

Private Sector Development in PRSPs: Stimulating market forces or increasing State interventions? The case of Tanzania¹

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Contents

Introduction

1. Is Private Sector Development integrated into the Poverty Reduction Strategy II?
2. Where are the proposed strategies for Private Sector Development leading to?
3. Outline of donor-financed activities in Tanzania

Bibliography

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¹ The following paper is a desk study of existing literature on behalf of the Swiss State Secretariat for Economic Affairs (seco).

Executive Summary

This paper goes further into the questions of to what extent Private Sector Development (PSD) has been integrated into the PRS(P)s of one of seco's GBS partner countries, and of whether the proposed strategies tend towards a withdrawal of the State from the market - through stimulating market forces, enabling framework conditions and improving the business environment - or whether they are accompanied by dirigiste State interventions, guidance of the private sector and the creation of additional parastatal institutions. An outline of donor-financed PSD activities will throw light on the orientation of international donors in this regard. The paper will focus on Tanzania as a pilot case study.

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Despite the internationally recognised commitment of the Tanzanian Government to enhancing the enabling environment for PSD, a closer look at the PRS II draft and the proposed strategies shows that, from a mere quantitative point of view, explicit and goal-oriented action to promote PSD is far below average, compared to the high importance of economic growth for poverty reduction in Tanzania, as well as the prominent mention of the private sector as the 'engine of economic growth' (Section 1).

A qualitative analysis of the proposed strategies for PSD and growth in PRS II (Section 2) reveals a certain ambiguity regarding the orientation of such strategies showing that PRS II does not unambiguously tend towards either a 'market-oriented' or a 'State-interventionist' approach to growth and the private sector. Proposed interventions, as well as official statements and declarations, offer a mixture of both. This outcome may be due to donors' perceptions of vested economic and political interests, a lack of coherence of strategies and coordination across Government, and the legacy of the socialist mindset impeding change. However, as Section 3 shows, main donors' interventions clearly support the market-oriented view of Tanzania's PRS and therefore assist Tanzania on its way towards a more liberal economic regime.

Introduction

In 2003, USAID reviewed the 27 existing PRSPs with regard to the role of Private Sector Development (PSD) in the PRSPs. One of the results is of particular interest: although *nearly all* countries accorded the private sector a role in poverty alleviation - usually in conjunction with sound macro-economic policies - *one-third* of them placed little faith in market forces as a tool for poverty reduction, typically seeing government as playing a leadership role, directing private sector activities in the most socially useful directions. In such cases, the private sector became an adjunct of government policy, with governmental directives guiding its development, and PRSPs indicating subsidies, directing credit, and preferential treatment for some enterprises or some sectors.

Benin, Cambodia, Ethiopia and Guyana are cases in point. All seek to promote the private sector by directing its development through government programmes. In the case of Benin, the government intends taking such actions as developing industrial estates and increasing the use of local building materials; and, more broadly, carrying out a PSD Programme that includes the supervision of privatised enterprises; strengthening the Centre for Business Support; implementing an Entrepreneurs' Training Project; arranging trailer parking and storage facilities; appointing a Private Sector Ombudsman; setting in place an Insurance Body, etc.

Hence, in assessing Poverty Reduction Strategies and Papers, it is important to distinguish between support for 'the private sector' and support for 'market forces'. The latter is more important, since 'support for the private sector' is a rather ambiguous phrase. One has to bear in mind, however, that economic growth per se, and particularly 'trickle-down effects', which in most cases are very weak, are not sufficient for lasting poverty reduction. Additionally, markets also 'fail'. Sustainable poverty reduction, therefore, requires targeted corrective action and selective government interventions, also in the market.

1. Is Private Sector Development integrated into the Poverty Reduction Strategy II?

In its draft version of PRS II, Tanzania has set ambitious goals for poverty reduction, which will require significant economic growth to finance the entailed additional government expenditures. In this regard, the PRS II draft recognises that high, sustainable, and broad-based growth is 'one of the major conditions' for poverty reduction and related efforts (pp. 10-11). PRS II assumes an annual GDP growth rate of 6-8 % by 2010. The private sector is considered as the engine of economic growth', having therefore an 'important role in achieving PRS outcomes' (p. 40).

