Reforms to the global financial architecture, notably to increase the country's access to concessional, low-cost and long-term development and climate financing, would be highly beneficial to Tanzania.

GENERAL INTRODUCTION

Tanzania has maintained a strong and resilient macroeconomic performance for the past four decades, supported by structural reforms and public infrastructure investment. Real GDP growth averaged 6.5% during the 2000-2019 period, enabling the country to graduate to lower middle-income status in July 2020. Despite these developments, about a quarter of the population still live in poverty, mainly as a result of the economic structure, in which agriculture sector is dominant, employing about two-thirds of the workforce while contributing only about a quarter of GDP. Prospects for sustainable growth and faster poverty reduction hinge on more robust transformation of the structure of the economy, so that most of the poor, especially in rural areas, participate in generating growth and benefit from that growth.

The Country Focus Report for Tanzania is aligned with the Bank's 2024 African Economic Outlook (AEO) report. The report is structured in three chapters. The first chapter presents the recent key macroeconomic trends and medium-term outlook and risks and outlines the focus areas for economic stability and transformation. Chapter 2 discusses the trends in Tanzania's structural transformation, highlighting the key issues and challenges that need to be addressed to accelerate the process of the movement of factors of production from low-productivity to high-productivity sectors for inclusive and sustainable growth. Chapter 3 discusses the financing requirements for Tanzania's structural transformation and the need for reforms of the global financial architecture.

MACROECONOMIC PERFORMANCE AND OUTLOOK

1

Key messages:

- Tanzania's economy continued to perform strongly, posting real GDP growth of 5.3% in 2023, up from 4.7% in 2022, driven by agriculture, financial services and insurance, construction and manufacturing on the supply side, and by investment on the demand side.

- The authorities pursued cautiously accommodative monetary policy in 2023, which, together with moderation in food and energy prices, helped to reduce inflation from 4.3% in 2022 to 3.8% in 2023. The Tanzanian Shilling depreciated by 8% in 2023, explained by foreign exchange shortage.

- The fiscal deficit declined to 3.5% of GDP in 2022/23 from 3.6% in 2021/22 due to expenditure controls and was financed by external and domestic borrowing. The primary deficit stabilised at 1.8% of GDP in 2021/22 and 2022/23 and is projected to moderate to 1.4% of GDP in 2023/24.

- The current account deficit narrowed from 7.3% of GDP in 2022 to 5.2% in 2023, supported by the continued recovery in tourism, and was financed by external commercial debt and official flows. Reserves declined to 4.5 months of import cover in 2023 from 4.7 months in 2022, explained by the authorities' response to the foreign exchange shortage.

- Tanzania's public debt is sustainable, and the risk of debt distress remains moderate. The stock of public debt represented 45% of GDP in 2023 against 43% in 2022, explained by new loans. External debt accounts for 71% of the total public debt, and it remained around 29% of GDP in 2022 and 2023.

- The banking sector, which accounts for 71% of financial assets, remained sound, the ratio of non-performing loans declining from 5.7% in 2022 to 4.3% in 2023 – below the desired benchmark of 5%.

- The outlook is positive, with real GDP growth projected at 5.7% and 6.0% in 2024 and 2025 respectively, due to expected improvements in agriculture, manufacturing, financial services, tourism and private investment, and continued reforms to improve the business environment. The major downside risks to the outlook include spillovers from geopolitical tensions and regional conflicts, an unfavourable global economic environment, a narrow tax base and climate related risks.

Introduction

This chapter presents an updated analysis of Tanzania's economic performance in 2023 and medium-term prospects over the period 2024-2025. It assesses, among others, trends in key macroeconomic indicators, fiscal and monetary policies, investment and public debt. The chapter also presents the main downside and upside risks to the Tanzania's economic outlook and provides policy options to foster high and resilient growth, to support macroeconomic stability and economic transformation, and to deal with the shocks that have continued to buffet the country economy.

Section 1: Growth performance

Economic growth

The performance of the Tanzanian economy has remained strong and resilient, recording 5.1% real GDP growth in 2023 compared with 4.7% in 2022, driven by agriculture, financial services, trade, manufacturing, construction, and mining on the supply side, and by private investment on the demand side. Growth in 2023 was boosted by favourable weather and provision of subsidised inputs, which supported agricultural production, and by continued implementation of reforms to improve the business environment, which supported an expansion of economic activity in manufacturing and communication and financial services. The agricultural sector recorded 3.5% growth in 2023 compared with 3.3% in the previous year, driven by increased production of major food crops, including maize, paddy, millet/sorghum, and cassava. Manufacturing recorded 5.0% growth compared with 4.1% growth in the previous year, while information and communication grew by 8.9% in 2023 compared with 7.4% growth in 2022. Finance and insurance was the fastest growing sector in 2023, accelerating to 16.5% growth compared with 9.2% in 2022. Despite its relatively small share in GDP (around 4%), this rapid growth resulted in a significant contribution to overall GDP growth –12.6%, second only to agriculture (16.1%). The strong performance of finance and insurance was driven mainly by an expansion of banking activity, which saw increases of more than 20% in both deposits and lending. This performance was also reflected in the growth of private credit to the other key economic sectors. Credit to agriculture increased by 43.5%, to manufacturing by 15.6%, to mining by 36.4%, and to construction by 23.5%.

Section 2: Other recent macroeconomic and social developments

Monetary policy and inflation

Monetary policy remained cautiously accommodative in 2023, allowing 11.9% growth in broad money supply, about the same as in 2022 (11.8%). The overall lending rate declined from 16.0% in 2022 to 15.3% in 2023, supporting 17.1% growth in private sector credit, mostly to the agriculture, mining and construction sectors, and personal loans. Annual average inflation declined from 4.3% in 2022 to 3.8% in 2023, helped by a moderation of domestic food prices. The Tanzanian Shilling depreciated by 8% in 2023, mainly because of foreign exchange shortages.

Fiscal developments

The fiscal deficit increased from 3.5% of GDP in fiscal year 2021/22 to 3.6% in 2022/23, financed by both external and domestic borrowing. The authorities sustained fiscal consolidation measures in 2023, with a particular focus on managing expenditure, while keeping fiscal deficits within the levels recommended under the International Monetary Fund (IMF) programme – the Extended Credit Facility (ECF). Tax revenues have stagnated at around 12% of GDP in fiscal years 2021/22 and 2022/23. As the authorities continued with expenditure reprioritisation, capital spending declined from 8.8% of GDP in 2021/22 to 7.3% of GDP in 2022/23, creating space for priority social spending, which increased recurrent expenditure from 10.1% of GDP in 2021/22 to 11.8% of GDP in 2022/23.

Primary balance

Interest payments have averaged 12% of domestic revenues over the past three fiscal years, resulting in a primary deficit averaging 1.7% of GDP over the same period. The primary deficit stabilised at 1.8% of GDP in 2021/22 and 2022/23 and is projected to moderate to 1.4% of GDP in 2023/24. Domestic interest payments account for two-thirds of total interest obligations. The main reason for the observed evolution of the primary deficit is a stagnation of tax revenues, which have averaged around 12% of GDP, while authorities continue implementation of multi-year public investment projects, especially in transport and energy. The evolution of the primary deficit also reflects recent developments in financing trends, with net domestic financing averaging 1.6% of GDP, mainly mobilised through issuance of treasury bills and bonds. The level of concessional financing of the budget has remained low, averaging about 1.9% of GDP over the last five years.

Public debt developments

The stock of public debt increased from USD 32.4 billion in 2022 to USD 34.8 billion in 2023 – equivalent to about 45% of GDP, explained by new loans, mainly for infrastructure projects. External debt accounts for 71% of the total public debt, and it remained around 29% of GDP in 2022 and 2023. According to the IMF's 2023 Debt Sustainability Analysis, published in April 2023, Tanzania's public debt is sustainable, and the risk of debt distress remains moderate; and the 2023 Debt Sustainability Assessment by the Ministry of Finance found all liquidity and solvency indicators of the debt burden to be within allowable thresholds. The present value (PV) of external debt is 19% of GDP, against sustainability threshold of 40%, and 113.2% of exports, against sustainability threshold of 180; and the debt service is 14.3% of revenue, against a sustainability threshold of 18, and 12.7% of exports against a sustainability threshold of 15%. Borrowing is guided by the Medium-Term Debt Management Strategy (2023/24-2025/26), which has the objective of meeting financing needs at the lowest possible cost.

External sector developments

Exports of goods and services increased from USD 12 billion in 2022 to USD 14 billion in 2023, while imports of goods and services declined slightly from USD 16.7 billion in 2022 to USD 16.0 billion in 2023. The current account deficit narrowed from 7.3% of GDP in 2022 to 5.2% of GDP in 2023, driven by tourism receipts, which increased by 33% from the previous year, and by gold exports, which increased by 8%. The current account deficit was financed largely by external commercial debt and official external flows. International reserves declined slightly to 4.5 months of import cover in 2023 from 4.7 months in 2022, explained by the authorities' response to the foreign exchange shortage.

Financial sector

Tanzania's financial sector remains dominated by the banking sector, which accounts for about 71% of financial assets. The banking sector remains sound, profitable, highly liquid, and adequately capitalised. The ratio of the banking sector's core capital to total risk-weighted assets is 18%, significantly higher than the minimum regulatory ratio of 10%, explained by adequate capitalisation of the sector, coupled with high profitability. The ratio of non-performing loans declined from 5.7% in

2022 to 4.3% in 2023, below the regulatory requirement of 5%. However, Tanzania's financial sector remains relatively shallow, as demonstrated by the ratio of domestic credit to GDP of about 15%, which is significantly lower than the sub-Saharan Africa average of 35%, and even lower than regional peers such as Kenya (32%) and Burundi (42%). Access to financial services in Tanzania has continued to expand, following an increase in the bank branch network, innovations in banking services, and rapid expansion of mobile money services in recent years. According to the findings of the recent FinScope Tanzania (2023) survey, financial inclusion has grown from 65% of the adult population in 2017 to 81% in 2023, although only 22% of the adults use banking services, while 54% use other formal non-bank financial services and 6% use informal financial services.

