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Employment and productivity growth in Tanzania's service sector

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Abstract: Despite Tanzania's rapid recent growth, the vast majority of employment creation has been in informal services. This paper addresses the role that different subsectors of formal and informal services have played in Tanzania's growth. It finds that subsectors such as trade services contribute significantly to employment despite their relatively low productivity, while subsectors such as business and transportation services display higher productivity and improve the environment for other firms to operate. The paper also acknowledges the role of high-performing small and medium-sized service firms and the tourism sector in contributing further to Tanzania's growth and structural change.

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JEL classification: E26, L80, L83, O14, O17

Tables and figure: at end of paper.

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1 Introduction

Between 2002 and 2012 Tanzania's economy grew more rapidly than at any other time in its history: average annual GDP growth was 6.5 per cent and average annual labour productivity growth was 4.1 per cent. More than three-quarters of this labour productivity growth is accounted for by structural change; the remainder is largely attributable to within-sector productivity growth in agriculture. The growth attributable to structural change is almost entirely explained by a rapid decline in the agricultural employment share and an increase in the non-agricultural private sector employment share. However, only 11.4 per cent of employment growth in the private non-agricultural economy is due to the expansion of the formal private sector; the remaining 88.6 per cent occurred in the informal sector (Diao et al. 2016).[1,2]

This paper assesses the role that services—both formal and informal—have played in Tanzania's recent growth and the role that they could play in its economic future. Section 2 examines the current pattern of structural change in Tanzania and estimates the contribution of the services sector to employment and productivity growth. Section 3 provides a snapshot of the formal services sector and highlights strategies for accelerating its growth. Section 4 presents new data on the size, structure, and productivity of micro, small and medium-sized enterprises (MSMEs) in the services sector. These data reveal large numbers of firms in the right-hand tail of the MSME productivity distribution, with output per worker exceeding the economy-wide average for manufacturing, and show that this 'in-between' sector (Lewis 1979) offers the potential for growth and job creation, if policies are better targeted at firms with the greatest potential to grow. Section 5 is devoted to the tourism sector, which has significant development potential. Section 6 concludes.

2 Employment and productivity growth in services: the big picture

To place the services sector in the context of the larger economy, we employ the growth decomposition methodology developed by McMillan and Rodrik (2011). To this end, we divide the economy into 10 main sub-sectors and split economy-wide labour productivity into that which can be attributed to within-sector productivity growth and that which is attributable to structural change. For the purposes of this paper, we define within-sector productivity growth as growth in labour productivity in any of the 10 sub-sectors and define productivity growth attributable to structural change as the productivity growth that occurs when employment is reallocated across these 10 sub-sectors as a result of different levels of average labour productivity. Details of the growth decomposition are presented in Appendix 1.

Table 1 highlights the main results of this exercise. Our analysis confirms that close to 80 per cent of Tanzania's recent growth in labour productivity is attributable to structural change. Employment shares have declined in agriculture—the sector with the lowest average labour productivity—and increased in various non-agricultural sectors, most of which are significantly more productive than agriculture.

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[1] Our definition of informality is based on that of the Tanzanian government, which distinguishes formal from informal firms based on licensure status and size.

[2] For details of these calculations, see Diao et al. (2016).

The growth decomposition presented in Table 1 does not tell us whether structural change in Tanzania was the result of job creation or simply labour reallocation across sectors. Like many African countries, Tanzania has had high population growth over the past decade, leading millions of young people to enter the job market. To this end, Table 2 links the growth in employment with the change in the economic structure by displaying 'new' employment opportunities across all non-agricultural sectors.

We define new employment by sector as the net increase in the number of employees in each sector between 2002 and 2012, computed using the population censuses. For these calculations we exclude agricultural employment, primarily because it has not played an important role in job creation; the net increase in agricultural employment accounted for only 11 per cent of the total increase in employment between 2002 and 2012; almost 90 per cent of the jobs created over this 10-year period were in the non-agricultural sector. Considering that agricultural employment made up more than 80 per cent of total employment in 2002 (Table 1, first panel, column 6), it is remarkable that almost all of the new jobs were created outside the agricultural sector.

Two key facts need to be highlighted in the 'new employment' decomposition presented in Table 2. First, a majority of new jobs were created in the private sector; almost 94 per cent of increased non-agricultural employment between 2002 and 2012 is in the private sector (Table 2, column 2). Second, 83 per cent of these private-sector jobs were created in the so-called 'informal economy' by micro and small firms (Table 2, column 6).

This trend in private-sector job creation by micro and small firms is often seen as a distressing phenomenon, as firms in the informal economy, or small firms in general, are often associated with low productivity and a lack of dynamism. However, once we link the trend in private-sector job creation with the results of the growth decomposition analysis shown in Table 1, the following stylized facts become evident. First, structural change accounted for almost 80 per cent of economy-wide labour productivity growth in Tanzania between 2002 and 2012 (Table 1, last row). Second, structural change was primarily achieved by growth in employment in small firms in the informal economy. These two facts together raise the possibility that some of Tanzania's growth in labour productivity is linked to the growth in employment in small firms.

There are two sectors that stand out as having contributed significantly to job creation in Tanzania over the period 2002 to 2012. These are manufacturing and trade services. Average labour productivity in Tanzania's manufacturing sector is more than seven times that of the agricultural sector. Although the sector is still relatively small, its extremely high productivity compared with the rest of the economy means that increased employment in this sector contributed 12.4 per cent of economy-wide labour productivity growth (Table 1, second panel, column 2). Notably, more than-two thirds of this increase in employment is accounted for by small, mostly informal, firms.

Like manufacturing, trade services productivity is relatively high in Tanzania. While labour productivity in this sector is only half that of manufacturing, it is still 3.5 times that of agriculture (Table 1, first panel, columns 1 and 2). More importantly, more new jobs were created in this sector than in any other sector between 2002 and 2012. As Table 2 highlights, amongst the nearly 1 million new jobs created in trade services, more than 99 per cent were created by the informal economy. Further, although these jobs were created by small firms in the informal sector, productivity in trade services did not fall. As the growth decomposition analysis of Table 1 shows, within-sector productivity actually increased modestly in the trade services sector between 2002 and 2012 (Table 1, comparing row 1 with row 2). As a result, job creation in Tanzania's trade services sector accounted for more than 18 per cent of economy-wide productivity growth between 2002 and 2012.