Despite the obvious and explicitly recognised importance of the private sector for growth and poverty reduction, PSD is not given the required priority in the PRS II draft, even from a mere quantitative point of view. In the PRSP, the necessity to en-

courage private sector involvement, particularly in the primary sector, is first mentioned briefly when the current poverty situation is assessed (p. 4). However, in the description of the framework of PRS II (chapter 3), there is no link to PSD, growth and reduction of income poverty being explained as a function of the quality and quantity of inputs (the factors of production), as well as enabling conditions for revenue collection and individual investment in human capital.

There is also no reference to PSD when growth strategies are mentioned (p. 11). According to PRS II, the growth strategy has to incorporate a trade strategy (pursuing the National Trade Policy), aimed at fostering innovative and competitive capacities of domestic producers. Also, while focusing on employment expansion, the growth strategy should carefully examine and exploit inter-sector linkages, giving particular attention to agro-based industries, rural non-farm activities, tourism and mining. No reference is made to promoting PSD to achieve the desired levels of sustainable pro-poor growth, despite the fact that self-employment and private sector employment are the main activities of 40% of adults in Dar es Salaam and 31% in other urban areas.

Chapter 4 of PRS II describes the envisaged strategies for poverty reduction, cluster 1 dealing with growth and reduction of income poverty. 'Promoting the private sector and development of SMEs' is mentioned as one of several outcomes needed to achieve broad-based growth, being on par with, e.g., 'promoting competitive trade and exports', 'reducing unemployment and addressing underemployment in rural and urban areas', and 'accelerating and sustaining GDP growth at between 6 and 8%' (p. 23). The absence of any cause and effect relationship, or functional hierarchy, between these outcomes gives the impression that linkages between the private sector and SME development, reduction of unemployment and income poverty, and broad-based economic growth are not being adequately understood. The same is true of the proposed strategies for achieving these outcomes, covering a number of areas related to issues of law and order, land, business environment, science and technological development, transportation and communication, environmental protection measures – and private sector development.

Annex II of the PRS draft, listing concrete strategies for achieving the desired goals and operational outcomes, does not provide any clarification in this regard. 'Streamlining and promoting trade and private sector development' is one of eleven outcomes expected to foster sustainable and broad-based growth, equal in rank to, for example, accelerating GDP growth, increasing exports, trade and manufacturing in GDP, reducing unemployment and underemployment, or increasing environmentally- and community-based tourism (Annex II, pp. 5-6). Although some of the proposed strategies explicitly refer to (or at least implicitly facilitate) private sector development or involvement, no clear 'means-end', or 'cause-effect' relations, and no clear linkage between a proposed strategy, private sector development, and the promotion of broad-based growth can be observed. Therefore, even from the mere quantitative point of view, no final statements can be made on the amount of planned pro-private

sector interventions in Annex II. In any event, explicit action aimed at fostering PSD is clearly lacking.

Furthermore, the draft version of PRS II proposes the promotion of self-employment and SMEs as a strategy to reduce income poverty in *urban* areas. However, no reference is made to private sector involvement or development when strategies for improving food availability and accessibility, or reducing income poverty, in *rural* areas are discussed.

The third PRS I progress report of the Tanzanian Government refers to the demonstrated commitment of the Government to develop a 'liberalised private sector-led economy' (p. 15). However, referring to concrete actions, the report only mentions 'considerable progress' in the implementation of the privatisation policy. The fact that no progress in improving private sector enabling conditions (the business environment) is reported *in that section* (although some related progress has been reported on other occasions) could also point to a weak understanding of the link between private sector development and its enabling conditions.

In short, considering the high importance of economic growth for poverty reduction in Tanzania, as well as the prominent mention of the private sector as the 'engine of economic growth', concrete, explicit, goal-oriented, and consistent action to foster private sector development is far below average, even from a mere quantitative point of view.

2.2 Where are proposed strategies for Private Sector Development leading to?

In this section, the proposed strategies for PSD in Tanzania's PRS II will be examined from a qualitative point of view. This section will, therefore deal with the question of whether the proposed strategies tend towards a withdrawal of the State from the market - through stimulating market forces, enabling framework conditions and improving the business environment - or whether they are accompanied by directive State interventions, guidance of the Private Sector, and the creation of additional parastatal institutions.

