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UNITED REPUBLIC OF TANZANIA

SELECTED ISSUES

July 2025

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SELECTED ISSUES

June 16, 2025

Approved By
The African Department

Prepared Melesse Tashu and Sebastian Acevedo (AFR)

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THE BUSINESS ENVIRONMENT AND PRODUCTIVITY IN TANZANIA— EVIDENCE FROM FIRM LEVEL DATA[1]

Using the World Bank's Enterprise Surveys (ES) data, this paper sheds light on the relationship between firm-level total factor productivity (TFP) and the business environment in Tanzania. It finds statistically significant evidence that cumbersome tax administration, limited access to finance, and limited access to transport are associated with lower firm TFP in the manufacturing sector. While regression coefficients are not statistically significant, negative associations between TFP and the regulatory burden, as well as power outage, are also evident in non-parametric relationships. On the other hand, there is no clear evidence for the relationship between incidence of corruption and TFP. These results underscore the importance of stepping up structural reforms to improve the efficiency of tax administration, ease the regulatory burden, and improve access to finance and reliable infrastructure. In particular, these reform areas should be given priority in the context of the Vision 2050 *and* Blueprint for Regulatory Reforms II *strategies.*

A. Context

1. Tanzania enjoyed robust economic growth in the past two decades, driven largely by public sector investment. Real GDP grew at an annual average rate of about 6 percent during 2000-23, when the share of gross fixed capital formation to GDP more than doubled from about 19 to 43 percent. While the private sector contributed more than half of the growth in total gross fixed capital formation during 2000-11, the trend reversed during 2011-23 when private sector fixed capital formation declined by 1 ppts of GDP.[2] In particular, FDI declined from about 5.7 percent of GDP in 2010 to about 2 percent of GDP in 2023.

2. However, economic growth has been characterized by declining productivity growth and slowing structural transformation:

- The contribution of TFP growth to real GDP growth declined from 1.6 ppts in the 2000s to -0.1 ppts in the 2010s and further to -2 during 2020-23 (Figure 1). While the slowdown in TFP growth since the 2000s was a global phenomenon, Tanzania's TFP growth lagged significantly that of countries in the Eastern Africa Community and Sub-Saharan Africa.

- A recent study finds that the contribution of structural change[3] to total labor productivity declined from 72 percent during 2006-2014 to -5 percent during 2014-2021, implying that 105 percent of labor productivity during 2014-2021 was driven by within-sector productivity gains (World Bank, 2023a). As further evidence of declining structural transformation, the share of

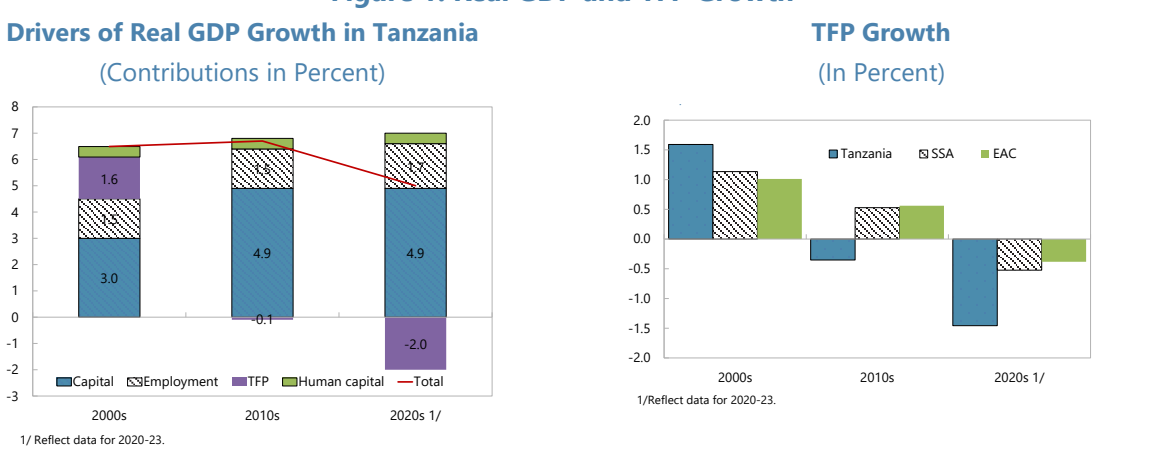
[1] Prepared by Melesse Tashu.

[2] During 2011-23, public sector gross fixed capital formation grew by 8.6 ppts of GDP, to 18.8 percent.

[3] Structural change in this context is defined as the reallocation of labor from low-productivity sectors (e.g. agriculture) to high-productivity sectors (e.g. construction and manufacturing).

merchandize exports to GDP declined by about 4½ ppts to 9.2 percent and the share of manufactured goods in total merchandise exports declined by about 4 percent to about 12 percent during 2011-23.

Figure 1. Real GDP and TFP Growth



Source: IMF staff calculations.

3. This paper explores empirically the extent to which weaknesses in the business environment might have contributed to the slowdown in firm-level productivity. A firm's productivity depends on the production technology it employs, but also on its institutional, policy, and regulatory environment— i.e., the business environment (Dollar et all, 2005; Fernandes, 2008; Anos-Casero and Udomsaph, 2009; Syverson, 2011). An enabling business environment supports productive use of inputs, reduces rent-seeking activities, and encourages skill acquisition, capital accumulation, and innovation (Anos-Casero and Udomsaph, 2009). Key aspects of the business environment that can influence productivity growth include business regulation, tax administration, access to finance, governance, and infrastructure such as electricity and transport (Dollar et all, 2005; Fernandes, 2008; and Augier et al 2012). By offering empirical evidence on the relationship between business environment indicators and TFP, the paper aims to inform the Tanzanian authorities' structural reform strategies through *Vision 2050* and the second phase of *Blueprint for Regulatory Reforms*.

