The Global Financial Crisis and Developing Countries

An update of the monitoring work

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Tanzania

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The country's economic context

For about 10 years, Tanzania was among those sub-Saharan economies performing above the continent average economic growth rate and controlled inflation rate, before the effects of rising fuel and food prices and later the global crisis arrested this positive record. The country has also sustained stable and peaceful transformations from a centrally controlled economy and one-party rule to a market-determined economy and pluralistic democratic system. With growth projected at less than 5% in 2009 (compared with historical levels of above 7% per annum) and an inflation rate of about 10% (compared with below 6% in previous years), Tanzania is faced with multiple challenges of insulating itself from the crisis and preventing the erosion of gains made in social and economic spheres. The current efforts have to be translated into solving both supply- and demand-side constraints for the economy to have the required impetus to deliver optimum income generation and distribution. Sustained success is necessary for the country to achieve the Millennium Development Goals (MDGs) by 2015 and targets of a middle-income industrial economy between 2020 and 2025. Despite recent problems, the country has enough foreign exchange stock held by government, individuals and banks to support five to six months of imports.

Transmission mechanisms to Tanzania

A multi-stakeholder national conference was organised by government in early 2009 to assess the impact of the crisis and chart out mitigation plans. This identified impacts through: 1) export trade from Tanzania to the US, Europe and Asia in commodities, as exporters experience reduced demand for goods: raw (e.g. cotton, tanzanite) and finished (e.g. knitted garments) and services, through reduced demand for tourist attractions and education facilities, for example; 2) import trade from the rest of the world: erratic and escalating importation costs of goods and services; 3) reduced capital inflows (foreign direct investment (FDI)), including diaspora remittances; 4) reduced bank lending and other bank transactions owing to reduced business; and 5) exchange rate and interest rate changes.

Among the effects in export trade have been both reduced demand and declining markets for traditional agricultural commodities such as cotton (more than 130,000 bales of cotton lacked a market early this year). Equally affected were companies and cooperatives. The manufacturing sector recorded a drop in export revenue of about 50%, mostly cancelled apparel orders to the US. Tourism was affected by a 30-40% decline in sales. The mineral sector suffered a blow as the price of tanzanite fell by about 80%, prompting a freeze in its sales. Revenue collection was projected to fall short of the fiscal year plan by 10%, equivalent to TZS 0.473 trillion ($0.353 billion). FDI was affected, as evidenced by the delayed or scaling-down in or withdrawal of new investments. The major source of foreign investment in Tanzania continues to be the UK, followed by Kenya, South Africa and India.

Banking/ financial system and weakened international trading system

One of the major consequences of the failed banking and financial system in developed economies is tightening of lending rules and therefore narrowed access path and raised rates of borrowing by both Tanzanian and wholly or partially foreign-owned financial institutions in Tanzania, mostly affecting wholesale banking involving large long investment projects. The government has also postponed plans to use sovereign bonds for financing infrastructural projects, which had been identified as critical for stimulating pro-poor growth. The increased cost of borrowing has also affected export and import trade. By March 2009, CRDB Bank alone had suffered defaulted repayment worth TZS 168 billion. The global financial crisis provided a reason for further postponement in liberalising the capital account.

Shielding factors

The partial shielding is manifested through: 1) the low level of integration with the international capital and financial markets, whereby the foreign asset component in the commercial bank system is less than 11% of total commercial bank assets in Tanzania; and 2) ensuring that commercial banks in Tanzania are licensed, regulated and supervised under Tanzanian law, meaning they are not operating as branches of parent banks abroad but as independent subsidiaries. These factors have helped delay the impact of the first round, especially the fact that most businesses and banks had limited amounts of foreign borrowing and none held securities in the international banks that were affected by the crisis.

Impacts for different sectors of the economy

The Tanzania Investment Centre reported a 30% decline in the value of new investment projects applied during the first half of 2009. The country received $750 million in FDI in 2008, compared with $600 million recorded in 2007. Agriculture was the most vulnerable sector, followed by tourism and mining. On the other hand, while traders of traditional export commodities (e.g. cotton) had severe loan repayment problems, exporters of non-traditional crops (e.g. cashew nuts and simsim) managed to repay 74% and 68% of their loans, respectively. The decline in horticultural products export orders by 30% threatened the jobs of 50,000 Tanzanians already employed and earning Tanzania about $130,000 annually.

Domestic financial crisis mitigating actions

Tanzania's government response included a homemade rescue package of $1.23 billion (TZS 1.7 trillion) included in its 2009/10 budget, which included time-bound support to the banking sector and a hastened approach to reduce supply- and demand-side constraints to production, value addition and export trade. Priorities include sustaining investment in infrastructure development (roads, irrigation) and farmer income stabilisation (via enabled marketing coops/companies). By August 2009, some $6.85 million (TZS 21.9 billion) had been used to bail out companies through loan guarantees. Other strategies include recapitalisation of the Tanzania Investment Bank (with plans for an agriculture sector investment lending window) and maintaining fertiliser subsidy levels (to offset tripled world market prices). International support has come from the G-20 (which had promised to provide an additional $220 million to the government's rescue package), the International Monetary Fund (IMF) (for foreign reserve stabilisation) and the African Development Bank (AfDB) and the Chinese and US governments for agriculture and infrastructure development. The objective of the package is to ensure that the economic gains made during the past 10 years are not drastically eroded. In light of the urgency under which the country had to come up with solutions, it is difficult to say whether there would have been a better system to address the crisis, but what is obvious is that there was delayed action to institute measures to streamline government expenditure (e.g. purchase and use of luxury vehicles, encouraging use of locally made goods and redirecting input subsidy funds to public infrastructural goods as a way of solving supply constraints in rural areas).

Conclusion

One of the anchors of Tanzania's economic stability and resilience to the crisis will be to continue with pro-poor growth strategies, enhanced management of macroeconomic variables, prudent management of the banking and financial sector and mobilising domestic and international support to mitigate crisis impacts. This will entail maintaining fiscal stability via both revenue mobilisation and prudent expenditure management, and controlling the money supply to meet inflation and economic growth targets, as well as maintaining an adequate level of foreign exchange reserves. In the short and medium term, alleviating the critical infrastructure constraints in the transport, communications and energy sectors and establishing a mechanism for translating economic growth into broad-based poverty reduction are crucial. Equally important will be to sustain the credibility of both public and private sectors in good governance and improving the environment for doing business within the country and with the outside world.

The next stage of this work will be to analyse the various impact transmission mechanisms and provide an update on how the economy has been affected by the financial crisis and the responses by government and private sector.