Capital Market Development and Growth in Sub-Saharan Africa: The Case of Tanzania

African Economic Policy
Discussion Paper Number 79
February 2001

Sam Q. Ziorklui, Howard University

in collaboration with:

Lemma W. Senbet [lsenbet@rhsmith.umd.edu], University of Maryland
Abdiel G. Abayo [Cap-Markets@Cats-net.com], Capital Markets and Security Authority
Flora Musonda [fmusonda@esrf.or.tz], Economic and Social Research Foundation
Bartholomew Nyagetera, University of Dar es Salaam
Longinus Rutasitara, University of Dar es Salaam
Gabriel D. Kitua [bankingraha.com], Bank of Tanzania

Funded by
United States Agency for International Development
Bureau for Africa
Office of Sustainable Development
Washington, DC 20523-4600

Equity and Growth through Economic Research

EAGER supports economic and social science policy analysis in Sub-Saharan Africa. Its primary goal is to increase the availability and the use of policy analysis by both public and private sector decision-makers. In addition to the goal of achieving policy reform, EAGER seeks to improve the capacity of African researchers and research organizations to contribute to policy debates in their countries. In support of this goal, EAGER sponsors collaboration among American and African researchers and research organizations.

EAGER is implemented through two cooperative agreements and a communications logistics contract financed by the United States Agency for International Development (USAID), Strategic Analysis Division, The Office of Sustainable Development, Bureau for Africa. A consortium led by the Harvard Institute for International Development (HIID) holds the cooperative agreement for Public Strategies for Growth and Equity. Associates for International Resources and Development (AIRD) leads the group that holds the cooperative agreement for Trade Regimes and Growth. The Communications Logistics Contract (CLC) is held by a consortium led by BHM International, Inc. (BHM). Other capacity-building support provides for policy analysis by African institutions including the African Economic Research Consortium, Réseau sur Les Politiques Industrielles (Network on Industrial Policy), Programme Troisième Cycle Interuniversitaire en Economie, and the International Center for Economic Growth. Clients for EAGER research activities include African governments and private organizations, USAID country missions and USAID/Washington, and other donors.

For information contact:

Yoon Lee, Project Officer
USAID
AFR/SD/SA (4.06-115)
Washington, D.C. 20523
Tel: 202-712-4281 Fax: 202-216-3373
E-mail: ylee@usaid.gov

Lisa M. Matt, Senior Advisor
BHM International
P.O. Box 3415
Alexandria, VA 22302
Tel: 703-299-0650 Fax: 703-299-0651
E-mail: lmatt@eagerproject.com
Contract AOT-0546-Q-00-5271-00

J. Dirck Stryker, Chief of Party
Associates for International
Resources and Development (AIRD)
185 Alewife Brook Parkway
Cambridge, MA 02138
Tel: 617-864-7770 Fax: 617-864-5386
E-mail: dstryker@aird.com
Contract AOT-0546-A-00-5073-00

Sarah Van Norden, Project Administrator
Belfer Center for Science & International Affairs
John F. Kennedy School of Government
79 John F. Kennedy Street
Cambridge, MA 02138 USA
Phone: 617-496-0112 Fax: 617-496-2911
E-mail: sarah_van_norden@harvard.edu
Contract AOT-0546-A-00-5133-00

Abstract

The establishment of the Dar es Salaam Stock Exchange (DSE) in 1998 marked an important milestone in the effort toward the development of a functioning capital market for the mobilization and allocation of long-term capital to the private sector. As of December 1999, four companies have been listed on the DSE. Three of these companies have raised a combined equity capital of TShs 28.57 billion (an equivalent of US$35.71 million) in the primary capital market. The fourth company, East African Development Bank has raised an amount of TShs 10 billion (an equivalent of US$12.5 million) through the issue of a four-year corporate bond.

This study shows that aggregate savings declined prior to the reform and increased during the reform period. However, expected increases in credit to the private sector did not take place despite policy reforms. The study also finds that the introduction of high-yield government short-term Treasury bills has increased the demand for Treasury bills at the expense of credit to the private sector. As a result, commercial banks tend to switch a greater proportion of their deposit liabilities into Treasury bills. This portfolio switching tends to crowd-out the private sector and productive activities from the capital market.

Other results show that regional integration and globalization of the Tanzania capital market would be beneficial in terms of attracting foreign capital, efficiency of utilization of capital and corporate governance. Foreign participation would also encourage domestic participation in the capital markets. Also, findings indicate that the CMSA has been effective in promoting good corporate governance in Tanzania. Disclosure requirements are specified and monitored by CMSA and DSE. The share price movement has been an effective way of demanding accountability from listed companies. The price movement at the DSE has also shown how the operations of a free market mechanism leads to efficient pricing of financial assets in the stock market.

The study found that even though the policy changes in Tanzania had a positive impact on capital market development, there are many challenges and problems that remain to be addressed in order to promote a functioning capital market in Tanzania.

Author:

Sam Q. Ziorklui [sziorklui@aol.com] is an Associate Professor of Finance at Howard University, School of Business, Department of Finance and Insurance. Since joining Howard in 1984, Dr. Ziorklui has taught undergraduate courses in corporate finance, financial institutions, and computer application of financial analysis. He also taught graduate courses in theory of finance and financial markets and institutions. He has conducted research and published articles on corporate finance, financial institutions and markets, financial sector reform and capital market development in Sub-Saharan Africa, including Ghana and Tanzania. He is the principal investigator of "The Development of Capital Markets and Growth in Sub-Saharan Africa: The Case of Ghana and Tanzania," funded by the U.S. Agency for International Development (USAID). He obtained his Ph.D. from Howard University in 1986.

Acknowledgment

We wish to convey our sincere thanks and gratitude to the US Agency for International Development (USAID) for their financial support for this study. We also acknowledge the useful help and assistance we received from Harvard Institute for International Development, (HIID) the prime contractor on the EAGER/PSGE collaborative agreement with Howard University. We would like to express a special thanks to Dr. Clive Gray, the Chief of Party at HIID and Dr. Malcolm McPherson whose useful comments have enriched this final report.

We would also like to express our sincere thanks to the Project Administrative staff at HIID, especially Ms. Sarah Van Norden, EAGER Project Administrator, Ms. Sara Piccicuto and Meg Nipson, former Project Administrators. Their invaluable support and paper works made this study possible.

We also wish to express our thanks to the Research Advisory Committee (RAC) members whose advice has improved this final report. Special thanks go to Professor S.M. Wangwe, Executive Director, Economic and Social Research Foundation (ESRF), Dr. Kibola, Chief Executive Officer, Dar es Salaam Stock Exchange (DSE) and Dr. F. Mboya, Director, Capital Markets and Security Authority (CMSA). We also thank Mr. Godius Kahyarara of ESRF for his useful assistance on the project.

Abbreviations and Acronyms

BOT	Bank of Tanzania
CEPA	Center for Policy Analysis
CIS	Collective Investment Scheme
CMO	Collaterized mortgage obligation
CMSA	Capital Markets and Securities Authority
DSE	Dar es Salaam Stock Exchange
DVP	Delivery versus Payment
EACB	East African Currency Board
EAGER	Equity and growth through Economic Research
ESOP	Employee stock ownership
ESRF	Economic and Social Research Foundation
FFYDP	First Five-Year Development Program
GDP	Gross domestic product
HIID	Harvard Institute for International Development
ILO	International labor organization
IMF	International Monetary Fund
IPO	Initial public offering
IPS	Industrial Promotion Services
LART	Loan and Advance Realization Trust
LDC	Less developed countries
NBC	National Bank of Commerce
NBFI	Non-banking Financial Institution
NESP	National Economic Survival Program
NGO	Non-governmental organization
NIC	National Insurance Corporation
OAU	Organization of Africa Unity
PBZ	Peoples Bank of Tanzania
PSGE	Public Sector Growth and Equity
PSRC	Parastatal Sector Reform Commission
RSC	Research Supervision Committee
SME	Small and medium enterprises
SOE	State-owned-enterprises
SSA	Sub-Saharan Africa
SSNIT	Social Security and National Insurance Trust
TBL	Tanzania Brewery Limited
THB	Tanzania Housing Bank
TIB	Tanzania Investment Bank
TOL	Tanzania Oxygen Limited
TRDB	Tanzania Rural Development Bank
TSLS	Two Stage Least Squares
UDSM	University of Dar es Salaam
UNECA	United Nations Economic Commission for Africa
USAID	United States Agency for International Development

Table of Contents

Tables/Charts

Executive Summary

The objective of this study is to examine the various problems that constrain the development of functioning capital markets in Sub-Saharan Africa (SSA) countries in general and Tanzania in particular. The study also examined the impact of the government's recent policy changes on capital market development and the operations of non-banking financial institutions that intermediate in the capital markets. The study analyzed the linkage between capital market development and the real sector growth in Tanzania. The issues of regional integration and globalization of the capital market have also been examined with policy implications. The study also addressed the impact of policy changes on equity and poverty alleviation in Tanzania.

The study conducted field surveys by administering survey questionnaires to various financial, regulatory institutions, the Dar es Salaam Stock Exchange (DSE), and the Bank of Tanzania (BOT). Additionally, secondary data have been collected to supplement primary data in the above analysis.

Parametric statistical analysis has been adopted in testing various hypotheses that have been derived from policy research questions of this study. Considering the above analysis, this study found that the policy changes in Tanzania have had positive impact and challenges on the capital market development. The passage of various regulatory laws and reforms such as the Foreign Exchange Act of 1992, the Capital Markets and Securities Act of 1994, the Insurance Act of 1996, and other relevant reform laws have provided strong legal foundations for efficient development of the capital market in Tanzania.

The policy changes of liberalization of interest rates and the removal of regulations on financial institutions resulted in more players in the capital market. The emergence of various financial and capital market institutions has enhanced the capacity for competitive environment in the capital market. The establishment of the Capital Market and Security Authority (CMSA) was an integral part in promoting an active capital market development in Tanzania.

The establishment of the Dar es Salaam Stock Exchange (DSE) in 1998 marked an important milestone in the effort toward the development of a functioning capital market for the mobilization and allocation of long-term capital to the private sector. During the short time of its establishment, four companies have been listed on the DSE as of December 1999. Three of these companies have raised a combined equity capital of TShs 28.57 billion (an equivalent of US$35.71 million) in the primary capital market. The fourth company, East African Development Bank has raised an amount of TShs 10 billion (an equivalent of US$12.5 million) through the issue of a four-year corporate bond.

In terms of financial resource mobilization through the banking system, the study shows that aggregate savings which was on the decline before the reform had increased during the reform period. However, contrary to expectations, the policy changes have not been accompanied by increases in credit allocation to the private sector. The study also found that the introduction of high-yield government short-term Treasury bills has increased the demand for Treasury bills at the expense of credit allocation to the private sector. As a result, commercial banks tend to switch a

greater proportion of their deposit liabilities into Treasury bills. This portfolio switching by the banks tends to crowd-out the private sector and productive activities from the capital market.

This study shows that regional integration and globalization of the Tanzania capital market would be beneficial in terms of attracting foreign capital, efficiency of utilization of capital and corporate governance. Foreign participation would also encourage domestic participation in the capital markets.

The study also shows that the CMSA has been effective in promoting good corporate governance in Tanzania. Disclosure requirements are specified and monitored by CMSA and DSE. The share price movement has been an effective way of demanding accountability from listed companies. The price movement at the DSE has also shown how the operations of a free market mechanism leads to efficient pricing of financial assets in the stock market.

Problems and Challenges

The study found that even though the policy changes in Tanzania have had some positive impact on capital market development, there are many challenges and problems that remain to be addressed in order to promote a functioning capital market in Tanzania.

The enactment of banking and financial institutions' reforms was supposed to strengthen the capital market institutions in order to mobilize financial resources for allocation to the private sector. However, the slow pace of restructuring the collapsed banking sector resulted in the decline of credit to the private sector, especially the productive sectors of the economy, including agriculture and marketing of agricultural products. The direct impact of this result is the reduction in growth potential and poverty alleviation in Tanzania.

There is inadequacy of competition within the financial sector. Such evidence includes the wide spread between deposit and lending rates, which has on average, been above 15% throughout the post - reform period. This suggests that financial prices do not adequately reflect market conditions and the cost of funds. An inappropriate interest rate structure is obviously likely to affect both stock prices and exchange rates, and thus the capital market generally.

The capital market remains underdeveloped. The problems of illiquidity, infrequent trading, and fewer listings of private companies limit the attractiveness of the capital market for domestic and foreign investors. The lack of absorption capacity and low demand for equity securities has been worsened by the lack of government incentives to attract new companies and investors to the stock market.

The infancy of the capital market structure is reflected in the fact that the DSE has only recently been established and currently has four companies listed on the exchange. This signifies that the instruments for resource mobilization in the capital market are still few and in the process of formation.

The government's fiscal policies of taxing dividends on equity securities while exempting interest income on short-term Treasury bills provide greater incentives for investing in government short-term securities at the expense of investment in long-term equity securities. In addition, the general weakness of the Tanzania currency and creeping inflation provide disincentives for investing in the capital market for long-term benefits.

One of the basic goals of reform has been to ensure a greater allocation of credit to the private sector for growth and poverty alleviation. However, our survey results show that the greatest problem facing the private sector is the access to credit, especially long-term capital for productive activities. The collapse of the banking sector in Tanzania due to large non-performing loans led to reduction of credit to the private sector. Furthermore, the banks' preference for short-term overdraft loans to corporate entities makes it difficult for even creditworthy corporations to raise long-term capital for productive enterprises.

The new regulation of high bank reserves also limits the ability of commercial banks to make long-term loans to the private sector. In addition, the requirement of tangible collateral also inhibits small enterprises from raising capital in the capital market.

The study also found that the capital market structure in its present form is not suitable for small and medium enterprises to raise capital in the form of equity securities. Unlike the US, where capital market structures are developed for small and medium-sized firms to raise capital in the Over the Counter (OTC-NASDAQ) markets, there are no such second tier markets in Tanzania to attract small firms that cannot be listed on the DSE.