Trade services includes retail, wholesale, and the food and beverages trade, and in Tanzania makes up the biggest share of the informal sector: about 55 per cent of informal businesses (FSDT 2012). In the last few years, it has been transformed into a competitive and private market and, though it is generally considered an unproductive industry, trade services is not without potential (FSDT 2012; McMillan and Rodrik 2011; NBS 2010; NBS 2014b). As a labour-intensive industry, trade services offers jobs to large groups of unskilled workers, including youth and those coming from agriculture, and the industry is already an important source of employment in Tanzania.

The business services industry in Tanzania is much smaller, accounting for only 0.8 per cent of total employment in 2012. It consists of financial and insurance activities, and the split between informal and formal firms in this sector is roughly 50/50. The numbers in Table 1 indicate that, although labour productivity in the business services sector is still quite high, it declined between 2002 and 2012, perhaps on account of the entry of more informal firms. However, the importance of business services comes from its impact on other industries rather than on employment. Financial and business development services are crucial for making other industries, such as manufacturing, more efficient, in turn creating more jobs and production (Jensen et al. 2008).

Mobile money services and firms providing business development services exemplify how business services can improve the functioning of other firms. All of the major telecommunications companies in Tanzania offer mobile money services, which makes it easy for businesses—most importantly, for MSMEs—to send and receive payments.

A number of firms, large and small, provide business development services to other businesses, mainly MSMEs. For example, Match Maker Associates is an impact investment fund that works closely with MSMEs, providing them business development services (BDS) and making loans to the ones that prove their viability, e.g. through its SME Impact Fund. A number of BDS providers help their clients in a variety of areas, such as registering and formalizing their businesses, developing written business plans, and providing general advice.

The transport and communication industries also provide essential services for other industries. Transport and communication services and business services are not especially labour-intensive, but can be skill-intensive, about 60 per cent of firms in both transport and ICT being classified as high-skill (Tan et al. 2016). Therefore, their biggest contribution to the economy is realized in their impact on other industries, rather than in their contribution to employment or their direct output. For example, improving the transportation infrastructure and increasing the capacity of maritime ports may result in more jobs in manufacturing. Just as the financial infrastructure for business services is lacking, so Tanzania currently suffers from poor transport and ICT infrastructure.

Tourism is an important services sector in Tanzania but it does not neatly fit into any of the categories described in Tables 1 and 2. This is because it is made up of parts of several other industries, including accommodation; food and beverages; transport; and culture, sports, and recreational services. Because of the important role that tourism plays in Tanzania, with its natural wonders and game parks, we include a detailed discussion of tourism in Section 5 of this paper. However, it is worth pointing out that a unique feature of the tourism industry relative to most other services industries in Tanzania is its potential for foreign exchange generation. Tourism brought in over US$1 billion in direct annual revenues and over US$4 billion in total (direct and indirect) contributions—amounting to approximately 14 per cent of GDP (WTTC 2015).

3 Employment growth in formal services

This section presents data on the contribution of formal services to employment and productivity growth in Tanzania using data from the Formal Employment and Earnings Survey (FEES). It then addresses some of the constraints that explain the slow growth of formal services, and examines the prospects for formal services growth in the near future, while considering some approaches the government could take.

As mentioned above, the vast majority of private employment growth has occurred in the informal sector, while the private formal services sector has remained quite small, accounting for just 7.6 per cent of total employment growth. Nearly three-quarters of this growth occurred in the utilities sub-sector, while formal business services contributed 1.6 per cent, transport services 0.5 per cent, and trade services a fraction of a per cent to total employment growth. This may be explained by the fact that the formal services sector comprises relatively skilled jobs, but employee skills and education levels are still low in Tanzania in comparison with other countries. Although mainland businesses with more than four employees are required to pay a 5 per cent Skills Development Levy, which is used to finance VETA, the government-run vocational training institute, the infrastructure in place to train workers appears to be largely ineffective. Tan et al. (2016) find that workers with secondary or vocational education do not make a greater contribution, on average, than workers with only primary education. The also find that firms may lack the capacity to conduct adequate in-house training, as this is found to have no association with better firm performance. Instead, firms appear to be bridging the skills gap by outsourcing professional services or hiring expatriate workers (Tan et al. 2016).

Further opportunities for formal services may lie in tradable services. Tanzania has consistently been a net services exporter since 2005, although 81.4 per cent of its exports come from travel and transport services (UNCTAD 2015). While most of the available analysis focuses on private firms, public services such as health and education may also be important sources of skilled employment growth. Tanzania's rapidly increasing population and its health and education initiatives are likely to lead to increased job creation in these sectors. For example, the ratio of teachers to students (1:45.6 for primary and 1:26.4 for secondary in 2012) is decreasing despite increasing enrolment (World Bank 2016). This suggests that more jobs are being and will continue to be created here.

4 Services firms in the MSME sector

We have shown in Table 2 that 82.5 per cent of the increase in services-sector employment in Tanzania between 2002 and 2012 took place in the informal sector. To understand the nature of these firms, we used Tanzania's first nationally representative survey of MSMEs, conducted by the Financial Sector Deepening Trust in 2010. While this survey is not without its limitations, it provides the only comprehensive data we have for assessing the role of small (and particularly informal) firms in Tanzanian services.[3] The survey covers about 3 million formal and informal

[3] The sampling frame is households and the selection of households is based on the 2002 census. This poses at least two problems. First, because the survey is household-based, it is representative of households and not businesses. Thus, since Tanzania is still a very poor country, the survey is likely to have missed some of the more productive businesses. Indeed, an analysis of the data reveals that mid-sized firms are under-represented in this dataset (FSDT 2012). Second, because the sampling framework is 2002 and there was a significant reduction in rural activity between 2002 and 2012 (Diao et al. 2016), the survey oversamples rural households. Therefore, readers should keep in mind

businesses, with a total of around 5 million employees. These firms accounted for almost 30 per cent of national private non-agricultural GDP in 2010.

