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Understanding The Dynamics of Economic Growth:

Exports and Economic Growth: An empirical investigation,
The case of Tanzania (1980-2005)

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List of Acronyms

FDI- Foreign direct investment

HPAE- High performing Asian economies

EAC- East African community

URT- United Republic of Tanzania

IMF- International Monetary Fund

Keywords

[Growth, trade, exports, imports, savings, investment, Tanzania]

Chapter 1 Introduction

1.1 Background

“Recently, economic growth has come back on the policy agenda with renewed vigour. In Tanzania, this is perhaps most vividly illustrated by the second Poverty Reduction Strategic Plan PRSP, which, unlike the first such plan, featured growth explicitly in its title: the National Strategy for Growth and Reduction of Poverty – MKUKUTA” Wuyts (2007).

Tanzania is certainly not the only country experiencing this markedly renewed interest in economic growth. Most recently, economic growth and poverty reduction have been identified as one of the top key priority areas of concern in nearly all countries’ development policies. The potential that high economic growth rates have in poverty reduction is probably one of the profound reasons why this subject has even received growing attention, over the last two decades. The success stories of high performing Asian economies (HPAEs)¹ in achieving high economic growth rates, over prolonged periods, have also been an additional stimulus to growing debates on economic growth and its potential to alleviate poverty.

Identifying channels through which successful economies have managed to: either maintain their position up the economic ladder, or why some have been able catch up where others have failed, still remains a question of interest to researchers and policy makers around the globe. Traditional growth theories identified accumulation of capital-human and physical- as the main determinants of disparities in economic growth and inequality levels between economies. As growth theory came to evolve, over time, this proposition was non-the-less challenged. The emergence of ‘new growth theories’ resulted in an acknowledgement of other factors thus resulting in a wide consensus of the complexity of the growth process. This does not merely mean that the role of capital accumulation can be neglected. On the contrary, capital accumulation has proven to be significant in all successful economies. High performing Asian economies provide testimony to this long lived proposition.

It is by the simple acknowledgement, of the complexity of the economic growth process, that this paper makes no attempts to address all the possible determinants of economic growth. Indeed, any attempt to analyse all interactions, ever perceived by man, between plausible growth determining factors and economic performance may only end up in producing frustrating results. For that matter this paper’s primary concern will be to investigate the interaction between trade, with more emphasis on exports, and economic growth. While trade and economic growth are the main concern of the present investigation, the analysis takes Tanzania as a case study. The analysis begins by comparing the evolution of economic growth rates with that of trade indicators, namely

¹ World Bank (1993) considered the following economies: Japan, Hong Kong, the Republic of Korea, Singapore, Taiwan, Indonesia, Malaysia, and Thailand as forming the group of high performing Asian economies. This paper adopts the same definition, even though some of these economies have not yet recovered fully from the economic crisis that hit these economies in 1997.

exports and imports, in Tanzania. The next step involves comparing the experiences of Tanzania with that of other economies, as we shall see in subsequent sections of this paper.

The interaction between trade and economic growth is one that has been extensively researched and well documented in economic literature. Despite the existence of extensive research and documentation, the relationship between the two still remains ambiguous. The controversies that exist in regard to the link between economic integration and growth performance, provides a wide scope of avenues for further investigation. Recent years have also witnessed a revived interest in the analysis of the links between trade and economic growth. There are several reasons that account for this, namely:

First, is the popular notion of the role of markets on economic growth that has clearly gained prominence over the past two and a half decades. This can be attributed to, one, the fall of the Soviet Union and failure of the states in many developing countries-Africa in particular and; second, advocacy by the World Bank and the IMF that saw to the limiting of state intervention in the production process. The two international financial institutions, the World Bank and the IMF, have aggressively advocated for trade openness and allowing markets to determine price movements of traded goods. The highly sighted World Bank's report of 1981, otherwise known as the Berg Report, set in motion the shift towards liberalization of African economies-most of which were then following inward (import substitution) trade policies. The report puts forward the argument that inward trade policies and excessive government intervention distorted key price ratios. According to the Berg report, this was the main constraint to Africa's economy as it was largely associated with the significant downfall in Africa's production and exports of goods and services; which in turn constrained import capacity of the continent. Recommendations made by the World Bank were, therefore, to let the market determine prices, an approach that came to be summarised as 'getting the prices right'.

Trade liberalization policies have, indeed, become a prominent component of policy advice to developing countries for the last two decades. Following this general view, the 1980s saw African economies forced into implementing trade liberalization policies that formed part of the conditions for donor supported structural reforms. Trade liberalization policies were meant to open up developing economies, especially those that adopted inward (import substitution) strategies and expose them to external competitive pressures. It was believed that this move would put pressure on protected domestic industries, thus challenging them to become more resource efficient and productive. It was also believed that with import liberalization, which also meant free movements of goods and services between economies, more capital goods, would become available thereby providing industries with the required factor inputs. This would in turn boost capacity utilization in domestic industries and more importantly revive agricultural export production in African economies. Trade liberalization was therefore seen as an integral part of the Structural Adjustment Programs (SAPs) geared towards improving the performance stagnant economies in African countries at the time. With time, outward-oriented trade policies which also included export-promotion became rather a 'conventional wisdom' as the means to achieving economic growth. In fact several empirical studies have also come to support this school of thought, indicating that more open economies tend to perform better than less open economies.

“Outward orientation makes it possible to use external capital for development without encountering serious problems in servicing the corresponding debt. Inward orientation of production is one reason why Latin American and African economies have experienced debt crises that have inhibited their growth in the 1980s. Outward orientation also generally results in more rapid growth of exports, and there associated with exporting that cause open economies to grow more rapidly over long periods of time” Dollar (1992).

Consequently there has been a dramatic shift in the stance of development policy with import-substitution being replaced by the export-led growth. Other studies that offer support in favour of openness to trade and export promotion policies include the work of a renowned Hungarian economist, Bela Ballasa. In 1977, Ballasa also reported results that echo in well with a number of other empirical evidences in support for the role of trade openness and export-led growth. Using a sample of 11 industrializing countries², Ballasa (1977) analysed the impact of export expansion on economic growth. These countries that were included in his sample fell in the category of those that then pursued either inward or out-ward oriented trade policies as well as those pursuing a mix of both policies. In his analysis, Ballasa (1997) pointed out that export expansion lead to accelerated growth rates, in terms of total domestic output. Ballasa (1997) went even further to remark that trade orientation was an important factor contributing to inter-country differences. He also pointed out that, countries that had adopted trade policies that were less biased to exports achieved income increments at lower costs in terms of investment. Dollar (1992) also made similar remarks when he studied 117 countries with different trade orientations using an index he derived from relative prices of traded goods.

Though some studies have provided support for trade openness, in promoting economic growth, others have presented contradictory results. Rodrik (1997), for instance, found no strong evidence to support that trade policies (orientation) had any significant impact on growth rates of African economies. His findings suggested that long term growth rates in African economies were mainly determined by a number of fundamentals, namely, human resource, macroeconomic policies, and demography. These findings later on found supported from Ndulu et al (2007) who argue that these factors pose as some of the major constraints to the average growth rates of African economies. In addition, Rodrik (1997), pointed out that excessive levels of export taxation in Africa played an important role in the relative decline of economic growth rates; though this was more case specific.

Rodríguez, F and Rodrik, D (2000) also present similar contrasting results. The authors begin by expressing concern over the empirical evidences that provide support for the positive impact of trade openness on economic growth. They pay particular interest in the indicators that are used to capture trade openness. Rodríguez and Rodrik (2000) argue that most of the indicators used as well as the techniques employed in analysing the impact of trade openness face serious measurement errors. In their opinion, relationship between trade openness and economic performance is dependent on a host of country and external characteristics, which therefore requires a more critical analysis of the circumstances under which openness to trade and channels through which trade policies impact on growth performance is likely to provide a better understanding of the underlying relationship.

The influence of high performing Asian economies, together with that of few African economies such as Mauritius, on the shift in contemporary development policies is one that can not be ignored. Trade and export-led growth features prominently in most explanations of the East Asian Miracle. International figures, for the past 20 years, have also recorded significant growth rates in international trade averaging 5.8 percent per annum, (Ndulu et al, 2007). This growth in international trade has been attributed to the economic integration and export

² The sample included Korea, Singapore, Taiwan, Israel, Yugoslavia, Argentina, Brazil, Colombia, and Mexico, Chile and India

performance of countries that Collier and Rodrik (2002) refer to as ‘globalizers’, which includes fast growing Asian economies. The evolution of the international trade growth rates is said to have also caused a shift in developing countries’ export structure, in favour of manufactured goods. An important feature associated to more recent trends in international trade refers to significant diffusion of technology, in countries such as China and India. There is no doubt that the degree of technological diffusion, which varies from country to country, has played a vital role in the shifting structural composition of export in developing countries. Significant levels of technological diffusion, have also allowed economies such as China and India to diversify their manufactured exports to more hi-tech exports. The size of the manufacturing sector is believed to reflect a country’s level of competitiveness. Recent studies, however, have suggested that the nature of manufactured export goods also influence the economic performance of any given economy. For instance, Ricardo Hausmann et al (2005) and Rodrik (2006) suggest that a country’s structure of manufacture exports matters over an above its expansion in volume of exports.

Discussions surrounding the nature of exports and their impact on economic growth date back to ancient times. Contrary to previous debates, that focused primarily on traditional versus non-traditional exports, more recent studies seem to put more emphasis on the nature of a country’s manufactured exports. Rodrik (2006) points out that, the recent ability for China’s exports to penetrate and dominate the world market lies primarily in the nature of its exports. China’s share in the world merchandise exports has grown significantly from 2 percent in 1960 to nearly 6 percent in 2003 (Rodrik, 2006). Both studies by Ricardo Hausmann et al (2005) and Rodrik (2006), make use of an index intended to capture the productivity level associated with a country’s export basket to explain why developing economies like China and India have managed to catch up with more advanced countries. In the case of China, the growing share of consumer electronics (reflecting the increased sophistication in production of manufactured goods) has been attributed to the country’s markedly growth rates in its manufactured exports and total domestic output-Rodrik (2006).

“...It is striking that these high performing economies (China and India) have export profiles that are especially skewed towards high productivity goods. In 1992, China’s exports were associated with an income level that is more than six times higher than that of China’s per-capita GDP at the time” Rodrik (2006)

Thus the foregoing leads one to argue that the economically meaningful differences in specialization patterns, of otherwise similar countries, explain the diversity in export performance and economic development.

Notwithstanding, controversies associated with the link between trade and economic growth, there is strong evidence to suggest that countries that are more integrated in the world economy tend to perform better. It is for this reason that the interaction between trade and economic growth attracts much attention till this very day.

The export-led growth hypothesis, which is the main focus of this paper, has long been under investigation. Empirical investigations, examining the role of export expansion on economic growth, date back to the late 1960s- Emery (1967), Syron and Walsh (1968), Serven (1968). Export promotion policies are said to boost economic growth as a result of efficient resource allocation in areas with comparative advantage, greater capacity utilization, and exploitation of economies of scale, as well as through generation of technical improvements in response to external competition (Balassa, 1978).