Also, the complementarity of capital and money markets in providing long-term and working capital to the private sector is hampered by the lack of responsiveness of the banking sector to credit needs of the private sector. The lack of foreign participation in the capital market is detrimental to the development of the capital market. Additionally, the lack of development of capital market instruments such as venture capital and institutions, investment banks, corporate bonds, mutual funds, and unit trusts, derivative securities, and options limit the attractiveness of the stock market for investors. The lack of financial derivatives and options precludes risk management by hedging underlying stocks in the futures and options markets.

Even though regional integration and globalization of the capital market in Tanzania has beneficial implications for the domestic economy, it has its risks as well. Capital market globalization has the risk of domestic price fluctuations, which may be the result of macroeconomic instability in the domestic economy. This was a clear lesson from the Southeast Asian countries' financial crisis.

In view of the complexities of the developmental problems in Tanzania and other SSA, it is our opinion that policy recommendations should be formulated to satisfy short-term, medium- and long-term goals and objectives. However, the sequencing of implementation of the policy recommendations may be at the discretion of the policy makers. With this in mind, we offer the following policy recommendations that are designed to address some of the problems and challenges facing the capital market in Tanzania.

Policy recommendations

1. The government's effort to tackle inflationary pressures by introducing cash budgets has helped in controlling inflation. However, recent developments in increases in energy prices and market speculation have led to deterioration in the value of the Tanzania Shilling. An effective monetary policy, coordinated by a prudent fiscal policy of balanced budget will provide stable macroeconomic environment that is necessary for capital market development.

2. The adoption of prudent fiscal and monetary policies are essential to maintaining internal and external stability in order to minimize the negative consequences of foreign shocks on the domestic economy, and thereby prevent financial outflows from the domestic capital market.

3. The government should provide fiscal incentives in terms of tax exemptions for new private firms that desire to be listed on the stock exchange. This policy has been introduced in Botswana and other countries with positive results.

4. Equal treatment of dividends on equity securities and interest income on Treasury bills will provide a level playing field for investors in equity and short-term money market financial instruments.

5. The introduction of various capital market products such as mutual funds, unit trusts, government, and corporate bonds will increase prospects for portfolio diversification and thereby enhance the attractiveness of the stock exchange and bond markets in Tanzania. These collective investment instruments would also attract small investors who may not be able to invest in individual stocks that require more income and greater sophistication and risk concentration.

6. Intensification of public education through television advertisements, radio, print media, and pamphlets will increase the exposure and benefits of the stock and bond markets.

7. The establishment of small business development centers and guaranteed business and project loans will enhance the prospects of small businesses to obtain loans for productive activities in the economy.

8. The harmonization of accounting practices and transparency of information disclosures are essential for price discovery and efficient portfolio management.

9. Computerization of the stock exchange should be accompanied by increases in the frequency of trading on the stock exchange. This will increase liquidity, marketability, and the attractiveness of trading on the stock exchange.

10. The establishment of an over the counter (OTC) stock exchange (sometime in the future) for small enterprises will enhance the attractiveness of listing small and medium-sized private firms in the stock exchange for raising long-term capital.

11. The government should be encouraged to undertake privatization of viable state-owned enterprises (SOEs) through the stock exchange rather than privatization through strategic investor channels.

12. The innovative approach of providing employees stock ownership (ESOP) of privatized government-owned enterprises will increase the ownership pool of privatized companies. This may also reduce the tension surrounding the privatization of SOEs and thereby alleviate the apprehension of employees who are fearful of losing their employment through privatization of SOEs. However, the consequences of retaining unproductive employees should also be weighed carefully in the implementation of this recommendation.

13. The government's practice of raising funds in the short-term market by auctioning short-term securities in the money market exerts much pressure on short-term interest rates. The synchronization of government sources and uses of funds in terms of issuing long-term bonds to finance long-term projects will provide stable short-term and long-term yield curves. Furthermore, government debt issued through the stock exchange has the potential of deepening the capital market. It also has the potential of increasing the liquidity and turnover of the stock exchange.

14. The practice of excluding foreign participation in the stock exchange contributes to low liquidity and low turnover in the stock exchange. We recommend changing the current policy to permit foreign participation in the domestic capital market in order to attract foreign capital to the domestic capital markets.

15. In terms of regionalization and globalization of the domestic capital markets, it is necessary to harmonize macroeconomic conditions as well as the legal and regulatory framework to be in harmony with regional and international standards. Additionally, there is the need to improve domestic capital markets in order to build internal capacity for domestic absorption of cross-border trades.

16. It is also necessary to harmonize trading rules and practices of domestic capital markets with neighboring markets. The adoption of international accounting standards and transparency of information disclosures will be essential to ensure regional co-operation among member countries.

17. The role of capital market development in promoting economic growth has been confirmed by this study. Additionally, the negative consequences of reduced credit to the private sector and its negative impact on poverty alleviation have been documented. It is therefore important to develop strategies and programs to ensure access to long-term credit by small and medium-sized enterprises that experience difficulty in raising capital in the post-reform era.

18. The role of non-governmental organizations (NGOs) in providing financial services to the poor, especially those in the rural areas should be encouraged. Thus, the re-allocation of many of the NGOs from the urban areas to the rural areas should be encouraged.

19. In order to ensure fairness and equity in terms of access to credit by the public, there is the need to establish various Consumer Bills of Rights as initiated in the US. This will protect the public from unfair practices of the banking sector in extending credit to the private sector. The enactment of the Equal Credit Opportunity Act, as an example, will exert pressure on financial institutions to adopt a uniform and transparent standard for screening loan applications for credit extension to business enterprises.

1. The Statement of the Topic and its Importance

1.1 The Statement of the Problem

In the early 1980s and 1990s, many Sub-Saharan Africa (SSA) countries embarked on comprehensive financial sector adjustment programs in order to mobilize financial resources for investment and growth. The financial sector reform had its primary objective the enhancement of the soundness of banking institutions in order to improve deposit mobilization and credit allocation to the private sector for investment and growth. However, recent studies have shown that the financial sector reforms did not make adequate provision for the development of capital markets in Sub-Saharan Africa (World Bank, 1994, 1990, De Melo and Tybout, 1986).

It is argued that the focus on commercial banks has led to the neglect of non-banking financial institutions (NBFI) that have comparative advantage in mobilizing long-term capital for investment. Those critics argue that commercial banks are not well structured to meet the long-term capital needs of the private sector for several reasons. First, commercial banks' assets and liabilities are of short-term nature, and as such, they are incapable of providing a greater supply of long-term capital to the private sector. Secondly, higher yields on short-term government Treasury bills provide greater incentives for commercial banks to hold a larger proportion of their asset portfolios in short-term government bills. This action has led to the crowding out of private enterprises, especially small and medium-sized enterprises (SMEs) from the credit market. Thirdly, government regulation in terms of reserve requirements and the new risk-based capital requirements constrain the ability of commercial banks to provide long-term capital to the private sector. Fourth, commercial banks face real challenges of assessing the risks of borrowers properly in an informational imperfect environment and would be averse against extending credit for business activities that are considered very risky.

On the other hand, it is argued that capital market institutions such as stock exchanges can better mobilize domestic and international capital. This is because of the following features:

a) Stock exchanges offer a simple mechanism for the transfer of funds, which encourages investors to participate in the market. This simplicity enables individuals to finance long-term investments even though most of them would like to commit their funds for only a short period of time.
b) Stock exchanges permit companies to access a large number of investors scattered the world over. When share prices are quoted publicly, the overseas' investors can gauge the level of domestic and international confidence in a particular company and the economy as a whole.
c) Stock exchanges can appraise the financial conditions and future prospects of a company in need of funds. The price of its securities and the magnitude of its price movements are clear indicators of the risk – return relationship involved.
d) Stock exchanges offer guidance to management through the cost of capital. The market determined cost of capital assists in determining the level of investment appropriate for a company (Abayo, 1992).

The development of well-functioning capital markets is therefore vital for growth and poverty alleviation in SSA. Capital markets have greater capacity for mobilizing domestic and foreign capital for productive investment in the domestic economy.

1.2 Policy Research Questions

The above discussions raise the following policy research questions: (a) what are the impact of financial sector reform on capital market development and the operations of non-banking financial institutions (NBFI) that intermediate in the capital markets? (b) To what extent has the existence of a stock exchange in Tanzania improved the prospects of raising long-term capital for growth and poverty alleviation? (c) What are the benefits and challenges of regional integration and globalization of capital markets in Tanzania? (d) What are the linkages between capital market development and real sector growth? (e) What are the policy implications of reform on equity and poverty alleviation in Tanzania?

1.3 The Objectives of the Study

The objective of this study is to provide a systematic investigation of the foregoing research questions using Tanzania as a case study. Specifically, the study has examined: (a) the structure of capital markets and NBFIs that intermediate in the capital markets; (b) the various constraints that impede the development of efficient capital markets and how these constraints can be removed; (c) the role of financial sector reform on capital market development; (d) the impact of prudential regulation/supervision on the development of capital markets; (e) the challenges and benefits of regional integration and globalization of the Tanzanian capital markets; and (f) the linkage between capital market development and real sector growth. The study also provides policy recommendations for addressing some of the major constraints to capital market development in Tanzania.

1.4 Significance of the Study

Many studies have been done to examine the performance of emerging capital markets in developing countries. However, many of these studies focus on the emerging capital markets of Southeast Asia, Latin America, and the Caribbean. Sub-Saharan Africa has not received the attention that the Southeast Asia and Latin American countries have received in the academic literature. Many capital markets in SSA are considered as “basket cases” and therefore were not featured in many studies of emerging stock markets.

This study is timely because it addresses many of the important research questions that have been raised by USAID/Washington, USAID/Tanzania, and other AID missions in Africa, the World Bank, and many government officials, and policy makers in Tanzania. A systematic investigation of the research questions has led to the formulation of policy recommendations toward the development of efficient capital markets in Tanzania. Additionally, policy lessons from this study may be applicable to other Sub-Sahara African countries that share similar problems with Tanzania. Also, the policy recommendations will enhance the private sector development programs of USAID and the World Bank, currently underway in Tanzania.

2. Literature Review

2.1 Introduction

This review seeks to examine the existing literature about the conditions that inhibit the development of capital markets in SSA in general and Tanzania in particular. Except for countries like South Africa, Ghana, Nigeria, Kenya, and Zimbabwe, most capital markets in SSA are still in their formative stages. Widening of the scope of capital markets in most of these countries has gone hand in hand with financial sector liberalization. For countries like Tanzania and Uganda, for example, the stock exchange is a recent development. However, a review of the academic literature and experiences of other SSA countries would yield useful lessons for Tanzania and other SSA countries with similar economic situations. The first part of the review looks at financial liberalization and implications for capital market development. It is followed by a review and critique of previous work in SSA. Related work in Tanzania is also highlighted, followed by deliberations on the intended contribution of this study in terms of analysis and policy for Tanzania as compared with the previous studies.

2.2 Salient Issues from Previous Studies

2.2.1 Financial Liberalization and Capital Market Development

In most of SSA countries, the capital markets remain small and less developed. From various studies, a number of constraining factors have been identified and generalized for most countries. One major constraint is financial repression together with weak and unclear legal framework. Key elements of financial repression include restrictions on entry into banking, often combined with dominating public ownership of major financial institutions. These include high reserve requirements on deposits, statutory ceilings on bank lending and deposits, quantitative restrictions on credit allocation, restrictions on capital transactions and foreign exchange transactions (Nyagetera, 1997).

Financial liberalization is aimed at removing financial repressive practices in order to contribute to growth through improved efficiency of financial intermediation, efficiency of capital stock, and an increase in the saving rate. Improved financial intermediation leads to higher savings and capital accumulation. The efficiency of capital markets is promoted as funds are channeled to high-productive projects. The transition from a repressed financial regime to a market oriented financial system will be greatly enhanced by the role of the government in providing an enabling environment. At the minimum, the government should ensure a more conducive macroeconomic environment that can support the institutional framework that is necessary for the development of a well-functioning capital market (Montiel, 1996, pp. 76-9). Additionally, the presence of a dynamic private sector that is motivated to participate in the development effort of the country is also very essential for private sector development.

There have been very few studies on the capital market development in SSA. Ogwumike and Omole (1997) observe that in Nigeria the stock exchange is constrained by government policies that do not promote mobilization of industrial finance. At one time, it was noted that interest rate policies favored growth of the money market rather than the capital market. The problem of awareness is also cited as a reason for reluctance of companies to go public. This explains low supply of securities. Informational constraints relate to inadequate disclosure of information due to the underdevelopment of information technology and manpower training.

Osei (1998) examines the institutional factors that affect the development of the Ghana stock market and finds that the legal and regulatory framework that ensures protection and security of investors is important. Using survey data, the study identifies such factors as low income, level of education, and information about the capital market as crucial.

2.3 The linkage between capital market development and growth

Evidence in more advanced countries and rapidly emerging capital markets of Southeast Asia and Latin America confirm the overall positive association between capital market development and economic growth. Several benefits are ascribed to capital (securities) market development. These include (a) mobilization of long-term savings for long-tenured investments, (b) providing risk capital (equity) to entrepreneurs, (c) broadening ownership of firms, and (d) improving the efficiency of resource allocation through competitive pricing. According to Demirguc-Kunt and Levine (1993) further gains to the economy arise due to lower cost of equity for firms and the discipline imposed on corporate managers since movements of share prices reflect managers' performance, existence of mechanisms for appropriate pricing and hedging against risk and increased inflows of funds to the thriving domestic stock market.

McKinnon (1973, 1991), Gelb (1989) and Fry (1988), Montiel (1996), among others, stress the positive contribution of capital market development to growth, while King and Levine (1993) and Ghani (1992) find strong correlation between measures of banking development and economic growth. Calamanti (1983) posits that the securities market can positively contribute to growth if supported by appropriate government policies.

Richard (1996) observes that the growth of stock markets increases the volume of long-term investments. Levine and Zeros (1996) establish a positive relationship between measures of stock market development and long-run growth rates. The stock markets are seen to provide a means for risk diversification, acquisition of information about firms, efficient allocation of funds and tying manager compensation to stock performance. Internationally integrated capital markets make diversification of risk possible, apart from the inflow of financial resources.