According to the Norwegian Agency for Development Co-operation's 'Study on Private Sector Development in Tanzania', the Tanzanian government, since 1995, has implemented a 'wide-ranging set of PSD-friendly reforms', which has led to a 'more liberal regime for the private sector than at any time since the 1960s'. Tanzania also scores high on regional comparisons for 'optimism' and 'improvement' of the business framework in several international ratings. Unquestionably, as recognised by the IMF, Tanzania has made substantial progress in macroeconomic stabilisation and related structural reform.

Despite the internationally recognised commitment of Tanzania to enhance private sector enabling conditions, and despite the fact that there is still a lot to do in this re-

gard, PSD-related strategies in the PRS II draft provide a rather confusing picture. As mentioned in the previous section of this paper, no clear 'means-end, or 'cause-effect' relations within and between the different outcomes and strategies are identified; there is also no clear linkage between a proposed strategy, private sector development, and the promotion of broad-based growth. In addition, some of the proposed strategies for achieving growth and reducing income poverty have contradictory effects. While some tend to stimulate market forces, by improving the business environment and reducing government intervention others seem to explicitly – or at least implicitly – expand state influence on the market and the private sector.

In this regard, on the one hand, PRS II proposes to:

- *reduce* excessive institutions in order to enhance the efficiency of markets;
- amend laws and practices that are discriminatory towards female access to productive resources;
- expedite the enforcing of contracts;
- harmonise trade standards;
- improve customs procedures;
- open markets for trade and finance; or
- improve the business environment by ensuring access to credit and property rights and improving regulation and taxation (see Annex II to PRS II, strategies listed on pp. 5-11).

On the other hand, PRS II proposes to:

- *develop* institutions that enhance the efficiency and evolution of markets;
- support institutions that promote investment, employment and income growth;
- increase public investment to *influence* the pattern of employment creation towards poverty reduction;
- develop Regional and Sector Strategies on investment for employment creation and increased production;
- provide targeted inputs-subsidy to selected food crops; or
- strengthen the 'Labour machinery' in order (among other thing) to increase productivity at enterprise level (see Annex II to PRS II, strategies listed on pp. 5-11).

Interestingly, only state and parastatal organisations are to promote the commercialisation of proven technologies, and the Ministry of Industry and Trade is responsible for increasing exports and manufacturing in the GDP (Annex II, pp. 5-6). This could suggest an intended industrial policy and state-led export promotion. According to PRS II, the sectoral ministries will be responsible for 'policy guidance, supervision, coordination, implementation and monitoring activities in their sectors and across sectors, which are contributing towards achievement of particular PRS outcomes' (PRS II, p. 40).

The third PRS progress report, 2002/03, of the Tanzanian government ambiguously refers to the government '*supporting* private sector investment so that it can create employment opportunities and raise income', and alludes to 311 private sector investment projects in the manufacturing sector, approved by the Tanzanian Investment Centre in 2002 and potentially employing 33,132 people. According to the report, the government has also established new parastatal organisations, such as the Labour Exchange Centre and the Tanzania National Business Council, and has approved a new programme (the Business Environment Strengthening in Tanzania, BEST) aimed at improving the business environment for private sector development. However, both the National Business Council and BEST have been evaluated positively with regard to enabling PSD by international donors.

'Vision 2025', a governmental document outlining the country's challenges during the first quarter of the 21st century, 'invites' the private sector to contribute by mobilising learning in its operations, by compliance with tax payments, by joining the fight against corruption, investing in technological innovations, etc. The document, however, contains few concrete measures designed to guide the process toward a more vigorous private sector.