Empirical analysis of the export-led growth hypothesis has been carried out using various approaches, which vary greatly in terms of: the type of sample used whether cross-section or

country specific; variables used to capture export performance; to the types of estimation techniques employed. In more recent years, country specific studies seem to have become even more popular as compared to cross-country analysis, especially where export-led growth hypothesis is concerned. This shift in preference is in response to the claims that cross-section empirical studies are often less accurate in capturing idiosyncratic characteristics of economies, such as technological levels, which are likely to differ across countries. As a result, estimates that are obtained from cross-section analysis have been alleged to capture merely average effects and not the important distinct features of many developing countries.

The other reason has to do with the sample size from which the estimates are drawn. Some cross-country estimates have been criticised to have been based on a rather small sample, where they include fewer than 12 countries (Medina-Smith, 2001). The evolution of time series econometric techniques that allows for a more precise determination of the causal relationship has also been one of the main contributing factors for this shift in favour of country case studies. Techniques such as VAR (vector autoregressive models) and VECM (vector error correction models) are often applied in most recent studies.

Determining the causal direction is indeed an interesting avenue to explore, especially for a developing economy like Tanzania. The common practice has been to augment the Cobb-Douglas production function by including an indicator of exports as extra factor input. Justification for the inclusion of exports into this analytical framework is on grounds that exports tend to raise total factor productivity, for reasons stated earlier (Ballasa, 1978; Feder, 1982; Medina-Smith, 2001). Using this framework of analysis in combination with econometric techniques including the VECM, the Angle-Ganger causality tests that several country case studies have attempted to determine the long run causal relationship between exports and economic growth. The analysis in this paper, however, doesn't follow this 'conventional' method mainly due to limited consistent data. Certainly, one would require data measured in real (constant) terms that also run consistently across a long period to render reliability and robustness in econometric estimates. However, availability of consistent data across long time series still remains a problem in many developing countries, as in the case of Tanzania.

The paper, therefore, simply looks at the patterns and trends between the two main variables of concern, namely economic growth and export performance. As we shall see in the subsequent sections, other factors such as investment and imports are also considered in the analysis. The paper also compares the experiences of Tanzania's performance to other economies. Countries included in the analysis include Kenya, Uganda, Mauritius, Malaysia and Thailand. The period under investigation largely falls between the years 1980-2005 where consistent data is available.

Growth experiences, both in terms of trade and domestic output performance, show large disparities across countries and time. Even within Africa itself, economic growth rates as well as poverty levels differ significantly across countries. Recent years have witnessed many Sub-Saharan African economies recover from long periods of decline and stagnation that aggravated poverty levels in the late 1970 and 1980s. I now briefly provide support to this assertion, by drawing evidence from a few countries. A more detailed analysis will follow in subsequent chapters of this paper.

Prior to the mid 1980s, all the three East African countries experienced a decline in their real GDP growth rates. This period corresponds to the time when many African economies experienced a major economic crisis; that saw the decline and stagnation in their overall output (GDP), accompanied with high poverty levels. African countries also experienced sharp drops in imports and export shares. The reasons for these declines, in overall GDP growth rates accompanied by drops in exports, varied from country to country.

In Tanzania, the sharp decline in exports, between the late 1970s to the mid 1980s, was largely attributed to government policies, which is argued to have initiated a downward trend in the production of export crops by changing official relative prices in favour of food crops.” Wuyts (1994). The shares of the country’s total exports of goods and services, as a percentage of GDP, fell from 21 percent in 1976 to a staggering 8 percent in 1983. This sharp drop in Tanzania exports over the period stated, constrained the country’s import capacity. As a result the share of imports also declined from 24 percent to 14 percent over the same period. As evidence, in later sections, will point out export as well as import shares started to grow again from the mid 1980s.

The story in the neighbouring countries, of Kenya and Uganda, was somewhat different. In Uganda’s, for instance, the decline in the shares of exports lasted till 1988. One plausible reason might have been the aftermath of Uganda’s 1978-79 Idd-Amin war with Tanzania that were later one amplified by internal factors. Kenya also suffered a drop in its shares of exports roughly around the same period. The evolution of Kenya’s total exports of goods and services followed, more or less, a similar trend.

The experience of Mauritius, on the other hand, displays a trend that is in contrast to those of Tanzania, Kenya and Uganda. The economy of Mauritius has experienced remarkable high real growth rates, for the past two decades. As will be shown in subsequent chapters, the manufacturing sector and export production of Mauritius’ manufactured goods has grown significantly over the past 20 years. The country’s manufacturing sectors has been contributing on average, nearly 60 percent in goods exports between the years 1980-2005. The impeccable success of Mauritius has been largely attributed to, among other factors, its home grown policy of export-led growth. Between the years 1980 to 2005, Mauritius stands out with the highest average exports share of 59.54 percent. Next to Mauritius is Kenya, with an average of share of 25.94 percent, followed by Tanzania (13.89%) and Uganda (13.89%). These results, indeed, indicate the level of diversity within African economies

The remaining part of this paper is structured as follows:

The following section will give a brief introduction to Tanzania’s overall economic performance, which will then be followed by a section on export-led growth theory. The sections after that will present the evolution of Tanzania’s export performance. This will afterwards be followed by a comparison of Tanzania’s performance in trade and economic growth with experiences from other countries.

1.2 Tanzania's economic performance: A brief overview

That economic growth has a great potential to reduce poverty is beyond dispute. But just like the nexus of between economic growth with other factors such as trade, the relationship between growth performance and poverty reduction still remains controversial. Irrespective of the various competing views on how economic growth can benefit the poor there is, none the less, little dispute that the poor are relatively better off in well performing economies. While some have claimed that economic growth is necessary but not sufficient for poverty reduction, there is evidence to suggest that economic growth tends to be accompanied with improved livelihood, in particular for the poor. Dollar and Kraay (2002) provided some evidence indicating that incomes of the poor, on average tend to rise or fall at the same rate as average income. The authors come to this conclusion after investigating a sample consisting of 92 countries over a period of four decades. They further comment that these results hold across regions, time, income levels and growth rates. They also suggest that other determinants of economic growth such as the rule of law, openness to international trade and well behaving financial markets affect incomes of the poor in the same manner they affect average incomes.

Like many developing economies, and in particular Sub-Saharan Africa, Tanzania still remains one of the poorest developing countries in the world. According to the country's (2002) household budget survey³, 36% of Tanzania's population lived below the national poverty line. It is also estimated that Tanzania has one of the highest maternal mortality rates in Africa; for every 1,000 births almost 6 women die in child birth (Demographic and Health Survey, NBS, 2005). The largest shares of the Tanzanian population, who are also the majority of the poor in the country, reside in rural areas. Agriculture still remains the main source of income to many Tanzanians, the majority of whom engage in small hold farming. The sector also contributes the largest share, about 45 percent, to the country's overall GDP. Though the share of agriculture in overall domestic output has been on the down fall recently, the sector remains the largest employer; with 75.1 percent⁴ of the country's population being engaged in agricultural activities. The next largest employer in Tanzania is the informal sector-employing 101 percent of the employed population followed by the private sector (8.6 percent).

Even with the recent high growth rates, Tanzania, still ranks amongst the poorest countries in per capita terms. Table 1.0 (see appendix) presents the mean per capita incomes of some selected countries over the period 1980-2005. Despite the high prevalence of poverty levels amongst its citizens, especially in rural areas, Tanzania's economy has never the less had its times of glory. The economy of Tanzania experienced significantly high growth rates between the early 1960s to late 70s and after the mid 1990s. It also experienced decline and stagnation between late 1970s and the mid 90s (with some temporary recovery in the mid 1980s). A close inspection reveals the following pattern in the evolution of the country's economic growth rate: one is the two distinct periods of significant growth on both ends of the growth trajectory. Second is the period of negative growth and stagnation sandwiched in between the late 1970s and mid 1990s. Third, and probably most interesting, is the distinct patterns of the country's recent growth performance (see fig 1.0). The growth trajectory has followed a smoother upward trend over the past few years, as compared to the earlier period when growth rates appeared to have larger year-

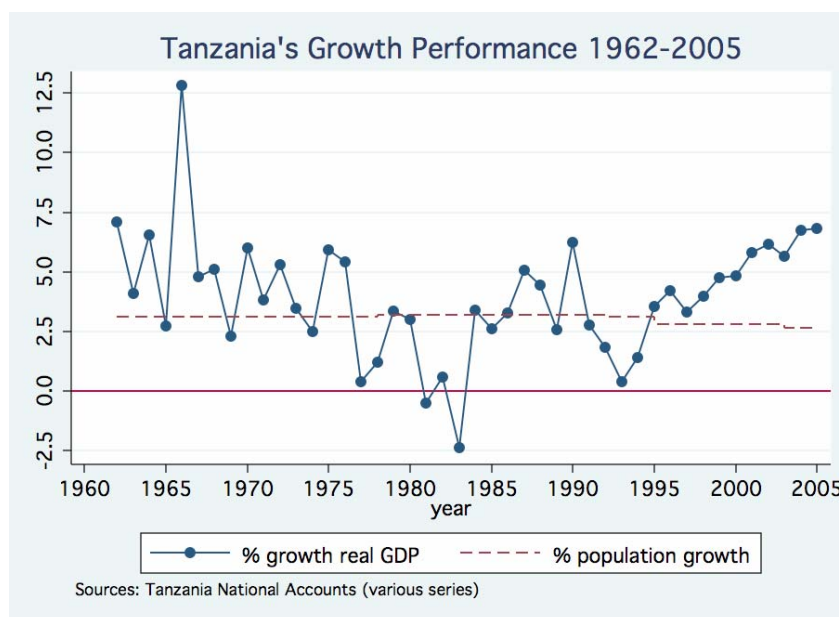
³ Source: National bureau of statistics; URT

⁴ Source: Integrated Labour Force Survey 2006, National Bureau of Statistics; URT

to-year variations. Even more recent growth figure still indicate stability in the countries economic performance. In 2006 the country's growth rate stood at 6.2 percent. This is only slightly below its previous year where it registered a growth rate of 6.7 percent (National Bureau of Statistics; URT). This indeed is surprising considering the country had experienced some shocks over this time. In 2006 Tanzania experienced severe food shortage and electrical power surges following poor rains in 2005; about half a million people in Tanzania faced severe hunger following very poor rainy seasons in 2005 when cash and food crop production plummeted by 50-70 percent (WFP, 2006). Surprisingly the overall economy hardly suffered from these shocks⁵. (Wuyts 2006) also made a remark with regard to this interesting phenomenon in Tanzania's growth trajectory.

“A distinctive feature of the growth trajectory during this period, for reasons as yet to be explained, was that, unlike in the previous periods, the growth momentum did not show pronounced year-to-year volatility” Wuyts, 2006

Figure 1.0: Tanzania's Growth performance



Note: Different time series for GDP at constant prices were spliced into a single index (1992 = 100). In case of an overlapping time series, the latest series was used from its starting point onwards. Growth rates were calculated by taking first differences of the (natural) logarithms of this GDP index.

Source: Wuyts (2007)

⁵ In 2006, the Gross Domestic Product in real terms grew by 6.2 percent compared to 6.7 percent in 2005 (URT)

This recent phenomenon in the growth pattern of the Tanzanian economy implicitly points out to a number of questions like:

‘What happened in the nineties that triggered economic growth in the Tanzanian economy?’ Or;

‘What factors may account for this distinct pattern in the growth rates, in particular from the mid 1990s, as compared to that experienced in earlier periods (the early 1960s to late 70s)?’

