UNITED REPUBLIC OF TANZANIA

Brief 5: The Role of the State in a Developing Market Economy

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The next phase of the National Strategy for Growth and Reduction of Poverty (MKUKUTA II) will commence in 2010, and implementation will require a shared understanding and appreciation of Tanzania's long-term goals, as well as a clear recognition of the division of responsibilities among key development actors. A deeper understanding of the role of the Tanzanian State within market-dominated economic management is, therefore, essential to inform and guide the development of the country's strategic direction to realise the goals of Tanzania's Development Vision 2025. Accordingly, Chapter 3 of PHDR 2009 discussed the role of the state in a developing market economy, the highlights of which are presented in this brief, the fifth and final brief in the series on PHDR 2009.

Introduction

Since the mid-1980s, the Government of Tanzania has re-oriented its central developmental responsibilities to: (i) provide policy and strategic direction for the country; (ii) create an enabling environment for the private sector to operate; and (iii) establish and strengthen the institutional framework for growth and accompanying regulatory and enforcement systems. As the country moves into the next phase of MKUKUTA it is important to reflect on national achievements and challenges over the last three decades and to examine the role and principal functions of the State in economic management and broader socio-economic transformation in light of current local realities, international experiences and perspectives, and new thinking in response to the global economic crisis.

State Involvement in Economic Management

All states have a role to play in managing their economies, but the nature and extent of this involvement is context-specific; there is no fixed role for the state that fits every economy. Each nation's distinct ideology determines the mix of market and non-market mechanisms used in the management of the economy which, in turn, locates the country's position along the continuum between a wholly-planned economy at one end and a market-rational economy at the other. Using the two instruments of planning and market to allocate resources, the state steers the process towards achieving the desired outcomes of the medium-term development strategy. This process of economic transformation is by nature continuously evolving, and the mix should be regularly reviewed to reflect experiences and improve outcomes.

It is argued that the role of the State in Tanzania must be developmental, using a mix of non-market instruments and selective proactive engagement to facilitate markets and the development of the private sector to ensure that resources are used effectively and efficiently towards realising Vision 2025. Non-market instruments are used to influence resource allocations to improve sub-optimal outcomes that may result from incomplete and imperfect information, high transaction costs and/or asymmetric power relations among agents. At the same time, developmental states utilise the market to enhance performance by encouraging competition and ensuring consumer protection.

Given the history of Tanzania, it is important to clarify that a developmental state role is not the same as that of a command state which adopts central planning, state ownership, and direct production of goods and services. Tanzania's Vision is to achieve a vibrant, developed market economy, which implies that the role of the state is facilitative rather than directive.

Functions of a State

Every state, whether developmental or market-rational, performs core functions:

- Defining the national vision and strategic direction
- Establishing medium-term strategies to translate the national vision into concrete action
- Strengthening and aligning the institutional framework for implementation of the medium-term strategies
- Maintaining macro-economic stability
- Ensuring good governance
- Addressing blockages to economic growth.

Defining the Vision

Defining the long-term vision for the country is the first role of any state. Such a vision must specify the desired socio-economic outcomes and the timeframe over which national goals are to be attained. For Tanzania this is provided in Vision 2025, which envisages a middle-income country with a high level of human development, free of abject poverty and characterised by: a good quality of life; peace, stability and unity; good governance; a well-educated and learning society; and a competitive economy capable of producing sustainable growth and shared benefits.

By 2025, it is envisaged that the economy will have been transformed from a low productivity agricultural economy to a semi-industrialised one. A solid foundation for a competitive, innovative and dynamic economy will have been laid, including a modernised and highly productive agricultural sector which will be integrated into, and supported by, the industrial and service sectors in rural and urban areas.

As a matter of principle, defining a country's vision is the responsibility of the political leadership, and clear ownership and implementation of that vision must be continually reinforced by that leadership. The vision is not an abstract definition of progress, but a strong magnet capable of influencing individual and social behaviour. Unless citizens can see the future benefits for themselves and society overall, the vision is unlikely to be attained. Therefore, consistent and clear communication with citizens is essential to ensure that the vision is understood and embedded into practice.