In his recent study published in The Journal of Economic Literature, Levine (1997) reviewed a body of literature that has bearing on the debate concerning the linkage between capital market development and real sector growth. In that study, Levine discussed the linkage between four different proxies of capital market development and real sector growth. These capital market proxies include (a) liquid liabilities (comprising currency plus demand deposits of banking and non-banking financial institutions), (b) bank credit as a ratio of total credit by the banking sector and the central banking sector, (c) credit allocated to the private sector as a ratio of total credit, and (d) credit extension to the private sector divided by GDP. Levine postulates a positive relationship between the above proxies of capital market development and real sector growth as represented by per capita income.

In another study by Atje and Jovanovich (1996), the authors focused their empirical work on the capital (equity) market development and growth, using various proxies. These include (a) stock market capitalization (where market capitalization refers to the value of listed shares, (b) stock market turnover ratio (measured by the total value of shares traded divided by market capitalization).

2.4 Critique and focus of the present study

The studies, especially those on SSA have contributed greatly to our understanding of the problems and challenges facing SSA countries in the development of the capital markets. More insightful are those studies about Nigeria and Ghana that directly address the problems of developing the capital markets that can be applicable to a new and emerging capital market of Tanzania. The Ghana and Nigerian markets have been in existence for a relatively longer time than Tanzania's (especially when speaking of the stock exchanges). It may be pointed out that the present study addresses most of the aspects raised by Osei (1998) in the case of Ghana, except on testing the market efficiency hypothesis. The Dar es Salaam Stock Exchange (DSE) is still small and young compared to Ghana's. However, the fundamental institutional and operational principles would be applicable to the Tanzanian market.

As can be seen from the above presentation, those studies on SSA and other developing countries focus attention on the hypothesis that capital market developments have a positive relationship with economic growth. These studies also highlighted the advantages of capital market development and growth. However, none of those studies on SSA provides empirical tests of the above hypotheses. In addition, none of the studies on Ghana and Nigeria has attempted to do that.

Our study provides the first attempt to test the above hypothesis, using primary and time series data. Although there is the question about the direction of causality between capital market development and economic growth, this study falls short of attempting to establish the direction of causation.

It is generally argued that in a few European and Asian countries, the banking sector has led in providing both short-term and long-term credit to the private sector for growth. In those countries, stock markets were not considered critical for the development of the country. Others consider stock markets as “casinos” for speculators. Also, until recently the stock market in France did not play much of a role in providing long-term credit to the private sector. Thus, others argue that the capital market development strategy with regard to the stock market is overblown. Some even went further to suggest that the establishment of stock exchanges in Sub-Saharan Africa will not make much difference in mobilizing and allocating credit to the private sector for growth and poverty alleviation.

In our own assessment, and in view of the general weakness of the banking sector and problems of non-performing loans, a healthy capital market through the establishment of stock exchanges will complement the banking sector. As Cho (1986) said, a healthy capital market with stock exchanges is a complement to the banking sector. As such, Sub-Saharan Africa has no choice of developing the banking sector at the expense of the capital (stock) market or vice versa. A strategy of developing a strong capital (stock) market will complement a restructured banking sector in order to mobilize long-term capital for allocation to the private sector for growth and poverty alleviation.

3. Structural Adjustment and Financial Sector Reform

3.1 Introduction

In the early years of political independence in Tanzania, the policy makers adopted the Arusha Declaration in 1967. This declaration empowered the government to nationalize private financial institutions as a way of mobilizing financial resources for allocation to the private sector for growth and poverty alleviation. This policy was aimed at providing credit to the private sector in order to promote growth and make the country self-reliant. However, as evidence shows, the repressive policies of the government had its own seeds of destruction.

As time passed, the implementation of the Arusha Declaration proved increasingly difficult. It became quite obvious that the Arusha Declaration had failed to transform Tanzania into a self-reliant state. By 1979, the distress in the Tanzania economy was clearly visible. Thus, a careful analysis of the Tanzania economy revealed the following shortcomings that constrained the development of a well functioning capital market in Tanzania.

a. Monopolistic and uncompetitive financial institutions,
b. Pervasive government intervention in the financial system,
c. Inadequate and ineffective resource mobilization instruments and strategies,
d. Large portfolio of non-performing loans within the banking sector,
e. Low and inadequate capital requirement of financial institutions,
f. Weaknesses in management and accounting systems and policies,
g. Loss of public confidence in the financial system,
h. Existence of institutional gaps in the financial system,
i. Weaknesses in management and in accounting systems and policies, and
j. An inadequate and inefficient payments system.

Thus, in order to arrest the deteriorating economic conditions, the government undertook an economic recovery program, which is the subject of discussion in the next section.

3.2 Structural adjustments and economic reform programs

Similar to other developing countries, Tanzania was badly affected by economic crisis of the 1970s and 1980s. Up to the early 1980's, the crisis had reached a critical level, especially after the oil price shock of 1979 and associated recession in advanced countries. In the early 1980s, the government launched two stabilization programs, namely the National Economic Survival Program (NESP) in 1980/81 and the Structural Adjustment Program (SAP) of 1982/83. The objectives of these programs were (a) to restore the national output to the pre-1978 level, (b) improve the public sector finances, (c) reduce inflation, (d) improve the balance of payments, and (e) restructure the economic activities through a system of incentives and prices. It was also designed to improve capacity utilization and labor productivity in Tanzania.

These objectives were to be achieved through the removal of inter-regional trade barriers and abolishing price controls. However, one of the major miscalculations was the expectation of foreign capital inflows, which never materialized. As a result, not much was achieved at the end of the reform program and there was the need for another adjustment program.

In 1986, Tanzania adopted a comprehensive and major economic reform namely, Structural Adjustment Programs under IMF/World Bank supervision. The economic recovery program adopted in 1986 has the following objectives:

- The attainment of broad fiscal and monetary stability demand management policies,
- The achievement of sustainable growth, and
- The opening up of the Tanzanian economy to the outside world by adopting an attractive foreign investment code and through economic liberalization.

The specific details of the policy change under the economic recovery program were announced in the budget speech of 1986 and formed the basis of standby arrangement with the IMF in August of the same year 1986. The first structural adjustment facility with IMF was first entered in 1987, followed by the second and third in 1988 and 1990 respectively. In 1989, the government embarked on the second phase of the economic recovery program named Economic Recovery Program II, also known as the economic and social action program.

3.3 Financial Sector Reforms

The financial sector reform which was initiated after the structural reform came later when it was realized that in order to sustain the development in the real sector, there was the need for a strong financial sector for mobilizing financial resources for allocation to the private sector for growth.

However, given the problems of the financial system and its overall limitations in operation, there was the need to carry out a comprehensive restructuring of the financial institutions in order to enable the sector to function efficiently. The performance of the financial sector in terms of resource mobilization, credit allocation, quality of service, and profitability were a major source of concern and dissatisfaction within the sector.

A review of the financial sector by the Presidential Financial Sector Reform Commission, 1990 revealed that savings mobilization declined continuously between 1979 and 1986. Financial assets, which were equivalent to nearly 50% of GDP in 1979, had fallen to 28% of GDP in 1986. The domestic saving rate, which had peaked at 25% of GDP in 1977, fell to 8% in 1985.

Thus, following the findings of the Presidential Commission, the Government has ushered in a comprehensive financial sector reform that aimed at achieving the following goals and objectives:

a. Liberalization of interest rates and exchange rates,
b. Restructuring of existing formal financial institutions through write-offs of non-performing assets,
c. Reforming the policy environment in which the existing institutions were operating,
d. To foster competition by encouraging the establishment of domestic and foreign-owned private banks including joint ventures with Tanzanian interests,
e. To strengthen adequate provision of Bank of Tanzania's prudential regulatory and supervisory roles of other financial units operations, and
f. To foster an efficient money market by creating new instruments.

As part of the financial sector reform, new legislations were put in place in order to restructure the legal framework (Nyagetera, 1997). The new legislation introduced since 1991 include the Banking and Financial institutions Act 1991, 1993. This repealed and replaced the Banking Ordinance 1960 and provides for the licensing of banks and other financial institutions, capital adequacy requirements, central bank supervision, regulation of financial institutions, and a deposit insurance fund.

The other legislation is the Loans and Advances Realization Trust Act of 1991. This provides for acquisition of non-performing assets of financial institutions, and machinery for their expeditious recovery. The third legislation is the Foreign Exchange Act of 1992, which provides for elimination of exchange controls and establishment of a free foreign exchange market and foreign exchange bureau de change. The fourth legislation is the Capital Markets and Securities Act (CMSA) of 1994, which provides for the establishment of the Capital Markets and Securities Authority. The Bank of Tanzania Act 1995 which repealed and replaced the Bank of Tanzania Act 1965, provides for replacement of multiple policy objectives with a single primary policy objective of price stability.

Under the restructuring of the policy environment, various policy measures were implemented. The elimination of government intervention in the financial sector was achieved by eliminating government administrative price setting in the financial sector. This led to granting the financial institutions greater autonomy in setting interest rates and exchange rates. Administrative resource allocation mechanisms in the financial sector have also been dismantled.

The restrictions on competition and free entry into the financial sector have been lifted. New commercial banks, merchant banks, bureau de change, insurance companies, and other financial institutions and intermediaries have been licensed.

The restructuring of the public sector was initiated through various reforms and downsizing of the civil service and the restructuring of the parastatal enterprises through the Parastatal Sector Reform

Commission. As a result, over one-third of the 400 plus parastatals have been restructured through privatization, joint ventures, and outright sales.

3.4 Political reforms

Apart from undergoing comprehensive economic changes, Tanzania has also made significant changes in the political sphere, especially since the early 1990s. In 1992, Tanzania adopted a multiparty democracy as part of the worldwide democratization process.

These political developments, particularly the pluralistic political environment, have positive impact on the country's economic management in general and financial sector in particular. It is expected that these political changes would lead to increased democratization, increased freedom of speech-movement, increased participation in the decision-making process, and efficient credit and other financial resource allocation. Additionally, these changes would enhance transparency in the political system, which is accountable to the public. The new political system has enhanced the establishment of legal and administrative framework for different players to participate efficiently in the country's economic management and decision-making. These are expected to increase the confidence of various players in the economy.

3.5 Fiscal policy changes and the macro-economic environment

In order to avoid deficit financing and thus have a firm control over the inflation, the government adopted a cash budget system. Following this system, the actual government expenditures are determined in accordance with revenue collection every month. This system has been effective in controlling government expenditures. This policy change has greatly improved and stabilized macro-economic environment.

Furthermore, the government has provided several fiscal incentives in order to encourage participation in the capital market development. Dividend income for listed companies is taxed at a lower rate of 5%. Withholding tax of 15% is charged on dividend distributed by companies that are not listed. Likewise, transactions taking place through the DSE are exempted from capital gains tax of 10%. Lower corporate tax for listed companies can encourage more companies to go public.

4. Institutional reforms, growth of capital markets, and financial institutions

4.1 Policy reforms and capital market development

Much has been done during the reforms to enhance activities of the capital market in Tanzania. Major institutional changes within the Tanzanian capital market include the establishment of Capital Markets and Securities Authority (CMSA) in 1994, and the establishment of private banks. In addition, there were efforts to promote the establishment of the first stock exchange in Tanzania. There were other efforts underway to promote NGOs and other organizations to assist in mobilizing funds for long-term investments.

During the period before reforms, there were no effective efforts to develop the capital markets in Tanzania for the mobilization of long-term capital. In addition, there were no efforts made to provide legal assurances against nationalization of foreign companies in order to forestall the fear of foreign investors. The new investment initiative and the private sector policies provide guarantees and assurance to foreign investors. As a result, foreign direct investments have been encouraged. Also, generous incentives including tax holidays for five years have been offered. However, foreign participation in the primary and secondary markets is not allowed.

4.2 The development of non-bank financial institutions

The non-banking financial institutions (NBFIs) in Tanzania encompass a wide range of institutions, which include deposit taking institutions (excluding current accounts), hire purchase finance institutions, contractual savings institutions (including pension funds and excluding insurance), and the foreign exchange bureau de change.

The measures adopted to restructure existing formal financial institutions were designed to enable the institutions to comply with the operating conditions and requirements of the new Banking and Financial Institutions Act 1991 and 1993.

The measures leading to the establishment of new financial institutions have flowed from implementing the provisions of the Banking and Financial Institutions Act 1991, 1993, the Foreign Exchange Act 1992, the Capital Market and Securities Act 1994 and the Insurance Act 1996. Consequently, new commercial banks, merchant banks, bureau de change and insurance companies, as well as a stock exchange and its associated institutions have been established in Tanzania. The existence of these new institutions has helped to reshape the character of the Tanzanian financial sector.

4.3 The Capital Markets and Securities Authority (CMSA)

The Capital Markets and Securities Authority (CMSA) was established by the Capital Markets and Securities Act, 1994. It became operational as a unit under the Bank of Tanzania (BOT) in April 1994. It became an autonomous body in July 1995.

The vision of CMSA is to develop and regulate a sustainable capital market, which is efficient, transparent, orderly, fair and equitable to all. Section 10 of CMSA Act, 1994 stipulates the main functions of CMSA as follows:

a. To formulate principles guiding the industry and to protect the integrity of the market against any abuses;
b. To maintain surveillance over securities business to ensure orderly, fair and equitable dealings in securities;
c. To register, license and regulate Stock Exchange, Investment Advisors, Securities Dealers and their agents and representatives and to control and supervise their activities with a review to maintaining proper standards of conduct and professionalism in the securities business;
d. To determine the minimum capital requirements for license holders given the size of operations and risk and monitor their solvency and take other measures which will protect the interest of investors where solvency of such license holders is in doubt;
e. To adopt measures that are likely to minimize conflict of interest that may arise for dealers, brokers and other market players;
f. To review, approve and regulate take over bids, mergers, acquisitions and all forms of business combinations in accordance with any existing rules and practice;
g. To advise the Minister for Finance on all matters relating to securities business in such a way that the necessary environment for growth and development of the capital markets is created; and
h. To do anything which is calculated to facilitate the discharge of its functions or is incidental or conducive to their discharge under the Act.