Tanzania is largely an agrarian economy, a point that was made earlier in this section. As a result the country draws most of its foreign earnings from exports of raw agricultural primary products. The large variations in growth rates during the earlier times may reflect the volatility in official international prices of, then, the country’s principal export commodities.

Before turning on to the next point, take another close look at fig 1.0. Obviously the reader will notice one other aspect that stands out clearly from fig. 1.0. Not only did Tanzania experience economic stagnation for a period of ten years from 1975, but there were as well years in which its per capita GDP growth was negative. This phenomenon is more pronounced in the late 1970s to the first half of the 1980s. As the economy crumbled, levels of inflation escalated to double digits, provision of social services worsened and manufactured consumer goods became scarce. The goods famine was even further amplified by the governments’ decision to ration consumer and manufactured goods such as farming inputs. The impact of which was increased levels of poverty, a sharp drop in production and exports of cash crops; which were the main source of foreign currency. As these points will be explained in more detail later on, I now wish to turn the readers attention to what has been happening in more recent years.

What accounts for the gradual rise in the country’s growth rates in the recent years? Though at this point I will not attempt addressing this question in great detail, the remaining part of will present some of findings that may shed some light into what may be happening. The table 1.1 presents some findings that have been derived from growth accounting as were reported by Bosthworth and Collins (2003) also sighted by Ndulu et al (2007). The table presents the share of contribution by physical and human capital-education- as well as factor productivity in overall domestic output (and or output per worker). From the table we notice some interesting patterns especially with respect the share of factor productivity. On the whole, factor productivity seems to have contributed the largest share in total output over the period 1960-2003. Throughout this period the share of factor productivity was at its highest in 1960-73. This period also corresponds to the time when the country had just attained its political independence and the economy was to a large extent driven by the private sector. Initial steps for government intervention, in Tanzania, started with the Arusha declaration 1967. This was later followed by state-led investment strategies, which started in the mid 1970s and lasted until the mid 1980s. The government policy which led into creation of massive investment capacity in industry, could explain the significant rise in physical capital observed in period of 1973-90. Tanzania experienced enormous rise in investment capacity, especially in industries, fuelled by aid investment between 1976 to the first half of the 1980s. This however, was not balanced by capacity utilization (look at the share of factor productivity in 1973-90) for reasons that will be presented shortly in the following section. Of more interest is again the rise in the share of factor productivity in recent years.

Table 1.1 lessons from growth accounting

Year	Output	output/wor ker	physical capital	Education	factor productivit y
1960–2003	3.76	0.88	0.12	0.04	0.73
1960–73	5.74	3.02	0.04	-0.13	3.12
1973–90	2.75	-0.25	0.24	0.12	-0.6
1990–2003	3.82	1.06	0.09	0.12	0.85

Source: Ndulu et al (2007, p.57); Bosworth and Collins (2003): Sources of growth in Africa 1960-2003

Understanding what accounts for this scenario may prove to be of great relevance to policy makers as the country strives to maintain high growth rates in the hope of meeting the poverty targets. Treichel (2005) arrives at similar results, as those presented in table 1.1, after decomposing the economy using the same growth accounting technique for the period 1991 to 2003. The author suggests the following argument as a plausible cause for the growth of factor productivity over this period

“While in the early 1990s, the contribution of total factor productivity (TFP) to growth was negative; its contribution since then has gradually increased, possibly reflecting the effect of structural reforms on the supply side of the economy, as well as the impact of higher foreign direct and public investment on technology.” Treichel (2005)

The author arrives at this conclusion after eliminating what he felt were rival explanations, that is, the various channels through which aid flow may have triggering factor productivity. Though Tanzania still receives significant amounts of aid flow, the author argues that Large-scale external assistance has had the greatest impact on priority sector expenditures such as education, health, and roads. The author further argues that while aid could have had an indirect impact on factor productivity through these channels it is too of a short a time to expect this to be the case.

In education, for instance, enrolments rates have risen drastically over the past few years. This is particularly the case at primary level. Increased enrolment rates in Tanzania, especially among girls, have been largely attributed to the country’s Primary Education Development Program (PEDP) that was first implemented in the country in 2002. The removal of user fee in primary education played a vital role in the success of the PEDP. Statistics also indicate an increase in the number pupils completing primary and secondary education. In spite of the significant improvement in Tanzania’s education system, Treichel (2005) points out that returns to education, through the accumulation of human capital, is only felt after a long.

The author makes a similar argument to also dismiss the effect through improved health services; on grounds that health indicators are yet to respond to increased expenditures in the health sector.

Is it true that FDI inflow has raised factor productivity in Tanzania over the recent years? We shall return to this point in the following sections of this paper. But before we get into that let’s first look at the theory on export-led growth hypothesis.

Chapter 2 Theoretical Framework

2.1 Theoretical consideration

While economic growth has long been of interest to economists and policy makers, the last two decades have witnessed an enthusiastic come back of this subject on the policy agenda. Lately, however, there seem to emerge a more general consensus among economists and economic researchers today that economic growth is a complex process. Empirical evidence suggests that in addition to capital accumulation (both physical and human capital-the latter usually captured by education levels), other factors including trade (economic integration), political and economic institutions, income distribution, and geographical characteristics play a crucial role in determining the long run-economic performance of any given economy.

“Growth theory has traditionally focussed on physical and human capital accumulation, and, in its endogenous growth variant, on technology change. But accumulation and technological change are best proximate causes of economic growth. No sooner have we ascertained the impact of these two on growth-and with some luck their respective roles also-that we want to ask: But why did some societies manage to accumulate and innovate more rapidly than others?....geography, integration, and institutions-allow us to organize our thoughts on the “deeper” determinants of economic growth”(Rodrik 2004a)

The relationship between international trade (economic integration) and economic growth is one of the areas that has been extensively researched and well documented in economic literature. The initial wave of favourable arguments with respect to the role of trade on economic growth can be traced back to the work of Adam Smith, subsequently enriched by Ricardo, Torrens, James Mill and John Stuart Mill in the first part of the 19th century (Medina-Smith, 2001).

The principle of comparative advantage, which forms the core of traditional trade theory, suggests that a nation maximizes its supply of goods by concentrating production where it is most efficient, and trades some of these products for imported products where it is least efficient. On this basis, it is possible to predict what goods a nation will export and import.

With the emergence of new (endogenous) growth theory in the 1980s, new approaches to examining the role of trade in achieving sustained long term economic growth were born. The reader may recall, from a point made earlier in the introduction, that even with these recent models support has been found for the positive impact of trade on economic growth. These studies have focused on a number of variables such as the degree of openness to trade, real exchange rate, tariffs, terms of trade and export performance, to verify that more open economies tend to have higher growth rates than those that are closed.

Dollar, D (1992), on examining sources of growth in 95 developing economies over the period 1976-85 points out that outward-oriented policies, reflected in a level of the real exchange rate that encouraged exports, fostered the development of the tradable sector in Asia, whereas inward orientation and an overvalued real exchange rate encouraged growth of the non-tradable

sector in Latin America (and Africa as well). Balassa (1978)⁶, Sachs and Warner (1995), Edwards (1992, 1998), and Ben-David (1993) are among the authors that arrive at similar conclusions. Their work, however, forms only part of a much broader nexus of economic literature and debates that have extensively analysed the link between international trade and economic growth.

The World Bank and the IMF are amongst the front-liners advocating for less restrictive trade policies, particularly in developing countries. These views, however, have been received with profound scepticism within the academia and development policy circles. Political economists have raised concerns especially with regard to the dangers of trade dependence.

There has also been some more criticism with regard to empirical literature that provides evidence in support of the role of openness to trade in promoting economic growth.

In their review of some recent literature on the link between trade orientation and economic growth⁷, Rodríguez, F and Rodrik, D (2000), claim to find little evidence that open trade policies--in the sense of lower tariff and non-tariff barriers to trade--are significantly associated with economic growth. The authors point out a number of limitations mainly in relation to the techniques used in the literature and the message that readers derive.

“There is a significant gap between the message that the consumers of this literature have derived and the "facts" that the literature has actually demonstrated.....In many cases, the indicators of "openness" used by researchers are problematic as measures of trade barriers or are highly correlated with other sources of poor economic performance. In other cases, the empirical strategies used to ascertain the link between trade policy and growth has serious shortcomings, the removal of which results in significantly weaker findings.” (Rodríguez, F., Rodrik, D., 2000)

The authors, however, strongly caution that their results are not to be interpreted to mean trade restrictions (protection) are the best alternative to achieving economic growth. They simply point out that the evidence provided by the existing literature still fails to clear beyond reasonable doubt the ambiguity that exists in the relationship between trade policies and economic performance.

In summary Rodríguez and Rodrik suggest that relationship between trade openness and economic performance is a conditional one, dependent on a host of country and external characteristics, and therefore a more critical analysis of circumstances under which openness to trade and channels through which trade policies impact on growth performance is likely to provide a better understanding of the underlying relationship. In their analysis, they distinguish between two related hypotheses, namely, countries with lower policy-induced barriers to international trade grow faster once other relevant country characteristics are controlled for, as opposed whether interna-

⁶His results point out that between 1960 to 1973 trade orientation was an important factor contributing to inter-country differences in the growth of incomes. The sample included countries that had by then established an industrial base such as Korea, Singapore, Taiwan, Israel, Yugoslavia, Argentina, Brazil, Columbia, Mexico, Chile and India

⁷ Papers reviewed include Dollar (1992), Ben-David (1993), Sachs and Warner (1995), Edwards (1998), and Frankel and Romer (1999)

tional trade raise growth rates of income. This paper is particularly concerned with the latter hypothesis, that is, establishing whether international trade impacts income growth rates.

Though most of the trade models have emphasized on the nexus between economic integration and growth performance, this paper seeks to contribute to a particular set of trade theory that primarily focuses on the role of export expansion as an important factor in promoting economic growth.

Empirical literature examining the role of export performance in economic process can be traced back to the late 1960s. However, it was not until the early 1980s that export orientation and export promotion policies secured a wide consensus amongst economic researchers and policy makers to an extent that they had become more or less “conventional wisdom”.

Various reasons provided in support for export-led growth hypothesis include:

First, export development allows the home country to concentrate investment in those sectors where it enjoys a comparative advantage which in turn may augment overall productivity;

Secondly, access to international markets allows for economies of scale to be realized in the export sector;

Thirdly, worldwide competitive pressure are likely to reduce inefficiencies in the export area through improved resource allocation and adoption of more efficient techniques in the overall traded-good sector, and;

A larger export sector makes available more resources necessary to import capital, both physical and human; in other words, export expansion relaxes the current account pressure for foreign capital goods by increasing the country’s external earnings and attracting foreign investment. (Fosu, 1990; Medina-Smith, 2001)

In addition to the aforementioned channels through which export expansion may lead to accelerated economic growth rates, the recent economic experience of the High Performing Asian Economies (HPAE) is one that cannot be ignored. A number of studies have associated the success of these countries to their level of economic integration, more specifically with respect to export-led growth.

That the effects of the recent economic developments in HPAEs stretch beyond their geographical borders is beyond dispute; there is evidence of improved livelihood of the people within these economies, not to mention the dramatic change in the structure of the economic world order. They have also influenced the evolution of international trade, is another aspect that was introduced in the previous sections.