B. Business Environment Indicators in Tanzania

Regulatory Burden

4. The private sector in Tanzania faces a cumbersome regulatory environment. According to the 2023 ES, 14 percent of firms' senior management time is spent on dealing with regulations, compared to an average of 8 percent for SSA and lower middle-income countries (LMICs) (Figure 2). Key challenges include high costs to start and operate a business, cumbersome licensing procedures, and redundant processes (World Bank, 2023a). Acknowledging these challenges, the authorities launched the *Blueprint for Regulatory Reform* (Blueprint) in 2018 to ease regulatory constraints for businesses (Government of Tanzania, 2018).

The Blueprint aims to: (i) adopt and implement mechanisms that promote and ensure an efficient regulatory policy; (ii) simplify the business-regulatory regime to avoid duplications and overlaps of mandates among regulatory agencies; and (iii) promote regulatory transparency by using Information and Communication Technology (ICT) platforms that provide information on regulatory processes to the general public.

5. Notwithstanding progress in implementing the Blueprint, significant challenges remain. The authorities' evaluation of the Blueprint implementation shows significant progress, including: (i) reduction of fees and streamlining of processes; (ii) introduction of electronic systems and one-stop centers; and (iii) consolidation and harmonization of regulations (Government of Tanzania, 2024a). However, it also highlights a number of outstanding and emerging challenges such as still insufficient harmonization of policies, laws and regulations, overlapping roles among regulatory bodies, inadequate personnel at one-stop centers, frequent slowdown and outages of new electronic systems, proliferation of electronic systems, and the introduction of new fees and regulations, in particular by local governments (Government of Tanzania, 2024a and 2024b).

Tax Burden

6. High compliance costs associated with a complex tax system have weakened the business environment. Key challenges include cumbersome tax filings, frequent changes in taxation requirements, and delays in reimbursements. Tanzanian taxpayers face more frequent visits than taxpayers in SSA and LMICs (Figure 2), and overly aggressive pursuit of additional revenues by the *Tanzania Revenue Authority* (TRA), including by issuing agency notices and seizing money from taxpayers' bank accounts without proper legal recourse.[4] These practices led to countrywide strikes by domestic retail traders and calls for dialogue by the diplomatic community in mid-2024.[5] The income tax on companies with perpetual unrelieved loss for three consecutive years discourages startup firms.[6]

7. The administrative process for VAT refunds remains very slow, constraining taxpayers' cashflow management. Supported by the ECF arrangement, the authorities have made progress in clearing verified VAT arrears on timely basis. However, the VAT Act currently only allows a business (other than a qualifying exporters) to claim a refund six months after it arose, contrary to good practices where refunds are paid or declined within 30 days from when the return is filed. Furthermore, VAT refund claimants are required to submit a 'Certificate of Genuineness' from a TRA-registered tax consultant, effectively auditing all refunds before they are paid, irrespective of risk, and adding to the taxpayer's cost of compliance.

[4] Agency notices are directives to third parties, typically banks, to transfer funds from a taxpayer's account to settle outstanding tax liabilities.

[5] *After Traders' Strike, Envoys Call for Dialogue Citing Unfair Tax Practices to Investors and Arbitrary Freezing of Bank Accounts in Tanzania*, The Chanzo, July 1, 2024.

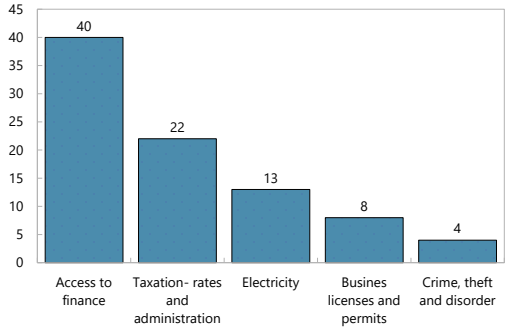
[6] Although the intended objective is to discourage use of aggressive tax planning by generating consistent losses, tax manipulators can still avoid paying taxes by generating very small profits rather than losses.

Figure 2. The Business Environment Indicators, 2023

Access to finance is identified as a major constraint to the business environment by the largest share of firms…

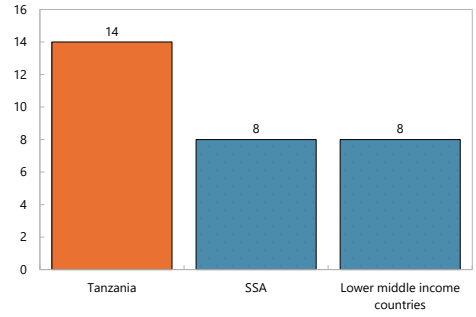
Top Five Business Environment Constraints in Tanzania

(Percent of Firms)



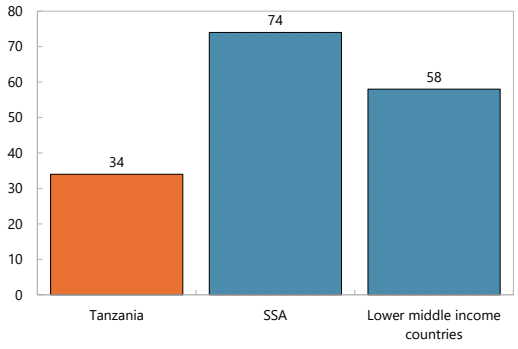
Senior managers of Tanzanian firms spent more time dealing with regulatory requirements than firms in peer countries…

Percent of Senior Management Time Spent Dealing with Business Regulations



However, Tanzanian firms face a lower frequency of power outage….

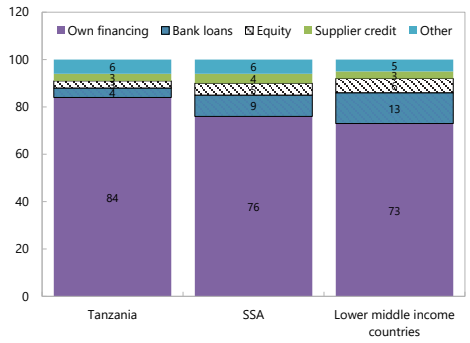
Percent of Firms Experiencing Electrical Outages



…as only a small share of Tanzanian firms are able to finance acquisition of fixed assets through loans.