Table 1 : Macroeconomic Indicators

	2019	2020	2021	2022	2023(e)	2024(p)	2025(p)
Real GDP growth	7.0	4.8	4.9	4.7	5.1	5.7	6.0
Real GDP growth per capita	3.9	1.8	1.9	1.7	2.3	2.7	3.1
Inflation	3.4	3.3	3.7	4.3	3.8	3.3	3.4
Overall fiscal balance, including grants (% GDP)*	-2.3	-1.5	-3.5	-3.6	-3.5	-2.5	-2.5
Primary balance (% GDP)*	-0.4	0.2	-1.8	-1.8	-1.4	-1.1	-1.2
Current account (% GDP)	-2.3	-2.3	-3.5	-7.3	-5.2	-4.7	-4.2
Total population (million)#	55.9	57.6	59.4	61.7	63.7		
Life expectancy at birth (years)	67.0	66.4	66.2	66.8	67.6		

Source: Data from domestic authorities; estimates (e) and predictions (p) based on author's calculations. AfDB Statistics Department, April 2024.

*Note: *Data for fiscal year ending 30 June in the specified year.*

 # From the National Bureau of Statistics population projections. Figure for 2022 is actual from 2022 National Census.

Social developments

In Tanzania, poverty is measured at two levels: the basic needs poverty line (which includes expenditures on food and other necessities of life, such as clothes); and the extreme poverty line, which considers only the expenditure necessary to meet the minimum calorie intake per day per adult equivalent – also, called food poverty. Based on the latest Household Budget Survey (HBS 2017/18), basic needs poverty declined from 28.2% in 2011/12 to 26.4% in 2017/18, while extreme poverty (food poverty) declined from 9.7% to 8.0%. While poverty is higher in rural areas (31.3%) than in urban areas, rural-urban migration has caused urban poverty to stagnate at around 16% over the two survey periods. Income inequality, measured by the Gini Index, increased from 0.34 in 2011/12 to 0.38 in 2017/18. Using the international poverty line of USD 1.25 per capita, the World Bank estimates that 44.95% of Tanzania's population is poor, and 54.59% is multi-dimensionally poor. This is largely caused by low levels of productivity in the sectors of the economy that employ most of the country's labour force, especially agriculture. According to the latest Integrated Labour Force Survey (ILFS 2020/21), unemployment declined from 10.5% in 2014 to 9.3% in 2021, while youth unemployment increased from 12.1% to 12.6% during the same period. Unemployment is higher among women (12.7%) than men (5.8%). Unemployment is partly explained by a mismatch of skills and lack of employment opportunities, especially among youths. Only 20% of the country's estimated one million new entrants in the job market secure employment.

Box 1 : Impact of tighter international financial conditions on Tanzania.

Tanzania is among the countries with the lowest ratios of tax to GDP, with domestic revenues stagnant at around 12% of GDP. This reality, combined with decline in concessional financing from traditional development partners, has led the authorities to resort to financing from the financial markets, both domestically and externally, to narrow the gap in the country's financing needs to address both economic and social infrastructure constraints. With the tightening of global financial conditions, including higher interest rates and increased exchange rate risks, Tanzania has faced challenges in mobilizing development finance from external sources in recent years, leading to a gradual increase in domestic borrowing, with potential adverse impacts on interest rates and associated crowding-out of private sector credit. Foreign direct investment inflows have also stagnated at around 1% of GDP over the past five years. In addition, Tanzania receives less than 1% of GDP as remittances annually, compared with up to 3.6% in neighboring Kenya. Together with a sluggish recovery in exports of goods and services, which only picked up from the low level of 13% of GDP at the height of COVID-19 pandemic in 2020 to 16% of GDP recently, this has put the country's external position under pressure, with international reserves dropping below 5 months of import cover, as authorities take measures to respond to the problem of foreign exchange shortage.

Section 3: Outlook and risks

Economic growth

Real GDP growth is projected at 5.7% and 6.0% in 2024 and 2025 respectively, driven by agriculture, manufacturing, financial services and tourism, and supported by private investment and reforms to improve the business environment. It is expected that growth will be boosted further by public investment, particularly the ongoing implementation of infrastructure projects, especially in the transport and energy sectors. In the medium term, growth will also be supported by the greater stability of the country's energy situation expected to follow from the recent commissioning of additional generation capacity at the Julius Nyerere Hydropower Plant, which started operations in February 2024, bringing 235 MW to the national grid and significantly reducing power shortages. The plant is expected to inject another 235 MW to the national grid, with the potential to end the power-rationing problem in the country completely, and to boost economic growth.

Monetary policy and inflation

Monetary policy is expected to remain accommodative during 2024-2025 to support economic recovery. Inflation is projected to decline to 3.3% and 3.4% in 2024 and 2025 respectively, supported by stability in food supply and the energy situation.

Fiscal and current account balances

Improved revenue performance is expected to reduce the fiscal deficit to 2.5% of GDP in 2023/24 and 2024/25, which will be financed by domestic and external borrowing. The current account deficit is projected to narrow to 4.7% of GDP in 2024 and further to 4.2% of GDP in 2025, supported by continued recovery in tourism and non-traditional exports, especially minerals. The current account deficit will be financed mainly by external borrowing.

Risks

The tailwinds to the outlook include the continued recovery of the tourism and hospitality-related sectors, the government's ongoing implementation of reforms to improve the business environment, and the improvement in the country's energy situation. The ongoing efforts to use digital technologies to simplify business registration and related services, together with rationalisation of regulations and procedures, will boost private sector development and support the expansion of economic activity. The commissioning of additional power generation capacity at the country's largest hydropower plant will also boost growth by addressing the problem of power cuts that have had adverse effects on economic activity, especially in the manufacturing sector. The project has already injected 235 MW into the national grid, and an additional 235 MW is expected before the end of 2024. The major downside risks to the outlook relate to spillovers from geopolitical tensions and regional conflicts with potential to disrupt trade and supply chains, unfavourable global economic environment with the potential to heighten risks and volatility in financial markets and to affect investment flows. The inflow of foreign direct investment (FDI) has stagnated at around 1.5% of GDP since 2021, and prospects for faster recovery hinge on the global economic environment. Another downside risk relates to fluctuations in commodity prices. Climate-related risks also pose a threat to the country's economic outlook, especially as the agriculture sector remains heavily reliant on the weather. Tanzania remains highly vulnerable to extreme weather events including prolonged droughts and floods.

Section 4: Policy options to foster high and resilient growth: supporting macroeconomic stability and economic transformation.

Tanzania has sustained strong macroeconomic performance for more than two decades, resulting in the country's reclassification as a lower-middle-income country in July 2020. However, the country's growth potential remains largely untapped because of constraints to private sector growth, most notably infrastructure gaps, especially in transport and energy, skills gaps and mismatch, regulatory bottlenecks, insufficient access to credit, and lack of business support services. These constraints have left the country with untapped investment opportunities in agribusiness, manufacturing, tourism, natural gas and mineral sectors, and in associated industries, including real estate, construction, housing and the financial sector. Policy options to foster higher and more resilient growth should focus on key reforms to address bottlenecks in private sector activity. Regarding macroeconomic policies, the authorities may focus on the monetary and fiscal policy options that facilitate the deepening of the country's financial sector and boost private sector credit. Regarding structural policies, the focus should be on reform measures to improve the business environment and attract private investment, including addressing infrastructure gaps, regulatory bottlenecks and skills gaps.

TANZANIA 'S STRUCTURAL TRANSFORMATION PROGRESS

2

Key messages

- The performance of Tanzania's economy over the past four decades has been strong and resilient, with annual GDP growth averaging 3.2% during the 1980-1999 period, accelerating to an average of 6.5% during the 2000-2019 period. Even at the height of the COVID-19 pandemic, Tanzania's economy avoided a recession, posting 4.8% growth in 2020.

- The structure of the Tanzanian economy has evolved significantly over the past four decades, characterised by movement of labour from the low-productivity agriculture sector to other sectors of the economy. The employment share of agriculture declined from 85% in the early 1980s to 65% in 2021/22, while employment in industry and services increased from 2.6% to 8% and from 12.6% and 29% respectively. This was matched by the decline in the share of agriculture in GDP and increases in the shares of industry and services.

- Tanzania's structural change in recent decades has involved the reallocation of economic activity from one low-productivity sector (agriculture) to other relatively low-productivity sectors, such as personal and retail services.

- Although Tanzania has been classified as a lower middle-income country since July 2020, the economy is characterised by a low economic complexity index, pointing to the country's low level of diversification and complexity of export basket.

Introduction

Tanzania has sustained strong economic growth over the past four decades, evolving from a predominantly agrarian socialist planned economy in the early 1980s to a market-oriented service-driven economy since 2000. This chapter presents a comprehensive overview of recent progress in Tanzania's economic transformation in a changing world, identifying the key trends and characteristics. It analyses the extent to which high growth has been accompanied by structural transformation, defined as the shift of workers from activities and sectors with low average labour productivity to those with higher average labour productivity, thus contributing to an increase in average labour productivity in the overall economy. The chapter also presents the financing needed to fast-track Tanzania's structural transformation. The analysis takes both a historical perspective and a forward-looking approach to structural transformation, comparing Tanzania's performance with that of Africa as a whole and that of peer countries, and drawing lessons for the future. The chapter also assesses the impact of socio-economic, financial, governance and external factors on Tanzania's structural transformation and financing gaps, with the aim of highlighting the main pull and push factors, to inform policy-making and investment opportunities.

Section 1: Taking stock of Tanzania's economic performance and transformation

Despite the country's episodic trend of growth since the early 1980s, Figure 2.1 suggests that Tanzania's economic performance compared relatively well both with the African continent as a whole and with the East African Community (EAC). Tanzania's economic performance over the past four decades has been positive and resilient, with real annual GDP growth averaging 3.2% during the 1980-1999 period, increasing to an average of 6.5% during the 2000-2019 period. During the early 1980s, Tanzania was still a planned socialist economy, and recovering from the devastating economic consequences of the Kagera war (1978-1979). From the early 1990s, the country started to implement reforms towards a market-oriented economy. Growth picked up, but governance challenges, including weak regulatory frameworks and gaps in economic management, led to high inflation, high fiscal and current account deficits, and mounting public debt (external debt peaking at 166% of GDP in 1994).