Since its creation, the CMSA has initiated several activities aimed at developing the Tanzanian capital market. It took several initiatives to develop the market professionals and participants in Tanzania through conducting courses leading to licensure for dealers/brokers representatives in the country.

4.4 The Dar es Salaam Stock Exchange (DSE)

The establishment of the DSE in 1996 marked an important milestone in the effort towards the development of the capital market for mobilization and allocation of long-term credit to the private sector. Even though the DSE was incorporated in September 1996, trading has not started until April 15th 1998 with the listing of the first company, Tanzania Oxygen Limited (TOL).

The DSE is governed by the Council of the Exchange. The Council consists of 10 members representing various interest groups as follows: (a) three licensed dealing members, (b) two associate members who represent listed companies, (c) one associate member who represents institutional investors, and (d) one member representing the public. The chief executive of the DSE is an ex-officio member who is in charge of policy implementations and the day-to-day operations of the Exchange.

The creation of the DSE was a government initiative through a comprehensive preparatory groundwork that was required to promote a stock exchange in Tanzania. It has seven stockbrokerage firms, licensed to deal on the exchange.

4.5 Official trading activities

Trading takes place twice a week on Tuesdays and Thursdays starting from 10.00 a.m. to 12.00 noon. Trading is conducted at the DSE floor under a continuous Open Outcry Auction Trading System. The representatives of Licensed Dealing Members converge at the trading floor and trade by shouting their orders to a board writer who records the orders on the board. A trade is takes place when a bid and an offer are matched. It has been observed that the infrequency of trading has affected the thinness and liquidity in the market.

The delivery and settlement of securities traded is centralized at DSE and is on Delivery versus Payment (DVP) five business days following the transaction date. Since June 1999, a central depository computer program has been installed and has replaced most of the physical delivery and settlement process.

4.6 Taxation of dividends and interest income

The withholding tax on dividend for listed companies is 5% and is taxed at the source. Dividends paid by non-listed companies would attract withholding tax of 15%. Stamp duty was 0.96% on consideration by the buyer until June 1999. Also, beginning July 1999, transactions taking place at the DSE are exempted from stamp duty. Beginning July 1999, the capital gains tax has been introduced in Tanzania. However, securities listed at the DSE are exempted from capital gains tax but corporate tax is 30%.

5. Research Methodology, Data and Sources

5.1 Research Methodology

This study is an integration of analytical framework with a synthesis of secondary financial and primary data collected through field survey questionnaires and interviews. Descriptive statistical tests and econometric analysis based on the hypotheses have been guided by the analytical foundations and stylized facts of the capital markets of Tanzania. The study utilized parametric techniques in testing the hypotheses and the analysis of the issues and policy research questions that have been raised in this study.

A field survey was conducted in Dar es Salaam where the largest number of commercial banks, listed companies, and regulatory agencies are located. This study randomly selected 60 unlisted and listed enterprises for interviews. The criterion used in selecting the sixty companies was their location in Dar es Salaam. The enterprises located in Dar es Salaam were stratified based on size and industry. Size was measured on the basis of number of employees.

No enterprises classified as micro-enterprises were selected in this study because none were in the database. Furthermore, the two listed companies were included in the sample.

Furthermore, all 18 banks and non-bank financial institutions (NBFIs) were included in this study. In addition, officials of the BOT and CMSA were also interviewed. The study also interviewed 17 non-governmental organizations (NGOs). All NGOs sampled are based in Dar es Salaam. The following criteria was used in selecting the NGOs:

a. They perform activities related to financial intermediation, e.g. mobilization of savings and provision of credit;
b. They facilitate enterprise and target group access to financial resources; and
c. They promote enterprising activities, e.g. direct production.

Table 1 shows that the response rate was somewhat encouraging despite few problems encountered by the field research officers. However, the response rate of the employees and the public was not quite encouraging. Five questionnaires were administered to each of the 60 enterprises selected. Only 46 or 15% were returned fully completed. Some NGOs appearing in the sampling frame were difficult to trace. Despite cooperation received from TANGO and TACOSODE, only eight firms could be located. This constitutes 47% of the sample.

Table 1: Selected sample distributions and returns

Sample	Number sent out	Number collected	Percentage
Enterprises (listed, unlisted)	60	51	85.00
Banks	18	17	94.00
Brokers and dealers	5	5	100.00
NBFI	11	11	100.00
Institutional investors	8	8	100.00
DSE	1	1	100.00
BOT	1	1	100.00
CMSA	1	1	100.00
NGO	17	8	47.00
Employees and public respondents	300	46	15.00
Total sample	422	149	35.00

5.2 Secondary data and sources

Secondary data were obtained from Bank of Tanzania (BOT) and other institutions included in the sample mainly in the form of annual reports. In addition, prudential guidelines by BOT, data emerging out of Dar es Salaam Stock Exchange (DSE) trading activities, prospectus issued by the two listed companies, stock market indicators, macro-economic variables such as GDP, CPI, exchange rates, inflation rates and capital flows are all part of secondary data collected by this study.

6. Empirical Findings

6.1 Introduction

This study found that while many of the economic reforms in other sectors of the economy were implemented from the mid-1980s, the financial sector reforms came seven years later from 1992. Even within the financial sector reforms itself, not all major policy changes have been implemented before the commencement of this study. In general, the financial sector reforms have lagged behind the reforms in other sectors. As a result, this may have affected the success of the development of the capital market and instruments in Tanzania.

However, on the whole, the initial impact of the reform shows some positive impact on the emergence of new financial institutions, legal and institutional reforms, interest rate and foreign exchange rate liberalization and public sector reforms.

The financial sector reform has led to more players in the market. The reform of the banking laws has encouraged the emergence of new banks and private financial institutions' participation in the financial market. The establishment of the first stock exchange - the Dar es Salaam Stock Exchange (DSE) has brought about an important development in the capital market evolution in the country. The entry of more financial institutions in the financial sector set in motion a competitive banking environment.

6.2 Resource mobilization and credit allocation

One of the major objectives of the financial sector reform was to facilitate the mobilization of financial resources and the flow of credit to the private sector for growth and poverty alleviation. The evidence shows that the financial reform has had positive impact on savings mobilization in the domestic economy over the period of the study.

Table 2 shows GDP growth rates, aggregate savings mobilization and credit growth rates as a percentage of GDP. The table shows that annual growth of aggregate savings as a percentage of GDP increased from 20.88% in 1986 to 27.32% in 1994; it was 22.28% in 1998. The study also shows that average savings rate was 20.45% (1985-1991) compared with 24.72% (1992 - 1997). The study also found that the deposit growth rate was positive both in nominal and in real terms. This was a turnaround since real deposit growth was negative during the period before 1990.

Table 2: GDP Growth Rates, Resource Mobilization, and Credit Allocation (%)

Years	GDP Growth	Savings/GDP	Credit/GDP	Credit/Deposit
1986	1.80	20.88	17.62	84.35
1987	7.00	20.08	25.38	126.40
1988	4.40	18.35	22.72	123.80
1989	2.60	18.55	25.74	138.76
1990	6.20	19.75	25.90	141.00
1991	2.80	20.75	28.61	154.00
1992	1.80	22.66	21.34	109.00
1993	0.40	25.72	23.07	102.00
1994	1.40	27.32	19.04	88.50
1995	3.60	26.58	12.94	48.80
1996	4.20	23.76	6.01	25.50
1997	3.30	22.26	6.15	27.70
1998	4.00	22.28	6.98	28.45

Source: Bank of Tanzania, Quarterly Economic Bulletin

However, credit allocation to the private sector during the above period was not as encouraging as has been envisaged in the reform programs. The experience of commercial bank lending during the period 1992 – 1998 shows that there was a general decline in the rate of growth of credit expansion as a percentage of GDP as exhibited in Table 2. The study shows that credit expansion to the private sector as a percentage of GDP which was as high as 28.61% in 1991, declined to 6.98% in 1998. Similarly, credit as a percentage of aggregate deposit also dropped from a high of 154% in 1991 to a little over 28.45% in 1998

This decline in credit was attributed to various factors. The collapse of the banking sector before the initiation of financial sector reform had a lingering effect on credit allocation to the private sector. In most countries, the banking sector provides the link between short-term and long-term credit to the private sector through loans and overdraft advances to the private sector. However, the history of loan defaults affected general morality of extending long-term credit to the private sector. Thus, reform has led to general reduction of credit to the various sectors of the economy including the agricultural sector.

The reduction has also been the result of the Central Bank’s implementation of its prudential, regulatory, and supervisory functions. The Bank of Tanzania’s imposition of lending restrictions to problem borrowers resulted in a sharp decline to parastatal enterprises, most of which had large non-performing loans.

The restructuring of NBC, the largest bank in the country also had a big impact on credit allocation to the private sector. During restructuring, NBC maintained a stringent loan portfolio management and loan provisioning system that resulted in a drastic decline of credit to the private sector. However, it is expected that the restructuring of NBC into corporate and microfinance divisions would benefit small and medium-sized enterprises for their credit needs.

Also, a general review of loan extension by the new and restructured banks shows that credit extension by the new banks were also very low. As a result, the anticipated increase in loans from new financial institutions in the Tanzania economy never materialized. This may be due to the lack of competition and the attractiveness of investment in government Treasury bills that has the potential of higher yields.

Another factor associated with poor performance in lending by banks is the increase in statutory reserve requirements. Minimum reserve ratio was 3% from 1987 to 1993. Thereafter, the ratio was increased to 12% in 1994 and 18% in 1995. In 1996, the ratio was reduced to 12% and later to 10% in 1997.

The declining nature of credit to the private sector after reform led to some criticism that the financial sector reform has not achieved one of its major objectives of credit extension to the private sector for growth and poverty alleviation.

6.3 Sources of financing

As has been discussed earlier, a major constraint for growth of the private sector is the lack of credit from the financial system. Our field survey results show that out of 60 private enterprises interviewed, 39% indicated that the largest source of business finance was individual savings. Savings and retained income from other business constitute about 27% of financing needs. Loans from relatives account for 12%. Bank loans (formal sector) constitute only 16% percent.

The results also indicate that the main source of capital for start-up capital was individual and family savings. The study shows that bank loans were made for on-going business in the form of short-term working capital and business expansion. Thus, private enterprises surveyed indicated that the difficulty in obtaining loans from banks remained the most significant problem in raising start-up capital and long-term financing. The respondents also mentioned that the short-term nature of loans made it impossible for undertaking long-term projects that have high yield potentials. The respondents also indicated that high interest rates on loans and collateral requirements remained major problems facing private enterprises in raising long-term capital from the capital market.

The study also found that the extent of the informal sector’s contribution to financing of private sector business in Tanzania could not be substantiated as has been indicated by previous studies. (Aryeetey, etc. 1997) The results show that only one percent of business financing is derived from loans from moneylenders. In addition, loans from non-government organizations (NGO’s) represent only one percent of business financing.

The survey of financial institutions in Dar es Salaam also revealed that the portfolio preferences of commercial banks in terms of loan portfolios are skewed in favor of short-term loans and overdrafts instead of long-term loans. In addition, there is a shift toward corporate (business) loans at the expense of small business loans. The survey revealed that all commercial banks ranked overdrafts as the most preferred form of loans of which overdrafts to corporations ranked the highest. Loans to small business constitute a very small percentage of bank portfolios. However, the banks indicated that they would prefer small business guaranteed loans as opposed to unsecured small business loans. Other facilities preferred by banks include line of credit for corporations, project loans and export/import loans.

6.4 The Dar es Salaam Stock Exchange (DSE) and its contributions

The study shows that the inability of the banking sector to provide long-term credit to the private sector has created the need for the development of the security market to fulfill the role of mobilizing and allocating long-term capital to the private sector for growth and poverty alleviation. The establishment of the DSE in Tanzania has been considered as an important development to raise long-term capital by issuing securities to the public in the form of initial public offerings or addition issue of stocks.

6.5 The performance of the DSE

This study found that the establishment of DSE in 1998 marked an important milestone in the effort toward the development of a functioning capital market for the mobilization and allocation of long-term capital to the private sector. By December 31, 1999, four companies[1] have been listed on the DSE. Three of these companies have raised a combined equity capital of TShs 28.57 billion (an equivalent of US$35.71 million) in the primary capital market. The fourth company, East African Development Bank has raised an amount of TShs 10 billion (an equivalent of US$12.5 million) through the issue of a four-year corporate bond.

In terms of individual performance, TBL was more successful in raising long-term capital on the DSE than TOL and TATEPA. However, compared with the capital structure of the company, this constitutes a very small portion of TBL's capital base. The capitalization of the other two equity-issuing companies also compared unfavorably with other listed firms in other SSA exchanges. The problem of illiquidity, infrequency of trading, and slow settlement are some of the drawbacks of the experience of the DSE.

6.6 Investment yield

Portfolio theory postulates that two major factors that affect the attractiveness of investments are the yields (return) and risk on investment. Generally, yields on equity securities are considered riskier than yields on deposits and government securities. As a result, investors may be attracted to invest in equity securities as long as the risk-adjusted return on the security is higher than the yield on government securities and bank deposits.

In the first year of its operations, the return on investment for TBL amounted to 44%. This comprised capital gains and annual dividend payment on the equity investment. This return for one year compared very favorably with interest earnings on bank deposits and yields on Treasury

---

[1] Three of these companies are equity companies - TOL Ltd, (TOL), Tanzania Brewery Ltd (TBL), Tanzania Tea Packers (TATEPA). The fourth company is a fixed bond issuing company - East African Development Bank (EADB).

bills. However, lack of data would not permit a computation of risk-adjusted yield on TBL's annual return during its first and second year of operations.