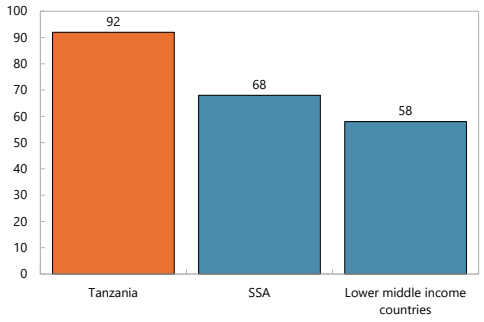
Sources of Financing for Purchases of Fixed Assets

(Percent of Total)



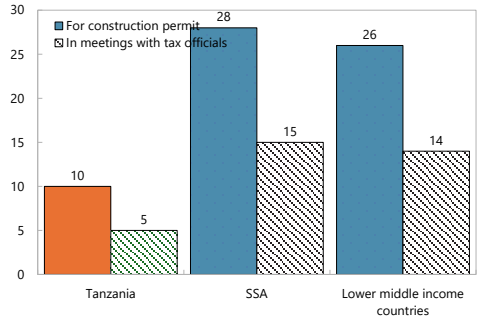
…and they are likely to meet with tax officials more frequently than firms in peer countries.

Percent of Firms that Meet with Tax Officials



…and are less likely to expect a bribe from public officials than firms in peer countries.

Percent of Firms Requested or Expected to Give Gifts or Informal Payments

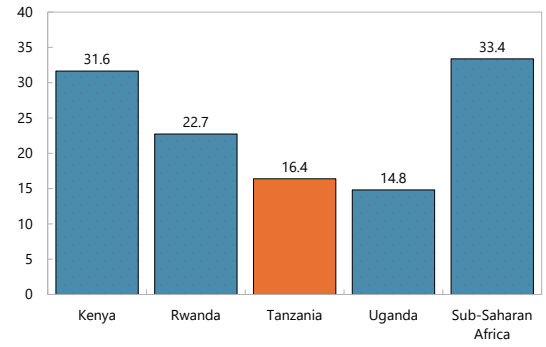


Sources: World Bank, Enterprise Surevys; and IMF staff calculations.

Access to Finance

8. Domestic credit to the private sector in Tanzania is among the lowest in the region. As of 2023, outstanding domestic credit to the private sector stood at 16.4 percent of GDP in Tanzania, against 31.6 percent in Kenya, 22.7 percent in Rwanda, and a SSA average of 33.4 percent (2022) (Figure 3). In the 2023 ES, access to finance is ranked by Tanzanian firms as the most binding constraint to business, and about 84 percent of firms relied on own funds to finance purchases of fixed assets, which is high even by regional standards (Figure 2). This reflects a shallow and underdeveloped financial sector, dominated by banks, with only nascent capital markets. The credit market is also constrained by underdeveloped financial market infrastructure, limited availability of credit information, and lack of effective collateral registry system (World Bank, 2023a).

Figure 3. Domestic Credit to the Private Sector, 2023
(In percent of GDP)



Sources: World Bank, World Development Indicators.

Access to Electricity

9. Notwithstanding recent progress, access to reliable electricity continues to be a key challenge for businesses. Access to electricity increased from 14.8 percent of the population in 2010 to 48.3 percent in 2023, but still lags peer country levels (e.g. Kenya: 76.2 percent; Rwanda: 63.9 percent; and Uganda: 51.5 percent).[7] Although the percent of firms experiencing electrical outages is low compared to regional averages (Figure 2), a significant challenge for those with electricity connections is the poor reliability and quality of service, caused by a deteriorating network with overloaded transformers, distribution feeders that are longer than industry good practice, poorly configured networks that hinder isolation of faults, and limited operations and maintenance services.[8]

Corruption

10. Tanzania ranks better than peers in terms of bribery incidence, but corruption vulnerabilities exist. According to the 2023 ES, only 7 percent of firms reported to have experienced at least one bribe payment request, compared to SSA and LMIC averages of 21 percent and 18 percent, respectively (Figure 2). Tanzania's score in the *Transparency International* corruption perceptions index improved by 11 points during 2015-24 to 41. However, the authorities assess that

[7] World Development Indicators Database.

[8] National Energy Compact for the United Republic of Tanzania.

corruption vulnerabilities still persist and, to combat it, they launched the National Anti-Corruption Strategy and Action Plan Phase Four (NACSAP IV) 2023-2030 (Government of Tanzania, 2023).

Transport

11. Tanzania's significant public investment on infrastructure in the past decade appears to have paid off. The share of firms identifying transportation as a major or severe obstacle to their business operations in the ES declined from 38.2 percent in 2013 to 9.4 percent in 2023. Still, the country's road density remains low at 9.6 km per 100 km^2 of land area, which could be an impediment to private sector productivity (Government of Tanzania, 2021).

C. Empirical Framework

Data Sources

12. Data on the business environment is drawn primarily from the World Bank's Enterprise Surveys. ES are nationally representative firm-level surveys of top managers and business owners in over 160 economies, including Tanzania. They provide insight into key business-related issues including government regulation, taxation, access to finance, corruption, infrastructure. ES also collect data on firm characteristics, performance, and geographic location, and cover small to large non-agricultural firms with a minimum of 5 employees. Firms that are 100 percent state-owned, public utilities, government services, health care, and financial services are not covered. For Tanzania, the ES were conducted in 2006 (394 firms), 2013 (698 firms), and 2023 (600 firms), making it possible to study the evolution of the business environment and its potential impact on private sector performance. To limit the potential bias on the BE by majority government owned firms, only firms with majority private ownership (over 50 percent) are included in the analysis.