The rate at which the HPAEs have caught up with the high income economies has also drawn considerable amount of attention from researchers and policy makers, thus motivating extensive documentation on “*What accounts for the success story of the HPAEs*” The existing literature attributes the success of these economies to a combination of a wide set of policies varying from country to country. None the less, irrespective of the unique characteristics of each economy in terms of their history and culture, factors which also had an important role to their individual success, there is evidence of some common threads among the high-performing East Asian economies.

On the whole, the success of HPAEs is said to be a result of high savings rate interacting with high levels of human capital accumulation in a stable, market-oriented environment-but one with active government intervention-that was conducive to the transfer of technology (Stiglitz, 1996).

An equally important feature, common and strongly associated to the high growth rates of the HPAEs, is their superior export performance. As a group, the HPAEs steadily increased their share in world exports from 8 percent in 1965 to 13 percent in 1980 and 18 percent in 1990 (World Bank, 1993).

The following section presents three arguments related to export expansion and the link exports to the economic performance in HPAEs.

The first argument refers to that given by the World Bank. The HPAE governments encouraged exports through a series of activities that varied over time and across countries⁸. Export-push policies in HPAEs not only led to the rapid growth in exports volumes (mostly in manufactured goods), but also in the changing composition of exports (World Bank, 1993). The various strategies adopted by HPAEs to promote exports included:

- **The provision of infrastructure:** to reduce the cost of doing business. This included investment in transportation, telecommunication, and electricity.
- **Preferential access to capital and foreign exchange:** nearly every HPAE had some program to ensure access to credit, often at subsidized prices. Indeed variations were also observed in terms of, the types of credit (long term versus short term), the degree of subsidization (guaranteed access versus subsidized rates), the selectivity (all exports versus targeted export activities) and the means of delivery (specialized state-controlled financial institutions versus market subsidies). A point worth mentioning is that exports provided a performance-based criterion for allocating credit. This in turn encouraged adoption of international standards, and accelerated the diffusion of technology. In addition to microeconomic incentives, fiscal and monetary tools, such as the exchange rate policy, were also used as part of the overall export-push strategy.
- **Market penetration:** again in this case nearly all governments in HPAE actively supported exporters through a number of different approaches ranging from direct subsidies (direct income tax incentives), subsidised market penetration (through exporter associations), promoting the creation of international trading companies.

Rodrik, D (1995), provides the second argument, suggesting that exports in East Asia may have been driven by increase in investment profitability, with outward orientation a consequence of the investment boom rather than its instigator. Rodrik⁹ argues the following: first the investment booms in Korea and Taiwan in the 1960s required a proportionate increase in imports (also as a percentage of GDP). However if a country faces a disadvantage in producing capital goods coupled with restrictive international borrowing exports must rise to pay for imports. Secondly as long as long as savings increase then increasing trade orientation will be observed alongside investment boom. He goes further to provide evidence to suggest that the relationship, in the case of Korea and Taiwan, ran from investment to imports and from imports to exports.

The third argument, also put forward by Rodrik et al (2005), relates directly to the link between exports and economic growth. In this argument, the authors point out that what an

⁸ For an elaborate discussion on the evolution of export-push policies adopted by the HPAEs, see World Bank, 1993, pp 123-147. Stiglitz, 1996 also reviews various export-push policies in HPAE.

⁹ The paper makes a comparison between Korea and Taiwan, on the one hand, with Turkey and Chile on the other.

economy exports is superior to simply the expansion in export volume. Using an indicator that captures the productivity level associated with a country's export basket¹⁰, Rodrik et al show that countries that export goods associated with higher productivity, such as hi-tech manufactured goods, tend to perform better, even after controlling for other country specific characteristics. Rodrik (2006) makes use of the same index to explain why China's exports and economic performance has been growing at a remarkable pace. From his analysis Rodrik (2006) points out that, in 1992, the level of sophistication of China's exports were associated with an income level that was more than six times higher than China's per-capita GDP at the time.

Does this mean that African, or for that matter developing, countries have no hope unless they diversify their exports to hi-tech manufactured exports?

Before moving on to the next section, I leave the reader with two points that crudely respond to the question just posed.

First of all, though China has been diversifying in terms of the composition of its exports, towards high-tech manufactured goods, the textile and apparel industry still retains a significant share in the country's manufacturing sector. China continues to lead in terms of textile and apparel exports. In 2005, the country's global textile and apparel share stood at 24.7 percent (The Indian textile journal, 2006). This is a sign that even African countries can still exploit their comparative advantages to boost their exports as well as economic performance.

Secondly, the interaction between the type and quality of a country's exports, and the quality of human capital has an even greater role in determining the pace of technological diffusion (World Bank, 1993). The development and quality of human capital is indeed one of the main factors that explain the performance gap between HPAEs with many African economies. Considerable investments in human capital, which resulted in high levels of labour force cognitive skills, permitted better firm-level adoption, adaptation and mastery of technology in HPAEs. This suggests that there is still a need for developing economies to put more emphasis on investing in human capital, which includes education and health, as one of the ways to accelerate the speed of technological diffusion in these economies.

¹⁰ The authors construct an index they call EXPY which is a weighted share of each commodity in a given country's total exports as a measure of the "quality" of a country's export basket.

Chapter 3 Analysis

3.1 Trade and export performance in Tanzania

This section begins by presenting a brief summary of the evolution of trade and export performance in Tanzania. To set ground for this discussion I will first site some key findings presented in a recent article, by Wuyts (2004)¹¹.

In his article, Wuyts (2004) makes a link between aid flow, investment and trade performance in the case of Tanzania. Using a basic accounting identity: $Domestic\ Absorption + Exports \equiv Aggregate\ output\ (GDP) + Imports$, the author shows that for nearly a decade and a half (1987-2001), Tanzania managed to use for consumption and investment more goods and services than it produced; by importing more than it exported.

The author then takes a step further to investigate how Tanzania managed, over the period under investigation, to import more than it exported; simply put how it financed its trade deficit. Certainly, one should bear in mind that there are several ways in which a country can finance its trade deficit. In his analysis, Wuyts argues that significant levels of foreign aid flow (grants and loans) into the country, were the main reason Tanzania managed to import more than it exported¹².

Wuyts, then rearranges the above identity into:

$Investment \equiv Domestic\ savings + Trade\ gap$, to makes one more intriguing remark.

Considering that, in the case of Tanzania, the trade gap and thus investment in excess of savings was largely financed by net aid flow, the author points out the intrinsic relevance of the size of trade gap, imports minus exports, as a key variable for policy makers.

I now take this as my point of departure, by first presenting the evolution of key variables that determine the trade gap, namely exports and imports. Figure (3.1) displays the evolution of Tanzania's exports and import, measured as a percentage of total output (Gross Domestic Product-GDP) for the period 1975-2005. Data used for the construction of export and import coefficients is the same as that used by Wuyts (2004), with an addition of four years. Given the relatively large span of the data, it allows for more coherent comparison across time. Most importantly it also allows one to observe the trends in both exports and imports coefficients, before and after the era of structural adjustment and economic reforms in the country.

¹¹ Wuyts. M (2004), a development economist and a lecturer at the Institute of Social Studies, in his article "Macroeconomic policy and trade integration: Tanzania in the world economy" analysed a number of variables related to the country's trade and economic performance.

¹² Wuyts, p.345

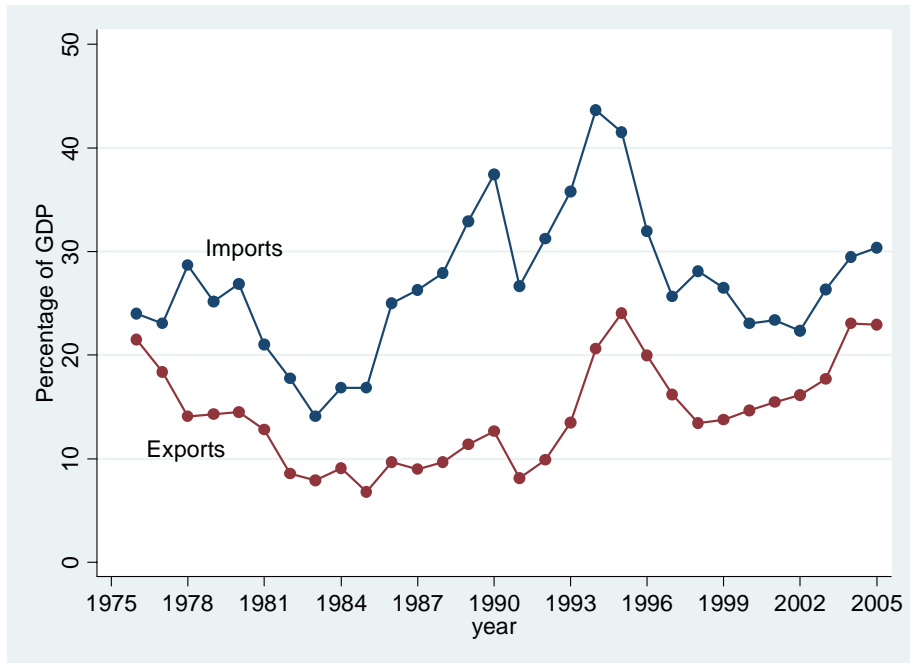


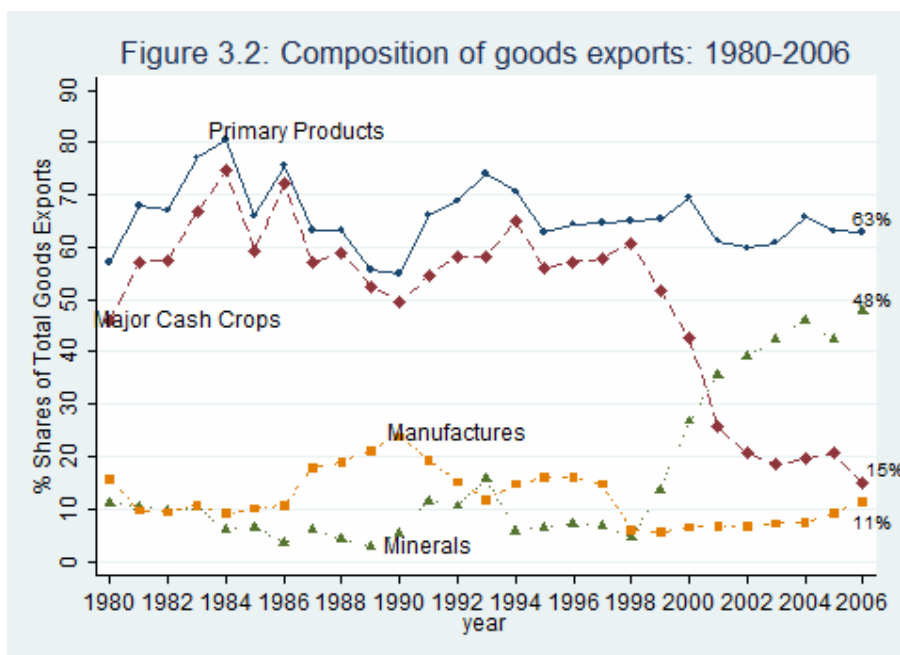
Fig. 3.1 Exports and Imports as a percentage of GDP in Tanzania 1976-2005
 Source: National Bureau of Statistics, Tanzania

From figure (3.1), one can easily pick up on the following pattern:

First, is the sharp decline in both exports and imports coefficients from the year 1975 to the mid 1980s.