On the other hand, the performance of TOL has not been encouraging. Its share price fell over 50 percent from its initial pricing. In addition, its turnover has been quite low and the number of deals was very small (only 67 compared with 390 for TBL). The total number of shares of 107,890 also compared unfavorably with that of 180,000 for TBL. Thus, the performance of TOL's in the first year of operation may not provide adequate returns to its shareholders. TATEPA is another profitable company listed on the DSE in 1999. At an IPO price of TShs 330 with a cash dividend of TShs 25 per share, the annual return on the stock was about 15% in the first year of operations.

Thus, the only poorly performing company, in terms of return on equity was TOL. Some of the reasons that explain the poor performance of TOL may be due to internal problems and high leverage or high debt ratio. The company has suffered internal managerial and financial problems as well as declining markets for most of its products. There is currently much pressure on management for efficiency and corporate accountability.

A review of financial statements of the two listed companies prior to their listing indicates that while TOL had most of its long term financing from debt issues, TBL had less leverage in terms of debt as a share of equity. Prior to listing, less than 5% of financing of Tanzania Breweries Ltd. (TBL) was long term debt financing. TBL's retained earnings accounted for about 26% in 1995 and 35% in 1996 and 43% in 1997. On the other hand, loan financing by Tanzania Oxygen Limited (TOL) was more than 70% of the firm's long-term funds. Owner's equity accounted for less than 30%.

6.7 The private sector and stock exchange performance

Previous research shows that the development of a viable capital market depends on a viable private sector firms that are willing to participate in the stock exchange in the form of listing firms to raise long-term capital. A viable and developed capital market relies on individuals, institutions, and corporate demand for securities issued in the capital market. These institutions include institutional investors, insurance companies, financial institutions, mutual funds, pension funds, and other corporate bodies.

The results of our survey confirmed that the demand for securities in Tanzania is affected by various factors that have been identified in other studies. These include the level of income of the local population, perception of risk in the market, tax considerations, and attractiveness of yields on capital market products as compared with alternative investment products. The level of public confidence in the financial sector also affects the demand for securities in the stock exchange.

Our survey results show that out of 46 employees interviewed, only 4.3% indicated that they had bought shares in the DSE. This represents a small percentage of individual participation in the stock exchange. This compares very unfavorably with the Ghana Stock Exchange, which saw greater participation by individual investors. However, this finding is not surprising given the short duration of the exchange, the limited number of products, and the infancy of the stock exchange.

In terms of their sources of income for investment in the stock exchange, about 57% indicated that their sources of funds for investing were borrowed funds and 28.6% were withdrawals from individual bank accounts.

In order to gain some insight into the reasons why some potential investors may not want to invest in the stock market, questionnaires were designed to elicit the above information. For those who did not participate in the stock exchange, the majority (60%) indicated that even though they heard about the stock exchange, they could not invest in the stock exchange because of low income. Ten percent indicated that the stock market is too risky and could lead to loss of capital. Another ten percent indicated that most companies in Tanzania are privately owned and would not want to be listed on the exchange. This implied that individuals might be willing to invest in particular companies if they were listed on the DSE.

A follow-up questionnaire to employees of firms about their willingness to buy their own companies if they were ever listed on the DSE got an encouraging response. Out of 146 respondents, 74% indicated that they would be willing to buy shares in their company if the company were to list shares on the DSE. This result also compares favorably with the results from Ghana. This has an important policy implication for the introduction of employee stock ownership (ESOP), especially with viable non-parastatals that are about to be privatized. Opinion gathered from the respondents about the perceived gains from participating in the stock market varied. All seven who responded to this question believed there is greater gain in the stock market. However, a greater majority of respondents believed that investment in Treasury Bills offers greater opportunity for higher yields. In terms of publicity and public education about the desirability of investing in the stock exchange, about 67% indicated that they were aware of the existence of the DSE. In terms of receiving information about the DSE, the study found that television advertisement ranked highest (31%), followed by newspaper and radio advertisement. Information brochures and posters about the DSE have also served as important sources of educating the public about the stock exchange and its importance of accumulating investment earnings.

The survey questionnaire results also show that out of 146 respondents, more than 46 percent lacks confidence in the financial system, 50% had moderate confidence while only 4.9% expressed high confidence in the financial system. In response to a follow-up question on the above topic, 65% of the respondents believed that the most important reasons for lack of confidence in the financial markets is the depreciating value of the Tanzanian shilling against foreign currencies.

The survey results also revealed that investors might not be attracted to the stock exchange because of limited investor awareness of the DSE because of its infancy, lack of adequate investment instruments, lack of adequate tax incentives[2], and lack of confidence in the financial system. However, the researchers recognized that most of the above problems of the DSE could

[2] Tax differentials on interest income on securities and savings deposit and government Treasury bills provide better incentives for investing in Treasury bills rather than securities on the DSE.

be attributed to its infancy. It is expected that with time, those problems would be resolved. The introduction of new products through privatization and introduction of debt instruments would enhance its attractiveness. The government's policy of tax incentives and fiscal discipline would also enhance the confidence of investors in the DSE.

6.8 The Challenges of Regionalization and Globalization of Capital Markets

As has been discussed earlier, one of the challenges of capital markets in SSA is the ability to mobilize long-term financial resources for allocation to the private sector for growth and poverty alleviation. However, in the age of capital market globalization and regionalization, greater benefits are realized through regional and global integration of capital markets.

Survey results indicate that respondents favor some level of regionalization and globalization of the Tanzania capital market. The survey results show that a major benefit of capital market regionalization and globalization is the possibility of greater inflow of foreign capital to the domestic capital market. The results revealed that as globalization proceeds, Tanzanian capital market operators would share the wealth of experience from the rest of the world on managing capital market institutions. Globalization is seen therefore as a source of better knowledge of how capital markets are efficiently managed.

It is also suggested that capital market globalization and regional integration would lead to improved market liquidity. Absorption capacity would increase leading to greater demand for products trading on the market and hence greater volume of activities. Globalization would also mean that Tanzanian participants would have access to international assets.

Globalization of the capital markets would also lead to opening of Tanzanian capital markets to the outside world. This would result in the integration of the Tanzanian economy into the world economic system. Instead of relying on government-borrowed funds and economic aid from donor countries, globalization would attract foreign inflows of capital and the elimination of inefficient operations. International capital markets would direct international capital to firms and sectors of the economy where they can be utilized more efficiently.

The respondents argue that globalization of capital markets would stimulate productivity, efficiency, and economic growth. It also means that Tanzanian firms would be able to compete globally for financial resources. As presented earlier, only the efficient firms would have access to international capital products. This will lead to improvements in corporate governance leading to better utilization of resources and ultimately economic growth.

The survey results also show that globalization and regionalization would promote confidence in the Tanzanian market. This would enable domestic firms to access cheaper financial resources, improve employment opportunities and lead to free movement of capital.

While we acknowledge significant benefits of globalization of capital markets, this study also raised caution flags. The respondents argue that without proper monetary control mechanism, globalization of capital markets could lead to foreign domination. More sophisticated and developed capital markets are likely to benefit at the expense of less developed capital markets like the Tanzanian capital market. They argued that in a global capital market, unfair market practices cannot be ruled out unless efforts are made to prevent them. They also pointed out that globalization of capital markets may thwart the development of domestic capacity for participation in the market. The growth of wide share ownership in the domestic market may also be jeopardized.

All respondents saw the possibility for increased capital flight when capital markets are globalized. Some argued that when capital markets are globalized, firms that are more efficient are likely to attract domestic resources abroad. The potential capital gains and dividends on investments attract more foreign investors. When these are exported abroad, significant financial resources could flow abroad. Furthermore, the experience of Asia has shown that foreign investors can depart abruptly when there are signs of increased risk or better opportunities in other capital markets abroad. They see the possibility of Tanzania being a net capital exporter when capital markets are globalized.

Other negative issues pointed out by respondents are greater opportunities for money laundering accompanying the globalization of capital markets. However, we could not find any evidence to support the above finding.

In the light of these issues presented above, the respondents suggested gradual approach to globalization of capital markets in Tanzania.

The respondents suggested that in the initial stages of regional integration and globalization, policies should be adopted to encourage national priorities. They suggested further that incentives should be devised to encourage market participants to behave in a manner consistent with national interests and priorities. However, in order to undertake the regionalization and globalization[3] of domestic capital markets, the following pre-requisites have been suggested:

a) Improve the environment for the capital markets:

- Adopt sound and consistent economic policies to assist in building up confidence in the capital markets
- Create a framework for assisting domestic market participants
- Institute a sound regulatory framework
- Promote wide share ownership
- Gradual removal of all economic barriers to share ownership

b) Build capacity for domestic participation:

- Improve corporate governance of domestic firms

[3] We would like to point out that the Tanzania capital market has been gloabalized to some extent as an evidence of the presence of some international financial institutions operating in the country. However, regionalization and globalization being conceived envisage the ability of cross-listing of domestic shares in international capital markets for capital market deepening in the domestic capital market.

- Institute incentives for domestic firms to go public
- Improve capital market infrastructure. This would include encouraging market facilitators such as investment advisors to emerge.
- Public education should aim at encouraging wide participation, elevating the level of sophistication of domestic investors.
- Create new products which will enable domestic participants, especially low-income earners to invest in the stock exchange. For example, mutual funds can be created to spread wide ownership of securities in the stock market.

c) Harmonize economic conditions:

In order to harmonize economic conditions in the various regions, the following issues need to be addressed before any plans for regional integration should be seriously considered:

- Currency convertibility
- Harmonization of taxation and fiscal policies of the various regions
- Access to bank loans
- Control of corruption and money laundering
- Infrastructure improvement
- Guard against unfair competition practices

d) In addition, the following sequence of regionalization and globalization of capital markets of the Tanzania capital market has been suggested as follows:

- Globalization of capital markets must be preceded by sound and stable economic policies
- Regional integration of the domestic market must precede globalization of capital markets
- Economic conditions in the regional groupings must be harmonized
- Economic barriers must gradually be removed
- Education programs must be devised to promote wide participation in capital markets and elevate the level of sophistication
- Capital market infrastructure must be improved
- Currency convertibility should be implemented at the national level to encourage cross-border trades and international settlement of stock trades
- Removal of political risk by promoting stable political systems to ensure confidence in the capital markets

6.9 Linkage between capital market development and real sector growth

As it has been pointed out in the earlier discussions, long-term capital constraints have been one of the major impediments to growth and poverty alleviation in Sub-Saharan Africa. Previous studies have established the positive correlation between credit extension and real sector growth.

Thus, the establishment of a functioning securities market has been considered an important development toward the promotion of long-term capital supply to the private sector for growth and poverty alleviation. This study attempts to examine the relation between the proxies of capital market development and real sector growth in Tanzania.

Earlier studies reviewed by Levine (1997) use various proxies of capital market development to include (a) liquid liabilities held by the public (DEPTH), (b) credit provided to the private sector by the banking sector as a ratio of total bank credit plus central bank credit (BANK), (c) credit to the private sector divided by total credit (PRIVATE), and (d) credit to the private sector divided GDP. However, in view of limited data, this study relied on a limited number of capital market proxy to examine the above relationship.

Real GDP growth has been used as a measure of economic growth. Credit extension to the private sector has been used as a proxy for capital market development in Tanzania. Using correlation analysis, the study attempts to establish the degree of correlation between economic growth and capital market development.

The study found that in nominal terms, Tanzania experienced economic growth throughout the period beginning 1986 to 1998. This represents an annual growth rate of 3.61% of GDP during the same period. However, the study also shows that there has been a slight reduction in real GDP growth after the financial sector reform. Average annual real GDP growth between 1986 and 1991 was 5.05% as compared with an average annual real GDP growth of 2.58% (1992 - 1998).

In terms of credit allocation to the private sector over the above period, the study shows that the average annual growth in credit extension to the private sector dropped from 52.84% in the first period (1986 - 1991) to only 6.60 percent during the second period (1992 - 1998). It appears that the reduction in real GDP over the same period may have been due to the reduction of financial services to the private sector because of the financial sector reform and its prudential requirements.

Credit allocation across different sectors indicates that trade and other services absorbed most of the credit available. The share of credit allocation to the trade services sector declined 86% in 1986 to 55% in 1998. Mining and manufacturing registered a much higher growth rates in credit allocation followed by public administration, agriculture and transportation. Allocation of credit to business and construction has remained between 1 and 3% of the total credit.

Mining and manufacturing consumes a significant portion of credit (24% in 1998) while its contribution to GDP was only 11% during the same period. Trade services, which absorbed 55% of the total credit available in 1998, contributed 25% to GDP.

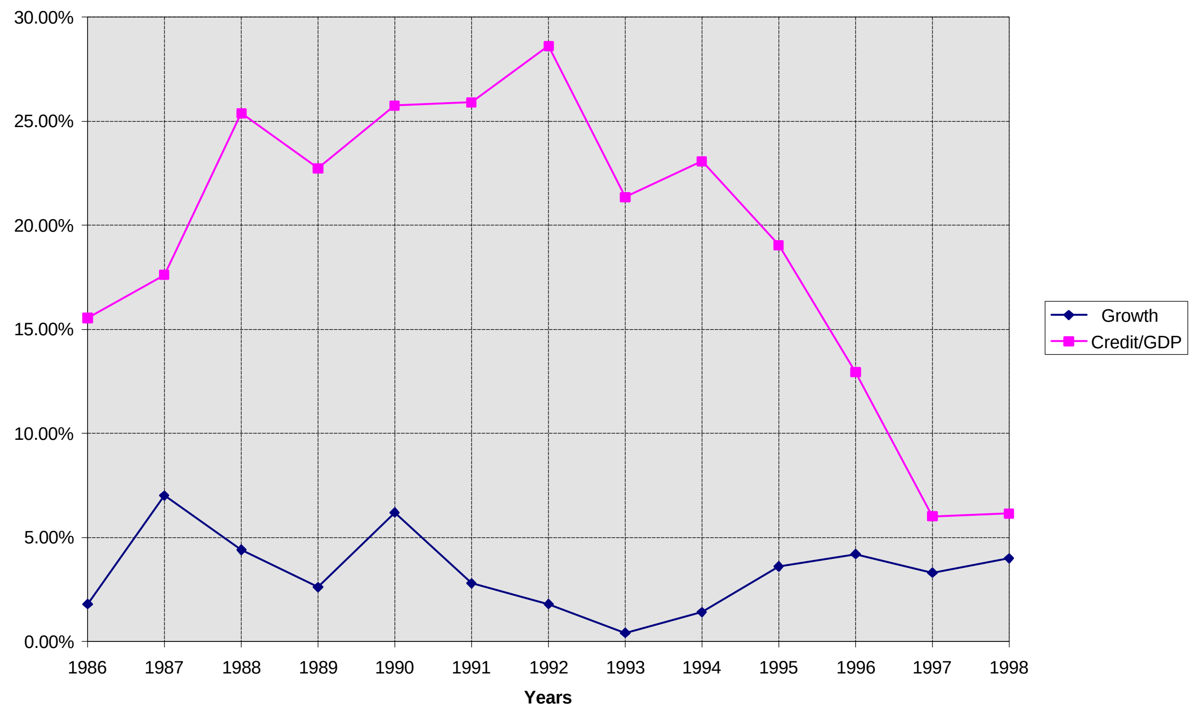
Responsiveness to credit allocation and output across different economic sectors was also reviewed. Agriculture was the dominant sector followed by trade services and public administration, mining/manufacturing, transportation, building, and construction. Despite the dominance of agricultural sector in the above period, the proportionate contribution to GDP declined from 44% (1986) to 35% (1998) during the same period. On the other hand, growth in output contributed by trade and services grew from 26% (1986) to 28% (1998). All sectors except transportation registered a strong positive correlation between credit and output during 1986 to 1992.