13. Data on TFP is drawn from Francis et al (2020) who computed firm-level TFP for manufacturing sector firms using ES data. Specifically, this study uses the TFP computed using a translog production function of firms' value-added (tfprVAKL).[9] The TFP data has two limitations. First, TFP is computed only for manufacturing sector firms, which restricts our ability to control for potential endogeneity problems by regressing firm-level TFP on industry-level business environment indicators. Second, even though there are overlapping firms in the ES over the three survey years, none of these firms have TFP data, implying that we cannot use fixed/random effect panel data models.

[9] A translog production function is a second-order Taylor expansion of Cobb-Douglas production function that interacts each input term with itself and all other combinations of input terms.

Methodology

14. Because of the above limitations, pooled OLS method is used to investigate the relationship between TFP and the business environment. A pooled OLS method is applied to the following general specification:

$$TFP_{it} = \beta_0 + \beta_1 \boldsymbol{BE}_{it} + \beta_2 \boldsymbol{X}_{it} + \varepsilon_{it} \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots (1)$$

where:

- 'i' and 't' represent firm and year indices, respectively.
- '*TFP*' refers to firm-level total factor productivity.
- '*BE*' represents a vector of business environment indicators for regulatory burden, tax burden, access to finance, power outages, corruption/bribery, and access to electricity and transport.
- '*X*' represents a vector of firm-specific control variables that affect firm productivity.
- 'ε' is an unobserved error term.

15. Business environment indicators used in the estimation include:

- *Regulatory burden*- measured by senior management time spent dealing with regulatory requirements.
- *Tax burden*- measured by the number of visits or required meetings with tax officials.
- *Corruption*- measured by the percent of public transactions for which a gift or informal payment was required (bribery depth).
- *Access to electricity*- measured by a dummy variable for a firm experiencing power outage in the previous fiscal year.
- *Access to transportation*- measured by a dummy variable for a firm identifying transportation as a major or severe obstacle to its operation.

Each BE indicator enters the regression one at a time along with control variables to mitigate potential multicollinearity problems, following the approach by Fernandes (2008) and Augier et al (2012). Since all indicators are defined to measure obstacles to the BE, their coefficients are expected to have negative signs.

16. Key control variables include firm size and age, share of products exported, dummy for foreign ownership, share of skilled workers, manager's year of experience, and dummies for firm location and year.[10] Smaller firms, export-oriented firms, firms with majority foreign

[10] Data source for all control variables is the ES.

ownership, firms with higher share of skilled workers, and firms with more experienced managers are expected to be more productive (Fernandes, 2008). On the other hand, TFP and firm age are expected to have an inverse 'U' relationship. With the exception of size, location, and year dummies, only statistically significant control variables are kept in the regression for sake of parsimony.