In 2000, Tanzania qualified for debt relief under the Heavily Indebted Poor Countries (HIPC) Initiative and started implementation of economic and social reforms under a Poverty Reduction Strategy (PRS). During the decade 2000-2009, Tanzania's average annual GDP growth accelerated to 6.4%, supported by significant inflows, including FDI (which averaged 3.2% of GDP annually) and official development assistance (ODA) (which averaged more than 9% of GDP annually). During the decade 2010–2019, average annual growth increased to 6.7%, driven by services, including finance and insurance, transport and communication, and supported by the government's ambitious public investment programme, especially in transport and energy.

While Tanzania's economy, like other countries, was hit by the negative impacts of the COVID-19 pandemic, it remained resilient, avoiding a recession and posting growth of 4.8% in 2020, while the African continent as a whole went into recession and the EAC region registered average growth of only 0.3%. In fact, excluding Tanzania, EAC growth in 2020 was negative. The Tanzanian economy started to recover gradually with the opening of trade corridors and lifting of travel restrictions, posting growth of 4.9% in

2021. However, recovery to pre-pandemic growth levels was slowed by spillover effects from geopolitical tensions and regional conflicts, bringing growth down to 4.7% in 2022. Figure 2.1 compares Tanzania's growth performance with the averages for the EAC and for Africa as a whole.

Figure 2.1a: Tanzania's real GDP growth compared with the EAC and Africa

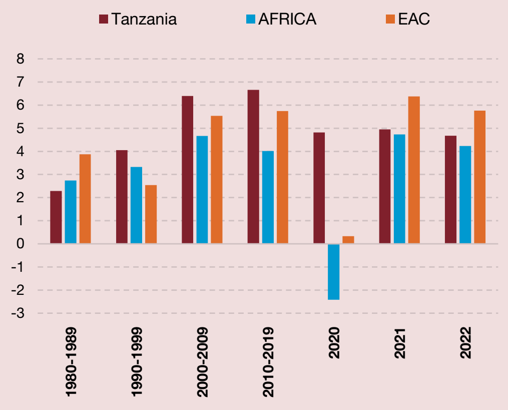
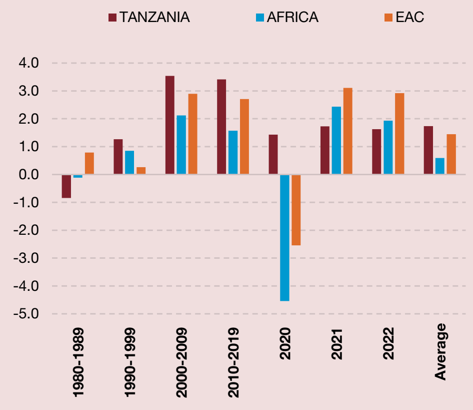


Figure 2.1b: Tanzania's per capita real GDP growth compared with the EAC and Africa



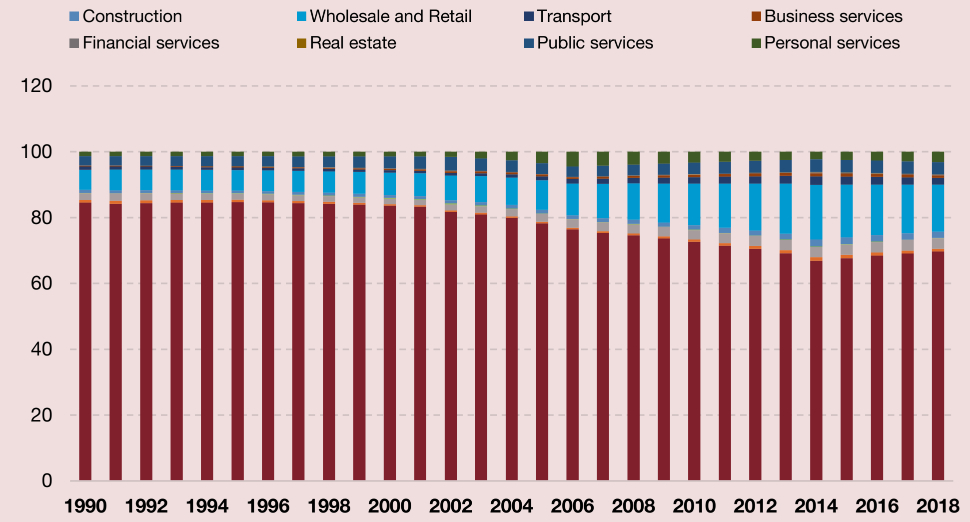
Source: African Development Bank Statistics and IMF World Economic Outlook Database.

Section 2: Tanzania's structural transformation: drivers, bottlenecks and opportunities

a. Tanzania's structural economic transformation

Tanzania has seen major structural changes in its economy since early 1980s. The share of agriculture in employment declined from 85% in the early 1980s to 65% in 2021/22, while employment in industry and service increased from 2.6% to 8% and 12.6% to 29% respectively over the same period (Figure 2.2). The share of agriculture in GDP declined from 42% in the early 1990s to 26% in 2022, matched by increases in the GDP share of industry (including construction) from 16% to 33%, and in that of services from 33% to 44% over the same period.

Figure 2.2: Sectoral employment shares in Tanzania (%), 1990-2018



Source: Authors' illustration using Economic Transformation Database (Kruse et al, 2023).

This evolution of Tanzania's economic structure has been driven by new growth frontiers such as communications, finance and insurance, construction and electricity, and mineral extraction. The share of manufacturing value-added in GDP has stagnated at around 8% since the 1990s, and the share of manufactured goods in merchandise exports has remained below 15%. Perhaps one of the notable developments is the sharp decline in the share of agricultural raw materials in Tanzania's merchandise exports, from 23% in the mid-1990s to an average of 3.4% over the past decade. This was accompanied by an increase in the importance of minerals in Tanzania's exports following large-scale mining investments in the country from the late 1990s.

While the structure of Tanzania's economy has undergone considerable changes, the expected broadly based wealth creation and poverty reduction have been mild. Agriculture remains the mainstay of the economy, employing close to two-thirds of the country's workforce, and supporting the livelihoods of the majority of the population. The manufacturing sector remains small, accounting for less than 10% of national output and employing less than 4% of the workforce. The new growth sectors, including financial and insurance services, mining, construction and real estate development, have weak linkages with agriculture and generate little employment. Available data suggest that the sectors with the greatest employment shares in Tanzania have the lowest relative productivity.

Table 2: Sectoral employment shares and relative productivity, 2018

Sector	Employment share	Relative productivity
Agriculture	69.7	0.4
Wholesale and retail	14.2	0.8
Public services	3.7	2.5
Manufacturing	3.2	2.8
Personal services	3.2	0.4
Transport	2.1	4.0
Construction	1.9	7.9
Business services	0.8	6.1
Mining	0.8	5.6
Financial services	0.2	16.2
Utilities	0.1	10.2
Real estate	0.02	145.4
Average economy productivity		16.9

Source: Economic Transformation Database

Table 2 presents the employment shares and relative labour productivity of the 12 main sectors in Tanzania. Relative productivity is calculated as the ratio of each sector's labour productivity to the average labour productivity of the economy as a whole. The average productivity level of the economy is presented in the last row. The data highlight significant labour productivity gaps between sectors. The agriculture sector, which in 2018 employed 69% of the workforce, is 98% less productive than the economy as a whole. This is partly explained by the level low level of mechanisation and dependence on rain-fed production of Tanzania's agriculture sector, mostly in rural areas, which is also dominated by smallholder farmers. At the other extreme, the productivity of the real estate sector, which employs a mere 0.02% of the workforce, is around nine times that of the overall economy. The financial sector has productivity close to the economy average, while the remaining nine sectors all have productivity levels below the economy-wide average.

Agriculture, personal services and wholesale and retail together employ 87% of the workforce but are the least productive sectors in Tanzania, with relative productivity below one. Only 12% of the Tanzania's workforce is employed in sectors with productivity exceeding two. And less than 1% of the workforce is employed in the three sectors of the economy with relative productivity levels above 10, which are real estate, financial services and utilities. This suggests that there may be some scope for gains in aggregate productivity from the reallocation of labour between sectors. While not all the highest-productivity sectors have much potential to absorb additional labour, even modest movements out of the lowest-productivity sectors seem likely to generate some growth. Although sectors such as business and financial services are more productive than manufacturing, they have much lower absorption capacity for low-skilled workers.

The employment share of the manufacturing sector increased only modestly from 2.0% in 1990 to 3.3% in 2018, implying that the sector absorbed very little of the workforce that moved out of agriculture. A positive development is that workers who moved out of agriculture were absorbed by tradable and relatively productive services, such as transport, business, and financial services, while some also went to construction and public services. Moreover, as shown in Table 2.1, apart from absorbing fewer workers in recent years, manufacturing's relative productivity is below that of tradable services, such as business and financial services. Manufacturing is also heterogeneous for productivity and employment absorption capacity. For example, while the textile sector is relatively labour-intensive but has low productivity, the chemical and pharmaceutical sector, which is capital and technology intensive, has higher productivity. The data above has shown that, like in many other African countries, Tanzania's structural change in recent decades, has involved the reallocation of economic activities from one low-productive sector (agriculture) to other relatively low-productivity sectors, such as personal and retail services. More than half of the workforce leaving agriculture are entering these activities. These are potential sectors well suited to the workers leaving agriculture – skills requirements are not very different, and capital requirements are small.