Second, is the subsequent period of growth, in both coefficients, after the mid 1980s before reaching a peak in the year 1995. The period after 1985, for which we observe a rise in the growth of exports as well as imports coefficients, also correspond to the era of structural adjustments in the country.

Another striking feature in relation to Tanzania's export performance is the evolution of the structural composition of its exports. Though Tanzania still remains largely an agrarian economy, the country has recently experienced a dramatic shift in the structural composition of its exports. The effect is even more distinct with goods exports-mainly exports of primary goods, though the story is almost similar with exports of services. Figure 3.2 gives the display of this evolution. The figure presents the share in total goods exports of primary products, major cash crops, manufactures, and minerals. The data covers a period between the years 1980-2006



Data source: Bank of Tanzania

Up until the late 1990s, the largest share of Tanzania’s goods exports was derived from a narrow range of primary agricultural products: coffee, cotton, cashew, sisal, tea, tobacco, and cloves. Before the turn of the century, they accounted for more than 50 percent of the country’s goods exports earnings. The year 1998, marked a turning point with a dramatic decline in the share of major cash crops, mirrored by a sharp rise in exports of primary exports of minerals (gold, diamond, and precious stones) (Wuyts.M, 2004). Figure 3.2 is an extension to Wuyts (2004), which covered the period 1980 to 2001. The shares of cash crops, once the fame of Tanzania’s main exports goods, have dropped at an overwhelming rate over the past eight years. As by the year 2006, cash crops accounted for only 15 percent of total goods exports. Compared to the results presented by Wuyts (2004), which covered a period of up to 2001, there has been a further drop in the shares of cash crops of about 13 percentage points in just 5 years! The sharp decline in share of exports of major cash crops, as a percentage of goods exports, has been complemented by that of minerals. As a percentage of exports of goods, minerals have risen from the low of 10 percent in 1998 to 48 percent in 2006; an increase of 9 percentage points from 2001. These results indicate a further shift from agriculture which still plays an important role in the livelihood of many Tanzanians.

Contributing further to the structural change in Tanzania’s exports is the significant rise of the country’s service exports, especially after the year 1995. Between the years 1987 to 2005, the share of service exports in total output has risen by nearly 14 percentage points, from 3.3 to 13.8 percent. In addition, the average share of services in total exports of goods and services over the

period 1995-2002 stood at 47 percent compared to the average of 33.8 percent over the years 1987-94¹³.

Several factors have been attributed to Tanzania's export performance, over the years, as well as to the more recent shift in the composition structure of the country's exports.

Wuyts (1994), Lipumba, N. et al (1988), point out the impact of the shift in domestic relative prices, in favour of food crops, which ultimately led to the downfall of exports and imports especially in the late 1970s and early 1980s. Wuyts (1994), however, argues that while the shifts in relative official prices indeed discouraged the production thus constraining exports of cash crops, more immediate factors were at play.

“...my focus is on the proposition that the demise of export crops was due to the fact the government policies initiated the downward trend in the production of export crops by changing official relative prices in favour of food crops.” Wuyts (1994)

Following the Arusha declaration in 1967, the government of Tanzania attempted a state-led investment drive-aiming at increasing industrial growth through direct investment in industry. This eventually saw birth to an industrialization strategy, in the mid 1970s, which sought to produce for the domestic market using local resources. This strategy, however, failed to take into account the significant role of exports as an important source of foreign exchange earnings necessary to finance recurrent imports-which were necessary to fuel the industrialization process.

Reacting to the theory put forward by Bevan et. Al. (1987; 1989; 1990) with reference to what was happening in Tanzania in the late 1970s and early 1980s; Wuyts (1994) provided the following argument:

First, the investment strategy that was then adopted by Tanzania was fuelled mainly by aid flow-investment aid. This, however, did not finance current imports.

Second, as investment capacity expanded it also meant an increasing demand for food, which in turn meant a raise in food prices, first in the parallel market followed by official prices. The author, further, points out that cash crop producers responded strongly to the movements in the relative prices of food versus cash crops. Evidence provided by Lipumba, N. et al (1988), collaborate with this story. In their analysis, the authors show that production of major cash crops (coffee, cotton, tea, tobacco, and sisal) responded negatively to the rise in food prices¹⁴.

The then prevailing exchange rate regime-a fixed exchange rate, made the situation even worse for the economy of Tanzania. Rising domestic prices in presence of a fixed exchange rate regime meant a decline in real exchange rates, thus creating pressure on imports. Therefore, shifts in relative prices coupled with falling exports (especially of cash crops) meant a constraint on foreign exchange, ultimately resulting in a decline in import capacity.

Falling imports, in particular re-curent imports, resulted in under utilization of industrial capacity that was already built. The government of Tanzania then responded by rationing farming inputs to peasants which in turn meant an even further drop in production and exports of cash crops-creating a vicious cycle.

In sum, put in the words of Wuyts, the high and rising rate of investment exerted upward pressure on relative prices of food vis a vis cash crops and, consequently, led to the decline in

¹³ The figures are based on the authors own calculations, using various national data series from the country's bureau of statistics.

¹⁴ The coefficient was largest for cotton.

export volume which, in turn negatively affected industrial output and supply of manufactured goods in the country-side. The reaction by the government, to ration peasants, further hampered exports and therefore foreign earnings needed to finance imports.

What explains the recent performance, and the structural change in Tanzania's export structure?

From the mid 1980s, Tanzania started to witness a recovery in its total exports, as well as imports. However, as the share of exports grew, an even more interesting pattern started to emerge. This refers to the recent significant shift in the compositional structure of Tanzania's exports of goods and services, a point I will turn to shortly. Take another look at figures 3.1 and figure 3.2

Starting 1986, the period that also corresponds to the time of growth in exports share, Tanzania implemented a series of donor supported economic reforms. Prior to these reforms, Tanzania attempted its own structural adjustment programs¹⁵ in the early 1980s. These earlier attempts were sought to address serious social-economic hardships that faced the country at the time. They were also made in protest of the conditionality reforms prescribed by the World Bank and the IMF. The initial home grown adjustment programs, however, proved unsuccessful. The prevailing economic crisis that lasted to the mid 1980s left Tanzania with choice but to adopt a series of donor supported reform programs¹⁶.

On the whole the economic reforms, adopted by the Tanzanian government, were meant to dismantle state economic controls and encourage more active participation of the private sector in the economy. The program included a comprehensive package of policies which aimed at:

Reducing budget deficit; removing most price controls; liberalizing trade and exchange rate regime; easing restrictions on the marketing of food crops; freeing interest rates; and restructuring of the financial sector, to name a few.

The earlier period of economic reforms, the era of 'structural adjustment' saw a change in the dynamics of aid, investment, and trade. The following played a major role in this transition:

Trade liberalization and investment policy: The transition from a state-led to a market driven economy was accompanied by promotion of trade liberalization, more in particular import liberalization. This move was geared towards opening up the economy to foreign competition. This involved, initially, lifting of controls on imports, which were subsequently followed by a reduction of tariff. Furthermore, imposition of strict demand management and the reduction in state economic activity brought to an end the earlier practice of financing investment through money creation. This caused for a dramatic move away from investment-led industrialization.

A change in donor policy also played a significant role in the early phase of the transition period. Investment-aid, which was primarily for supporting import substitution industrialization, was later on replaced by 'program aid' that went into settling balance of payments-to fund a trade deficit to exceed depressed levels of exports. The move sought to help fragile economies open up and integrate more deeply into the world market.

¹⁵ The National Economic Survival Program (NESP) in 1981-1982 and the Structural Adjustment Program (SAP) in 1983-85

¹⁶ The first of these was Economic Recovery Program (ERP I) adopted in 1986-1989, followed by ERP II in 1989-1992.

These strategies specifically aimed at stimulating export production, particularly in agriculture, and attracting foreign investment to a newly competitive economy, the point I now turn to.

The years following economic reforms in Tanzania, saw a gradual increase in the production and crops exports. The evolution of the volume of agricultural exports, however, displays a rapid rise until 1996-97, and the subsequent fall. The fall in agricultural exports volumes, in the later half of the 1990s, is captured well by the trend in export prices of these commodities Wuyts (2004, p.371-2). The story is non-the less different before the years 1996-97. After the year 1986, export volumes of cash crops moved in contrast to the movements in their prices- with export volumes expanding despite the fall in export prices. The effect of falling export prices after 1996-97, partly explains the recent shifts in the structural composition of Tanzania's exports noted in figure 3.2.

The second reason refers to foreign direct investment flowing into the country. Tanzania has also been experiencing an increase in foreign direct investment (FDI), most of which flows into the mining and tourism industries. FDI flows increased from an average of 150 million US\$ per year before 1997 to an average of 450 US\$ by 2005. This has led to the diversification of the country's exports.

Conclusion

This section attempted to give a brief summary on the evolution of trade and export performance in Tanzania, dating back to the mid 1970s. The period of economic crisis in Tanzania, suffered a severe decline in both exports and imports suffered severely. The import substitution industrial policy that was then adopted by the government of Tanzania was sighted as the underlying cause for the import draught during this period. The argument that was put forward was that country policies that were implemented in the mid 1970s shifted relative prices, there by, exerting upward pressure on relative prices of food vis a vis cash crops. This consequently, led to the decline in export volume which, in turn negatively affected industrial output and supply of manufactured goods in the country-side. The reaction by the Tanzanian government to ration farming inputs continued to weigh harder on export production. Foreign exchange was further constrained by rising domestic prices interacting with the fixed exchange rates regime, eventually resulting in import starvation. This in turn led to a further decline in production and exports of cash crops, thus creating a viscous cycle.

The recovery in exports and import shares followed the era of economic reforms. As exports shares increased the structure of Tanzania's exports composition also shifted, from cash crops in favour minerals and services. This came about mainly as a result of declining export prices for cash crops as well as increasing FDI inflow into the mining and service sector.

The next question of interest is to see how Tanzania's trade and export performance compares to other countries. The following section, therefore, takes up this task by comparing Tanzania's experience with that of other countries, namely Kenya, Uganda, Mauritius, Malaysia, and Thailand. These countries have been selected for the following reasons:

Both, Kenya and Uganda are neighbouring African countries bordering the northern part of Tanzania. These countries share fairly similar climatic conditions with that of Tanzania. However, probably, most importantly these countries share a long history of economic and political relations. In 1967, the three countries formed an intergovernmental organization (The East African Community-EAC) which only lasted for ten years, until the year 1977. The regional

economic integration has recently been revived¹⁷, only this time including other neighbouring countries of Rwanda and Burundi.

Mauritius on the other hand, was selected because of its export performance also accompanied by relatively high growth rates in total output (GDP).

The remaining two countries, that is, Malaysia and Thailand represent the group of fast growing East Asian economies. The still existing debates on the positive impact of trade on the recent performance of the high performing Asian economies, makes it sensible to include them for comparison purposes.

Furthermore, the two countries were selected to represent the lot of the East Asian countries due to consistent data availability.