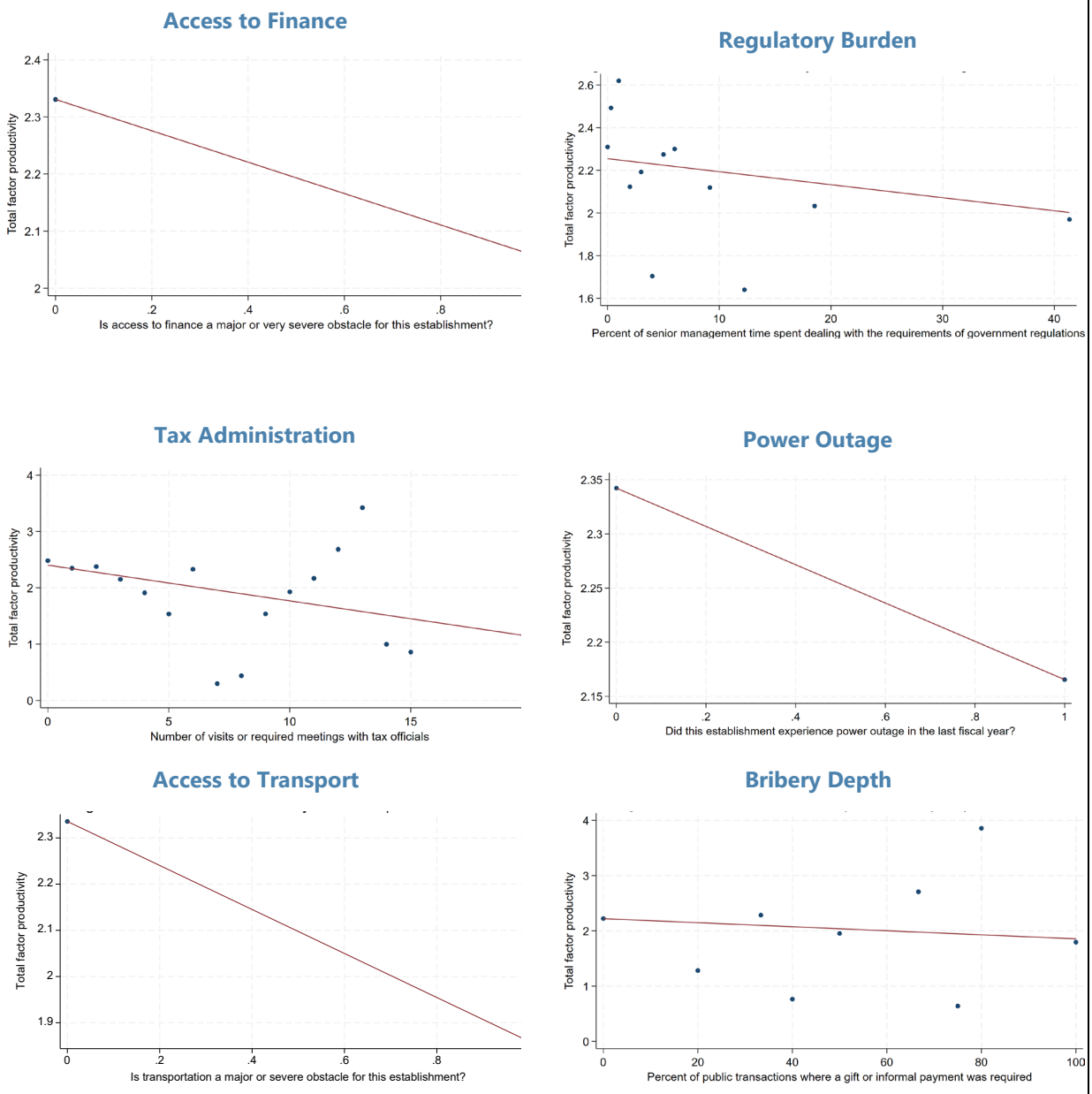
D. Estimation Results

17. Simple correlation analysis provides tentative evidence that deteriorations in the business environment are associated with lower firm TFP. Figure 4, which presents binscatter plots[11] of TFP with each of the BE indicators, show that:

- Firms that identify access to finance as a major constraint tend to have lower TFP than those which do not.
- TFP is negatively correlated with senior management time spent dealing with government regulations (regulatory burden) and the number of visits/required meetings with tax officials.
- Firms experiencing power outage and firms that identify transportation as a major/severe obstacle have lower TFP than those which do not.
- There is no clear evidence of correlation between TFP and the percent of public transactions where a gift or informal payments was required (corruption).

[11] Binscatter plots provide a non-parametric way of visualizing the relationship between two variables when observations are too numerous to interpret visually in a standard scatter plot. Binscatter groups the x-axis variable into equal-sized bins, computes the mean of the x-axis and y-axis variables within each bin, then creates a scatterplot of these data points. In the case where x is a dummy variable, there will be just two bins- '0' and '1'.

Figure 4. The Business Environment Indicators and Firm TFP in Tanzania



Sources: World Bank, Enterprise Surevys; and IMF staff calculations.

18. The regression results confirm the negative association between TFP and obstacles to business environment, but only some of them have statistically significant coefficients (Table 1). Indicators for regulation, power outage, and corruption have negative signs as expected, but their coefficients are not statistically significant. On the other hand, the coefficients for tax administration, access to finance, and access to transport are statistically significant. The estimated coefficients indicate that:

- Each visit by tax officials to the firm is associated with a decline in TFP by 0.06 ppt.
- Firms that identify access to finance as a major/severe obstacle are likely to have a 0.3 ppt lower TFP than those which do not.
- Firms that identify access to transport as a major/severe obstacle are likely to have a 0.4 ppt lower TFP than those which do not.

19. Regarding the control variables:

- A firm's age and foreign ownership are positively and significantly associated with TFP.
- Export share, worker skills, and manager's experience were statistically insignificant (with unexpected negative sign in the case of export share and manager's experience).
- The years 2013 and 2023 are associated with lower average TFP than 2006, which is in line with macro trends discussed in the first Section, but the coefficients are not statistically significant.
- Firms located in Dar Es Salaam and Zanzibar are likely to be more productive, on average, than firms located in Arusha (the benchmark location), but firms located in other regions do not have statistically significant TFP difference from those located in Arusha.
- Large size firms have statistically significant lower average TFP than small firms.

Table 1. Tanzania: Pooled OLS Regression Results between TFP and Obstacles to the Business Environment

VARIABLES	(1) Government regulation	(2) Tax administration	(3) Access to finance	(4) Power outage	(5) Corruption	(6) Transport
Control variables						
Firm age	0.0180**	0.0122*	0.0134**	0.0129*	0.0141**	0.0135**
	(0.00768)	(0.00656)	(0.00668)	(0.00667)	(0.00677)	(0.00664)
Foreign ownership (>=50)	0.567*	0.583*	0.549*	0.563*	0.526*	0.549*
	(0.326)	(0.326)	(0.308)	(0.313)	(0.317)	(0.311)
Year-2013	-0.223	-0.170	-0.204	-0.160	-0.386	-0.0441
	(0.227)	(0.218)	(0.223)	(0.221)	(0.236)	(0.228)
Year-2023	-0.0228	-0.127	-0.131	-0.282	-0.197	-0.137
	(0.241)	(0.230)	(0.229)	(0.248)	(0.234)	(0.228)
Dar Es Salaam	0.513**	0.454*	0.416*	0.391*	0.482**	0.396*
	(0.242)	(0.232)	(0.235)	(0.235)	(0.236)	(0.232)
Dodoma	0.453	0.488	0.515	0.513	0.700	0.532
	(0.554)	(0.541)	(0.566)	(0.534)	(0.540)	(0.580)
Mbeya	0.392	0.443	0.380	0.417	0.513	0.384
	(0.352)	(0.343)	(0.344)	(0.345)	(0.358)	(0.352)
Mwanza	0.340	0.138	0.0681	0.168	0.222	-0.0463
	(0.538)	(0.494)	(0.423)	(0.481)	(0.761)	(0.400)
Pemba	-0.265	-0.356	-0.372	-0.538	-0.0391	-0.340
	(0.364)	(0.360)	(0.359)	(0.359)	(0.383)	(0.351)
Zanzibar	0.765*	0.850**	0.845**	0.857**	1.010***	0.766**
	(0.398)	(0.351)	(0.359)	(0.352)	(0.366)	(0.357)
Medium firms (20-99)	-0.0970	0.0250	-0.0296	0.0248	0.184	0.0187
	(0.185)	(0.181)	(0.178)	(0.179)	(0.190)	(0.181)
Large firms (>=100)	-0.633**	-0.454*	-0.578**	-0.509**	-0.307	-0.481*
	(0.270)	(0.267)	(0.257)	(0.257)	(0.259)	(0.258)
Business environment indicators						
Regulation	-0.00278					
	(0.0132)					
Tax administration		-0.0581**				
		(0.0264)				
Access to finance			-0.282*			
			(0.155)			
Power outage				-0.278		
				(0.196)		
Corruption					-0.00420	
					(0.00304)	
Transport						-0.386**
						(0.186)
Constant	1.715***	1.931***	1.931***	2.040***	1.650***	1.861***
	(0.291)	(0.273)	(0.273)	(0.311)	(0.272)	(0.266)
Observations	447	477	479	476	431	479
R-squared	0.060	0.065	0.064	0.061	0.059	0.066
F-value	1.95*	2.67***	2.51***	2.06**	2.05**	2.61***