Establishing Medium-term Development Strategies

Translating the national vision into a development strategy entails setting out the means of reaching the outcomes specified in the vision. These outcomes invariably take time to be realised; recent experience from emerging economies in Asia show that a period of at least thirty years is required. Therefore, a medium to long-term development strategy must be sustained beyond a single phase of government.

Experience has shown that political commitment, patience, continuity, and unwavering focus are prerequisites for achieving desired socio-economic transformation. Strong political leadership ensures the life of the vision, but implementation of that vision must transcend political boundaries. Implementation must also be supported by a strong, committed and competent civil service, led by a cadre of talented and well-trained senior government staff who are drawn from an increasingly competent pool of citizens.

Adjustments may be needed to the strategic path due to economic and political constraints, some of which may lead to unexpected or unplanned outcomes.[1] Financial, social and capacity constraints involve inescapable trade offs and political consensus, inherent to any national development strategy and especially difficult to manage in a low-income country. The growth path of the Asian tigers is characterised by adjustments, abandoning what did not work and nurturing what did. Adjustments though should not be at the expense of the overall direction, rather refinements within the medium-term development strategy.

Strengthening and Aligning the Institutional Framework for Implementation

Once the strategic direction has been determined it is crucial that implementing institutions and incentive systems are properly aligned in order to effectively support implementation.

These include:

- (i) the institutions of government,
- (ii) the private sector and civil society, and
- (iii) market and regulatory systems.

Incentive systems within the institutional framework must provide very clear expectations and benefits which are derived from the vision and the strategic choices of the country.

The Institutions of Government

In many African countries, including Tanzania, it has been the practice for central government ministries to coordinate and distribute resources. This can result in the preferential allocation of human and financial resources to central ministries. Lessons from Asia on this matter are useful, where the choice of strategic sectors/activities determines the centrality of ministries and the allocation of human resources. Thus ministries are aligned to the thrust of the strategic direction and become responsible facilitators with oversight for the strategy's implementation.

A strong state is required to establish the development direction of the country and to oversee implementation. However, being a strong state does not necessarily mean direct ownership and implementation of development activities by the state. Developmental states recognise the strengths and capabilities of all development actors, taking advantage of them to achieve national economic development goals. In other words, the state leads, providing guidance to all actors including the private sector and local communities, towards the desired outcomes.

Any direct state ownership and implementation of development activities is dependent upon the state's comparative advantage in relation to other actors. Activities characterised by large and lumpy investment or that are public consumption in nature often require direct, though not necessarily exclusive, state involvement. The provision of public services, such as education or health, can be facilitated through public-private partnerships with non-state actors in the private sector as well as civil society organisations, as has been successfully demonstrated in Tanzania.

[1] The expansion of primary and secondary schools is a case in point for Tanzania, where rapid expansion in school infrastructure and student enrolments has put increasing pressure upon teacher numbers and the delivery of quality education. Another example is the global financial and economic crisis that necessitated adjustments in many countries, including Tanzania.

States must have the capacity and willingness to provide incentives for results-oriented performance. Incentives are not only important to induce new investments and innovation, but also to avoid losses or misuse of resources. Experience shows that in low-income countries selective incentives that provide realistic rents over specified timeframes can promote performance. Such incentives may be necessary for strengthening the local business sector, and are justifiable so long as they are provided for activities that have social as well as private benefits and the rents contribute towards national development. Consistent with these ends, it is the responsibility of the state to stop activities that are losing public resources, or not contributing to the desired goals of transformation.

To effectively and efficiently undertake the responsibilities outlined above, it is vital to create and maintain a highly-skilled and committed bureaucracy. Without a competent bureaucracy the danger exists that government itself can become an impediment to transformation, a source of government and system failure. To avoid this, government staffing must be characterised by recruitment and promotion based on demonstrated ability, salaries must be competitive with the private sector, and high performance standards must be upheld. Efficient government systems are also essential. Experiences from other developing countries show that it takes time to build and transform a bureaucracy to achieve high performance. Given limited resources, it may be appropriate to adopt a deliberate approach which focuses efforts on progressively strengthening the bureaucracy, with priority on staff and systems in those institutions which are most strategic to realising the national vision of socio-economic transformation.