MSMEs contributed 99.6 per cent of total trade services value added in 2010. These smaller firms were mostly retail shops and hotels/restaurants, and their total value added was TZS5.14 trillion (Table 7).

4.1 Productivity and the in-between sector

The literature on firm-level productivity commonly argues that firms in the MSME sector are unproductive (see, for example, La Porta and Shleifer 2014). However, it misses the enormous heterogeneity among MSMEs. We show this heterogeneity in Tanzania in Figure 1, which plots the distribution of the log of monthly value added per worker for all firms in the MSME sector in 2010. The vertical lines in Figure 1 represent economy-wide average productivity in agriculture (green), trade services (blue), and manufacturing (purple).

Figure 1 shows that the majority of MSMEs have average productivity levels higher than that among agricultural firms. This is consistent with evidence presented in McMillan and Rodrik (2011) and McMillan et al. (2014): that structural change outside agriculture in Tanzania has been growth-enhancing since about 2000. A large share of these firms have productivity levels higher than economy-wide trade services productivity, and a smaller but still sizeable chunk of firms have productivity greater than economy-wide manufacturing productivity. This is important because it means that a good number of MSMEs contribute to raising labour productivity (and growth) in Tanzania's economy. In the process, they provide jobs for a large number of Tanzanians, especially youth.

Arthur Lewis (1979: 219) was among the first to identify the subset of firms we find in Figure 1 as

> units of production of all sizes, and in particular a great number of one-to-five-man undertakings in manufacturing, transport and a wide range of services—often nowadays called the informal sector. Some of this activity belongs in the modern sector as we have defined it; i.e., it will expand with economic development; the rest—e.g., some of the handicrafts and some of the services—belong to the traditional sector in that they will contract.

He called these 'small- to medium-scale' firms with the potential to grow the 'in between sector'—neither completely formal and modern, nor traditional. Following Lewis, we define firms in the in-between sector as MSMEs whose value added per worker is greater than the economy-wide value added per worker in manufacturing.[4] This is because the exceptional performance of these firms strongly indicates that, as the economy grows, their owners acquire the skills needed to stay in business and the potential to grow with it. This is consistent with recent writing on the importance of 'managerial capital' in economic development (Bruhn et al. 2011), a concept closely linked to that of 'firm capabilities' (Sutton 2012). These are the subset of high-capability firms in the MSME sector.

We report output per worker and the number of in-between firms by sector in Table 3. The leading in-between sub-sector is food retail shops, followed by some manufacturing sub-sectors. Although

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that our analysis is likely to understate the contribution of small businesses to economy-wide productivity and employment and also to understate the importance of small businesses in urban areas.

[4] See Diao et al. (2016) for an analysis of a different definition of the in-between sector.

trade services firms in the in-between sector are not as productive as their manufacturing counterparts, with about 78 per cent of their value added per worker, the gap between trade services and manufacturing is much smaller in the in-between sector than overall (according to the 2012 Census data presented in Table 1, trade services has about 47 per cent of the value added per worker of manufacturing overall). Moreover, services accounts for over 90 per cent of firms and 85 per cent of employment in the in-between sector, with over 800,000 workers. The fact that there is a subset of service sector firms that are more productive than ordinary manufacturing firms and almost as productive as the top-performing small manufacturers suggests that service firms can contribute highly to productive employment.

4.2 MSME policies

Tanzania implemented its first national MSME sector policy in 2003, when the Ministry of Industry and Trade published the Small and Medium Enterprise Development Policy (SMEDP). The SMEDP is one of several programmes designed to help Tanzania realize 'Vision 2025'[5], an important part of which is focused on facilitating productivity growth in agriculture, manufacturing, and MSMEs. The policy commits the government to supporting MSME development by addressing the constraints specific to MSMEs. Two other policy initiatives of the early 2000s also address the development of MSMEs. The National Microfinance Policy of 2001 aimed to achieve widespread access to finance by MSMEs in urban and rural areas, while the Economic Empowerment Policy of 2004 sought to empower Tanzanians to participate actively in the economy by creating a favourable business environment, improving the legal and regulatory framework, and facilitating access to finance, skills, technology, premises, and information.

A wide range of MSME programmes are in place in Tanzania and they are executed by an equally wide range of government institutions, donors, and NGOs. The rationale for most of these programmes is to contribute to job creation and growth, but assistance to the MSME sector by government, donors, and NGOs has been fairly ad hoc and certainly not targeted at firms with growth potential. A UNIDO (2012) report evaluating Tanzania's MSME policies found that inadequate coordination, weak synergies among stakeholders, insufficient resources to implement programmes, a lack of prioritization, and inconsistencies in legislation had hampered Tanzania's efforts to foster productivity growth in MSMEs.

4.3 Targeting the in-between sector

One clear implication of our work is that not every owner of a micro or small firm is an entrepreneur. As illustrated in Figure 1, more than half of MSMEs have extremely low productivity. These businesses help families to survive and so are important. But unlike the owners of the businesses in the in-between sector, many of these business owners report that they would prefer to have a wage-paying job. In other words, they are what Banerjee et al. (2015) have dubbed 'reluctant entrepreneurs'.

We have found a surprisingly large number of firms in the in-between sector. There is a significant right-hand tail of firms in the MSME manufacturing sector that have productivity levels equal to or greater than those in the formal manufacturing sector. The total number of employees operating in the in-between sector in all activities falls slightly short of 1 million, and average monthly value

[5] Vision 2025 is a national long-term development strategy adopted in 1999 by the Mkapa government that focuses on livelihoods and economic growth, among other issues.

added per worker for these firms is US$351. These are the firms that are most likely to have the capability to grow into medium-scale manufacturing enterprises.