Robust standard errors in parentheses
*** p<0.01, ** p<0.05, * p<0.1

E. Concluding Remarks

20. Using the World Bank's Enterprise Survey, this study finds evidence that obstacles to the business environment are associated with lower firm productivity in Tanzania. In particular, limited access to finance, burdensome tax administration, and limited access to transport are associated with lower TFP with statistically significant coefficients. Although the regression results do not find statistically significant association between TFP and the regulatory burden, Tanzanian firms face more regulatory hurdles than firms in peer countries, and other diagnostic studies, including by the authorities, have identified the regulatory burden as one of the major constraints to the business environment. Similarly, the regression analysis does not find a statistically significant association between TFP and power outages, but a large share of firms (34 percent) in the ES reported having experienced power outages, making access to electricity an important area in need of further improvement. Finally, Tanzania appears to have made significant progress in reducing corruption, as neither the non-parametric bivariate correlation nor the regression results show clear association between TFP and indicators of corruption.

21. The analysis of the study highlights the importance of stepping up key structural reforms, focusing on:

- *Improving access to finance*. Reforms should facilitate access to finance for the private sector, including by expanding the quality of credit information, establishing a legal framework for collateral secured transactions and collateral registries, and upgrading the digital infrastructure (e.g. payment systems, digital ID, and data sharing) to expand digital financial services.

- *Enhancing the efficiency of tax administration*. Continuing to automate tax systems, strengthen the risk-based compliance management framework, and increase the capacity of the TRA would be key to reduce the need for in-person meetings and to improve the efficiency of tax administration. Completing and implementing the automation of the VAT refund process will also help ease undue delays in tax refunds.

- *Easing the regulatory burden*. Building on recent progress, more decisive efforts are needed to streamline regulatory requirements, avoid regulatory loopholes and duplications, consolidate regulatory agencies, and automate regulatory procedures, including along the lines envisaged by the authorities under *Blueprint II*.

- *Upgrading infrastructure*. Ongoing investments in road and railway infrastructure will help ease constraints to transport infrastructure. Improvements in the reliability of electricity service require investments in grid stabilization, network rehabilitation, reinforcement, and digital technologies to enhance operational flexibility. Ensuring that electricity tariffs are cost reflective would enable TANESCO to perform the required operations and maintenance without relying on budget support from the government.

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FOSTERING HUMAN CAPITAL IN TANZANIA'S RAPIDLY GROWING POPULATION[1]

Tanzania's human capital development needs are staggering and need to be addressed urgently to reap the benefits of the ongoing demographic transition. Almost half of Tanzanians are under 18 years of age, and the population is projected to double to more than 130 million by 2050. Currently, Tanzania lags its peers in terms of the coverage and quality of education and health services; one-third of children under 5 years are stunted, placing the country among the 10 most affected in the world. In addition, schools are not adequately staffed, affecting education quality, with student-teacher ratios in pre-primary, primary, and lower-secondary schools at 163, 61, and 27 respectively. This paper (i) takes stock of recent changes since the launch of the ECF program, including improvements in priority social spending; (ii) highlights the challenges to close current gaps in health and education and improve service delivery, and (iii) provides some policy recommendations.

A. Background

1. Tanzania has seen important progress in access to education, but significant challenges remain. In 2014, the government launched a policy guaranteeing free access to education up to lower-secondary (fee-free basic education program), which resulted in a large inflow of students into the education system. However, resource allocation did not keep pace with these policy goals: student-teacher ratios have soared, and significant infrastructure gaps and scarcity of trained teachers and textbooks have affected education quality and outcomes. An additional challenge is the attrition of students both within and between the three basic education cycles (preprimary, primary and secondary) (UNICEF, 2024).

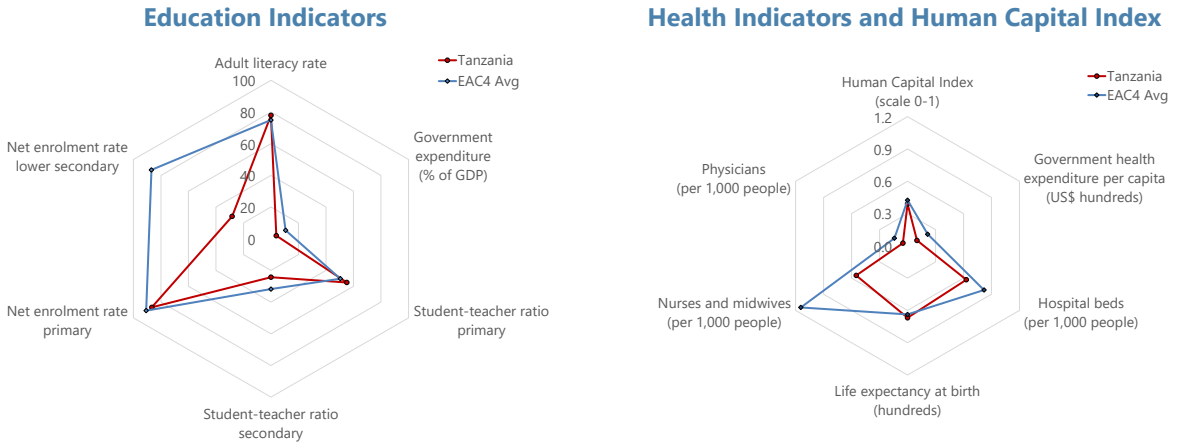
2. On the health front, important improvements have also been made. Maternal and under-five mortality rates have been substantially reduced, and the health sector workforce has continued growing, with new recruits deployed predominantly to rural areas. However, there remains significant shortages of health facilities and workers at all levels of health care, as well as of medical supplies, and laboratory equipment. For instance, addressing the gap in human resources of about 66 percent, particularly at the primary health care level, would require hiring some 200,000 health workers. Furthermore, high fertility rates continue to put pressure on the healthcare system, potentially hindering further progress in health outcomes.