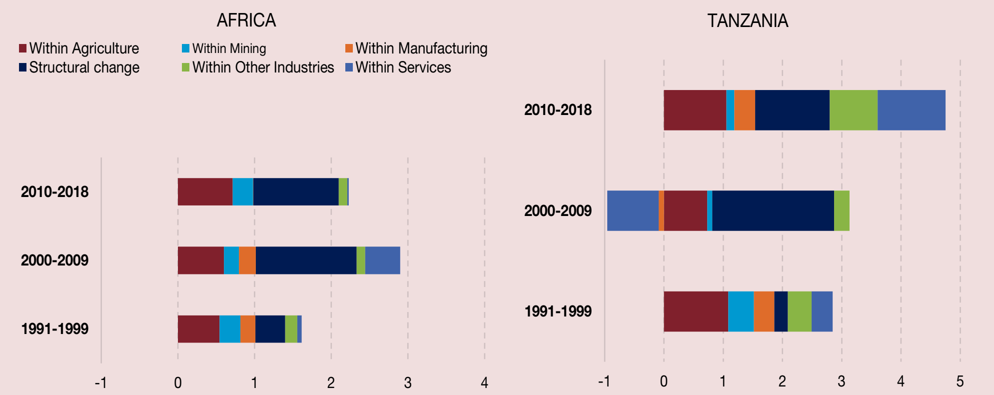
Based on sectoral employment shares, and with Tanzania's agriculture share of employment declining only modestly from 85% in 1980s to 65% in 2022, coupled with agriculture value-added of 26% of GDP in 2022, the pace of transformation is slow. The country is classified as structurally underdeveloped and is still at an early stage of structural transformation.

Although Tanzania has been classified as a lower middle-income country since July 2020, its economy is characterised by a low economic complexity index (ECI), an indicator of the diversity and complexity of the export basket. This indicates a limited diversity of productive know-how in the economy, particularly of complex and specialised know-how, and an inability to produce a great diversity of sophisticated, high-value products. The low ECI is also mirrored by Tanzania's level of export concentration, exports being highly concentrated in a few products, giving rise to a high export concentration index. This makes the country more vulnerable to global shocks than more structurally developed countries, where exports are more equally distributed among a range of products. This aspect of vulnerability in Tanzania's economy was vividly exposed with the outbreak of the COVID-19 pandemic, when the country's debt profile deteriorated from low risk of debt distress to moderate risk because of the small export basket limiting the potential to absorb shocks.

b. Unpacking Tanzania's structural transformation through labour productivity decomposition

This section applies McMillan and Rodrik's methodology to examine the decomposition of labour productivity in Tanzania and compare it to the African average over the three decades. Firstly, productivity can increase within sectors due to capital investment, technological innovation, efficiency gains arising from intra-industry trade, and reduction of misallocation within sectors. Secondly, productivity can grow through the reallocation of labour from low- to high-productivity sectors — the "structural change" component. This section aims to determine the extent to which labour productivity growth in the 1990s, 2000s and 2010s can be attributed to structural change.

Figure 2.3: **Structural change in Tanzania and Africa, 1991-2018**



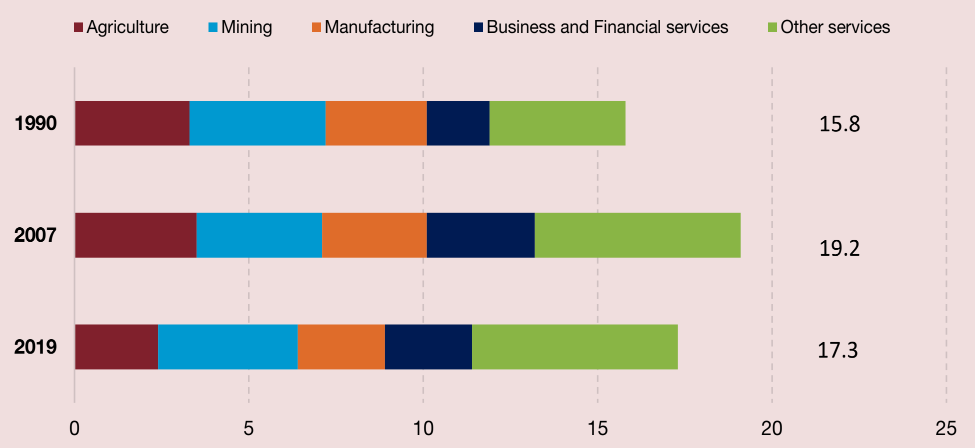
Staff calculations using employment and value-added data from the ILO and WDI.

During the period 1991-99, Tanzania's labour productivity growth was largely driven by capital investment, technological innovation, efficiency gains arising from intra-industry trade, and reduction of misallocation within sectors (Figure 2.3). Growth in labour productivity was driven mainly by the intra-sectoral component, led by the agricultural sector, which accounted for about 38% of productivity growth in the 1990s. During the 2000–2009 period, structural change was dominant, accounting for more than 90% of labour productivity growth. The contribution from structural change remained important during the 2010-2018 period, accounting for about 26% of overall labour productivity growth.

c. Rapid growth in income and jobs embodied in services exports: new evidence.

Studies have emphasised both the role of supply-side constraints and the significance of demand as a constraint to structural change in developing countries, particularly in Africa. These studies underscore the role of foreign demand and integrated markets in driving structural change in African countries, most of which are constrained by small market size. A recent study by Mensah and de Vries (2024) has broadened the analysis to assess the possible effects of expanded market size through the African Continental Free Trade Area, which has the potential to provide comparative advantages to the continent to fast-track structural transformation. The study calculates the domestic value-added and jobs embodied in exports using the hypothetical extraction method introduced by Los et al. (2016). This method uses the ratio of value-added to gross output, and the ratio of employment to gross output, to compute the value-added and the number of jobs embodied in exports respectively.

Figure 2.4: Sectoral domestic value-added embodied in exports (% of GDP), 1990, 2007 and 2019.



Source: AEO 2004; Mensah and de Vries (2024)

The findings of the study point to an increase of around 100% in the number of jobs embodied in exports over three decades. More significantly, the study finds that the share of jobs embodied in services exports is increasing rapidly compared with other sectors. A rising share of domestic value-added in manufacturing is observed during the 2000s, followed by a decrease in the 2010s, primarily driven by manufacturing activities based on natural resources. The contribution of other manufacturing industries remains stagnant, a finding consistent with the general observation that the export-oriented sector of manufacturing is not expanding. Rather, most manufacturing firms are producing to meet local demand, mainly dominated by food, food processing and allied subsectors, such as manufacturing of packaging products. These findings align with the trends in Tanzania's manufacturing value-added, which grew at an annual average of 2.6% in the 1990s, increasing to 8.6% in the 2000s, slowing to 6.5% in the 2010s. Services have been at the centre of Tanzania's recent transformation trends, as demonstrated in Box 2.

Box 2 : Structural transformation in Tanzania: a tale of services-led growth.

Tanzania's recent experience of structural transformation has been broadly similar to those of other lower-middle-income countries, with the increase in the employment share of services roughly matching the decline in the share of agriculture. From 2006 to 2014 (the first period), business and trade services absorbed most of the labour shed by agriculture (6% of employment out of 7%). From 2014 to 2021 (the second period), labour flowed from services back to agriculture (2% of employment), reflecting a contraction of demand, especially for services provided by hotels and restaurants, during the COVID-19 pandemic. The employment share of manufacturing barely changed.

While productivity growth in services was negative over the first period, it turned positive in the second, dwarfing that in manufacturing. Infrastructure investments, which increased rural electrification eightfold and overall internet access sevenfold in less than a decade, were reportedly instrumental in this productivity growth. Tanzania's public gross fixed capital formation increased from 33% of GDP to 43% in the second period, and the subsequent improvements in transport and information and communication technologies (ICT) helped boost market access and reduce operating costs.

However, a second reason for the strong performance of the services sector may be directly related to COVID-19. During the second period, the share of employment in agriculture increased by two percentage points while the share of employment in non-tradable services fell. Anecdotal evidence suggests that in Tanzania (as in many richer countries), one way of coping with COVID-19 was migration out of cities and back to rural areas. The workers most likely to leave the city were probably informal workers in the services sector. While this was happening, and somewhat unrelated to COVID-19, the second period also saw a proliferation of small informal firms employing fewer than 10 workers, mostly in trade services. In 2013, about 145,000 firms were formally registered; by 2021, this number had increased to almost 400,000. Concurrently, the share of business and trade services in formal employment climbed from 10.5% to 26.1%, and that of transport and communications from 18.5% to 27.6%. In short, services played a key role in Tanzania's recent economic growth.

Source: World Bank 2023.

d. Drivers to accelerate Tanzania's structural transformation.

Recent studies have emphasised the critical role of structural transformation in driving economic growth. There is also evidence that structural transformation has significantly contributed to a reduction of extreme poverty and inequality in many African countries, including Tanzania. Using an exploratory regression approach, AEO 2024 identifies the key drivers of structural transformation in 2000-2019 – natural resources, exchange rate policies, labour market dynamics, demography, governance, human capital and technology.

Governance

Tanzania has made progress in strengthening governance systems and institutions, providing a foundation for a stable macroeconomic environment and a strong and resilient economy. Continued improvement in the country's governance, including improved policy predictability and legal and regulatory reforms to improve the business environment, will be central to accelerating Tanzania's structural change.

Exchange rate policy

Studies have found a competitive exchange rate to be crucial to structural transformation. Currently, Tanzania maintains a flexible exchange rate regime, and, although the Central Bank occasionally participates in the interbank foreign exchange market to smooth market volatility, there is little risk of overvaluation thwarting economic transformation.

Business environment and labour market flexibility

Tanzania continues to implement reforms to improve the business environment, including simplification of business registration and licensing, and streamlining of the regulatory framework. Tanzania has also continued to update the laws and regulations governing labour and land in line with the changing economic environment. However, realising significant gains from such reforms has been a challenge, mainly because of the high level of informality in the economy. Labour laws and regulations have been put in place allowing significant flexibility in hiring and firing and including provisions to simplify acquisition and use of land by businesses, but challenges still exist in these factor markets.