3.2 Tanzania in the world economy

The previous section gave an overview of Tanzania's trade performance from the mid 1960s to present times. The evolution of the country's economic integration in international trade produced some distinct patterns, especially with reference to the periods during and after economic crisis in the late 1970s and early 1980s. The section also presented evidence of diversification in Tanzania's exports that has occurred in more recent years. In addition, it was argued that government policies played a vital role in the country's economic performance. The mid 1980s is of historical significance to Tanzania, as an economy and to its people, as it marked a new era of transition towards an open economy. The years after 1986 were marked by significant changes not only in the government's policies, but also in terms of the country's economic performance. The impact of economic and political reforms was felt in almost every aspect of life of a common Tanzanian. As pointed out earlier, the chief concern of the economic reforms was to revive the economy from prolonged periods of decline and stagnation. It was then believed that the best strategy to achieving this goal was by dismantling state control and encouraging private participation in economic activities. One of the specific objectives was to boost export production by, not only, getting the 'prices right' but also through attracting FDI's into new competitive areas.

Though the country still faces a number of challenges, especially with respect to the fight against poverty, a number of economic indicators have improved over the years. However, the country still has a long way to go to catch up with the rest of the world. The introduction to this paper presented some of the disparities between Tanzania's trade performances, in terms of exports, in comparison to other countries in the world. The following takes up the task of going into a more detailed analysis, to compare Tanzania's experience in trade and exports performance with that of other countries.

¹⁷ The first major step in establishing the East African Federation is customs union in East Africa signed in March 2004 and commenced on 1 January 2005.

3.3 Tanzania, Africa and High performing Asian economies: A comparison

For comparison, three countries have been selected from Africa namely, Kenya, Uganda and Mauritius. The analysis here uses data from the World Bank development indicators 2006. In addition, the values that are used to calculate shares of export, import, domestic investment, are all measured in current US dollars. The analysis that follows begins with presenting some trends in the shares of imports and exports, as a percentage of GDP, from the Kenya, Uganda and Mauritius.

The years before the mid 1980s, Kenya and Uganda experienced similar downward trends in their shares of imports and exports as was the case in Tanzania (see figures 3.3 and 3.4 in Appendix). Mauritius on the other hand, has had a gradual increase in both coefficients, over the same period of time. Furthermore, Mauritius has consistently maintained higher exports shares compared to Kenya, Uganda and Tanzania between 1980 and 2005. Table 3.2 below presents the average export shares for Mauritius, Uganda, Kenya and Tanzania for the years 1980 to 2005.

Table 3.2. Average export shares, as a percentage of GDP, 1980-2005

Country	Mean	Std. Dev	Max	Min
Mauritius	59.54	7.87	42.33	72.26
Uganda	11.68	5.06	4.09	26.46
Kenya	25.94	4.59	20.20	40.44
Tanzania	13.89	5.04	6.77	24.07

Data source: World Bank

It is evident from table 3.2 above that Mauritius stands out with the highest share of exports, in GDP; an average of 59.54 percent over the whole period between the year 1980 to 2005. Of the three East African countries Kenya is the one with the highest average share of exports; 25.94 percent, after which Tanzania follows with an average of 13.89 percent then Uganda with an average of 11.68 percent. Before we turn to the factors that enabled Mauritius to maintain large export shares compared to the other three countries, let us have a brief look at what has happening within the two East African economies of Kenya and Uganda.

One doesn't need to make a critical inspection before noticing an interesting pattern in Kenya's exports and imports around the years 1992-98 (see fig. 3.3 in appendix). The data displays a sharp rise in both coefficients, of exports and imports, in 1992-93 then followed by a significant drop of both coefficients up till the end of the 1990s after which they start to rise again. The sudden jump, of approximately 15 percentage points, in Kenya's exports shares that happened in 1992-93 is well captured by fig 3.6 (in the appendix) which breaks down total exports into exports of goods and services. This period coincides with the time when Kenya experienced a boom in the tourism sector as well as in the production and export of tea. We also observe a very similar pattern with the shares of manufactures, in exports of goods, a point I will turn to shortly. The sudden jump in Kenya's export coefficient was therefore a combined effect of a boom tourism, manufacture and agricultural production and export mainly tea.

The story in Uganda is somewhat different from that of Kenya, and Tanzania. In 1980, the share of Uganda's exports, to overall GDP, balanced with the level imports share. This implies that by then Uganda had a zero trade balance. Subsequent years, however, saw a dramatic decline in both coefficients, with imports recovering shortly after. While imports recovered by 1984, the

shares of export, as a percentage of GDP, progressively declined from over 25 percent up to below 5 percent by the year 1988 thus creating a large trade deficit for the country.

The persistent decline in the shares of total export, of Uganda, is almost perfectly mirrored by the performance in the country's exports of goods-which are mainly primary agricultural commodities. The significant drop in Uganda's exports of goods after 1980, together with total exports of goods and services, may have been the aftermath of Uganda's 1978-79 Idd-Amin war with Tanzania. Recently, Uganda's export performance, in terms of its share of exports in GDP, has been recovering. In addition to the rise in the country's export coefficient, there is also indication of diversification in Uganda's exports. This is mainly due to increased service exports; the share of Uganda's services in total exports of goods and services rose from 3 percent in 1980 to 36 percent in 2005.

The figures presented so far indicate that on the whole East African share some similarities in the evolution of their trade performance in terms of exports and imports. But even with some of these similarities Kenya still seems to be performing better as compared to its counterparts, Tanzania and Uganda. On the other hand we have Mauritius that manifests a contrasting experience to the whole of East Africa. In fact Mauritius has performed better in terms of exports and economic growth as compared to many African economies. What then makes Mauritius special from other African economies? We now to some of the factors that have been attributed to the success of this 'isolated' island in Africa

The success of Mauritius's export performance has been attributed to its export promotion policies which targeted export diversification and export-led growth. Ndulu, B., et al (2007) point out that the country's policies that aimed at securing manufactured export-led growth, played a pivotal role not only in expanding the country's export capacity, but also in promoting the country's economic growth performance. The authors also argue that Mauritius' degree of trade openness has enabled the country to achieve high annual growth rates in imports and exports. Figure 3.5 also provides evidence to support this, as both coefficients of exports and imports tend to move together. Mauritius, compared to Kenya, Uganda and Tanzania, has managed to maintain a small trade gap (see fig 3.9). The figure indicates that Mauritius has, in addition to maintaining high export and import coefficients, the country has managed to achieve a trade surplus-in 1985-88, and 2001-2005. The role of the government in ensuring that market forces work in favour of economic growth is increasingly gaining consensus. Though this notion runs contrary to the main ideas that dominated in the era of structural adjustments, the importance of government initiatives has been acknowledged as an important factor in stimulating growth in HPAEs. A similar case applies to Mauritius, where Ndulu et al (2007) also made a remark on the significant role played by the Mauritanian government, in addition to of course FDI inflow.

“In successfully exploiting the global opportunities for growth, the role of the government was emphasized in creating political, social, and economic institutions for the better functioning of markets.” Ndulu et al (2007)

Notably, the success of this economy has been impeccable thus making headway over most African economies. Advocates of export-led growth have long stressed on the importance of the manufacturing sector. It is therefore argued that the size of a country's manufacture sector is a reflection of its competitiveness in the world market. Therefore the rate at the manufacture sector grows in an economy, in part indicates the level of technological breakthrough and diffusion in a given economy. The share of the manufacturing sector still remains low in many African economies, including Tanzania. Take another look at figure 3.2 which presents the shares of various goods commodities, in goods exports. The reader will easily notice how, in the case of

Tanzania, the share of manufacture in goods exports has remained significantly low over the years. The coefficient of Tanzania’s manufactured exports improved only slightly from the mid 1980s to the early 1990s before gradually declining to 11 percent in year 2005. Comparing the three East African economies, Kenya’s manufacturing sector appears to perform relatively better of the three. Mauritius, on the other hand, has had a more vibrant growth in its manufacturing sector, for the past twenty years. This point brought out even more clearly when one looks at figure 3.8, where the shares of Mauritius’ manufacture is nearly as high as those in HPAEs. The evolution of Mauritius’ goods exports, presented here, tally fairly well with the remarks made by Ndulu et al (2007) where they point out that from the mid 1980s the volume of goods exports in Mauritius grew at an annual rate of 5.4 with sugar, textiles and clothing accounting for 90 percent of the country’s exports.



Fig. 3.8 Shares of manufactures in goods exports: 1990-2005

Having looked at some experiences from Africa, let us now turn the camera to High performing Asian economies (HPAEs). The extraordinary growth rates of these economies, over the past two decades, have seen renewed interest in export-led growth hypothesis. Trade, and in particular export expansion, features as an important factor to the persistent high growth rates of the HPAEs. However, controversy still exists on the direction of causality especially with regard to the remarkable growth performance of these countries. In other words what caused HPAEs to grow at the observed pace; did export expansion lead to economic growth or was it the other way round? There is no doubt that finding the correct answer to this question may be of great

relevance for policy makers, especially for developing economies like Tanzania. Never the less, investigating the causal relationship between economic growth and export expansion in the context of the recent growth experience of the East Asian ‘Tigers’ is beyond the scope of this paper. Irrespective of the controversies that surround the issue of causal direction between economic growth and export expansion, there a number of potential lessons that can be drawn from their experiences. High performing Asian economies, indeed share some commonalities namely high rates of domestic savings, investment, exports, and substantial investments in human and physical capital, to name a few. The remaining part of this section will, therefore, present some of these aspects while making comparisons with Tanzania’s experience.

The first anomaly that emerges between Tanzania’s experience and that of the HPAEs has already been presented in Figure 3.8 above. Manufactured exports in HPAEs have risen tremendously in the last several years. This growth in the share of manufactures has been the main determinant to the expansion in total export capacity that has been witnessed in some Asian economies (World Bank, 1993). The share of manufactured exports in HPAEs has risen not only as a percentage of domestic exports, but also as a percentage in world exports. Table 3.3 displays the shares of exports from HPAEs as a percentage of world total exports for the years 1965, 1980, 1990. As a group these fast growing economies managed to raise their share of manufactured goods in the world exports by nearly 13 percentage points in only two decades. This achievement is seen in part as a result of high rate of technological diffusion that has taken place in these economies, a point that was made earlier. The high rate of technological diffusion has also enabled some Asian economies like China, and India to diversify their manufacturing exports towards hi-tech manufactured commodities such as consumer electronics (Rodrik, 2006). While manufactures, in these countries, accounting for more than 70 percent of their goods exports, developing countries like Tanzania are still at the very low end with a share of only around 10 percent. This is one of the significant differences between low income countries like Tanzania, and fast growing economies like Malaysia, Thailand or even Mauritius.

Table 3.3 Share in World export

Share in world exports			
Economy	1965	1980	1990
Total exports			
Japan	5	7	9
Four Tigers^a	1.5	3.8	6.7
Southern Asian NIEs^b	1.5	2.2	2.4
HPAEs sub totals	7.9	13.1	18.2
Export of manufactures			
Japan	7.8	11.6	11.8
Four Tigers^a	1.5	5.3	7.9
Southern Asian NIEs^b	0.1	0.4	1.5
HPAEs sub totals	9.4	17.3	21.9

a Republic of Korea, Hong Kong, Singapore, and Taiwan, China

b Indonesia, Malaysia, and Thailand

Source: World Bank (1993), UN Trade Systems data

FDI inflows into Asian economies have been sighted as one of the important factors to the expansion in exports, in particular manufacture exports, in Asian countries. Following economic reforms, Tanzania has also managed to attract foreign direct investment. However, the bulk share of the FDI flowing into the country have gone into the mining sector (40 percent), and the remaining distributed to other non-agricultural sectors primarily into tourism, the financial sector and manufacturing. The result of which has been a rapid expansion in exports of minerals in Tanzania, for the past few years. While the financial and the tourism sectors have also responded positively to FDI inflow, Tanzania's manufacturing industry appears to still be responding at a much slower pace. Factors such as the high costs of doing business, the target market for produced manufactured goods (domestic as opposed to export-oriented), and inferior technologies may be some of the plausible reasons for the slow response of Tanzania's manufacturing industry to FDI inflow. Identifying main constraints to Tanzania's manufacture industry and exports is, however, beyond the scope of this paper.