3. Tanzania lags regional peers in both education and health spending and access to services. The government of Tanzania spends less than its EAC peers (Figure 1) in health, resulting in less doctors, health workers, and hospital beds, although life expectancy is slightly higher. Similarly,

[1] Prepared by Sebastian Acevedo.

Tanzania has a lower education spending, lower enrollments in primary and lower secondary schools, and a high student-teacher ratio in primary schools.

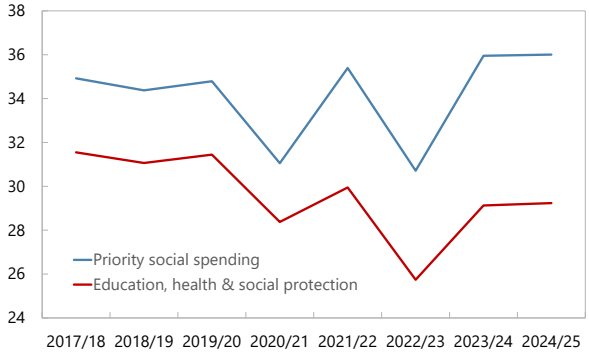
Figure 1. Education and Health Indicators[1]



Sources: WDI database, and IMF staff calculations.
[1] Data for 2022 or latest available.
Note: EAC4 average includes, Burundi, Kenya, Rwanda and Uganda.

4. Under the current ECF program, a key objective has been to protect and increase spending on social sectors to support Tanzania's development objectives. In FY20/21, Priority Social Spending (PSS)[2] had declined to 5.5 percent of GDP, as the government prioritized ramping up development spending (mainly infrastructure) at the onset of the pandemic (Figure 3). In FY21/22, with the support of the RCF facility, PSS rose temporarily to 6.7 percent of GDP to address the impact of COVID-19 and strengthen health and education services. When the ECF program was approved, in July 2022, a key objective was to enhance PSS over time by opening fiscal space through domestic revenue mobilization and rebalanced spending.

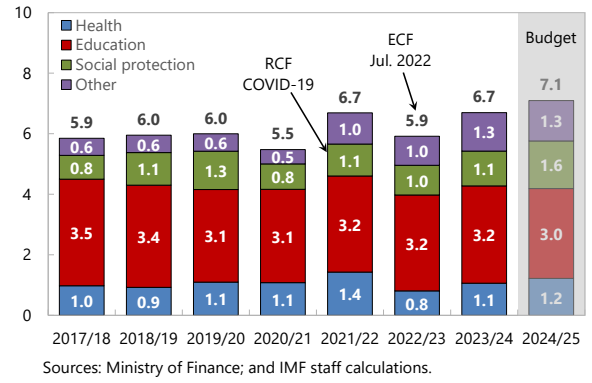
Figure 2. Priority Social Spending
(Percent of Total Government Spending)



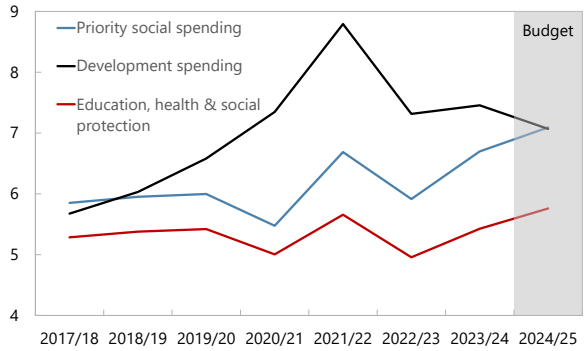
Sources: Ministry of Finance; and IMF staff calculations.

[2] The Tanzanian government's definition of PSS is comprised of spending on education, health, social protection, that is the traditional definition of social spending, plus spending on "Other PSS" which includes rural roads and electrification, water, and subsidized fertilizers for the agricultural sector.

Figure 3. Composition and Evolution of Social Spending



Sources: Ministry of Finance; and IMF staff calculations.



Sources: Ministry of Finance; and IMF staff calculations.

5. Despite increases in PSS in recent years, its composition has not reflected relative priorities in education and health. PSS increased from 5.5 percent of GDP in FY20/21 to 6.7 percent of GDP in FY23/24. A further improvement to 7.1 percent of GDP is planned by end FY24/25, with the help of a supplementary budget that increased PSS spending by 0.2 percent of GDP. However, over the past three years the "Other" PSS category received most of the increase (0.8 pp of GDP), followed by social protection (0.3 pp), while no progress was made on health and only a marginal increase was observed in education spending (0.1 pp). In addition, while some rebalancing took place from development spending toward PSS, most of the increase in PSS was allocated to infrastructure spending on rural roads and electrification, with only modest improvement in what is traditionally defined as social spending on education, health, and social protection (Figure 2 and 3).

B. Authorities' Strategy

6. The government is embarking on an ambitious reform of the education sector. The Ministry of Education is working towards increasing mandatory education from 6 to 10 years, which will include one year of pre-primary education, seven years of primary school, and two years of lower secondary school. The government is also revising its curriculum to align it with modern needs and global educational standards, focusing on science, technology, engineering, and mathematics (STEM), as well as life skills and vocational education through improved Technical and Vocational Education (TVET). The government is also working on improving teacher training and continuous professional development to raise the quality of education and ensure teachers can effectively implement the new curriculum.