Sutton and Olomi (2011) provide a 'map' of Tanzania's firm capabilities in manufacturing. One of their conclusions is that in Tanzania, as in several of the other African economies where they carried out enterprise mapping exercises, few business owners were capable of managing a medium-sized firm effectively. The scarcity of 'organizational capital' (Sutton and Olomi, 2011) suggests that public policies aimed at growth and job creation should be attempting to identify and assist those micro and small firms that are in the right-hand tail of the productivity distribution—those with organizational capital.

A logical place to begin is by talking to the owners of these small businesses. There is no substitute for face-to-face dialogue between business owners and government officials, but such structured engagements between the public sector and private firms, especially small enterprises, are rare in Tanzania.[6] An important lesson that the government of Tanzania can learn from China is that Chinese officials had and still have regular meetings with ordinary business owners. As a result of these meetings, officials often take concrete steps to remove constraints on profits and growth. An example is provided by Zhang and Hu (2014), who recount the story of one province's journey to becoming the largest potato growing region in China and eventually an exporter of potato chips.

The survey that we have been using to identify firms in the in-between sector (FSDT 2010) asks MSME owners to identify the three most important things that the government (or other partners) could do to facilitate small business growth in Tanzania. The results were as follows: 45 per cent of the firms in the in-between sector reported that providing access to finance was the most important thing. The second and third most important actions were to provide information about market opportunities and to ease the regulations controlling business. It is telling that access to credit was repeatedly singled out as a severe obstacle, since the ratio of domestic credit to GDP in Tanzania is one of the lowest in the world (te Velde 2015).

The survey findings are consistent with the evolving literature on microfinance. The assumption that breaking financing constraints will boost business start-ups or allow micro and small business owners to scale up their operations and grow into larger firms appears to be true only when business owners have the skill and resources to profit from the investment (Banerjee et al. 2013; Bauchet et al. 2011). In India, for example, Banerjee et al. (2015) found that while microfinance *on average* had no effects on firm performance, it did have a significant positive impact on firms with high growth potential. Similarly, in Nigeria, a business plan competition was launched in order to identify high-potential entrepreneurs. The winners were given a substantial amount of money—on average US$50,000—to implement their business plans. Three years after the implementation, a follow-up survey of these businesses showed that the programme had been successful in helping the winning firms to achieve higher survival rates, acquire more capital and employ more workers (McKenzie 2015). MSME-financing programmes in Tanzania, on the other hand, make no attempt to screen firms for their growth potential.

Many programmes implemented in Tanzania focus on MSME training. Recent research from other countries suggests that microenterprise training initiatives have been largely ineffective (McKenzie and Woodruff 2012). A review of impact evaluations of training programmes revealed that few of

[6] The Tanzania National Business Council (TNBC) is the organization that acts as Tanzania's forum for public–private dialogue. Its membership consists of representatives drawn equally from the business community and the public sector. The TNBC has attempted to represent the interests of small firms, but it has a strong large-firm bias in its membership, and it meets infrequently.

the evaluations found any significant impacts of training on sales or profitability; this was due to a combination of small changes in business practices and low statistical power (Fafchamps and Woodruff 2016). Although it is not clear from the existing evidence whether the training was ineffective because the trainers themselves were ineffective or because training is not what the business owners required, it is relevant that none of the programmes evaluated addressed gaps in market information, the second most important constraint identified by in-between sector business owners. Significantly, none of the MSME owners in the 2010 survey reported a need for training.

One resource that provides services to MSME owners in Tanzania is the Small Industries Development Organization (SIDO), which is a government organization specifically geared to small business development. It is present in all regions of mainland Tanzania, where it provides business training, technology development, market facilitation, and small loans to entrepreneurs. However, its training programmes are mostly geared towards basic skills for micro-entrepreneurs and its loan ceiling of TZS6 million (US$2,750) is considered to be far too small by both clients and staff. Many loans go to petty traders because the demand for loans of that size from SIDO's target clients (especially those that can be considered in-between sector firms) is not enough to utilize the full portfolio; these firms are seeking loans ranging from TZS5 million to TZS50 million.

5 The tourism sector

Tourism is one of the most important industries in Tanzania, which has the resources to attract those interested in adventure trips, hiking, beach holidays, and cultural history tours. Since the late 1990s, Tanzania has been taking advantage of its tourism assets in the hope of growing into one of the world's premier tourism destinations. By all indications, its efforts are paying off, but there is still much unrealized potential. In this section, we use data from the World Travel and Tourism Council (WTTC) to examine the characteristics of tourism during the period 2002–2012 and compare them with the other services sectors. We then use data from the 2015 Travel & Tourism Report (World Economic Forum 2015) to delve deeper into the current state of tourism and its potential.

It is worth noting that government estimates put tourism's contribution significantly higher than the WTTC; however, the WTTC has more recent and more consistent data. It is also important to note that the tourism data used in this paper include only tourism's direct contributions to the economy (ignoring indirect contributions), and do not necessarily include the informal sector; thus, the numbers discussed likely under-represent tourism's importance in the overall economy.

5.1 Economic contribution

While we cannot exactly compare tourism with the other services industries, looking at its economic contribution from 2002 to 2012 gives us some idea of its relative importance. As Table 8 shows, tourism's real contribution to GDP has grown consistently since 2002, and recently has been worth more than US$1 billion annually. Its share of GDP in 2012, however, was only about 4.5 per cent, which is a small share of the services sector as a whole. However, its indirect contribution to GDP is estimated to be much higher, suggesting that, like business, transport, and communication services, tourism has wide-ranging economic benefits. Table 8 also shows that the number of jobs in tourism has steadily increased. Tourism's share of employment was about 3.15 per cent in 2012, putting it above both transport and business services, and indicating that tourism may have the potential to account for a significant portion of employment in the country.

