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REPOA Brief

Drivers of productive capacity for industrial and trade expansion in Tanzania

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	Key messages
Importance	➢ The development of productive capacities is important in sustaining economic growth and enhancing expansive and effective integration into the global economy.
Challenges	➢ Tanzania is confronted with the daunting task of developing productive capacities and transforming the structure of its economy in the face of its rapid population growth and a rapidly evolving global economic and geopolitical environment. ➢ It also encounters various constraints on the use of trade and economic policy instruments to foster industrialization and trade expansion.
Comparative Advantages	➢ Blessed with human resource growth potential and abundant natural resources, the latter including sizable arable land, forests, fisheries, minerals, rich biodiversity, and wildlife resources. ➢ Occupies a strategic geographical location as a major seaport hub in East Africa and has borders with three non-EAC States—Malawi, Mozambique and Zambia—in addition to the 5 EAC States.

Objectives	➢ **To explore and understand the best practice cases and the underlying opportunities and constraints for enhancing the expansion of productive.**
	➢ To explore the significance of developing productive capacities for economic growth and poverty reduction, and the underlying internal and external drivers.
	➢ To explore and understand the value added for policymakers of a focus on enhancing productive capacities.
Coverage	The analytical framework of productive capacity for industrial and trade expansion involves:
	✓ **Sources and trends of productivity growth,**
	✓ **Short-to medium term internal drivers of productivity growth,**
	✓ **Long term internal drivers of productivity growth,**
	✓ **External drivers of productivity growth.**

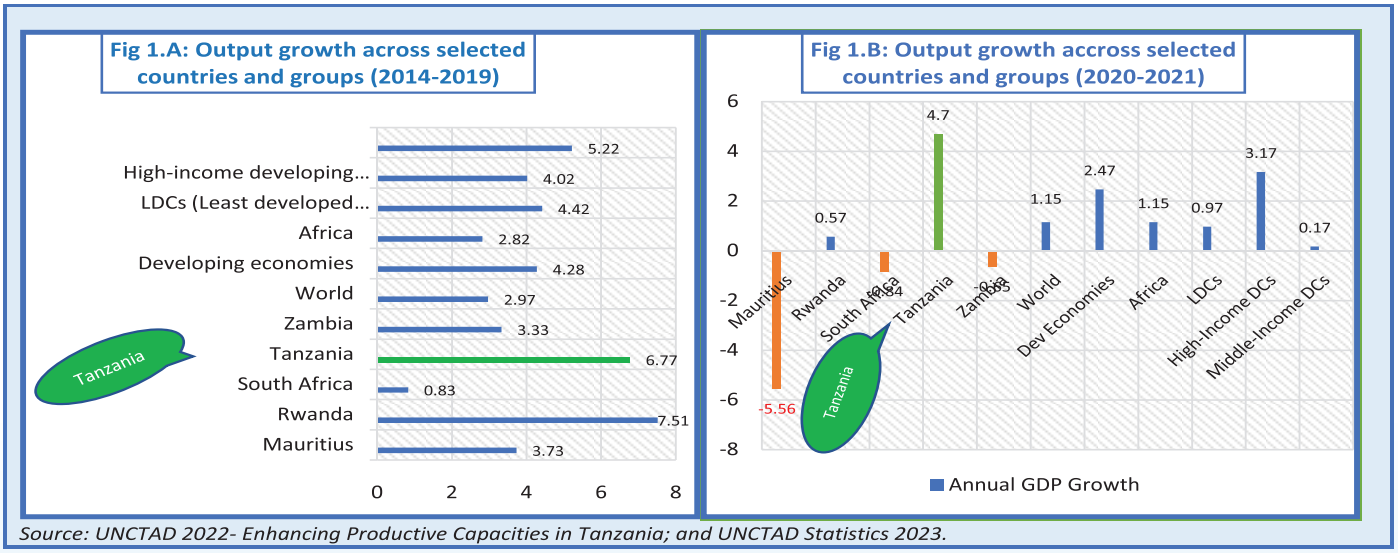
Baseline definitions on productive capacities and productivity growth are drawn from the relevant multilateral agencies:

Baseline Definitions – Productive Capacities and Productivity Growth	
UNCTAD	Defines productive capacities as *the productive resources, entrepreneurial capabilities and production linkages which together determine the capacity of a country to produce goods and services and enable it to grow and develop*
NEPAD	Defines productive capacity as *the ability to produce goods that meet the quality requirements of present markets and to upgrade in order to tap future markets—to ensure a sustainable participation in the new global production system based on production networks*.
World Bank	Defines productivity growth as *the key driver of sustainable income growth and poverty reduction—the efficiency with which societies combine their people, resources, and tools —and is the central driver of the development process*
UNIDO	Defines productivity as *the ability to transform inputs into outputs—a key to poverty reduction as it generates skilled jobs which are sources of income and social participation*.
OECD	Productivity is considered *a key source of economic growth and competitiveness*·

Economic growth indicators for Tanzania

Since the turn of the millennium the Tanzanian economy has grown at more than 6 percent and in per capita terms by more than 3.5 percent despite its rapid population growth. Quite positively, over the past three decades its growth performance has been consistently above the average for Africa. When assessed at the global level, its economic growth performance has also been impressive.