The Private Sector

Despite worldwide recognition of the critical role of private enterprise in any nation's development, in many sub-Saharan African countries the organised formal domestic business sector remains nascent and under-developed. Governments must proactively support and promote the private sector as a partner in socio-economic transformation. The most important prerequisites for attracting private businesses are, first and foremost, political stability followed closely by an enabling business environment characterised by ease of entry, expansion and closure. An environment of reduced uncertainties and costs of doing business, as well as clear management of government and market failures provides incentives for the private sector to assume risk.

At a general level, the state needs to ensure a level playing field for all private business. Competition by firms in the market has proven to be far more effective against unnecessary monopolistic rent-seeking than any price-setting mechanisms the state could prescribe and enforce. At the same time, the state may need to take proactive measures to develop and nurture the formation of strong national players in the private sector, so that they may compete effectively with international players. The challenge is to support the emergence of such national champions without succumbing to political patronage and capture, all the while maintaining a competitive environment.

The Market

Efficient functioning of the market requires strong institutional oversight, the establishment and enforcement of property rights and contracts, competition and consumer protection, and information systems to close the gap between buyers and sellers. In developing economies, oversight institutions are often missing, inadequately equipped to perform their function effectively, or may sometimes be unrealistic in their demands of the market. This may lead to the market falling short of expectations. Experience from successful developmental states shows that where the market does not perform according to expectations, the best course of action is to support the institutions of the market, rather than succumb to the temptation to substitute the market with non-market instruments.

As markets are still evolving, market failures can be expected. However, it is crucial that markets continue to develop and that they interact with non-market institutions to deliver developmental goals. For this reason, the government should focus on the overall performance of the economic system – rather than on individual institutions. Successful developmental states have succeeded in creating and developing markets through an interactive process between market and non-market institutions. Experience shows that growth can occur even before institutions are fully developed, as long as these institutions are supported and allowed to co-evolve with socio-economic transformation. The state should proactively develop the capabilities of non-market institutions and ensure that they positively interact with market institutions to support the implementation of the development agenda.

Maintaining Macro-economic Stability

The private sector expects a reasonable degree of predictability in the economy in order to make informed decisions on investments. It is the responsibility of a government to ensure that national fiscal and monetary policies provide macro-economic stability and give the appropriate signals to influence the actions of various economic agents.

Within the context of developmental states, macro-economic policy must be firmly aligned with the developmental agenda. This is not simply an issue of determining macro-economic policy to get the overall investment climate right, rather it is achieving a mutually supportive combination of macro, meso and micro outcomes. That is, macro-economic policy is used as a means to the end of achieving developmental goals.

Ensuring Good Governance

Good governance assures a level and fertile ground for investment and transformation – which in turn leads to more opportunities for increased business and employment. In this sense, good governance is integral to achieving the goals of the medium-term development strategy. Therefore, the contribution of governance is seen in relation to the achievements of the final outcomes of the development strategy, rather than in the specific components of governance in isolation.

Given limited institutional capacity, it is impossible simultaneously to solve all the governance problems in any low-income country. Activities that are critical to the development strategy or whose resource requirements are significant must be prioritised. For example, it is important to insulate key infrastructure investments from the tendency towards poor governance. By their nature, infrastructure investments are big money items, and therefore they tend to attract special interests and engender corrupt practices. Similarly, there should be a strategy to strengthen the capacity of the judiciary in prioritising reforms and improving performance in areas which are key to economic growth. The current gradual reform of the judiciary in Tanzania, especially with respect to commercial courts, non-judicial remedies (such as voluntary arbitration) and economic crimes, is a move in the right direction.

It should be recognised that all developing countries have limited institutional capacity, and global expectations can sometimes differ from local norms. Integrating the components of good governance is an evolutionary process of enhancing accountability by developing the ingredients and systems to fit the domestic context and establishing appropriate institutions and competent human resources to regulate and monitor progress. Public opinion, civil society and the media are key components in achieving good governance and should be valued as such by the state.

Addressing Blockages to Facilitate Implementation

In the course of implementation, development actors may face constraints which cannot be addressed by individuals, because they are either too expensive or they are public in nature and the benefits cannot accrue to individual investors. The facilitative role of the developmental state is especially important in overcoming such constraints.