Productivity in tourism grew by approximately 50 per cent from 2002 to 2012, and the value added per worker in 2012 was US$4,381. Tourism is therefore a more productive industry than trade services, and similar to transport. However, while tourism performs relatively well in terms of its economic contribution, it is important to note that its contribution to both GDP and employment has not increased over the period 2002–2012. This section will go on to examine the factors that are restricting further growth in the tourism industry, and consider its potential if those restrictions are removed.

We first want to better understand the tourism market in Tanzania, including the products it offers, who its primary clients are, and where most consumption takes place. Table 9 shows the breakdown of the industry between business and leisure tourism, and between domestic and foreign tourists. As Table 9 shows, Tanzania is dominated by foreign and leisure tourism. Most foreign tourists come from Europe and the United States. These tourists travel a great distance to reach Tanzania, often at a very high price, and are only likely to do so for longer holidays. Residents of East African Community (EAC) countries represent a great source of potential. The EAC is home to approximately 140 million people, who would be able to travel to Tanzania cheaply and on short holidays (Rugimbana 2016). Further research is needed to identify this market, and more marketing and promotion should be aimed at this group.

Table 9 also shows that domestic tourism has risen. According to an interview with the Executive Director of the Tourism Confederation of Tanzania, Richard Rugimbana (2016), it is generally understood that domestic tourism is composed primarily of Tanzanians travelling for business meetings or to see friends and family. Developing domestic tourism would be fruitful for Tanzania, as the benefits of foreign tourism tend to be repatriated to foreign firms. The World Bank (2015) suggests that almost 30 per cent of tourist spending leaks into foreign markets, through the consumption of imported goods or services from foreign-owned businesses, while domestic tourism revenue may be more likely to remain in-country. While there is major potential for domestic tourism development in Tanzania, further research is needed to identify its current structure and value contribution, and the products consumed by domestic tourists.

5.2 Restrictions and solutions

Though tourism appears to be doing well in terms of performance, the data show that it made essentially the same contributions to GDP and employment in 2012 as it did in 2002. There are several remaining challenges in the industry, which are preventing it from unlocking its full potential. According to a report completed by the Tourism Task Force in 2016, these challenges include the destruction of wildlife and natural resources, overregulation and the heavy burden of taxation, poor infrastructure, lack of human capital in the tourism industry, insufficient investment in and diversity of tourism assets, and insufficient marketing, promotion, and branding (Tourism Task Force 2016).

The issue of wildlife depletion is especially concerning, as Tanzania's competitive advantage in tourism comes from its natural resources. Poaching, deforestation, interference with water sources, and dynamite fishing all serve to devalue Tanzania's tourism assets (Tourism Task Force 2016). Additionally, high-density tourist flows in areas such as the Serengeti and Kilimanjaro contribute to wildlife erosion (World Bank 2015). If drastic action is not taken to preserve its wildlife, Tanzania could lose its competitive edge in less than 20 years (Rugimbana 2016). Already, Tanzania's global rank for natural resources has dropped from 2nd in 2011 to 7th in 2015, thanks primarily to poaching decimating the elephant population (Blanke and Chiesa 2011; Crotti and Misrahi 2015; Tourism Task Force 2016).

To address the impact of high-density tourism, the government has implemented a 'high-value low-density' (HVLD) tourism policy, attempting to make Tanzania a 'high-end' tourist destination that caters to a very wealthy population (World Bank 2015). This strategy aims to conserve Tanzania's tourism assets, while attracting high-spending tourists. However, the quality of tourism services in Tanzania is currently too low to make this HVLD policy feasible, and it does not depict the reality on the ground. Moreover, costs for tourism in Tanzania are currently high relative to its competitors (Rugimbana 2016).

These high costs are partly due to overregulation and taxation, which force tour operators and other service providers to charge higher prices in order to break even. The environment for tourism investment in Tanzania is harsh, and the number of licences required, taxes to be paid, and other regulatory burdens ranges from 10 to 115 per provider. These regulations are levied by the central government as well as local officials, and it becomes very expensive for tourism operators to meet all of the requirements (Tourism Task Force 2016).

The overriding fact remains, however, that Tanzania does not offer a level of service quality commensurate with its HVLD policy. A major issue is the shortage of high-quality hotel accommodation; if Tanzania hopes to increase its international tourist arrivals significantly, it will need more quality accommodation. Additionally, there are not enough well trained people working in the tourism industry. Tanzania lacks training options for those in the tourism industry, and those that it does have provide a low quality of instruction (Tourism Task Force 2016). Even if Tanzania were to improve its service quality, the HVLD policy would be viable only for certain tourism packages, such as safaris (World Bank 2015).

Tanzania's tourism strategy also lacks an emphasis on diversifying the products it offers. Currently, about 80 per cent of tourism goes to the North, largely because of a lack of infrastructure in the South and West (Rugimbana 2016). To make these corridors attractive to tourists requires the development of infrastructure, accommodation, and differentiated tourism products (World Bank 2015). Developing more circuits will also result in job creation, in addition to helping Tanzania keep pace with its regional competitors.

The final major concern for Tanzania in tourism is its marketing. The country does not go far enough to promote its tourism products abroad, and the government should direct more of its budget towards this goal. As of now, Tanzania may be considered indistinguishable from its competitors. However, it boasts some of the most iconic tourist sites in the world—the Serengeti, Kilimanjaro, Ngorongoro Crater, and Zanzibar. If Tanzania amplifies its international branding and advertising efforts, it will likely increase the number of international tourist arrivals (Tourism Task Force 2016; World Bank 2015).

5.3 Potential (country comparisons)

If Tanzania were to successfully address these restrictions, it would unlock great potential. To better understand how the tourism industry might contribute to Tanzania's economy, we look at data from the 2015 Travel and Tourism Report. Tanzania's tourism industry currently ranks 93rd in the world, suggesting that there is significant room for improvement (Crotti and Misrahi 2015). We compare Tanzania with South Africa and Kenya to get a better idea of how it is faring regionally; the results of this comparison are presented in Table 10. Kenya and South Africa both have populations similar to Tanzania's. Kenya is a major regional competitor of Tanzania, offering similar services but with a higher level of service quality and lower prices. South Africa is also a regional competitor, but provides a better example of an industry to emulate, offering even higher-quality tourism services and introducing new types of products, such as lifestyle tourism.