Box 3 : Tanzania's potential for renewable energy

Despite their huge potential, Tanzania has yet to exploit its renewable energy sources fully. Hydropower, for example, has a potential of 4.7 GW, but only 561 MW of installed capacity, comprising only 35% of the country's total generation capacity. There is also huge potential for geothermal energy, with a potential of 5 GW; for solar energy, with average sunshine of more than 9 hours per day; and wind, with speeds of 0.9–9.9 m/s across many parts of the country. Tanzania has an estimated 57 trillion cubic feet (TCF) of discovered natural gas reserves. Under the Tanzania Natural Gas Utilization Master Plan 2016-2045, 8.3 TCF of the 57.54 TCF is allocated for electricity generation. The allocated natural gas can generate approximately 7.09 GW using combined cycle gas turbine technology. However, by 2021, only 100 million cubic feet of the 8.3 TCF had been exploited, producing 527 MW of electricity.

Trade policy

Tanzania maintains a liberalised trade regime, under which external trade restrictions on imports have been removed, export and import procedures have been simplified, and price controls have been eliminated. In the context of the ongoing reforms, Tanzania has continued to implement measures aimed at eliminating barriers to trade, including simplification of custom procedures and rationalisation of taxes, duties and fees. This drive has been crucial to accelerating structural transformation.

Urbanisation

Tanzania's urban population increased from 20% of the total in 1980 to 35% in 2022. This trend has partly contributed to the evolution of the structure of Tanzanian economy, as labour moves from agriculture in rural areas to engage mostly in retail trade and other low-productivity services in the urban areas.

Technology

Although Tanzania has continued to make progress in adopting ICT, the impact of technology on the country's structural transformation remains small, as demonstrated by the low ECI. However, technology has huge potential to drive Tanzania's structural transformation, as demonstrated by recent developments involving increased technology intensity, leading to relatively higher productivity levels, in certain sectors of the economy, including the financial services, utilities and real estate sectors. The country has adequate digital infrastructure, but technology penetration in held back by pricing and regulatory bottlenecks. Although Tanzania is linked to three international under-sea fibre cables, the country currently uses only a third of the total international bandwidth available to it.

Quality of public infrastructure

Tanzania continues to face significant infrastructure gaps, especially in transport, energy, water supply and port facilities. Tanzania lags behind its regional peers in access to and quality of infrastructure. According to the Africa Infrastructure Development Index produced by the African Development Bank, Tanzania's scores are lower than those of Uganda, Rwanda, Kenya and South Africa. In recognition of this challenge, Tanzania continues consistently to prioritise infrastructure in its plans, strategies and budgets. Infrastructure is a top priority in the Government's Five-Year Development Plan (FYDP III, 2021/22-2025/26). The key priority areas of infrastructure focus include transport, energy, water, agriculture and ICT. Quality infrastructure is critical to improving the performance of other economic sectors and driving structural transformation. As shown in Box 2.3, Tanzania has huge renewable energy potential, but very little is tapped, even as the country continues to struggle with energy issues.

Human capital development

Tanzania has made progress in various aspects of human capital development, including access to basic education, gender equality in basic education and reduction of child and maternal mortality rates. However, gaps remain, especially regarding the quality of education and health services and nutrition outcomes. Tanzania's human capital index (HCI) is 0.389 (on a scale from zero to one), lower than Kenya's HCI of 0.546. Tanzania spends less than 1% of GDP on research and development.

e. Bottlenecks to Tanzania's structural transformation

Demographic challenges

Tanzania's population is growing rapidly, at an annual rate of 3%. The country also has a youthful population, people aged 15 to 35 years accounting for 35% of the total population, and children aged below 18 years for almost half. According to the 2022 census, the age dependency ratio declined from 91.5% in 2012 to 87.1% in 2022. Inadequate economic opportunities, especially for youths, are the main constraint to the pace of progress towards achieving the demographic dividend.

Climate change

Tanzania is highly vulnerable to the adverse impacts of climate change, which include seasonal weather variation, frequent and prolonged droughts, frequent floods, intense winds, and sea level rise and associated saltwater intrusion. Extreme weather events such as floods and prolonged droughts already affect millions of people and their livelihoods and impact negatively on the country's long-term growth.

Informal sector

Tanzania's economy is characterised by high level of informality. The country's private sector is dominated by micro, small and medium scale enterprises, most of which operate informally. This informality poses regulatory challenges to the authorities, and also limits small businesses' access to finance and other business services, stifling their growth potential.

Political environment

Tanzania is peaceful and politically stable, providing a solid foundation for economic progress and prosperity. However, while the country's political environment does not threaten the functioning of the economy, the slow pace of poverty reduction and persistent inequality could potentially lead to elements of fragility.

Financing constraints

The recent FinScope survey suggests significant progress towards financial inclusion, mainly driven by a recent expansion in mobile money services. However, access to credit remains a challenge, especially for small businesses. The financial sector is also characterised by a wide interest rate spread, with higher lending rates coupled with low deposit rates.

Section 3: Finance to fast-track Tanzania's structural transformation: How much is at stake? Tanzania's commitments to structural change

a. Structural change in the Tanzania's Five-Year Development Plan (FYDP III)

Tanzania's ambitions to expedite structural transformation are embodied in the Government's Five-Year Development Plan (FYDP III, 2021/22-2025/26), which focuses on realisation of an inclusive and competitive economy; deeper industrialisation and service provision; investment and trade promotion; human development; and skills development. FYDP III aims to improve productivity and export performance by strengthening industrialisation, trade and competitiveness. The Plan, whose theme is 'Realising Competitiveness and Industrialisation for Human Development', is an expression of the Tanzania Development Vision 2025 objectives of building a strong, competitive economy that is industrialising and exporting more value-added products and services while consolidating domestic markets.

The focus of FYDP III is to build a strong productive base through continued structural transformation characterised by a shift of factors of production and the relative GDP shares of agriculture, manufacturing and services, and increased sophistication of final products. To this end, FYDP III prioritises improvement of key productive infrastructure, including roads, railways, water, air transport and reliable access to energy. It also entails commitments to strengthen the business and investment enabling environment through effective policies to facilitate free private sector competition; and to improve and strengthen the education and training systems, including reform of the education curriculum in line with labour market needs; and to integrate research and development with productive economic activities.

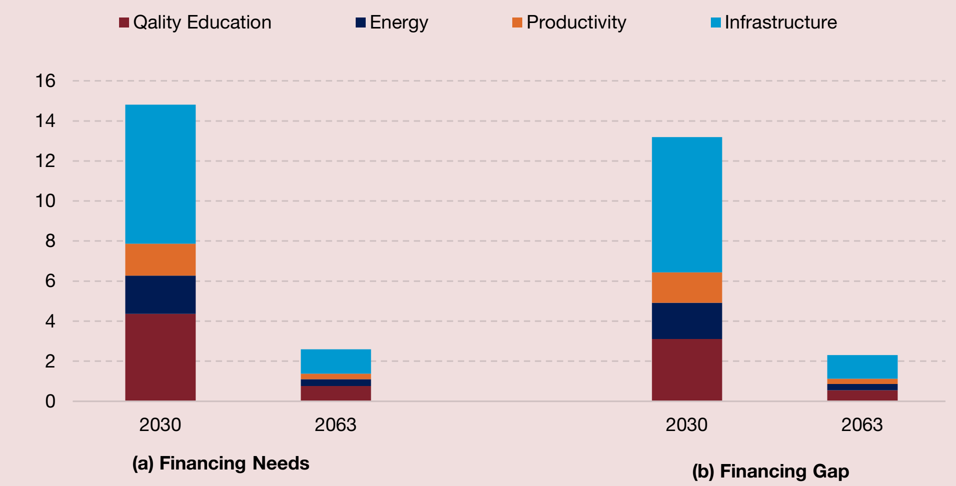
Among many other targets, FYDP III aspires to increase exports from 16% of GDP in 2019/20 to 28% of GDP in 2025/26, and to increase the share of manufactured goods in merchandise exports from 35% to 40%. It also aims to increase the share of mining in GDP from 5.6% in 2019/20 to 10% in 2025/26, and to raise the share of manufacturing employment from 6.7% to 12.8% over the same period. The share of agriculture in GDP is projected to decline from 26% of GDP in 2019/20 to 23% of GDP in 2025/26, and agricultural employment from 65% to 60% of the country's workforce.

b. Financing needs and financing gap

Tanzania's annual financing needs to accelerate structural transformation, and the associated financing gaps, are estimated both for the 2030 Agenda for Sustainable Development and for the African Union's Agenda 2063, using data from the AEO. The AEO methodology focuses on the resources needed, and the financing gap to be filled, to propel the country to the same level of performance as other developing countries in sectors critical to structural transformation. The interconnection of the Sustainable Development Goals (SDGs) and the synergies between them mean that they all contribute directly or indirectly to structural transformation. Some SDGs are, however, more directly linked to achieving such transformation, and require much more financial investment than others, particularly Goals 4 (quality education), 7 (energy), 8 (productivity), and 9 (infrastructure).

AEO 2024 uses a benchmark approach linked to the SDGs to quantify the annual financing needs and financing gap to achieve high performance across these four sectors. The methodology used assumes that SDG performance in each of these four sectors is a function of a set of specific input variables, such as education spending per student, electric power consumption per capita, gross domestic expenditure on research and development per capita, and road density.

Figure 2.5: Estimated annual financing needs and financing gap to fast-track structural transformation.



Source: AfDB Statistics Department

Estimates using the AEO 2024 benchmark methodology suggest that Tanzania would need USD 14.8 billion annually until 2030 to accelerate its structural transformation process and put it on a par with high-performing developing countries with currently comparable levels of development. Using Agenda 2063 as a reference reduces the annual financing needs USD 2.6 billion. The bulk of these resources are required in infrastructure (47% of the total), highlighting the current dearth of investment in the sector, followed by education (30%), energy (13%), and productivity-enhancing research and development (10%) (Figure 2.5a).

Considering Tanzania's current performance levels in these four critical sectors, the annual financing gap to fast-track the country's structural transformation is estimated at USD 13.2 billion (about 14.3% of projected 2024 GDP) under the SDG framework, and USD 2.3 billion (about 2.5% of GDP) under the Agenda 2063 deadline, with a longer time horizon and spread of investment. Road infrastructure is the largest contributor to the financing gap (51%), followed by education (25%), energy (14%) and productivity (10%) (Figure 2.5b).