In short, the Tanzanian PRS II does not unambiguously tend towards either 'growth through stimulating market forces' or growth through increased state interventions'. As illustrated above, the proposed strategies offer a mixture of both. International donors pay tribute to Tanzania's macroeconomic reform, the government's commitment to withdraw from commercial activities, to improve public-private dialogue, to enhance the enabling environment for PSD, and to reduce costs of doing business. They also claim, however, that there has been 'mixed overall progress', with some reforms that are key to the private sector making little progress and with vested economic and political interests and the legacy of the socialist mindset impeding change. Also, according to the British Development Cooperation (DFID), government approaches to growth and to the private sector are not yet coordinated or fully coherent. The World Bank criticises governmental SME development programmes for not being fully consistent with best practice in SME development, and local government units dealing with SMEs for viewing their role as controlling and policing rather than promoting development goals. The absence of any clear statement of principle in Tanzania's PRS II in favour of either a 'market-oriented' or a 'State-interventionist' ap-

proach to growth – governmental declarations of intent and activity reports are ambiguous, too – does not allow for any final conclusion in this regard. Nevertheless, Tanzania unquestionably is on its way towards a 'more liberal' economic regime and, therefore, PSD based on an improved (market) environment.

2.3 Outline of donor financed PSD activities in Tanzania

The following section will provide a closer examination of donor-financed PSD activities in Tanzania. It aims at determining whether the activities of five main donors (the World Bank, the US, the UK, the Netherlands and Sweden)² support the more market-oriented or the more State-interventionist view of Tanzania's PRS.

PSD activities of the World Bank

The World Bank aims at contributing to sustained and accelerated economic growth and broadened impacts on reducing income poverty, through private sector and rural development. Concrete measures tend towards improving export crop quality, reducing marketing costs and the tax burden on farmers, and improving access to markets and finance. With respect to PSD, the focus is on strengthening the business environment, in particular for SMEs, as well as on legal and administrative reforms to enhance the functioning of land, credit, and labour markets. In addition, enhancing public sector performance by strengthening the capacity of public sector institutions is prioritised.

In this regard, concrete areas of reform include strengthening of financial management, strengthening of the national audit office, procurement reform and the implementation of anti-corruption strategies. The World Bank, together with other donors (USAID, DFID, and SIDA, among others) supports reforms and capacity building of the Tanzania Revenue Authority and reviews central and local taxation regulations; it also supports initiatives to review the Income Tax Act and customs laws. Further, it helped to establish the National Business Council, a government-private sector dialogue mechanism aimed at increasing private and foreign direct investment, and assists the development of the financial sector and supports concrete rural and micro-finance projects.

PSD activities of the US

According to the Strategy Paper, 2004, and the Tanzania Country Strategic Plan, 2005-2014, USAID's economic growth programme for Tanzania aims at increasing Micro and Small Enterprise (MSE) participation in the economy by improving the policy and regulatory environment for MSEs, strengthening MSEs as value-adding businesses, and providing targeted technical assistance to improve the overall environment for business. Business skills training and technical assistance are supplied to

² Selection of the donors according to instruction by seco

increase farm yields and product quality, as well as the competitiveness of agricultural enterprises.

USAID's strategy to improve the MSE policy environment focuses on three main areas: strengthening business associations (advocacy and lobby capacities); promoting private-public policy dialogue; and augmenting the capacity of selected government agencies charged with regulating and facilitating agricultural production and trade (e.g. the Tanzania Revenue Authority or the Ministry of Finance). Support is provided to strengthen the government's ability to implement policy-related changes, particularly in implementing the SME and National Agricultural Policy. In order to broaden the market access of MSEs, the access of agricultural entrepreneurs to inputs and (export) markets is being improved. In addition, USAID strengthens the capacities of MSEs through a combination of formal skills training (business courses) and selected assistance in applying improved technology (including marketing strategies).

Due to USAID efforts, the Tanzania Coffee Board agreed to allow the direct export of coffee without using the state-run auction; the coffee association has been issued the first direct export license for coffee. Further achievements include producing better quality coffee (and therefore higher prices), increased productivity, market awareness and, in the end, higher income for farmers in the Southern Highlands.

PSD activities of the UK

According to its Tanzania Country Assistance Plan, June 2003-December 2004, DFID aims at promoting the development of a clear, long-term growth strategy for sustainable poverty reduction. It seeks to utilise opportunities for dialogue through, *inter alia*, private sector forums, sectoral dialogues and the implementation of the National Trade Policy. Particular emphasis is put on consolidating the enabling role of the state in regard to private sector led growth.