As Table 10 shows, Tanzania's tourism industry is ranked significantly lower than those of the two comparison countries. Its share of GDP is about on a par with its regional competitors, but tourism accounts for a lower employment share in Tanzania than in the similarly sized South Africa, indicating that tourism could contribute more to employment growth in Tanzania in the future. Value added per worker is significantly lower in Tanzania than in the other countries, suggesting that more could be done to improve productivity.

The direct GDP contribution of the tourism industry is significantly lower in Tanzania than in the comparison countries, which, notably, is due to the lower number of visitors and not to their level of spending. In fact, visitors to Tanzania spend significantly more than visitors to either of the comparison countries, as would be expected with the HVLD model. While this is a positive factor for conservation and would benefit the industry if it could increase tourist numbers without lowering prices, it is likely that costs are currently prohibitive to large numbers of tourists.

If Tanzania were to address the major restrictions to growth of its tourism industry, specifically investing in infrastructure development in the South and West, reducing taxes and regulations, and improving the quality of services, this sector could achieve higher productivity and might double its contribution to GDP and employment (Rugimbana 2016).

6 Conclusion

Services, both formal and informal, have been extremely important to the Tanzanian economy in recent years, accounting for the bulk of employment growth while positively affecting overall labour productivity by absorbing labour from agriculture. However, different sub-sectors contribute in different ways. Trade services is not extremely productive but contributes significantly to employment. Meanwhile, business services and transport and communication services do not have high employment densities but provide valuable services enabling other firms to function. Tourism, which spans the formal and informal segments of different service sub-sectors, has played a major role in the growth of services in Tanzania but still has much untapped potential, despite its efforts to transform the country into a high-value destination.

The growth of formal services in Tanzania has been slow in recent years, possibly due to the skills deficit of the Tanzanian workforce. The current educational system and vocational training programmes have not been doing enough to endow workers with the skills their employers need. An alternative model to promote vocational skills could be similar to the one used by Malaysia, where a 1 per cent levy is used to finance in-house employee training for MSMEs run by private providers (Tan and Gill 2000). This enables the training provided to be demand-driven and directly relevant to specific firms' needs. However, there is a subset of MSMEs within the informal sector that resemble formal firms, in that they are more productive than economy-wide manufacturing averages and have significant potential to grow. Targeting these firms with support to overcome the obstacles they face in formalizing and growing may have a substantial impact on employment and productivity growth.

To support the growth of in-between sector firms, the government needs to develop more targeted interventions designed to identify small firms with the potential for growth and address the constraints they face. For example, rather than providing subsidized loans or training to an untargeted range of micro and small firms determined mainly by the availability of resources, the government could use existing institutions, such as SIDO, to develop programmes better targeted at in-between sector firms. By adapting its training programmes and advisory services to its higher-potential clients and by offering larger loans to such clients rather than the current practice of

providing small loans to petty traders, SIDO could have a greater impact on businesses with growth potential despite its limited resources.

Heavy regulation and multiple taxation are citied by services firms as major obstacles to growth, especially in the tourism sector. In addition to the easing of these burdens, targeted public investment, both in hard infrastructure and in soft business and worker skills, could go a long way towards strengthening the services sector. Such investments could include improving roads and power supplies and reworking the vocational training model in line with those that have succeeded in Asian countries, as well as targeting high-potential firms with relevant business development services and affordable credit programmes. Overall, Tanzania will require a broad-based approach if it is to transform its services sector from the sector of last resort for labour into an engine of growth.

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Tables and Figure

Table 1: Tanzania's economy-wide labour productivity growth decomposition (2002–2012)

	Value added per worker (constant 2005 in TZS billion)		Labour productivity growth in 2002–2012 (%)	Sector GDP share		Sector labour share		Labour productivity growth decomposition (2002–2012 total, %)		
	2002	2012		2002	2012	2002	2012	Within	Between	Total
Agriculture	351	509	44.8	34.2	27.0	81.7	65.8	15.5	-9.7	5.7
Mining	4,057	1,581	-61.0	2.4	3.3	0.5	2.6	-1.5	4.0	2.5
Manufacturing	3,575	3,706	3.7	8.2	9.6	1.8	3.2	0.3	6.2	6.5
Utilities	6,467	1,792	-72.3	2.3	1.9	0.3	1.3	-1.7	2.2	0.5
Construction	5,560	5,119	-7.9	7.3	9.9	1.0	2.4	-0.5	8.6	8.1
Trade services	1,607	1,760	9.5	14.9	16.0	7.5	11.3	1.4	8.0	9.4
Transport services	5,968	5,442	-8.8	6.5	7.5	0.8	1.7	-0.5	5.9	5.4
Business services	35,298	20,860	-40.9	12.1	13.5	0.2	0.8	-3.5	15.0	11.6
Gov't services	3,178	3,762	18.4	11.2	10.7	4.1	3.5	2.9	-2.6	0.3
Personal services	213	114	-46.4	0.8	0.7	2.1	7.4	-0.2	0.7	0.5
Total private economy	761	1,148	50.1	88.8	89.3	95.9	96.5	9.2	41.0	50.1
Total	832	1,240	50.4	100	100	100	100	12.1	38.3	50.4
Contribution to total economy's labour productivity growth (total economy's labour productivity growth in 2002–2012 = 100)										
Agriculture								30.7	-19.3	11.4
Mining								-3.0	7.9	5.0
Manufacturing								0.6	12.4	12.9
Utilities								-3.3	4.3	0.9
Construction								-1.1	17.1	16.0
Trade services								2.7	15.9	18.7
Transport services								-1.0	11.7	10.7
Business services								-6.9	29.8	22.9
Gov't services								5.7	-5.2	0.5
Personal services								-0.5	1.4	0.9
Total								23.9	76.1	100.0

Source: Diao et al. 2016.