These huge financing needs and associated financing gaps mainly reflect Tanzania's underperformance on key SDGs directly linked to structural transformation (and on other development indicators). On road infrastructure, the largest financing needs and financing gap reflect the country's shortfall as a result of decades of underfinancing to upgrade existing road infrastructure and to open new roads to match population growth and economic dynamism. Tanzania's estimated road density is very low, at 9.8 km per 100 km2 compared with Africa's median road density of around 12 km per 100 km2, and an estimated average of around 42.5 km per km2 in high-performing developing countries. According to AfDB (2018), challenges related to legal, regulatory and institutional frameworks also discourage private capital investment, especially in road infrastructure, where the return on private investment may not be obvious.

On education, although Tanzania has made significant progress on expanding access through increased enrolment at primary and secondary levels, the enrolment rate in tertiary education remains low. Fast-tracking structural transformation will require achieving and sustaining full enrolment of the country's school-age population (the assumed target being 100% enrolment for primary and secondary and 50% for tertiary education, according to Gaspar et al., 2019), while also greatly increasing spending per student so as to upgrade education equipment and facilities (such as buildings, transport vehicles and virtual learning equipment), to increase the salaries of education professionals (particularly in the public education system), and to enhance access to technical and vocational education and training. It is estimated that one million young people enter the labour market every year in Tanzania, but that only 20% attain official employment. According to AfDB (2020), improving the quality of curricula would further help to mitigate the widespread skills mismatch and equip graduates with the skills they require when entering the labour market.

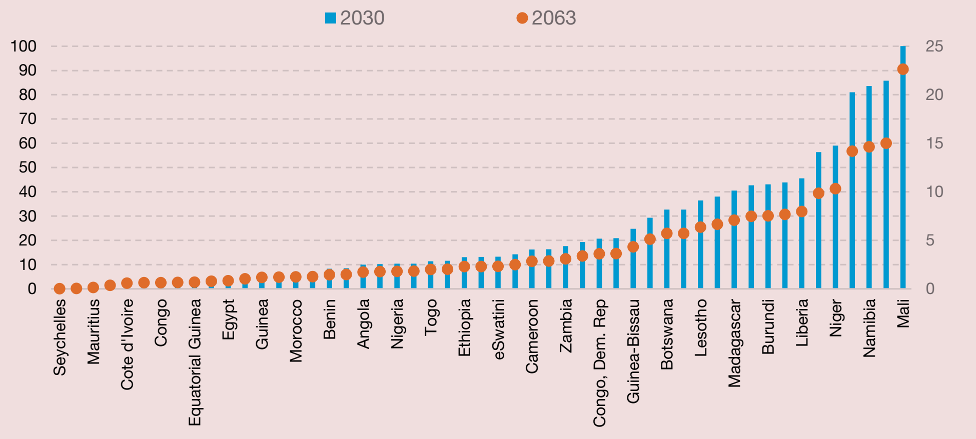
On energy, Tanzania will need to scale up efforts to increase access, which still lags behind its regional peers and comparable countries. About 42% of Tanzania's population has access to electricity, which is below the 50% average for sub-Saharan Africa, 76% in Kenya and 48% in Rwanda, and significantly lower than the 91% average for lower middle-income countries as a whole. As well as ensuring universal access to electricity, accelerating structural transformation will demand increasing per capita electricity consumption to align it with that in high-performing developing countries.

Finally, accelerating structural transformation in Tanzania will require developing a robust national research and development agenda and providing the means of implementation (human, financial and technical capital), to support technological upgrading and innovation. The country's research and development should also link with investments in ICT. According to UNCTAD (2019), investment in ICT is one of the essential means of implementation of all the SDGs, and has a critical role in accelerating progress on structural transformation.

c. Closing the financing gap through domestic resource mobilisation

Closing the financing gap to realise Tanzania's transformation objectives will require further efforts to mobilise domestic resources. Tanzania's revenue to GDP ratio has stagnated at around 12% for several years, while total expenditures have averaged 18% of GDP in recent years. As highlighted in the previous section, the current revenue effort clearly falls short of the level needed to close the estimated annual financing gap to fast-track Tanzania's structural transformation. Enhancing the efficiency of public spending and tax collection is thus crucial to closing the huge financing gap for structural transformation. Tanzania will require an increase in tax to GDP ratio of 14.2 percentage points to achieve the SDGs by 2030, and of 2.5 percentage points to achieve the Agenda 2063 objectives. Figure 2.6 presents the required increases in tax to GDP ratios to close the estimated financing gaps for African countries. Tanzania's required increases of 14.2 and 2.5 percentage points to meet the 2030 SDG targets and Agenda 2063 respectively are similar to the estimated median increases of 13.2 and 2.3 percentage points for African countries.

Figure 2.6: **Required increase in tax-to-GDP ratio to close the estimated annual financing gap in Africa.**



Source: Staff calculations and database from African Development Bank statistics.

Conclusions and recommendations

This chapter has presented a detailed analysis of the trends in and key characteristics of structural transformation in Tanzania, the challenges to accelerating such transformation, and estimates of the associated financing requirements. This section underscores the policy options and recommendations to accelerate structural transformation at the national and regional levels, and to the Multilateral Development Banks (MDBs).

a. Role of the government

A key role of the government in facilitating structural transformation is to ensure macroeconomic stability, strong institutions and implementation of policy measures that promote inclusivity and a conducive business environment.

Fiscal and monetary policy to foster macroeconomic stability

Prudent fiscal and monetary policies are key to promoting economic stability and improving the business environment needed to accelerate structural transformation.

- Use of modern and policy-based instruments of monetary policy will help to maintain price stability and facilitate economic growth and structural transformation. For example, Tanzania has recently started to implement a price-based monetary policy framework, which has the potential to send better signals to the markets for better pricing of financial products.

- Prudent fiscal policy and properly managed public investment programmes will support growth to facilitate structural transformation.

- Sustaining financial sector reforms will help to increase efficiency and improve access to financial services, especially for small enterprises. While three decades of financial sector reforms in Tanzania have resulted in an increased number of providers and better coverage, pricing of products remains a challenge, as demonstrated by the wide interest rate spread.

- Scaling up domestic revenue mobilisation will require efforts to facilitate the expansion of private sector economic activity, especially of small and medium enterprises, and to bring the informal sector into the tax net.

Financial sector for structural transformation

Investment and financial sector policies and strategies could prioritise targeting streamlined incentives to catalyse private capital flows to the sectors most critical to structural transformation.

Sustain reforms to improve business environment

Tanzania's structural transformation is driven by the dynamism of the private sector. It is therefore important to sustain reforms to improve the business environment for the private sector to thrive and realise its potential. Industrialisation and manufacturing will be supported, and structural transformation expedited by improving logistics management and trade facilitation, overcoming foreign exchange shortages and ensuring reliable energy supply.

b. Role of MDBs in supporting Tanzania's structural transformation

MDBs, including the African Development Bank and the World Bank, the IMF, and other development finance institutions have an important role in supporting sustainable growth and accelerating structural transformation in Tanzania and other countries in Africa, both through provision of financial resources, technical assistance and capacity building, and through sharing best practice and lessons learned from other countries. These institutions can also play a crucial role in providing policy advice and supporting private sector development.

Building workforce for the future

Tanzania needs to scale up investments to build requisite human capital suited to local realities, circumstances and development priorities, including through adequate skills training to prepare the workforce for the future. Key policy priorities include improvements in the quality of education, including through targeted investments to improve learning infrastructure at all levels and strengthening of the curriculum; and targeted investments to improve the quality of health services and nutrition outcomes – including reduction in stunting among children, which remains high in the country.

Investing in youth to harness demographic dividend

Targeted vocational education and training and entrepreneurship programmes for youths would help to harness Tanzania's demographic dividend.

Infrastructure to accelerate transformation

Tanzania is implementing an ambitious national infrastructure programme, which is prioritised in FYDP III. Strengthening implementation capacity and ensuring quality infrastructure in rural areas would significantly accelerate structural transformation.

3

FINANCING STRUCTURAL TRANSFORMATION IN TANZANIA: THE NEED FOR REFORMS OF THE INTERNATIONAL FINANCIAL ARCHITECTURE

Key messages

- Tanzania's journey towards structural transformation requires significant investments in infrastructure, human capital, climate action and productivity-enhancing technology. The current call for reform of the international financial system offers a pathway for the country's meaningful participation in resource allocation decisions that will help to unlock vital resources for these investments.

- Tanzania needs to optimise the use of domestic resources to finance structural transformation, including through reforms to increase tax revenues and enhanced efficiency in public spending.

- Tanzania would benefit significantly from reforms to the global financial architecture aimed at increasing access to concessional, low-cost and long-term development and climate financing.

- The country should sustain reforms aimed at attracting more FDI by implementing measures to improve the investment climate and the overall business environment.

Section 1: Introduction

This chapter presents the external financing needed for Tanzania to achieve structural transformation while dealing with the threat of climate change. It uses estimates produced by the African Development Bank of the financing needs and gaps to fast-track structural transformation (AEO 2024) and to finance climate actions by 2030. Using the Bank's estimates, the chapter assesses Tanzania's capacity to scale up domestic resource mobilisation, including the much-needed increase in the tax to GDP ratio, to close the financing gap and to fast-track the country's structural transformation by 2030 and 2063, and motivates the needs for reforms to the international financial architecture.

Section 2: Tanzania's stand on reform of the international financial architecture

Tanzania, like many other countries has been affected by the ripple effects of the COVID-19 pandemic, the many ongoing conflicts and geopolitical tensions and climate shocks, which undermine the significant progress made in human development over the past two decades, and hold back the pace of economic transformation. These headwinds have affected economic activity and have been accompanied by shortfalls in development finance and shrinking fiscal space. Securing external financing has been difficult because of volatilities in international financial markets and limited availability of resources from international financial institutions.

Considering the above realities, Tanzania would therefore benefit significantly from reforms to the global financial architecture aimed at increasing access to concessional, low-cost and long-term development and climate financing. In view of Tanzania's most pressing development financing needs, the key focus of the reforms to the global financial architecture should be to make international finance more stable and international markets more accessible and less volatile.