Chart 1 below shows the relationship between Credit/GDP and real GDP growth over the period from 1986 to 1998. For the greater part of the above period, the chart shows divergence between Credit/GDP and growth. However, a clear pattern emerged between 1994 and 1998 when negative relationships between Credit/GDP ratios was observed.

This study shows that the drastic decline in credit allocation to the private sector between 1994 and 1998 was not accompanied by a precipitous decline in real sector growth. The declining slope of Credit/GDP trend (between 1994 and 1998) was associated with an upward sloping growth trend during the same time period.

This relationship has policy implications. First, the negative relationship between credit and output between 1994 and 1998 may be due to the substantial loan write-offs by the two biggest public-owned banks - NBC and CRDB following the implementation of prudential regulations imposed as a part of financial sector reform. Thus, it is likely that the extent of credit extension to the private sector may have been underestimated. Secondly, the pattern of credit extension after reform may have resulted in efficiency of credit allocation to the private sector. As a result, this may have improved the marginal efficiency of credit allocation to the private sector. It may also reveal a resource gap in which case domestic production is being financed by foreign resources.

Chart 1: Relationship between Credit/GDP and GDP Growth Rates



For the entire period, the study shows a weak elasticity of change in real GDP to changes in credit of about 0.15%. This shows that a one-unit change in credit will lead to 0.15% increase in real GDP. Sectoral analysis also shows that the responsiveness of output to changes in credit differs from sector to sector. The study shows that the agriculture sector that contributes about one third of GDP indicates that there is no strong correlation between changes in credit and agricultural output. The sector with the stronger elasticity was trade services, which exhibits an elasticity of 0.18% changes in output to one percent changes in credit allocation to that sector. Other sectors with a high change in credit to a change in output responsive rates are: (a) transportation with an elasticity of 0.18% responsiveness to a 1% change in credit allocation. Mining and manufacturing registered an elasticity of 0.07% to 1% change in credit. The unexpected result of the study is the negative correlation between building and construction sector, which shows a negative correlation between credit allocation and output from that sector.

6.10 Equity, poverty alleviation, and strategies for capital market development for SMEs

The overriding objective of financial reform and capital market development is to ensure that financial services in terms of mobilization and allocation of credit to the productive sectors of the economy are enhanced. Thus, the anticipated goal is to increase long-term capital to the private sector for expansion of productive opportunities, which will increase the welfare of the people.

However, our study shows that financial sector liberalization and capital market development strategies have been accompanied by unintended consequences. These resulted in a new class of displaced workers, which has policy implications of social concerns of liberalization and poverty issues in SSA. None of earlier studies have addressed equity and poverty issues associated with capital market development and financial sector reform. To that extent, this study has contributed greatly to the understanding of social issues and policy implications of poverty alleviation following reforms in SSA countries in general and Tanzania in particular.

Thus, the question arises as to whether the policy changes have contributed to poverty increase. If so, what additional policy changes are necessary to alleviate poverty in the country? This study would like to point out that equity and poverty alleviation issues are policy concerns, which should be incorporated in the strategy for reform and capital market development. We admit that equity, in particular, did not readily feature in the instruments we used in the survey. However, a general analysis and observation of the stylized facts of the demographics of the Tanzanian population would show that the majority of the population in Tanzania is poor and live at subsistence levels. Thus, the low income of the majority of the population limits their participation in the formal capital markets. The situation is even worse in the rural areas where most of the residents live in abject poverty.

Thus, equity considerations would not only imply raising incomes in general (in urban and rural areas) but also designing policies that would give access to potential rural investors. This would require making the capital markets reach the rural folks. This requires heavy investments in physical infrastructure (roads, telecommunications, financial institutions, and information media), which at the present, are biased in favor of urban areas.

It is conceivable to suggest that the stock market would provide an opportunity for individual investors to diversify their risk and at the same time to maximize their returns by their ownership of private corporations. On the other side, one can also argue that income limitations will preclude the majority of the population, especially the poor from benefiting from the stock exchange.

In terms of raising long-term capital through the issue of securities, data shows that the structure of most stock exchanges in SSA including Ghana and Tanzania are not well suited for small enterprises to raise capital. Unlike the U.S. for example where the existence of capital markets for small and medium enterprises enable small and growth companies to raise capital, such institutions that specialize in providing credit to small and medium-sized enterprises are not available in Tanzania. As a result, small and medium-sized enterprises and low-income people are marginalized in the formal capital markets.

A useful role for the government is to pursue a second-best strategy of developing financial products that may be suited for those small and medium enterprises that may not be able to raise credit in the securities market or the formal credit market. Such institutions may include the establishment of over-the-counter stock exchanges with fewer requirements for listing and raising of long-term capital in the formal capital market. In addition, government guaranteed programs through small business development centers may provide useful functions for financial intermediation that maybe suited to small and medium-sized firms.

We recognize the important role being played by some financial non-governmental organizations (NGOs) to engage in financial intermediation, credit extension, and promotion of income-generating ventures, which are aimed at fighting poverty in Tanzania. Seven of the NGOs that were surveyed provide loans, and the number of beneficiaries increased from 1052 in 1993 to 4,888 in 1997. Most of the beneficiaries are individuals who belong to women groups or co-operative groups.

The urban-based poor could take advantage of the growing financial and credit NGOs that seem to concentrate in the urban areas and are targeted to specific socio-economic groups, including women who are unemployed in the formal sector. Some of the NGOs have succeeded so far in penetrating into the informal sector thereby harnessing the economic potential that the formal sector would otherwise bypass.

Furthermore, the financial NGOs, more than the formal financial institutions, have penetrated into the informal sector. Fifty seven percent acknowledged working with the informal sector clientele. As such, these financial NGOs can possibly be another medium for poverty alleviation in Tanzania.

7. Conclusions, Policy Implications, and Recommendations

7.1 Conclusions

This study examines the problems of capital market development as a major constraint to growth and poverty alleviation in Sub-Saharan African in general and Tanzania in particular. It also examines the impact of the government's recent policy changes in terms of structural adjustment and financial sector reforms and how those policy changes affected the development of financial institutions that intermediate in the capital markets. The study also reviews other studies on capital market development in Sub-Saharan Africa and how they relate to the problems in Tanzania. Other issues that have been examined in this study include the prospects and challenges of regional and globalization of capital markets in Tanzania. The study also analyzed the policy implications of reforms on equity and poverty alleviation in Tanzania.

In order to examine the above issues, the study focused on various policy research questions as basis for administering survey questionnaires to capital market financial institutions and regulatory agencies to collect primary data for the analysis. Secondary data on financial, capital markets and macroeconomic data supplemented the primary data.

This study utilized parametric statistical analysis in testing various hypotheses that have been derived from the research questions. Based on the above analysis, this study found that the financial sector reform has led to more players in the capital market. The entry of more financial institutions in the financial sector set in motion a competitive banking environment. In addition, the financial resource mobilization has also shown some improvement as evidenced by increases in deposit growth. However, this deposit growth was not matched by increases in credit to the private sector.

Various reasons explain the above anomaly. The introduction of high-yield government short-term Treasury bills provides an alternative and attractive investment opportunity for commercial banks and other investors. As a result, commercial banks and other investors prefer to invest in short-term and relatively low risk Treasury bills. This has "crowded out" the private sector from the credit market. In addition, the restructuring of the banking sector in Tanzania has also put limits on credit extension to the private sector by the commercial banks.

The credit reversal has also been the result of the Central Bank's implementation of its prudential, regulatory, and supervisory functions. Bank of Tanzania's (BOT) imposition of lending restrictions to problem borrowers resulted in a sharp decline to parastatal enterprises, most of which had large non-performing loans. The restructuring of NBC, the biggest bank in the country also had a big impact on credit allocation to the private sector.

The establishment of the DSE has provided the opportunity for investors to transform their stock holdings into liquidity form when it is needed. In addition, the return on investments provides sufficient signals for investors to participate in raising long-term capital for expansion and growth. The stock exchange also provides adequate mechanism for efficient assignment of prices of the share values of underlying companies and thus closely evaluates managerial competence and good corporate governance.

However, even though the financial sector reform has had some positive impact on the financial sector in Tanzania, various problems confront the policy makers in terms of developing the capital market in Tanzania.

The payment system is still cash-based. Checks are not generally accepted as a medium of payments. There are long delays in the transfer of funds both within and between townships. In addition, there is the lack of competition within the financial sector. Such evidence includes the wide spread between the deposit and lending rates, which has on average been above 15% throughout the post - 1994 period. This suggests that financial prices do not adequately reflect market conditions and the cost of funds. An inappropriate interest rate structure is obviously likely to affect both stock prices and exchange rates, and thus the capital market generally.

The infancy of the capital market structure is also reflected in the fact that the Dar es Salaam Stock Exchange (DSE) has only recently been established. This signifies that the instruments for resource mobilization in the capital market are still few and in the process of formation.

The study also shows that the lack of investor awareness of the exchange, the problem of illiquidity, thinness of trading, and infrequency of trading limit the attractiveness of the stock exchange. The lack of absorption and low demand for stock exchange products also account for the low performance of the stock exchange. The government policy of favoring interest income on government securities also provides a disincentive for investing in the stock exchange in Tanzania. In the next section, we discuss the policy implications of the above problems and offer some policy recommendations.

7.2 Policy implications and recommendations

One of the major goals of the government's policy reform is to strengthen the banking sector in order to mobilize financial resources for allocation to the private sector. The increase in financial resources has been the direct result of the interest rate liberalization and legal reforms of the banking laws in Tanzania. However, this policy reform has not been accompanied by increased credit to the private sector. The direct impact of this policy reform is the reduction in the growth potential and poverty alleviation in Tanzania.

In order to alleviate the negative consequences of the above policy changes, the establishment of institutions that cater for credit needs of small and medium-sized firms are needed. This will include the establishment of small business development centers that would assist small enterprises in raising credit for business incubation, business planning, accounting, and control.

The role of government in creating an enabling environment has been demonstrated by the positive impact of the policy changes on the development of the private sector financial institutions, and instruments. The adoption of sound economic policies of inflation control, stable foreign exchange management, and balanced budget approach will enhance the confidence of the public.

In view of the infancy of the DSE and the lack of awareness by the majority of the population, much work and publicity is required to propagate the desirable attributes of the DSE. This requires the intensification of public education in order to promote investor awareness.

The lack of product diversification in the capital market provides dis-incentive for investing in the capital market. The introduction of new products through privatization and introduction of debt instruments are needed.

Open market monetary policies by the Bank of Tanzania have led to an inverted yield curve. This represents a situation where short-term yields are higher than long-term yields on long-term financial instruments or debt securities. This results from excess supply of short-term government securities, which drives up interest rates and drives down asset prices. This policy also has a tendency of crowding out the private sector from the capital market.

Government fiscal policies should be governed by synchronization of sources and uses of funds. This requires capital budgeting of government projects and issuing both long-term and short-term government securities. This is because the excessive reliance on short-term government securities to finance government operations has a tendency of exerting greater pressure on short-term interest rates. The balancing of short-term securities with long-term government bonds will take some pressure off short-term interest rates.

The liberalization of regulation on foreign participation in the domestic capital market has the potential of enhancing competition and inflow of foreign capital to the domestic capital market. However, an adoption of an inward-looking regulation that excludes foreigners from participation in the domestic capital market has a tendency of stifling competition and inhibiting foreign capital inflow into the domestic economy. Thus, an open policy to encourage foreign participation in the domestic capital market should be preferred to an inclusive policy that denies foreign participation in the domestic capital market. This may also address the problem of liquidity constraints and the limited absorption capacity of the stock exchange.

In view of the infancy of the DSE and the structure of the private firms in the country, it may be necessary to provide fiscal incentives to attract private firms to be listed on the DSE. The provision of tax incentives in the form of tax holidays to unlisted firms would encourage unlisted firms to be listed on the stock exchange.

The participation of private sector in the capital market is very crucial for capital market development. However, the government's policy of differential tax policies on interest income on Treasury bills and dividend on equity securities has a tendency of discouraging investment in equity securities. Equalization of tax policies on interest income on government securities and dividend on equity securities will provide a level-playing field for investors in the capital market.

The lack of technology in the form of communications, computer networks, equipment and manpower training imposes a major constraint to capital market development. Government's investment in capital market structures such as information technology, computer networks, communications, and capital market equipments would enhance the prospects of capital market development in Tanzania.