A per Figure 1.A below, in the period 2014-19, the annual average real output growth rate for Tanzania was about 6.8 percent compared to 5.2 percent for middle-income developing countries, 4.4 percent for LDCs, 4.3 percent for developing countries, 3 percent for the world, and 2.8 percent for Africa.



Source: UNCTAD 2022- Enhancing Productive Capacities in Tanzania; and UNCTAD Statistics 2023.

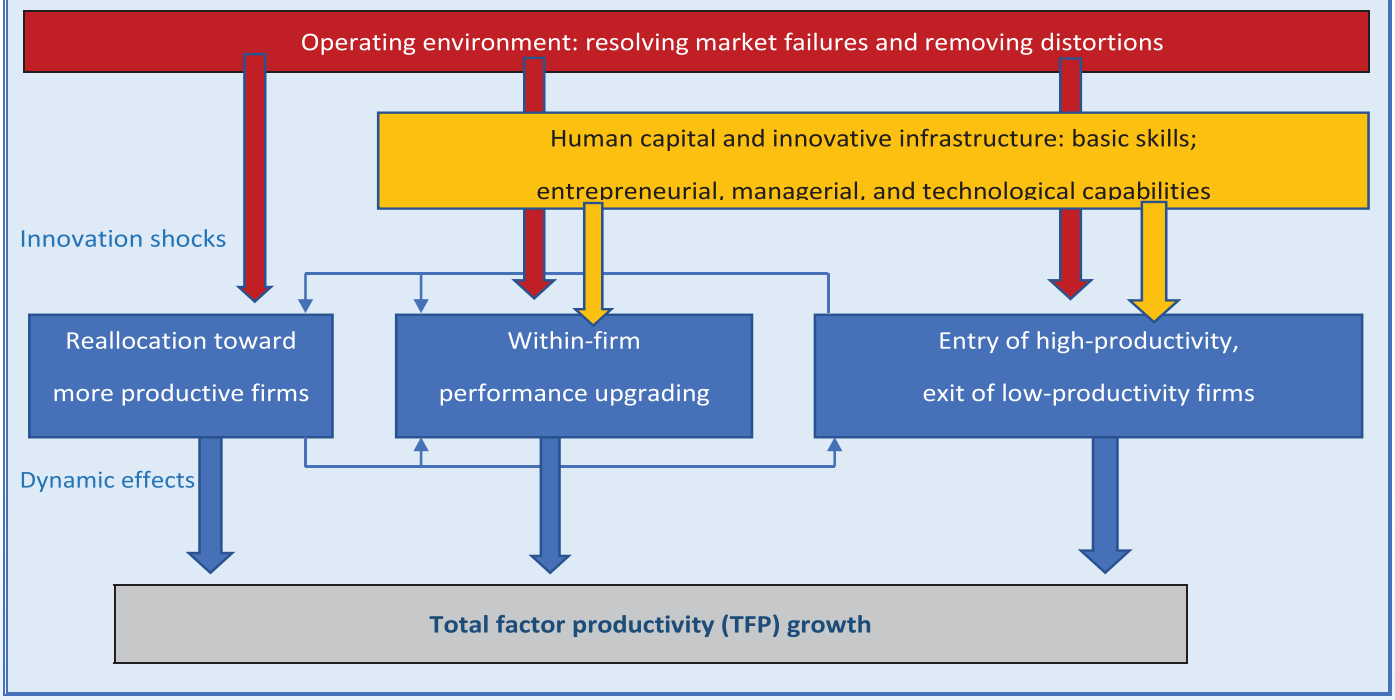
Challenging prospects with the impact of COVID-19 on drivers. As per Figure 1.B, the COVID-19 pandemic has made the near-term outlook for productivity and economic growth more challenging. Weaker investment and trade, erosion of human capital, slower labour reallocation, heavier public and private debt burden, and widening inequality stands to push down the productivity growth. The prospects for further trade integration have diminished, and the expansion of global value chains has lost momentum. Sharp declines in global trade and investment, amid the pandemic, could further accelerate these trends. For many countries, though Tanzania still records a relatively higher growth, this trends into subdued activity, instability, and new pressures on governments. Yet the pandemic may also create productivity-enhancing opportunities such as lasting organizational and technological changes for business and education, reshaping global value chains toward higher diversification, and changing social norms.