As a crucial part of the development of a coherent growth strategy, DFID supports government's efforts to translate policy into an improved environment for PSD, by reducing the costs of doing business and unlocking the growth potential of Tanzanian enterprises. DFID, recognising the need for clear, consistent and appropriate business legislation, supports Tanzania's Business Environment Strengthening (BEST) programme, and assisted with the drafting of the new company law. DFID is also engaged in reforming and strengthening the capacity of the Tanzania Revenue Authority. Additionally, DFID supports increased pro-poor assistance by the financial sector, e.g. through assistance to micro finance institution, and promotes capacity building of SME development agencies. DFID also collaborates with other donors in supporting the establishment of Business Development Service providers and, together with USAID, works to link local artisans with 'socially conscious markets' abroad.

PSD activities of the Netherlands

The overall objective of the Dutch PSD-related development cooperation with Tanzania is to improve the enabling environment for Micro-, Small- and Medium sized enterprises, through a decreased regulatory and institutional burden for the private sector and improved access to financial services. In policy dialogue with the government, therefore, it promotes the development of a coherent policy framework. Special attention is paid to Cabinet's finalisation of a Private Sector Development strategy, after consultation with stakeholders, as well as to local taxation and revenue collection issues. Furthermore, the Dutch development cooperation supports multi-donor funded programmes that address key weaknesses in the business environment, such as BEST or the Financial Sector Deepening Trust, and backs initiatives to facilitate dialogue between the local private sector and district governments. It also supports innovative University entrepreneurship and mentoring programmes. Additionally, the Netherlands chairs the Private Sector Development sub-group of the Development Policy Group, the forum where most bilateral donors in Tanzania meet.

Other interventions aim at supporting programmes to improve SMEs' access to financial services, building capacities of Business Development Service providers and strengthening business lobby groups.

PSD activities of Sweden

The Swedish Development Cooperation (SIDA) supports the efforts made by the Tanzanian Government and the private sector to enhance the creation of a favourable business environment. Areas of particular importance supported by SIDA include: institutional and entrepreneurial development, the provision of business services, policy reforms and development, the commercialisation and privatisation of state-owned companies, trade promotion and the provision of capital, including micro-finance.

SIDA also provides assistance to programmes aimed at developing the Tanzania Chamber of Commerce, Industry and Agriculture into a network able to provide appropriate services to the business community. Support is also provided to the formulation of the National Trade Policy and the implementation of the Competition Policy and Law. Other measures include efforts to increase the capacity of the Ministry of Industry and Trade with regard to the implementation of the Competition Policy and Law and the reduction of business transaction costs.

Furthermore, institutional support is provided for research and the development of activities to further improve micro finance interventions. Assistance is given to reviewing the legal, regulatory and supervisory framework for micro-finance and to facilitating and supporting the development of savings and credit co-operatives. In collaboration with other major donors, SIDA provides assistance to BEST, and supports re-

forms and capacity building of the Tanzania Revenue Authority. Together with the Netherlands, Sweden invests in building the capacity of national, regional and local governments to implement SME development strategies.

Comparison and Outlook

A comparison of the above summarised PSD approaches of the World Bank, the US, the UK, the Netherlands and Sweden shows the similarity of the intervention strategies as well as a common mainstream. The strategies of all donors focus on:

- (1) capacity building of government institutions that are key for enabling PSD in Tanzania;
- (2) support to government policies and initiatives that improve the enabling role of the state with respect to private sector led growth;
- (3) the promotion of private-public dialogue, including strengthening private sector advocacy and lobbying capacities'
- (4) interventions to foster MSMEs' capacities through skills training, selected technical assistance, business service provision and access to finance and micro-finance.

Since these strategies tend towards either improving the enabling environment for PSD (all donor-supported government initiatives have been evaluated positively in this regard) or directly strengthening MSME's, the interventions of the main donors clearly support the more market-oriented view of Tanzania's PRS. They therefore assist Tanzania on its way towards a more liberal' economic regime, although PRS II does not unambiguously reflect such intentions, as the previous two sections of this paper have shown.

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