Regional integration and globalization of the capital market has its benefits and challenges. In addition to enhancing increased inflow of foreign capital, regional integration and globalization of the domestic capital markets has the potential of promoting efficiency of capital mobilization, efficient allocation, and corporate governance of domestic firms. However, capital market globalization has the dangers of capital flight, which may be the result of macroeconomic disequilibrium in the domestic capital market. The adoption of prudent fiscal and monetary policies are essential toward maintaining internal and external equilibrium in order to minimize the negative consequences of foreign shocks on the domestic economy.

The inability of reform to address capital constraints of the private sector, especially, small and medium-sized enterprises has policy implications on equity and poverty alleviation following financial sector reforms. In order to address the poverty situation in Tanzania, there is the need to improve access to long-term finance for small and micro-enterprises. It is our hope that the spin-off micro-finance institutions from the National Bank of Commerce will address the credit needs of the small enterprises in the country. In addition, the establishment of small business development centers and guaranteed project loans will go a long way in addressing the credit needs, employment, growth, and poverty alleviation of the majority of Tanzanians.

8. References

Abayo, A.G. (1993). Corporate Disclosure Requirements and the Stock Exchange. *The Tanzania Stock Exchange and Capital Market Initiative*, Volume II (1993).

ADB (African Development Bank (1997) Special Issue on "Financial Sector Reforms, Domestic Resource Mobilization and Investment in Africa" *African Development Review Vol. 9, No. 1*

Aryeetey, Ernest, Hemamala Hetige, Machiko Nissanke, and William Steel. (1997) *Financial Market Fragmentation and Reforms in Sub-Saharan Africa*, World Bank Technical Paper, No. 356, African Region Series, (1977).

Bank of Tanzania. (1996). *Economic and Operations Report for the Year Ended*, various issues.
Calamanti, A. (1983). "The Securities Markets and Underdevelopment: The Stock Exchange in the Ivory Coast, Morocco and Tunisia" *The Credit Markets of Africa Series***,** Finafrica Cariplo-Milan.

Cho, Yoon Je (1986). Inefficiencies from financial liberalization in the absence of well-functioning equity markets, *Journal of Money, Credit and Banking*, vol. 18, pp. 191-199

Demirguc-Kunt A. and Levine, R. (1993) "Stock market development and financial intermediary growth," *World Bank Working Papers WPS* 1159; Washington D.C.

Demirguc-Kunt A. and Levine, R. (1996) "Stock Markets, Corporate Finance and Economic growth: An Overview" *The World Bank Economic Review* 10 (2) pp. 223-40.

Emenuga, C. (1997). "Development of Stock Markets in Sub-Saharan Africa," *African Development Review* Vol. 9 No. 1 1997 June, pp. 156-85.

Feldman, R. A. and Kumar, M.S: (1995). Emerging Capital Markets: Growth, Benefits and Policy Concerns *The World Bank Economic Review,* Vol. 10, No. 2 1995, pp. 181-200

Fry, M. L. (1988). *Money, Interest, and Banking in Economic Development.* Baltimore: The Johns Hopkins University Press.

Gelb, A. H. (1989). "Financial Policies, Growth and Efficiency," *World Bank Working Paper* WPS 202.

Ghani, E. (1992). "How Financial Market Affect Long-run Growth: A Cross Country Study," *World Bank Working Paper WPS* 843.

Goopta, Sudarshan (1994). Are portfolio to Emerging countries Complementary or Competitive? *World Bank Policy Research Working Paper,* No. 1360, September.

Gurley, John, and Edward Shaw. (1955). *Financial Aspects of Development and Growth, American Economic Review*, (September): 515-38.

Inanga, E. L. and Emenuga, C. (1997). "Institutional, Traditional and Asset Pricing Characteristics of the Nigerian Stock Exchange," *AERC Research Paper.* No. 60

Jefferies, Keith (1995). The Botswana Share Market and Its Role in Financial and Economic Development: *World Development*, vol. 3, No. 4.

Johnston B.R and Pazarbasioglu C. (1995). "Linkages between Financial Variables, Financial Sector Reform and Economic Growth and Efficiency," *IMF Working Paper*, WP/95/103.

King R.G. and Levine R. (1993) "Finance, Entrepreneurship, and Growth: Theory and Evidence" *Journal of Monetary Economics*, 32: 513-42.

Levine R. and Zervos, S. (1996) "Stock market Development and Long-run Growth, *The World Bank Economic Review*, 10(2): pp. 323-40.

Levine, Ross (1997). Financial Development and Economic Growth: Views and Agenda, *Journal of Economic Literature*, June, pp. 68 - 726

Morck, R., Shleifer, A. and Vishney, RAW. (1990)."The Stock Market and Investment: Is the Market a Side-show?" *Brooking Papers on Economic Activity*: 2: 157-215

McKinnon, R.I. (1973). *Money and Capital in Economic Development***,** Washington D.C.: the Brooking Institution.

McKinnon, R.I. (1991). *The Order of Economic Liberalization: financial control in the transition to a market economy* Baltimore: The Johns Hopkins University Press.

Montiel, P. J. (1995) "Financial Policies and Economic growth: Theory, Evidence and Experience" *Journal of African Economies*, AERC Plenary Sessions 1994-95, Supplement to Vol. 5 No. 3 Part I.

Mugo, M. (1997) "Stock Market Development and Economic Growth: The Impact of Financial Sector Liberalization in Kenya", *Research Proposal to AERC*, Nairobi.

Ogwumike, F.O. and Omole, D.A. (1997). "Mobilizing Domestic Resources for Economic Development in Nigeria: The Role for the Capital Market" *AERC Research Paper No. 56***,** Nairobi.

Osei, K.A. (1998) "Analysis of the Factors Affecting the Development of an Emerging Capital Market: The Case of the Ghana Stock Exchange" *AERC Research Paper,* 76, Nairobi.

Page, John. (1994). The East Asian Miracle: Building a Basis for Growth, *Finance and Development* (March), 2-5.

Richards (1996). "Volatility and predictability in National Stock Markets: How do emerging and mature markets differ?" *IMF Staff Papers,* Vol. 43 No.3, pp: 461-501.

Shaw, E.S. (1973). *Financial Deepening in Economic Development***,** New York: Oxford University Press.

Soyibo, A. (1997). "Banking sector reforms in Africa: Effects on Savings, Investment and Financial Development," *African Development Bank,* (1997) Vol. 9 No. 1 op. cit.

Sunita, K., Nellis, J. and Shirley, M. (1994) "Privatization: Lessons from Market Economies," *The World Bank Research Observer***,** Vol.9 No. 2 pp. 241-72.

Turtleboom (1991). "Interest rate liberalization: some lessons from Africa***,"*** *IMF Working Paper,* WP/91/121.

Villanueva and Mirakhor (1990). "Strategies for financial reforms" *IMF Staff Papers,* Vol. 37, No. 3, pp. 509-536.

Senbet, W. Lemma, A Saunders (1992). Financial research on Africa: a Financial Theory Perspective, *Journal of African Finance and Economic Development*, vol. 1, No. 1. Pp. 1-23.

_________________. *Financial Regulation and Liberalization in Africa Under Incentive problem and Asymmetric Information, forthcoming in Financial Liberalization and Financial markets in Sub-Saharan Africa,* African Economic Research Consortium (AERC).

_________________. (1996). Perspectives on African Finance and Economic Development, *Journal of African Finance and Economic Development*, Spring 1996, vol. 2, No. 1. Pp. 1-23.

Wai, U. Tun and Hugh Patrick (1973). Stock and bond issues and capital markets in less developed countries, *IMF Staff Papers*, July.

World Bank. (1996). *Financial Market Fragmentation and Reforms in Sub-Saharan Africa.* Washington, DC.

To Order EAGER Publications

EAGER Publications/BHM
P.O. Box 3415
Alexandria, Virginia 22302
Tel: (703) 299-0650 Fax: (703) 299-0651
e-mail: spriddy@eagerproject.com

EAGER Publications can be downloaded from www.eagerproject.com or through USAID's website at www.dec.org

Policy Briefs based on EAGER research funded by the U.S. Agency for International Development:

1. Can Mali Increase Red Meat Exports? Metzel, Jeffrey, Abou Doumbia, Lamissa Diakite, and N'Thio Alpha Diarra. *Prospects for Developing Malian Livestock Exports*. Cambridge, MA: Associates for International Resources and Development, 1997. Available in French.

2. The Livestock Sector in Mali - Potential for the Future. Metzel, Jeffrey, Abou Doumbia, Lamissa Diakite, and N'Thio Alpha Diarra. *Prospects for Developing Malian Livestock Exports.* Cambridge, MA: Associates for International Resources and Development, 1997. Available in French.

3. Mali's Manufacturing Sector: Policy Reform for Success. Cockburn, John, Eckhard Siggel, Massaoly Coulibaly, and Sylvain Vézina. *Manufacturing Competitiveness and the Structure of Incentives in Mali.* Cambridge, MA: Associates for International Resources and Development, 1997. Available in French.

4. Growth and Equity: Gemstone and Gold Mining in Tanzania. Phillips, Lucie Colvin, Rogers Sezinga, Haji Semboja, and Godius Kahyarara. *Gemstone and Gold Marketing for Small-Scale Mining in Tanzania.* Arlington, VA: International Business Initiatives, 1997. Available in French.

5. Financial Services and Poverty in Senegal. Ndour, Hamet, and Aziz Wané. *Financial Intermediation for the Poor*. Cambridge, MA: Harvard Institute for International Development, 1997. Available in French.

6. Need to Promote Exports of Malian Rice. Barry, Abdoul W., Salif B. Diarra, and Daouda Diarra. *Promotion of the Regional Export of Malian Rice.* Cambridge, MA: Associates for International Resources and Development, 1997. Available in French.

7. Trade Policy Reform: A Success? Metzel, Jeffrey, and Lucie C. Phillips. *Bringing Down Barriers to Trade: The Experience of Trade Policy Reform.* Cambridge, MA: Associates for International Resources and Development, 1997. Available in French.

8. Excise Taxes: A Greater Role in Sub-Saharan Africa? Bolnick, Bruce, and Jonathan Haughton. *Tax Policy in Sub-Saharan Africa: Reexamining the Role of Excise Taxation.* Cambridge, MA: Harvard Institute for International Development, 1997. Available in French.

9. Status of Financial Intermediation for the Poor in Africa. Nelson, Eric. *Financial Intermediation for the Poor: Survey of the State of the Art.* Bethesda, MD: Development Alternatives Incorporated, 1997. Available in French.

10. Foreign Direct Investment and Institutions. Wilhelms, Saskia K.S. *Foreign Direct Investment and Its Determinants in Emerging Economies*. Cambridge, MA: Associates for International Resources and Development, 1997. Available in French.

11. Strong Institutions Support Market-Oriented Policies. Goldsmith, Arthur. *Institutions and Economic Growth in Africa.* Cambridge, MA: Harvard Institute for International Development, 1997. Available in French.

12. Reducing Tax Evasion. Wadhawan, Satish, and Clive Gray. *Enhancing Transparency in Tax Administration: A Survey*. Cambridge, MA: Harvard Institute for International Development, 1997. Available in French.

13. Can Africa Take Lessons from the U.S. Approach to Tax Evasion? Gray, Clive. *Enhancing Transparency in Tax Administration: United States Practice in Estimating and Publicizing Tax Evasion.* Cambridge, MA: Harvard Institute for International Development, 1997. Available in French.

14. Estimating Tax Buoyancy, Elasticity and Stability. Haughton, Jonathan. *Estimating Tax Buoyancy, Elasticity, and Stability.* Cambridge, MA: Harvard Institute for International Development, 1997. Available in French.

15. Estimating Demand Curves for Goods Subject to Excise Taxes. Jonathan Haughton. *Estimating Demand Curves for Goods Subject to Excise Taxes.* Cambridge, MA: Harvard Institute for International Development, 1997. Available in French.

16. Fixed or Floating Exchange Rates? Amvouna, Anatolie Marie. *Determinants of Trade and Growth Performance in Africa: A Cross-Country Analysis of Fixed Versus Floating Exchange Rate Regimes.* Cambridge, MA: Associates for International Resources and Development, 1997. Available in French.

17. Trade and Development in Africa. Stryker, J. Dirck. *Trade and Development in Africa.* Cambridge, MA: Associates for International Resources and Development, 1997. Available in French.

18. Increasing Demand for Labor in South Africa. Stryker, J. Dirck, Fuad Cassim, Balakanapathy Rajaratnam, Haroon Bhorat, and Murray Leibbrandt. *Increasing Demand for Labor in South Africa.* Cambridge, MA: Associates for International Resources and Development, 1998.

19. Structural Adjustment: Implications for Trade. Barry, Abdoul W., B. Lynn Salinger, and Selina Pandolfi. *Sahelian West Africa: Impact of Structural Adjustment Programs on Agricultural Competitiveness and Regional Trade.* Cambridge, MA: Associates for International Resources and Development, 1998. Available in French.

20. The Uruguay Round: Impact on Africa. Hertel, Thomas W., William A. Masters, and Aziz Elbehri. *The Uruguay Round and Africa: A Global, General Equilibrium Analysis.* Cambridge, MA: Associates for International Resources and Development, 1998. Available in French.

21. Are Formal Trade Agreements the Right Strategy? Radelet, Steven. *Regional Integration and Cooperation in Sub-Saharan Africa: Are Formal Trade Agreements the Right Strategy?* Cambridge, MA: Harvard Institute for International Development, 1997.

22. Textiles in South Africa. Flaherty, Diane P., and B. Lynn Salinger. *Learning to Compete: Innovation and Gender in the South African Clothing Industry.* Cambridge, MA: Associates for International Resources and Development, 1998. Available in French.

23. Barriers to Business Expansion in a New Environment: *The Case of Senegal.* Beltchika-St. Juste, Ndaya, Mabousso Thiam, J. Dirck Stryker, with assistance from Pape Ibrahima Sow. *Barriers to Business Expansion in a New Environment: The Case of Senegal.* Cambridge, MA: Associates for International Resources and Development, 1999. Available in French.

24. Government and Bureaucracy. Goldsmith, Arthur. *Africa's Overgrown State Reconsidered: Bureaucracy and Economic Growth*. Cambridge, MA: Harvard Institute for International Development, 1998.