In addition to the expansion of exports, HPAEs have also managed to maintain a trade surplus, especially in more recent years; by exporting more than they import. As pointed out earlier, these economies have also maintained high levels of domestic savings and investment rates. Fig 3.10 presents the shares of investment, savings and trade gap as a percentage of GDP for a period 1975 to 2005. The figure clearly points out to the distinctions between these countries as compared Tanzania in terms of investment domestic savings and trade performance.

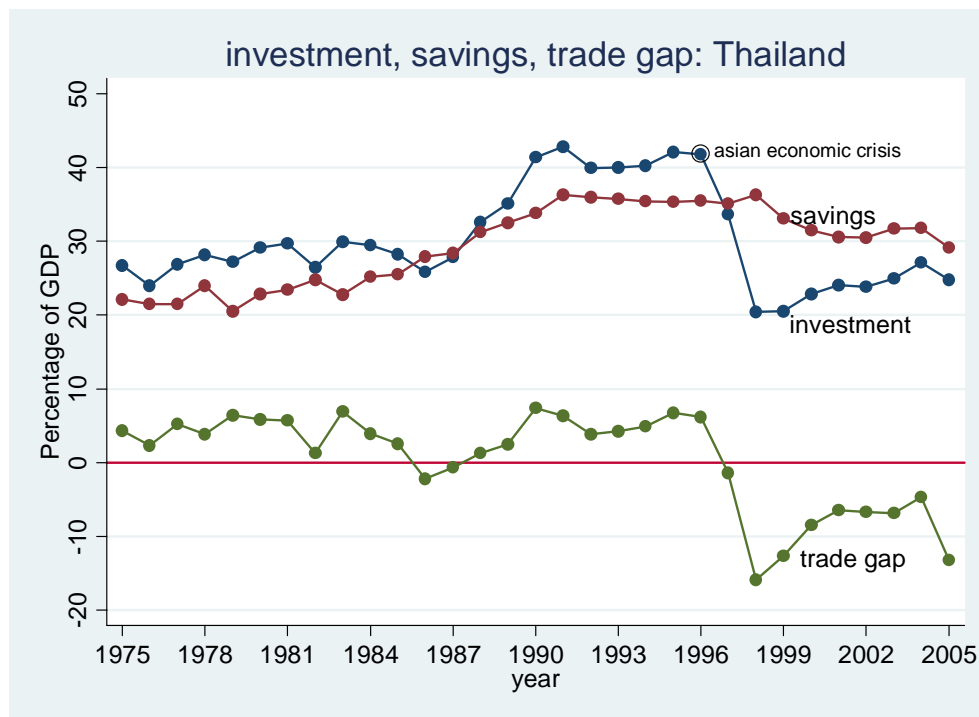


Fig 3.10 Investment, Savings and trade gap : Thailand

The Asian countries as can be noted in figure 3.10 suffered from an economic crisis in 1997 which temporarily affected gross investment and savings. A similar pattern emerges with real

grows rates in overall GDP. While for some Asian economies this was only temporary, it has left a lasting mark in some Asian economies such as Indonesia. In the case of Thailand one can also pick up the close similarity in the pattern of investment and trade gap. This pattern may be an indication of support for the argument linking export expansion with FDI inflow that has featured prominently in many recent case studies of HPAsEs.

In sum there are distinct disparities between Tanzania's experience with that of fast growing economies in Asia and Africa in terms of trade performance and investment. The Tanzanian economy has recently registered high growth rates similar to that of fast growing economies (refer table 1.0 in appendix). The growth in Tanzania's domestic real output has also been accompanied with rising shares of exports of goods and services.

Has the rise in Tanzania's exports of goods and services increased overall output?

Having looked at the experience of Tanzania's growth performance in terms of GDP, and the evolution of some trade components, namely exports imports shares we now set out to see whether the rise in exports has influenced the economic performance of the country. I remind the reader that it is not the intention of this paper to identify the causal relationship, given the limitations posed by availability of data. The intention is to only see whether exports had any role in the continuous rise in the growth rates that have been registered, in particular over the past few years. It was pointed out that the period ending the 1970s, both imports and exports shares dropped drastically. Fig 1.0 also presented the evolution in the real growth rates that covered the period between 1965 and 2005. The reader will notice that by comparing fig 1.0 and fig 3.1 that real growth rates fall around the same time exports declined. The real growth rates also started recovering around the same time that export shares started picking up in the mid 1980s. Both exports shares and real GDP growth seem to gradually increase from the mid 1990s. But does this mean that the rise in exports has lead to real GDP growth? Given the data limitations it was not possible to run formal tests. However the author attempted to check for an association between the two variables. The author checked for a simple correlation between real growth rates in total exports of goods and services with real growth rates in GDP. Consistent data available from the World Bank development indicators, measured in constant prices only runs from 1990 for the case of Tanzania. However, even with this very small sample the results were interesting. To check if there is any association between exports and real GDP growth rates, the only formal test that the author could perform was a simple correlation between real growth rates of exports and real GDP growth rates. This simple test of association produced a negative coefficient of 0.2321, which is surprising given that they both seem to increase gradually especially in the years after 1996. There have been known cases where exports expansion has a negative effect on economic growth. However, there is very little that one can draw from this simple test of association. For one to have strong grounds to suggest if there is any long term relationship between exports and real GDP growth a much larger sample would be required.

Chapter 4 Conclusion

The paper set out to investigate the interaction between exports and real growth rates in Tanzania. The objective of the paper was motivated by two things namely, the continuous real GDP growth rates even in times when the country experiences shocks and; the increase in exports of goods and services. The growth rates in more recent years have also followed a more different pattern than the earlier period when it experienced similar growth rates. As opposed to the times in the early 1960s the recent growth patterns have followed a smoother upward trend. To establish what may account for this phenomenal outcome the paper started with presenting some evidence from growth accounting. The decomposition of the country's economy into the shares of factor inputs, namely human and physical capital, indicate that factor productivity-estimated from the residual-comes out as the major contributor to Tanzania's economic growth rates in recent years. The share of factor productivity was at its highest in the 1960s and early 1970s. Treichel (2005) who also came up with similar findings suggested that the rise in factor productivity in the recent years may have been the result of FDI inflow into the country. The country has indeed managed to attract more FDI inflow mainly into non agricultural sectors, with mining receiving the largest share of all.

Economic integration: the paper presented evidence of the rise in total exports as well as imports from the mid 1980s. This rise was a result of the structural reforms, the share of imports have been largely influenced by the liberalization policies that were implemented from 1986 by the Tanzanian government. Arguments set forward by authors including Wuyts (1994), Lipumba et al (1988) suggested that the sharp decline in exports in the country, which were associated with a starvation in imports, were largely attributed to the government before the mid 1980s. It was argued that the governments' investment strategy, at the time, that was fuelled by investment aid shifted relative prices by exerting an upward pressure in favour of food crops. This consequently, led to the decline in export volume which, in turn negatively affected industrial output and supply of manufactured goods in the country-side. Rationing of farming inputs by the government together with the effects of the fixed exchange rate regime accelerated the drop in export production, further reducing import capacity, thus creating a viscous cycle.

A further shift from agricultural primary exports: As Tanzania experienced an increase in the share of total exports more was happening to the structural composition of its exports. Evidence points out to a dramatic shift from agriculture, which still plays fundamental role to the livelihood of the many Tanzanians. In four years alone, the share of major cash crops in the country's exports of goods has dropped by another 13 percentage points indicating an even further shift towards non-agricultural exports. The shift away from agricultural exports is mainly due to both external and internal factors. On the one hand, there is a fall in international prices of Tanzania's primary exports (Wuyts, 2004), where as on the other hand there is deterioration of the quality of cash crops produced in the country (PHDR, 2005). According to Tanzania's Poverty and Human Development Report (2005) the deteriorating quality of cash crops is largely associated by low productivity levels in smallholder agriculture. The report points out that while Tanzanian and Kenyan coffee fetched the same average price before 2000, the subsequent prices for Tanzanian coffee has fallen far below that for Kenya. It was earlier pointed out that before the decline, production of cash crops rose in contrast to the falling international prices. The growth in cash crop production was, however, resulted merely from the expansion of land under cultivation and not due productivity increase. It should be noted that low productivity levels vary greatly between producers of cash crops in the country. It has been shown that large estates or

commercial farmers as well as smallholder farmers participating in integrated producer schemes, tend to have substantially higher productivity levels. Absence of modernization in agricultural practices, that is, how people relate to agriculture as a business, has been identified as the main cause for persistent low productivity levels in small holder farming (Semboja, 2006). It is therefore argued that transformation from traditional to modern agricultural practices, is key to sustained growth of agriculture. In order to transform the agricultural sector in Tanzania, small holder farmers therefore need to be integrated into systems and institutions that have the capacity to convert knowledge into innovation. In Tanzania, as in many other parts of the world, these systems and institutions already exist where smallholders are part of an integrated modernised system; commonly known as out-growers in Tanzania, or also referred to as contract farmers in other places. These systems are designed such smallholders pass through a mentoring process which is vital for transforming the largely uneducated and traditional peasantry into modern farmers (Semboja, 2006). Given that the majority of the Tanzanians still depend on agriculture as a main source of income, sustained growth of the sector is of primary concern. It also has major policy implications especially with regard to Tanzania's poverty reduction strategy. The government needs to realize the potential of such schemes in bringing about change, not only to the poor but also to the economy as a whole.

In addition to improving the agricultural sector, the Tanzanian economy still has a wide scope for other development opportunities. As the paper had already pointed out, sectors such as tourism have great potential to contribute the country's sustained economic growth. Tanzania is blessed with a wide range of tourist attractions, some of which still remain untapped. Promotion of the historical sites in places like Bagamoyo, and Pangani as well as developing the coastal stripe is some of the areas that the government may also consider as potential development strategies.

Expanding the manufacturing sector in Tanzania still remains a challenge. The sector remains largely dominated by small textile and light consumer goods industries, aimed at the domestic market. There is therefore a need for proper policy interventions that will encourage export orientation in the manufacturing sector. This may include easing the cost of doing business, providing incentives and awarding new discoveries, encouraging public-private partnership, improving infrastructure and enhancing human resource.