There is an urgent need to recalibrate the existing multilateral approaches to financial governance, including the principles of sovereign debt management, financing of the green transition and costs of the climate crisis, and crisis resolution mechanisms to address the new realities of the global political economy. Key measures include adequate capitalisation of the MDBs to enable them to respond adequately and in a timely fashion to the development challenges of those countries that need assistance and to play a greater catalytic role in leveraging private finance on affordable terms and resources from other development partners. The Bank has demonstrated the effectiveness of this approach in its support for the construction of the Regional Standard Gauge Railway project linking Tanzania, Burundi and the Democratic Republic of the Congo, using concessional and semi-concessional resources to leverage financing from the private sector. The Bank structured the financing of the project in the form of loans and guarantees to optimise the level of resources to support the project, which aims to develop the Central Corridor network by incentivising large-scale mining and commercial agriculture. In respect of Tanzania, the Bank was mandated by the authorities as lead arranger to structure and mobilise financing of up to USD 3.2 billion from commercial banks, development finance institutions, export credit agencies and institutional investors to finance the project. This level of financing would not be possible through direct concessional and semi-concessional loans. Another area of reform is for the IMF to consider delinking access to resources from quotas and, instead, to determine access on the basis of income and vulnerabilities.

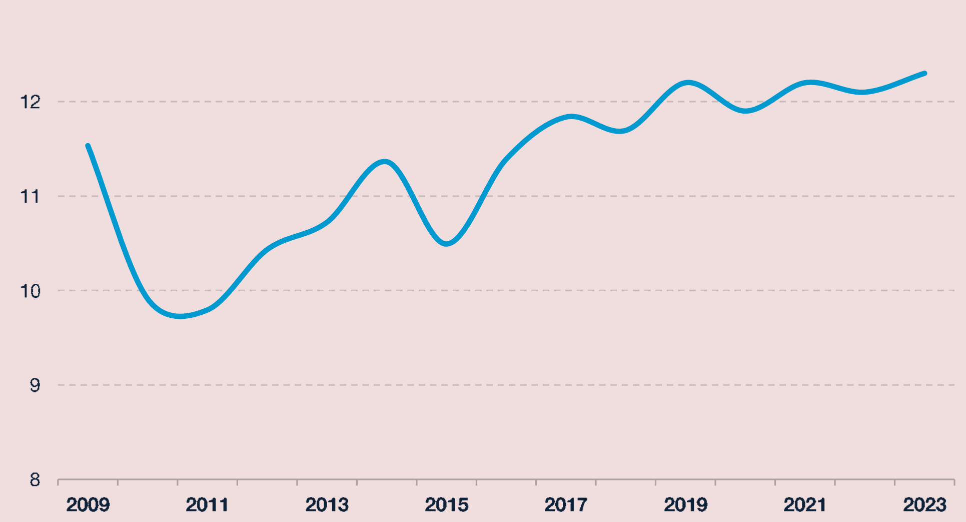
MDBs could also play a greater catalytic role to help developing countries like Tanzania in leveraging resources from other development partners. In this aspect, too, the African Development Bank is a leading example, having successfully mobilised co-financing to support several large infrastructure projects in transport and energy sectors in Tanzania, and important projects in agriculture and food security. The Bank has leveraged financing from other development partners to support the construction of important regional road projects linking Tanzania with neighbouring countries, power generation (for example, the Rusumo and Kakono hydropower projects) and power transmission lines connecting Tanzania to regional power pools (for example, the Kenya-Tanzania interconnector).

Section 3: Mobilising additional resources for Tanzania's structural transformation

Tanzania's tax to GDP ratio of 12% (Figure 3.1) is lower than the averages for sub-Saharan Africa (16.3%), the Southern African Development Community (SADC) (19.8%) and the EAC (14.6%).

While Tanzania's tax to GDP ratio is low, the country's financing needs remain enormous, with limited financing options. As discussed in Chapter 2 above, Tanzania will need to mobilise significant additional tax revenues to bridge the estimated financing gap to fast-track structural transformation.

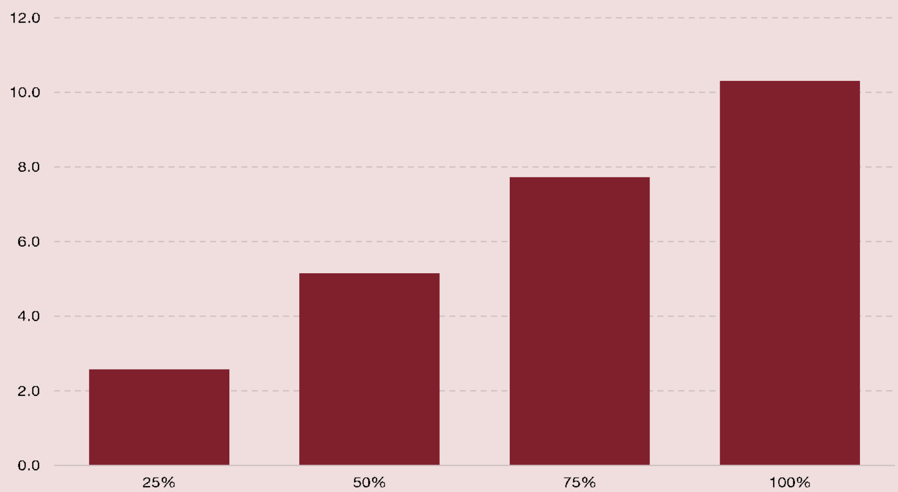
Figure 3.1: **Trend of tax revenues, 2009-2023 (% of GDP)**



Source: Staff calculations and database from African Development Bank statistics.

One of the major reasons for Tanzania's stagnant tax to GDP ratio is the high level of informality in the economy. Tax exemptions, inefficiencies in enforcement and frequent non-compliance have contributed further to the problem. Enhancing the efficiency of public spending and tax collection is thus crucial to closing the huge financing gap for structural transformation. Improving the efficiency of value-added tax (VAT) collection (measured as the ratio of VAT revenue as a percentage of GDP to the VAT rate) alone could significantly boost tax revenue. Using data from AEO 2024, we estimate that, with a 25% VAT efficiency rate, Tanzania could potentially increase tax revenue by more than 2.5% of GDP, while an efficiency rate of 50% could increase tax revenue by more than 5% of GDP (Figure 3.2). These additional revenues could be allocated to financing the country's structural transformation. Improving the efficiency rate in the collection of other types of tax revenues (such as corporate income, excise, personal income and property taxes) could also help the country to self-finance a significant share of its financing gap for structural transformation.

Figure 3.2: Potential increase in Tanzania's tax revenues from improved VAT efficiency



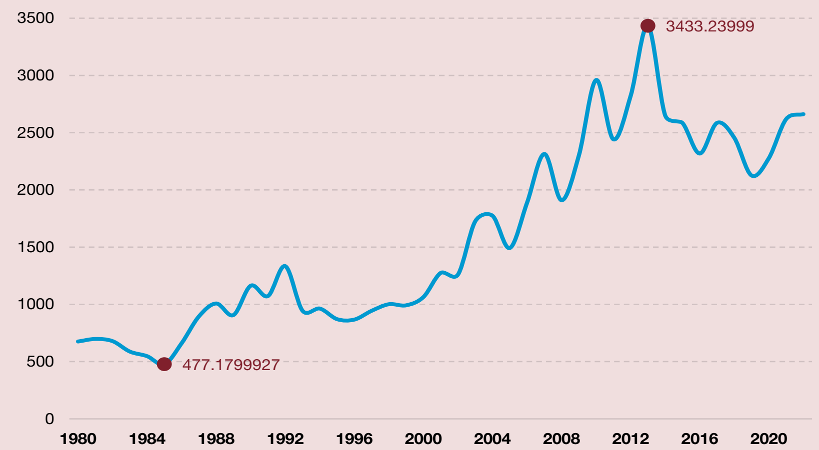
Source: Staff computations based on USAID Collecting Taxes Database.

In addition, Tanzania's financial sector remains shallow, lacking depth and breadth for effective resource mobilisation. The ratio of private credit to GDP is low, at 15%, and products suited for long-term financing are limited. The banking sector, which dominates the country's financial services, is characterised by a wide interest rate spread, with very high lending rates and low deposit rates.

Structural transformation entails an increase in total factor productivity through two channels: technological improvements and physical and human capital investments to raise within-sector productivity (e.g. to increase agricultural yields); and a shift of productive resources from low-productivity to high-productivity sectors (generally from agriculture to industry and services). Achieving significant progress in structural transformation requires policy and regulatory reforms to encourage innovation and entrepreneurship, as well as major investments in infrastructure, human capital and technology. As discussed in Chapter 2, fast-tracking structural transformation will require Tanzania to mobilise additional financing amounting to USD 13.2 billion annually for investments in the four key pillars, to be sourced from external flows and domestic private and public resources.

Tanzania's experience regarding official development assistance (ODA) has been generally positive over the past four decades, ODA increasing from USD 676 million in 1980 to USD 2.7 billion in 2022, the lowest amount (USD 477 million) being received in 1984, and the highest (USD 3.4 billion) in 2013 (Figure 3.3). ODA flows to the country have supported investments in both economic and social infrastructure necessary to the country's transformation.