Table 2: Contribution to new employment by sector, non-agricultural formal and informal 2002–2012

	Total		Formal		Informal	
	Number of increase	Share in total increase (%)	Number of increase	Share in total increase (%)	Number of increase	Share in total increase (%)
Mining	404,212	11.4	9,021	0.3	395,192	11.1
Manufacturing	313,882	8.8	103,049	2.9	210,833	5.9
Utilities	194,960	5.5	194,960	5.5	-	0.0
Construction	281,864	7.9	521	0.0	281,343	7.9
Trade services	966,807	27.2	1,304	0.0	965,503	27.2
Transport services	182,383	5.1	18,497	0.5	163,886	4.6
Business services	105,871	3.0	56,924	1.6	48,947	1.4
Personal services	881,053	24.8	0	0.0	881,053	24.8
Public sector	224,579	6.3	224,579	6.3		0.0
Total private non-agriculture	3,331,032	93.7	384,275	10.8	2,946,757	82.9
Total non-agriculture	3,555,611	100.0	608,855	17.1	2,946,757	82.9

Source: Diao et al. 2016.

Table 3: Firms in the in-between sector by line of business

Sector	Monthly VA per worker	Number of firms	Total employment	Productivity relative to average	Mean employees per firm
Retail shop foodstuffs	983,723	3,762	4,692	1.96	1.25
Mfg. building materials	859,682	5,288	42,130	1.72	7.97
Mfg. furniture	851,342	7,014	21,016	1.70	3.00
Mfg. textiles	697,944	10,214	13,837	1.39	1.35
Wholesale	686,069	20,303	46,460	1.37	2.29
Retail shop textiles	639,257	9,572	12,926	1.28	1.35
Repair services	585,116	4,214	5,879	1.17	1.40
Retail shop general	561,051	70,524	122,520	1.12	1.74
Retail street vendor	536,882	20,090	31,315	1.07	1.56
Retail stall other	514,157	12,333	38,606	1.03	3.13
Food services	467,149	60,386	154,888	0.93	2.56
Beverage services	453,610	26,460	55,925	0.91	2.11
Retail stall food	450,036	70,240	139,478	0.90	1.99
Personal services	450,017	4,989	16,733	0.90	3.35
Transport	442,272	1,127	2,527	0.88	2.24
Retail stall textiles	396,044	26,723	50,322	0.79	1.88
Mfg. grain milling	377,765	6,471	44,647	0.75	6.90
Mfg. wood products	362,042	2,254	11,528	0.72	5.11
Retail shop household items	337,604	19,729	96,015	0.67	4.87
Mfg. liquor	328,138	6,446	10,113	0.65	1.57
Business services	323,566	6,219	20,105	0.65	3.23
Retail Fuel	140,746	685	1,333	0.28	1.95
Retail Shop OMG	135,759	3,848	15,962	0.27	4.15
Extraction	49,327	974	3,200	0.10	3.29
Total services	470,698	361,204	815,686	0.94	2.26
Total manufacturing	602,738	38,661	146,471	1.20	3.79
Total	501,220	399,865	962,157		2.41

Notes: Mfg = Manufacturing; OMG = other manufactured goods.

1 TZS = US$0.0007 (2010).

The in-between sector is defined as firms whose value added is greater than economy-wide manufacturing value added.

Source: Authors' calculation from Diao et al (2016).

Table 4: Sectoral distribution of MSME firms

	Number of sample	% in total
Extraction	21	0.4
Manufacturing	928	16.6
Grain milling	95	1.7
Beverage	466	8.3
Textile	189	3.4
Wood	30	0.5
Building materials	59	1.1
Furniture	89	1.6
Trade services	4,479	79.9
Wholesale	145	2.6
Retail with shops	865	15.4
Retail with stalls	1,376	24.5
Retail on street	402	7.2
Beverage services	441	7.9
Food services	1,250	22.3
Transport	17	0.3
Business services	31	0.6
Repair and personal services	130	2.3
Total	5,606	

Source: Authors' calculation using MSME survey 2010 (FSDT 2012).

Table 5: Regional distribution of MSME firms

Region	Population share	Total employment %	Urban employment %	Rural employment %
Dodoma	5.44	3.85	39.55	60.45
Arusha	3.21	2.74	56.68	43.32
Kilimanjaro	2.95	2.75	45.26	54.74
Tanga	3.85	5.07	50.45	49.55
Morogoro	6.01	6.44	53.17	46.83
Pwani	2.66	3.1	38.12	61.88
Dar-es-Salaam	14.64	17.32	100	0
Lindi	2.24	2.61	41.32	58.68
Mtwara	3.04	2.44	42.52	57.48
Ruvuma	3.11	3.83	43.33	56.67
Iringa	5.9	4.59	37.16	62.84
Mbeya	10.88	8.02	40.52	59.48
Singida	1.93	2.34	37.18	62.82
Tabora	2.67	2.08	55.26	44.74
Rukwa	2.42	2.41	35.54	64.46
Kigoma	2.04	1.73	9.56	90.44
Shinyanga	7.16	6.81	36.36	63.64
Kagera	2.9	2.83	15.67	84.33
Mwanza	8.9	10.7	36.86	63.14
Mara	3.27	4.6	48.32	51.68
Manyara	1.65	1.58	37.99	62.01
Kaskazini Unguja	0.34	0.19	0	100
Kusini Unguja	0.26	0.14	0	100
Mjini Magharibi	1.54	1.11	79.99	20.01
Kaskazini Pemba	0.48	0.38	12.19	87.81
Kusini Pemba	0.51	0.35	27.87	72.13
Total		100	51.29	48.71

Source: FSDT 2012.