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Appendix

Fig 3.3 Share of exports and imports in overall GDP

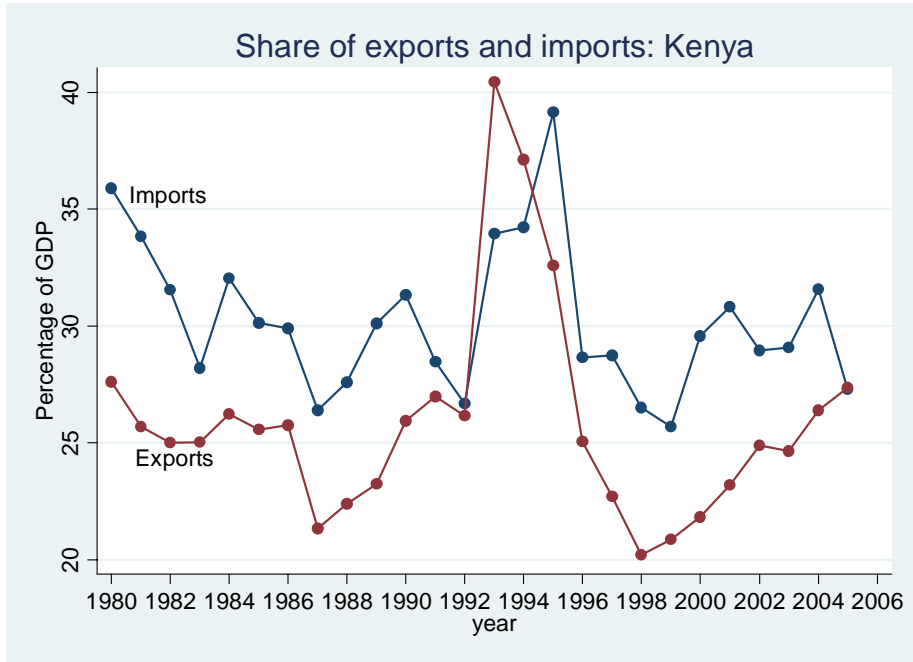


Fig 3.4 Share of exports and imports in overall GDP

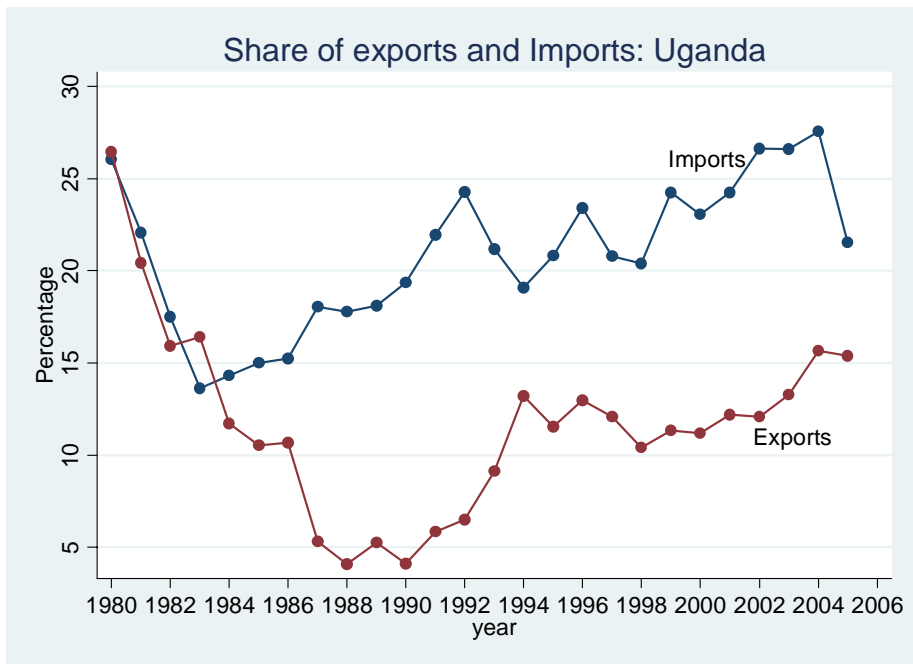


Fig 3.5 Share of exports and imports in overall GDP

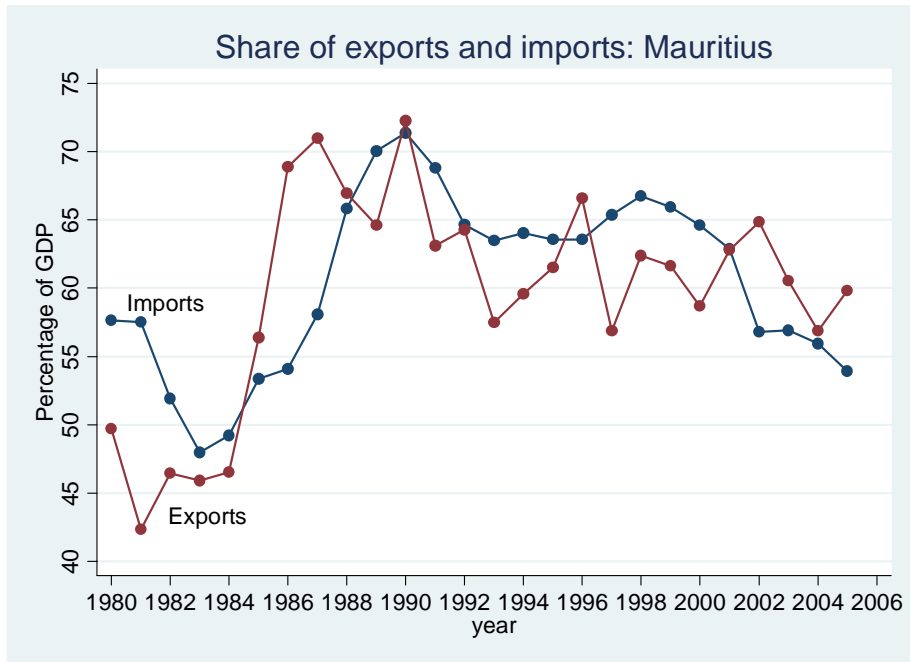


Fig 3.6 Exports of goods and services as a percentage of GDP

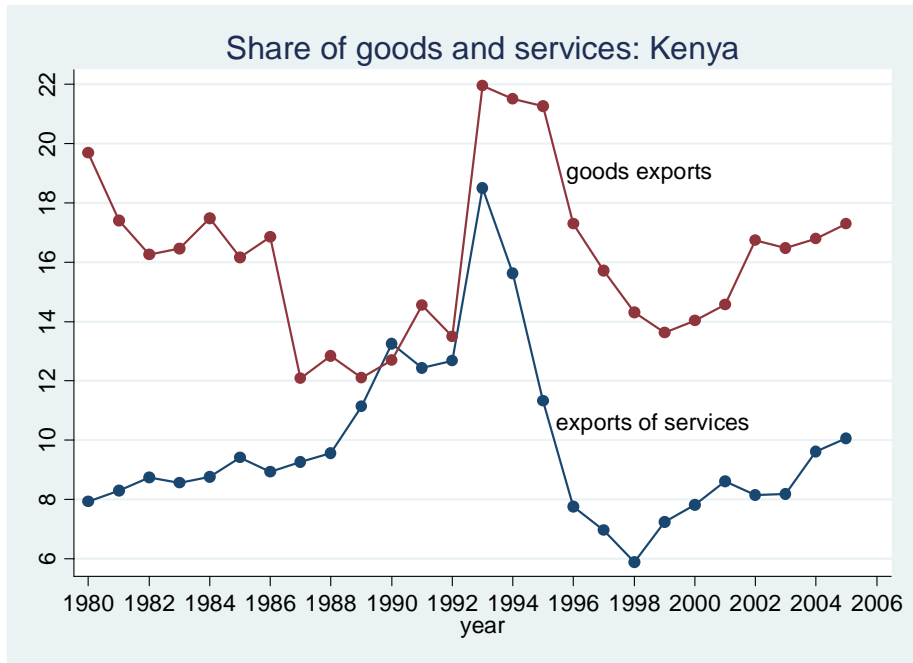


Figure 3.7 Export shares of goods and Services in overall GDP



Fig 3.9 Share of Investment, savings and trade gap in overall GDP

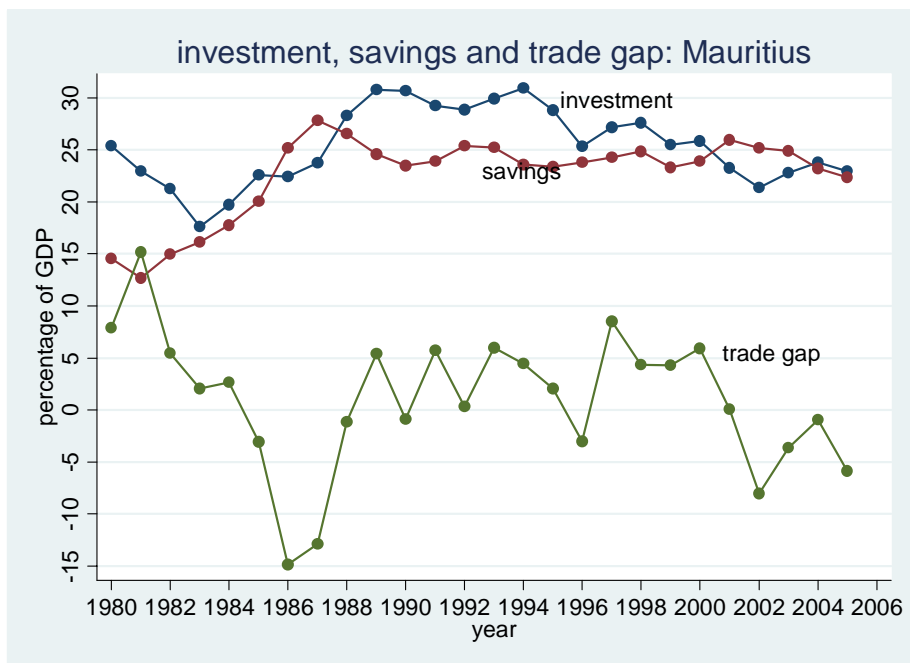


Fig 1.0 Average per capita income, constant USD in PPP

country	1980-85		1986-90		1991-95		1996-2000		2001-2005	
	Mean	std.error	mean	Std.error	mean	std.error	Mean	std.error	mean	std.error
Thailand	2791.1	76.1	3827.3	260.6	5659.9	281.2	6352.1	171.0	7064.6	242.9
Malaysia	4388.2	100.5	4958.3	200.1	6752.7	306.5	8238.6	157.0	8993.2	236.8
Kenya	1048.8	13.2	1093.4	13.4	1054.9	13.4	1047.0	4.9	1058.3	12.6
Uganda	830.3	18.3	786.7	14.6	896.4	26.6	1101.6	22.4	1237.6	18.1
Cote d'Ivoire	2120.9	84.7	1769.8	35.0	1539.8	23.0	1644.8	20.8	1489.0	18.0
Niger	960.7	54.4	822.8	9.8	719.6	16.4	704.8	10.5	698.6	3.9
Sri Lanka	1965.3	50.6	2239.2	30.2	2645.0	80.9	3200.7	84.0	3769.6	106.5
Mali	744.4	24.4	686.4	10.5	694.5	8.0	750.8	15.5	885.8	12.0
Egypt, Arab Rep.	2308.0	76.6	2651.8	45.5	2881.7	39.3	3303.7	74.9	3695.5	49.1
Mauritius	4376.4	102.6	5850.1	248.5	7365.8	186.1	8963.2	267.6	10621.3	218.5
Burkina Faso	863.1	13.3	916.6	11.8	914.1	4.8	977.3	7.7	1047.0	12.4
Tanzania			507.9	6.3	492.3	6.1	504.7	5.8	602.8	20.5

Data source: World Bank