25. What Can We Do To Stop Smuggling in Tanzania? Phillips, Lucie Colvin, Rogers Sezinga, and Haji Semboja. Based on EAGER research in Tanzania on gold and gems marketing. Arlington, VA: International Business Initiatives, 1997.

26. Financial Programming in East and Southern Africa. Workshop held in Lilongwe, Malawi. June, 1999.

27. Restarting and Sustaining Growth and Development in Africa: A Framework for Action. Duesenberry, James S., Arthur A. Goldsmith, and Malcolm F. McPherson. *Restarting and Sustaining Growth and Development in Africa*. Cambridge, MA: Harvard Institute for International Development, 2000.

28. Restarting and Sustaining Growth and Development in Africa: Enhancing Productivity. Duesenberry, James S., Arthur A. Goldsmith, and Malcolm F. McPherson. *Restarting and Sustaining Growth and Development in Africa.* Cambridge, MA: Harvard Institute for International Development, 2000.

29. A Pragmatic Approach to Policy Change. Duesenberry, James S., and Malcolm F. McPherson. *Restarting and Sustaining Growth and Development in Africa: The Role of Macroeconomic Management.* Cambridge, MA: Harvard Institute for International Development, forthcoming in 2000.

30. Finance Capital and Real Resources. Duesenberry, James S., and Malcolm F. McPherson. *Restarting and Sustaining Growth and Development in Africa: The Role of Macroeconomic Management.* Cambridge, MA: Harvard Institute for International Development, forthcoming in 2000.

31. The Role of Central Bank Independence in Improved Macroeconomic Management. Duesenberry, James S., and Malcolm F. McPherson. *Restarting and Sustaining Growth and Development in Africa: The Role of Macroeconomic Management.* Cambridge, MA: Harvard Institute for International Development, forthcoming in 2000.

32. Governance and Macroeconomic Management. Duesenberry, James S., and Malcolm F. McPherson. *Restarting and Sustaining Growth and Development in Africa: The Role of Improved Macroeconomic Management.* Cambridge, MA: Harvard Institute for International Development, 2000.

33. The Benefits and Costs of Seignorage. McPherson, Malcolm F. *Seignorage in Highly Indebted Developing Countries.* Cambridge, MA: Harvard Institute for International Development, 2000.

35. Global Trade Analysis for Southern Africa. Masters, William A. Based on EAGER research in Southern Africa. West Lafayette, IN: Purdue University, 2000.

36. Modeling Long-Term Capacity Expansion Options for the Southern African Power Pool (SAPP). Sparrow, F. T., Brian H. Bowen, and Zuwei Yu. *Modeling Long-Term Capacity Expansion Options for the Southern African Power Pool (SAPP).* West Lafayette, IN: Purdue University, 1999.

38. Africa's Opportunities in the New Global Trading Scene. Salinger, B. Lynn, Anatolie Marie Amvouna, and Deirdre Murphy Savarese. *New Trade Opportunities for Africa.* Cambridge, MA: Associates for International Resources and Development, 1998. Available in French.

39. Implications for Africa of Initiatives by WTO, EU and US. Plunkett, Daniel. *Implications for Africa of Initiatives by WTO, EU and US.* Cambridge, MA: Associates for International Resources and Development, 1999.

40. Domestic Vanilla Marketing in Madagascar. Metzel, Jeffrey, Emilienne Raparson, Eric Thosun Mandrara. *The Case of Vanilla in Madagascar.* Cambridge, MA: Associates for International Resources and Development, 1999.

41. The Transformation of Microfinance in Kenya. Rosengard, Jay, Ashok S. Rai, Aleke Dondo, and Henry O. Oketch. *Microfinance Development in Kenya: Transforming K-Rep's Microenterprise Credit Program into a Commercial Bank.* Cambridge, MA: Harvard Institute for International Development, 1999.

42. Africans Trading with Africans: Cross-Border Trade – The Case of Ghana. Morris, Gayle A., and John Dadson. *Ghana: Cross Border Trade Issues.* Arlington, Virginia: International Business Initiatives, 2000.

43. Trade Liberalization and Growth in Kenya. Glenday, Graham, and T. C. I. Ryan. Based on EAGER Research. Cambridge, MA: Belfer Center for Science & International Affairs, 2000.

46. Labor Demand and Labor Productivity in Ghana. Gyan-Baffour, George, and Charles Betsey, in collaboration with Kwadwo Tutu and Kwabia Boateng. *Increasing Labor Demand and Labor Productivity in Ghana.* Cambridge, MA: Belfer Center for Science & International Affairs, 2000.

47. Foreign & Local Investment in East Africa. Phillips, Lucie C., Marios Obwona, Margaret McMillan, with Aloys B. Ayako. *Foreign and Local Investment In East Africa, Interactions and Policy Implications: Case Studies on Mauritius, Uganda and Kenya*. Arlington, Virginia: International Business Initiatives, 2000.

48. Does it pay to court foreign investment? Phillips, Lucie C., Marios Obwona, Margaret McMillan, with Aloys B. Ayako. *Foreign and Local Investment in East Africa: Interactions and Policy Implications*. Arlington, Virginia: International Business Initiatives, 2000.

49. Ethnicity & Investment Promotion: A Thorny Path for Policy Makers. Phillips, Lucie C., Marios Obwona, Margaret McMillan, with Aloys B. Ayako. *Foreign and Local Investment in East Africa: Interactions and Policy Implications*. Arlington, Virginia: International Business Initiatives, 2000.

50. Monetary and Exchange Rate Policy in Uganda. Musinguzi, Polycarp, with Marios Obwona, and J. Dirck Stryker. *Monetary and Exchange Rate Policy in Uganda*. Cambridge, MA: Associates for International Resources and Development, 2000.

African Economic Policy Discussion Papers

1. Kähkönen, S., and P. Meagher. July 1998. *Contract Enforcement and Economic Performance.* Available in French.

2. Bolnick, B., and J. Haughton. July 1998. *Tax Policy in Sub-Saharan Africa: Examining the Role of Excise Taxation.* Available in French.

3. Wadhawan, S. C., and C. Gray. July 1998. *Enhancing Transparency in Tax Administration: A Survey.* Available in French.

4. Phillips, L. C. July 1998. *The Political Economy of Policy Making in Africa.*

5. Metzel, J., and L. C. Phillips. July 1998. *Bringing Down Barriers to Trade: The Experience of Trade Policy Reform.* Available in French.

6. Salinger, B. L., A. M. Amvouna, and D. M. Savarese. July 1998. *New Trade Opportunities for Africa.* Available in French.

7. Goldsmith, Arthur. July 1998. *Institutions and Economic Growth in Africa.* Available in French.

8. Flaherty, D. P., and B. L. Salinger. July 1998. *Learning to Compete: Innovation and Gender in the South African Clothing Industry.*

9. Wilhelms, S. K. S. July 1998. *Foreign Direct Investment and Its Determinants in Emerging Economies.* Available in French.

10. Nelson, E. R. August 1998. *Financial Intermediation for the Poor: Survey of the State of the Art.* Available in French.

11. Haughton, J. August 1998. *Estimating Tax Buoyancy, Elasticity, and Stability.*

12. Haughton, J. August 1998. *Estimating Demand Curves for Goods Subject to Excise Taxes.*

13. Haughton, J. August 1998. *Calculating the Revenue-Maximizing Excise Tax.*

14. Haughton, J. August 1998. *Measuring the Compliance Cost of Excise Taxation.*

15. Gray, C. August 1998. *United States Practice in Estimating and Publicizing Tax Evasion.*

16. Cockburn, J., E. Siggel, M. Coulibaly, and S. Vézina. August 1998. *Measuring Competitiveness and its Sources: The Case of Mali's Manufacturing Sector.* Available in French.

17. Barry, A. W., S. B. Diarra, and D. Diarra. April 1999. *Promotion of Regional Exports of Malian Rice.* Available in French.

18. Amvouna, A. M. July 1998. *Determinants of Trade and Growth Performance in Africa: A Cross-Country Analysis of Fixed verus Floating Exchange Rate Regimes.* Available in French.

19. Stryker, J. D. June 1999. *Dollarization and Its Implications in Ghana.* Available in French.

20. Radelet, S. July 1999. *Regional Integration and Cooperation in Sub-Saharan Africa: Are Formal Trade Agreements the Right Strategy?*

21. Plunkett, D. September 1999. *Implications for Africa of Initiatives by the WTO, EU and US.*

22. Morris, G. A. and J. Dadson. March 2000. *Ghana: Cross-Border Trade Issues.*

23. Musinguzi, P., with M. Obwona and J. D. Stryker. April 2000. *Monetary and Exchange Rate Policy in Uganda.*

24. Siggel, E., and G. Ssemogerere. June 2000. *Uganda's Policy Reforms, Industry Competitiveness and Regional Integration: A comparison with Kenya.*

25. Siggel, E., G. Ikiara, and B. Nganda. June 2000. *Policy Reforms, Competitiveness and Prospects of Kenya's Manufacturing Industries: 1984-1997 and Comparisons with Uganda.*

26. McPherson, M. F. July 2000. *Strategic Issues in Infrastructure and Trade Policy.*

27. Sparrow, F. T., B. H. Bowen, and Z. Yu. July 1999. *Modeling Long-Term Capacity Expansion Options for the Southern African Power Pool (SAPP).* Available in French.

28. Goldsmith, A., M. F. McPherson, and J. Duesenberry. January 2000. *Restarting and Sustaining Growth and Development in Africa.*

29. Gray, C., and M. F. McPherson. January 2000. *The Leadership Factor in African Policy Reform and Growth.*

30. Masters, W. A., R. Davies, and T. W. Hertel. November 1998 revised June 1999. *Europe, South Africa, and Southern Africa: Regional Integration in a Global Context.* Available in French.

31. Beltchika-St. Juste, N., M. Thiam, J. D. Stryker, with assistance from P. I. Sow. 1999. *Barriers to Business Expansion in a New Environment: The Case of Senegal.* Available in French.

32. Salinger, B. L., D. P. Flaherty, and M. Keswell. September 1999. *Promoting the Competitiveness of Textiles and Clothing Manufacture in South Africa.*

33. Block, S. A. August 1999. *Does Africa Grow Differently?*

34. McPherson, M. F. and T. Rakovski. January 2000. *A Small Econometric Model of the Zambian Economy*.

37. Barry, A. W., Salinger, B. L., and S. Pandolfi. December 2000. *Sahelian West Africa: Impact of Structural Adjustment Programs on Agricultural Competitiveness and Regional Trade*.

40. Bräutigam, D. July 2000. *Interest Groups, Economic Policy, and Growth in Sub-Saharan Africa*.

43. Glenday, G., and D. Ndii. July 2000. *Export Platforms in Kenya*.

44. Glenday, G. July 2000. *Trade Liberalization and Customs Revenues: Does trade liberalization lead to lower customs revenues? The Case of Kenya*.

46. Goldsmith, A. June 2000. *Risk, Rule, and Reason in Africa*.

47. Goldsmith, A. June 2000. *Foreign Aid and Statehood in Africa*.

49. McPherson, M. F., and C. Gray. July 2000. *An 'Aid Exit' Strategy for African Countries: A Debate*.

51. Isimbabi, M. J. December 2000. *Globalization and the WTO Agreement on Financial Services in African Countries*.

53. McPherson, M. F., and C. B. Hill. June 2000. *Economic Growth and Development in Zambia: The Way Forward*.

56. McPherson, M. F., and T. Rakovski. July 2000. *Exchange Rates and Economic Growth in Kenya: An Econometric Analysis*.

57. McPherson, M. F. July 2000. *Exchange Rates and Economic Growth in Kenya*.

58. McPherson, M. F. July 2000. *Seignorage in Highly Indebted Developing Countries*.

67. Phillips, L. C., M. Obwona, M. McMillan, with A. B. Ayako. December 2000. *Foreign and Local Investment in East Africa: Interactions and Policy Implications*.

EAGER Research Reports

Cockburn, John, E. Siggel, M. Coulibaly, and S. Vézina. October 1998. *Measuring Competitiveness and its Sources: The Case of Mali's Manufacturing Sector*. Available in French.

McEwan, Tom et al. *A Report on Six Studies of Small, Medium and Micro Enterprise Developments in Kwazulu-Natal*.

McPherson, Malcolm F. *Sustaining Trade and Exchange Rate Reform in Africa: Lessons for Macroeconomic Management.*

Metzel, Jeffrey, A. Doumbia, L. Diakite, and N. A. Diarra. July 1998. *Prospects for Developing Malian Red Meat and Livestock Exports*. Available in French.

Phillips, Lucie C., M. Obwona, M. McMillan, with A. B. Ayako. December 2000. *Foreign and Local Investment In East Africa, Interactions and Policy Implications: Case Studies on Mauritius, Uganda and Kenya*.

Salinger, Lynn B., H. Bhorat, D. P. Flaherty, and M. Keswell. August 1999. *Promoting the Competitiveness of Textiles and Clothing Manufacture in South Africa.*

Sparrow, F. T., and B. H. Bowen. July 1999. *Modeling Electricity Trade in South Africa: User Manual for the Long-Term Model*.

Other Publications

McPherson, Malcolm F., and Arthur Goldsmith. Summer-Fall 1998. Africa: On the Move? *SAIS Review, A Journal of International Affairs*, The Paul H. Nitze School of Advanced International Studies, The John Hopkins University, Volume XVIII, Number Two, p. 153.

EAGER All Africa Conference Proceedings. October 18-20, 1999.

EAGER Regional Workshop Proceedings on the Implementation of Financial Programming. Lilongwe, Malawi. June 10-11, 1999.

EAGER Workshop Proceedings Senegal. November 4-6, 1998.

EAGER Workshop Proceedings South Africa. February 4-6, 1998.

EAGER Workshop Proceedings Tanzania. August 13-16, 1997.

EAGER Workshop Proceedings Ghana. February 5-8, 1997.

EAGER Workshop Proceedings. Howard University. July 17-19, 1996.

EAGER Workshop Proceedings Uganda. June 19-22, 1996.