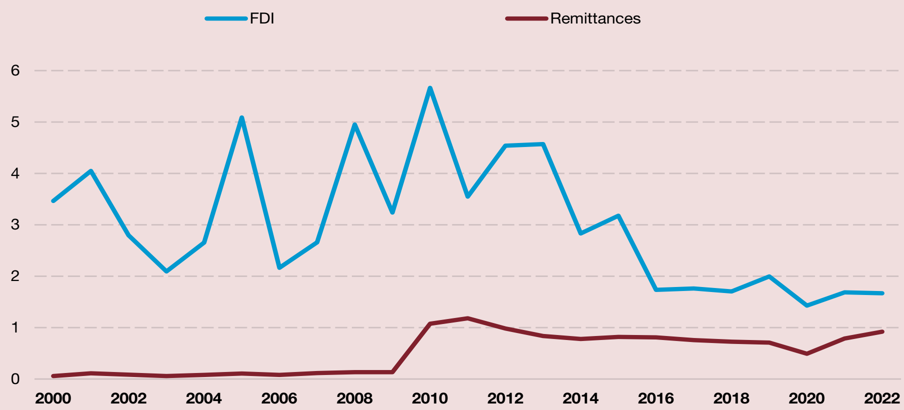
Figure 3.3: Official development assistance to Tanzania, 1980–2022 (million USD)



Source: World Development Indicators

However, in line with the recent global financial squeeze, ODA to Tanzania dropped from USD 3.4 billion in 2013 to USD 2.1 billion in 2019, before gradually picking up to reach USD 2.7 billion in 2022. A similar trend is observed in the inflow of FDI to Tanzania, which picked up from the late 1990s, reflecting investments in the extractive sector, particularly mining. Annual FDI inflows to Tanzania averaged 3.9% of GDP during the ten-year period from 2005 to 2014, before dropping to an annual average of 1.9% of GDP in the 2015-2022 period, again partly as a result of the global financial squeeze. Similarly, remittances have remained below 1% of GDP in recent years. Recent trends in FDI inflows and remittances to Tanzania are highlighted in Figure 3.4.

Figure 3.4: FDI inflows and remittances (% of GDP)



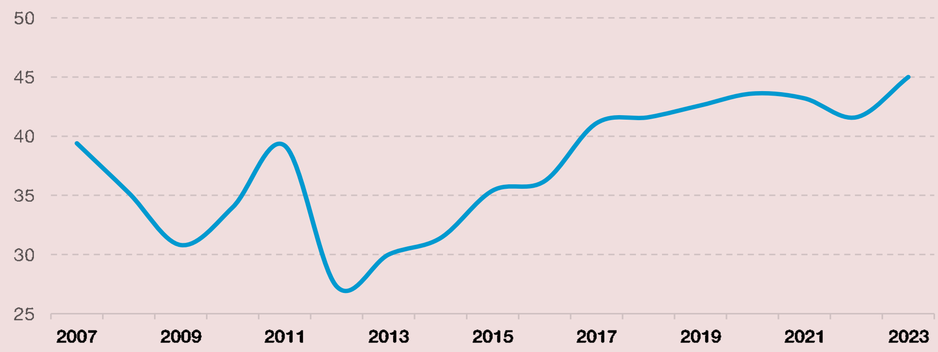
Source: World Development Indicators

Clearly, the above trends in ODA, FDI and remittance flow to Tanzania suggest that these resources are not sufficient to close the financing gap to fast-track structural transformation. This points to the importance of reforming the international financial architecture to improve external resource flows into the country.

Section 4: Dealing with public debt

Tanzania's public debt remains sustainable, and the country's risk of debt distress is moderate. Tanzania's prudent macroeconomic policies have supported resilient GDP growth, a favourable public debt profile, and greater capacity to absorb semi-concessional loans to finance development. While the country's risk of external debt distress deteriorated from low to moderate in 2021, owing to the effects of the COVID-19 pandemic on exports, its public debt has remained sustainable. Figure 3.5 shows the trend of Tanzania's public debt, which has been relatively stable in recent years.

Figure 3.5: Trend of Tanzania's public debt (% of GDP)



Source: Ministry of Finance, IMF.

According to the Debt Sustainability Analysis published by the IMF in April 2023, Tanzania's debt carrying capacity has improved, and the country has space to borrow externally for public investment without compromising its debt sustainability over the medium term. Even with the current public investment financing plan, Tanzania's public debt is projected to decline from 44% of GDP in 2023 to 37.8% of GDP in 2024/25. In dealing with public debt, the authorities have maintained a strict Medium-Term Debt Management Strategy, which focuses on securing finance at low cost while minimising risks.

Section 5: Financing climate action

Tanzania's recently updated nationally determined contribution estimates that the country will need about USD 6.3 billion annually to finance climate action. It is estimated that USD 1 billion will be needed annually to address the immediate climate risks, and about USD 5.3 billion annually for adaptation and mitigation measures to achieve the country's green growth objectives. This is crucial in light of the country's vulnerability to the adverse impacts of climate change, including heavy rains leading to floods, prolonged droughts and strong winds. The country experiences extreme events such as floods and prolonged droughts, which affect millions of people and their livelihoods and impact negatively on long-term growth. The authorities estimate the costs associated with climate change impacts in the country at about 1-2% of GDP per year. The key sectors of the Tanzanian economy, including agriculture, industry and natural resources, are vulnerable to climate-related risks.

In the agricultural sector, prolonged droughts have led to some water bodies drying out and to loss of biodiversity and grazing lands, which have significantly and adversely affected agricultural production and productivity. High dependency on rain-fed agriculture is the main reason for the sector's high vulnerability to climate change. Recently, the government of the United Republic of Tanzania estimated that the loss of agricultural GDP arising from the impacts of climate change over the coming five decades will be USD 27 billion, equivalent to an annual average of about USD 540 million. In recent years, electricity generation from the country's hydropower plants has also been severely affected by droughts, leading to country-wide power outages and affecting economic activity in other sectors of the economy.

Conclusions and recommendations

While Tanzania joins other African countries to advocate for reforms of the global financial architecture, with the aim of unlocking concessional resources for financing to propel structural transformation, the country itself needs to take measures to optimise domestic resources, including the following.

- **Financial deepening:** with private sector credit at 15% of GDP, Tanzania's financial sector is still shallow, and incapable of mobilising resources effectively to finance the country's transformation. There is a need to deepen the country's financial sector, including through digital financial solutions to play a more prominent role in facilitating structural transformation.

- **Boosting domestic revenue:** with tax revenues averaging 12% of GDP, Tanzania needs to scale up reform measures to expand the country's tax base and boost domestic revenues.

- **Optimising gains from natural resources:** Tanzania needs to put in place measures to ensure optimal benefits from its natural resources, such as minerals and gas, especially by strengthening its capacity to negotiate contracts for these resources.

- A coordinated approach in regional and continental fora could allow Tanzania to strengthen its voice and to benefit from an increase in the scale of low-cost and long-term concessional financing.

- As an active member of the African Union, Tanzania can add its voice through this channel, and benefit from reform of the global debt architecture.

- Tanzania maintains a good relationship with the international community and enjoys a significant presence of United Nations organisations. Better collaboration with international and national stakeholders and adequate and timely sharing of information will improve the country's access to emergency financing facilities.

- As a member of both EAC and SADC, Tanzania has an opportunity to use these regional blocks in adding voice to the need for reform to increase the inclusivity of the governance of the global financial architecture.

- Through active engagement in regional blocks and collaboration with multilateral institutions in generating knowledge and advocacy for greening the wealth of nations, Tanzania can add its voice and benefit from the requirement to adopt policies for this purpose.

- Tanzania has a vibrant commercial banking sector, already active in mobilising finance through green bonds. Tanzania can continue to strengthen the existing institutional and regulatory frameworks to accelerate further private sector financing for transformation and climate justice.

REFERENCES

- AfDB (African Development Bank). 2018. African Economic Outlook 2018: Infrastructure and Its Financing. Abidjan, Côte d'Ivoire: African Development Bank.
- AfDB (African Development Bank). 2020. African Economic Outlook 2020: Developing Africa's Workforce for the Future. Abidjan, Côte d'Ivoire: African Development Bank.
- AfDB (African Development Bank). 2024. African Economic Outlook 2024: Driving Africa's Transformation. The Reform of the Global Financial Architecture. Abidjan, Côte d'Ivoire:
- Bank of Tanzania, February 2024 Monetary Policy Statement. Accessed at: https://www.bot.go.tz/Publications/Filter/3
- Bank of Tanzania, Monthly Economic Review (various issues): Accessible at: https://www.bot.go.tz/Publications/Filter/1
- Gaspar, V., D. Amaglobeli, M. Garcia-Escribano, D. Prady, and M. Soto. 2019. "Fiscal Policy and Development: Human, Social and Physical Investment for the SDGs." IMF Staff Discussion Note 19/03, International Monetary Fund, Washington, DC.
- International Monetary Fund (MF), 2023. Second Review Under the Extended Credit Facility Arrangement and Request for a Waiver of Non-observance of a Performance Criterion—Press Release; Staff Report; and Statement by the Executive Director for the United Republic of Tanzania. IMF Country Report No. 23/425. IMF, Washington DC.
- Kruse, H., E. Mensah, K. Sen and G. de Vries (2023). A Manufacturing (Re)Naissance? Industrialization in the Developing World. IMF Economic Review 71, 439–473.
- Los, B., M.P. Timmer, and G.J. de Vries. 2016. Tracing Value-added and Double Counting in Gross exports: Comment. American Economic Review 106: 1958–66.
- Mensah, E. B., and G. J. de Vries (2024). "The Role of Exports for Income and Job Creation in Sub-Saharan African Countries: New Evidence using the Africa Supply and Use Tables Database", GGDC research memorandum 197.
- UNCTAD (United Nations Trade and Development). 2019. Least Developed Countries Report 2019: The Present and Future of External Development Finance—Old Dependence, New Challenges. Geneva: UNCTAD.
- UNCTAD, 2023. World Investment Report, 2023. Geneva: UNCTAD.
- United Republic of Tanzania, 2018. National Population Projections. National Bureau of Statistics, Ministry of Finance and Planning, Dar es Salaam; and Office of the Chief Government Statistician Ministry of Finance and Planning Zanzibar
- United Republic of Tanzania, 2023. Economic Survey, 2022. Ministry of Finance, Dodoma Tanzania.
- United Republic of Tanzania, 2024, Tanzania Basic Demographic and Socio-Economic Profile Report. Ministry of Finance, Tanzania National Bureau of Statistics and President's Office - Finance and Planning, Office of the Chief Government Statistician, Zanzibar. The 2022 Population and Housing Census: Tanzania.
- United Republic of Tanzania. 2021/22 Integrated Labour Force Survey, analytical report.

- World Bank (2023). “Privatizing Growth: A Country Economic Memorandum for the United Republic of Tanzania”, World Bank: Washington, DC.

AFRICAN DEVELOPMENT BANK GROUP
GROUPE DE LA BANQUE AFRICAINE DE DÉVELOPPEMENT