Infrastructure Development

Infrastructure investments have higher social than individual returns, particularly in the context of poor remote areas. Infrastructure development inherently requires long-term commitment and major capital investments, therefore, these 'public good' investments are most commonly made by the state, although innovative public-private partnerships can also be organised. Infrastructure investments reduce risks and raise returns within the economy, especially within the private sector, including for household producers. However, the challenge for large and sparsely populated sub-Saharan economies is to focus these investments in areas that can produce the greatest linkages within the economy and underpin the highest development returns. The temptation to spread investments thinly across the country in response to political demands should be resisted.

Human Resource Development

Successful implementation of a focused development agenda requires a supply of skilled human resources that meet the demands of the market. Without a well-functioning skilled labour force, productivity will remain low. The building of human resource capacity underpins the transformational process in any society. It is important therefore that there is a strong linkage between the provision of basic education and the development of capabilities for growth and transformation. This linkage can only be achieved where states set high standards for quality in education.

As countries strive to provide universal primary education, it is crucial to raise the quality of primary, secondary and technical education, to appropriately equip students for subsequent employment and, for those who continue academically, for tertiary education. In Tanzania, the ongoing discussion about focusing government-sponsored student loans towards strategic training at the tertiary level is a move in the right direction. This move is important because it will provide the right signals to service providers of technical and higher education, both public and private, on where to focus their training. It may also raise competition among training institutions to attract students and state loans, thus raising the standard of the education provided. In this way, the state encourages private-public partnerships to produce the skilled labour force required to realise the national vision.

Social Protection

Experience shows that even in countries that have built-in mechanisms for shared growth, some citizens remain vulnerable. The context for countries such as Tanzania with a high incidence of poverty and a large concentration of people around the poverty line has often been referred to as generalised insecurity. The challenge is how to address this level of insecurity in a forward-looking and productive manner.

A review of existing public schemes for the provision of social security and social assistance shows low coverage with high fragmentation and dispersal of efforts involving many actors. Therefore, future mechanisms and interventions for social protection must be designed and implemented systemically and in a transformative manner. Social protection should not be conceived simply as income support for the poorest, but should serve as an instrument for the development of human capabilities and systems. In this way, social protection can enable all citizens to contribute to and benefit from the realisation of the national vision.

Knowledge Creation, and Research and Development for Innovation

The world is characterised by fast changing political, economic and technological developments. States have to create capabilities to adjust, and where possible take the lead to create or seize opportunities. Growth and transformation is driven by knowledge, therefore, the state must promote knowledge creation, sharing and use at all levels in society. This generation and transfer of ideas must be a two-way process.

Research and development (R&D) for innovation is critical to success in globally competitive markets. The potential contribution of R&D has been undervalued in the recent past, largely because of its typically long-term nature and uncertain outcomes. Yet no country can make significant headway without innovation and the adoption of new technologies, and these are dependent on R&D, which cannot be left entirely to private enterprise in any country. In Tanzania there is a revived recognition of the importance of research. However, the key is to link this to the medium-term development strategy.

Managing the Environment

Traditionally, environmental management has focused on minimising environmental costs, through balancing the demands of growth, the need for development, and protection of the natural environment. However, a new era of global environmental governance has introduced an additional variable into the equation. The environment is now a global rather than a national issue; an issue of global concerns and global solutions. Environmental management can, therefore, be a valuable resource for growth and development, an opportunity which should be proactively incorporated into the development agenda. In this way, sound environment management practices can potentially yield high returns rather than represent cost burdens.

Conclusion

The overall conclusion is that a developmental role is appropriate for the Tanzanian government during this stage of the country's socio-economic growth and transformation. The Government should navigate the country's course towards realising the goals of Vision 2025 within the context of a defined medium-term development strategy, surviving the necessary adjustments along the course. It is crucial that markets continue to develop and that they interact with non-market institutions to deliver developmental goals. Furthermore, the state must acknowledge and promote the private sector as a key partner in national development.

Strong political leadership and a highly skilled bureaucracy backed by effective systems will be required to provide steady national direction. Investment in higher education and an effective incentive system will be vital for building a competent and committed bureaucracy. In addition, clear, focused communication and signals for all citizens and development actors will be required in implementation of the medium-term development strategy. Economic and political constraints may necessitate adjustments to the strategic path towards Vision 2025, but an uninterrupted view should be maintained of Tanzania's long-term horizon – to be a vibrant, developed market economy capable of sustained growth and shared benefits.

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