Sources and trends of productivity growth

The growth of *productivity*—the efficiency with which societies combine their people, resources, and tools—is the main driver of the development process for industrialisation and trade expansion, leading to wealth accumulation and poverty reduction. Long-term incremental improvements in earnings in industry and/or agriculture—the source of employment and livelihoods for many of the population in the developing countries—can be achieved mainly by raising and sustaining industrial worker and farmer productivity.

As per Figure 2, productivity gains within each sector of economic activity are primarily the outcome of increased dynamism within individual production units. Resource reallocation from less- to more-productive firms and activities contributes to industry-level productivity growth in any market economy—especially in low-income economies with greater economic distortions resulting from incomplete markets, coordination failures, and limited technology.

Fig. 2: Drivers of Productivity Growth



New technologies reduce the cost and improve the efficiency and efficacy of service delivery in all social spheres. Half of referenced productivity growth is due to improvements within firms obtained by innovating, adopting new technologies, and implementing best managerial practices. The rapid and extensive gains of countries like Chile and China, for instance, suggest that while removing distortions (such as imperfect financial markets, labour market regulations, or distortionary taxes) may yield large gains during initial reform periods, once the big distortions have been eliminated, productivity growth is more likely to come from the process of upgrading products and processes within existing firms and sectors, and from new firms.

Internal and external drivers of productivity growth Internal drivers.

The internal drivers of productivity growth include productivity-enhancing organizational features and practices that shape firms' capabilities. These include the following:

Technological progress	•1. A firm's TFP hinges on its ability to create, acquire, and use advanced technology; •2. Technological innovation, driven partly by R&D and complemented by physical capital and workers' skills, will boost labour productivity and output; •3. New production techniques allow firms to improve product quality and expand the range of marketed products; •4. An increase in patenting and the variety of products can also strengthen firm productivity
Input quality	•1. Higher-quality labour and capital can raise a firm's labour productivity measured as output per worker or per worker hour; •2. Better-educated, well-trained, and experienced workers tend to be more productive; •3. New capital goods enable faster productivity growth, through embodied technical progress.
Management	•1. Good management can improve the efficiency of production; •2. The best managerial practices include setting clear targets, monitoring progress, and rewarding performance; •2. Incentives for team production, cross-training, work experience, and frequent employee-manager communication can also raise firm productivity.

Long-run internal productivity growth is driven by innovation, investment in physical capital, and enhanced human capital. This requires a growth-friendly environment, with supportive institutions and macroeconomic stability. Innovation, cross-border technology transfer, and expertise in producing complex and sophisticated exports have increased in importance, along with demographic factors.

Long-run internal drivers	**Growth-friendly environment, with supportive institutions and policies, including policies that promote macroeconomic stability and the rule of law;**
	Expertise in producing relatively complex and sophisticated exports, which is associated with international technology diffusion.

External drivers. Outside forces influence productivity within and between firms. These external factors can allow each firm to improve its efficiency (the "within" effect) and stimulate more efficient firms to grow faster than others (the "between" effect). These include the following:

Regulatory and operating environments	Institutions and regulations influence firm productivity partly through incentives to invest in human and physical capital, and to acquire technology;
	Firm productivity tends to be lower in poorly regulated markets: weaker enforcement of competition laws can allow a large inefficient firm to drive productive competitors out of the market by abusing its market power;
	Private firms may be reluctant to undertake costly R&D when competitors, especially those in the informal sector, can infringe intellectual property rights;
	The enforcement of property rights, and public-private partnerships to create technology extension centres in sectoral clusters, can increase firm participation in global value chains and raise productivity;
	Improvements in the business environment and conducive regulatory practices—fair competition, increased business freedom— support growth of TFP and labour productivity.
Spill-overs and input markets	The presence of highly productive firms can have spill-over effects and raise the productivity of other firms;
	These spill-overs occur as knowledge and innovation are transferred through trade, FDI, and agglomeration channels;
	Flexible and integrated capital and labour markets can promote the reallocation of inputs toward the most productive firms.

Conclusion and policy recommendation

The enhancement of productive capacities of a country constitutes a potentiality for production, economic growth, industrial and trade expansion. Productive resources, entrepreneurial capabilities and production linkages are created and transformed over time. As this occurs sustainably, the potential output of an economy increases, thus making economic growth, industrial and trade expansion possible and sustainable.

It is recommended that this framework of analysis is adapted to inform policy analysts, private sector practitioners, and decision makers in public institutions responsible for promoting economic growth, industrial development, investments, trade expansion, and private sector development. It is the ability these actors to address the various constraints to productivity growth that Tanzania can sustain its growth momentum, realize its development potential, and achieve significant poverty reduction.

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