Table 6: MSME contribution to national employment (1,000 people)

	National economy (Census 2012)	Formal economy (FEES)	Census (FEES)	MSMEs (MSME 2010)
Manufacturing	585	260	325	648
Trade services	2,067	240	1,827	3,104
Wholesale and retail trade	1,738	119	1,619	1,893
Wholesale	110			90
Service workers shop and stall sales workers	1,061			1,586
Street vendors and related workers	567			217
Hotel, restaurants and food services	329	119	210	1,173
Transport	311	62	249	
Transport and storage	238	43	195	
Information and communication	73	19	54	
Construction	439	45	394	
Other private services	1,349		1,349	178
Other private non-agriculture	861	205	655	20
Total private non-agriculture	5,612	812	4,800	3,912

Note: We applied individual weights in the calculation, which were different from the weights applied in the National Baseline Survey Report for MSME (FSDT 2012). Because of this, and also because some firms did not have an ISIC code in the data and hence are not included in our calculation, the total MSME employment number of 4 million in this table is lower than that in FSDT (2012), where it is around 5 million.

Sources: Authors' calculation using Census 2012 report (NBS 2014c), FEES report (NBS 2014a), and MSME survey data (FSDT 2012).

Table 7: MSME contribution to national and sectoral GDP (in current TZS billion)

	National economy	Formal economy		MSME
	(National account 2010)	(ASIP 2008)	(ASIP 2009)	(MSME 2010)
Total manufacturing	3,022			538
Beverage		183	499	164
Food processing		26	494	65
Textile		842	117	166
Wood products excluding furniture		1,108	5	18
Furniture		207	21	53
Building related materials		12	252	71
Trade services	5,163			5,141
Wholesale and retail trade	4,442			3,941
Wholesale				394
Retail with shops				3,151
Street vendors				396
Hotel and Restaurants	721			1,200
Transport	3,689			-
Transport and storage	2,537			-
Information and communication	1,152			
Construction	3,146			
Other private services	5,042			196
Other private non-agriculture	3,175			10
Total private non-agriculture	23,237			5,884
Total economy	43,571			

Note: The value added calculation is extremely difficult for the MSME survey, given that many small firms did not keep an account. The methodology for such a calculation is shown in the Appendix.

Sources: Authors' calculation using National account after rebasing (NSB 2015), ASIP (NBS 2013), and MSME survey data (FSDT 2012).

Table 8: Tourism's contribution to GDP, employment, and productivity

	Value added per worker	Contribution to GDP (real USD bn)	Percentage share of GDP	Thousands of jobs	% Share of total employment
2002	2,932.22	0.74	3.83	252.27	3.20
2012	4,381.67	1.49	3.94	340.29	3.15
% growth	0%	1%	0%	0%	0%

Source: WTTC Data Gateway (2015).

Table 9: Tourism spending breakdown, business vs. leisure, domestic vs. international

	Spending (real USD in bn)				Share of total tourism spending			
	Business spending	Leisure spending	Domestic tourism spending	International tourism spending	Business spending	Leisure spending	Domestic tourist spending	International tourist spending
2002	0.37	0.86	0.33	0.89	0.30	0.70	0.27	0.73
2012	0.31	2.13	0.70	4.98	0.25	1.74	0.57	4.07
% growth	-16%	149%	109%	459%	-16%	149%	109%	459%

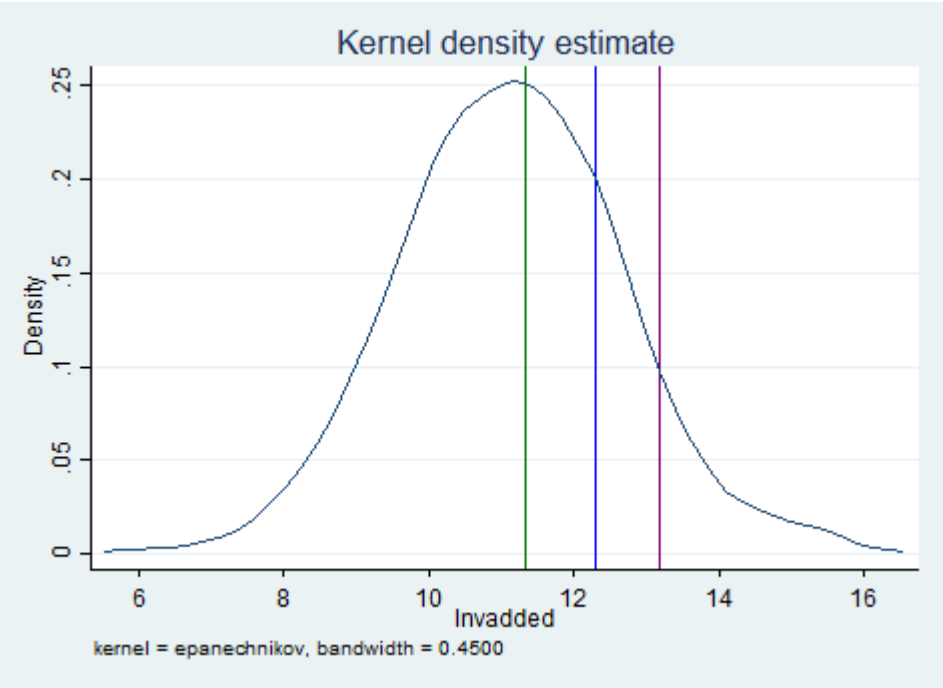
Source: WTTC Data Gateway (2015).

Table 10: Country comparisons

	Rank	Tourism contribution to GDP (USD millions)	Tourism share of GDP	Tourism contribution to employment (thousands of jobs)	Tourism share of employment	Value added per worker (US$)	International tourist arrivals (thousands)	Spending per international tourist (USD)
Tanzania	93	1,506	4.5	402	3.8	3,744	1,063	1,769
South Africa	48	10,681	3.0	646	4.6	16,547	9,537	969
Kenya	78	2,120	4.8	226	4.1	9,367	1,433	615

Source: World Economic Forum (2015).

Figure 1: Productive heterogeneity of small firms



Notes: Green = average ag productivity; Blue = average services productivity; Purple = average manufacturing productivity.

Source: Authors' calculations using MSME survey 2010 (FSDT 2012).