7. In recent years, the government has also expanded access to health. The Universal Health Insurance (UHI) Act, passed in November 2023 established a framework for mandatory health insurance coverage and subsidized premiums for low-income citizens. The healthcare system transformation focuses on universal health coverage, quality reproductive and maternal health services, and human resource development, with community health workers playing a vital role (DPG

Tanzania, 2025). A new initiative also aims to train over a hundred thousand community health workers to serve in priority regions.

8. The forthcoming *Development Vision 2050* aims to transform Tanzania into a prosperous, inclusive, and self-reliant country by 2050. It focuses on economic growth, human development, and social justice, building on progress made under *Development Vision 2025*. The vision places human capital at its center and outlines ambitious goals for education and health to contribute to the nation's inclusive socio-economic growth and sustainable development. In education, the aim is to improve the quality, accessibility, and relevance of education, prioritizing investment in early childhood and lifelong learning to develop a highly skilled and competitive workforce. In health, the vision seeks to ensure universal healthcare coverage, reduce mortality rates, improve the quality of healthcare services, and ensure access to essential health services for all citizens, emphasizing the importance of prevention, maternal and child health, and addressing non-communicable diseases.

C. Challenges Ahead

9. Demographic pressures are particularly strong in Tanzania. The World Bank (WB, 2024) and UNICEF (UNICEF, 2023) have highlighted Tanzania's challenges in dealing with a young population that is expected to double by 2050. Over the past few decades, Tanzania has significantly reduced infant and child mortality rates, but fertility rates have remained high, contributing to a rapid population growth rate of 3 percent. A slow fertility transition is typical of African countries, but in Tanzania, women have an average of 4.8 children, almost double the 2.6 rate in lower middle-income countries, and higher than in Sub-Saharan Africa (4.3). Tanzania is currently a pre-dividend country given its high fertility levels and youthful age structure.[3] To harness the demographic dividend, it is key to achieve a favorable age structure, which would benefit from scaling up affordable and high-quality family planning services, expanding girls' access to education, which is the main socioeconomic determinant of fertility, and promoting women's economic and social empowerment (Lee, 2023).

10. Securing a demographic dividend will require major efforts to address the above gaps in education and health. There is a risk that current demographic pressures may outpace the economy's capacity to provide essential services and opportunities, such as education, healthcare, and employment. To accrue the economic benefits of the demographic dividend, the labor force should be well educated, and the private sector should be able to provide sufficient jobs. Thus, the need to allocate more resources to ensure access to quality education and health services, as noted above, is all the more critical in light of the rapidly growing young population, to ensure a smooth

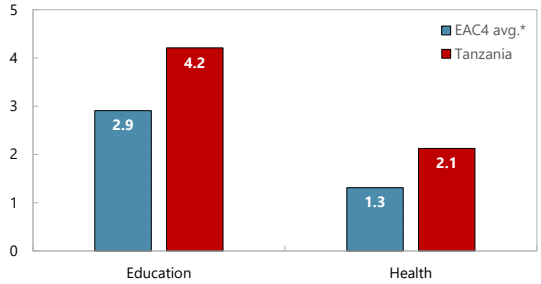
[3] The World Bank defines the demographic dividend as "the economic benefit that can take place when a country undergoes a rapid decline in mortality, followed by a rapid decline in fertility, thus producing smaller, healthier families and a youth cohort that can be educated and empowered to enter the labor market with the appropriate skills" (WB, 2024).

transition into the labor market. Additionally, an enabling environment for a thriving private sector and job creation are also needed to ensure economic opportunities (see chapter I).

D. Investing in Human Capital

11. To reach the Sustainable Development Goals (SDGs) on education (SDG4) and health (SDG3) by 2030, Tanzania would need to increase spending on these sectors by an additional 6.3 percent of GDP over the next five years. The Fiscal Affairs Department of the IMF developed tools to assess the additional spending needs to achieve the SDGs by 2030 (Piergiorgio et al, 2023). Each country is benchmarked against the best performing peers in their income group to estimate the spending needs to improve their SDG rating to that level. In the case of Tanzania, public spending in education would need to increase by 4.2 percent of GDP by 2030 to reach the top performers among Low Income Countries (LICs) in terms of their student-teacher ratio, enrollment levels, and other spending, and achieve an SGD4 index above 87.[4] That is, in 2030 Tanzania's public education spending would need to be about 7.5 percent of GDP. In the health sector, Tanzania would need to increase its spending by 2.1 percent of GDP over the next five years, to achieve a similar level of coverage and quality of service as the top performing countries among LICs, reaching an SDG3 index of at least 75.[5] The additional effort required for Tanzania to reach the SDGs on health and education is more than 2 percent of GDP above the average for other EAC member countries at a similar level of development (see chart), highlighting both the increasing demand for public services of a rapidly growing population, and the existing gap in coverage and quality. Although the amount to reach the SDGs are daunting, and achieving them by 2030 could be out of reach, the costing exercise is useful to understand orders of magnitudes of needed spending for continued progress toward these goals.

Figure 4. Additional Public Spending Needed to Achieve SDGs by 2030
(Percent of GDP)



Source IMF SDG Costing Tool 3rd Edition (Piergiorgio et al, 2023); and IMF staff calculations.
*Burundi, Kenya, Rwanda, Uganda

12. The fertility level and pace of population growth are key determinants of these public investment needs. The World Bank estimates that under current high-fertility levels, the school age population in Tanzania would reach 65.5 million by 2061, while under a low fertility scenario (2.5

[4] The benchmark for education assumes a target of universal enrollment for primary and secondary levels and 50 percent for preprimary and tertiary education, which is akin to 2 years each of preprimary and tertiary education and 12 years of combined primary and secondary education. It also assumes reducing the student-teacher ratio from 46 to 18 and keeping wage growth in the sector below nominal GDP growth. The benchmarking exercise also assumes that the private sector participation in Tanzania's education sector will increase 14 pp to 46 percent, alleviating some of the spending pressure on the government.

[5] The benchmark for health assumes a 45-fold improvement in the number of doctors to 2.3 doctors per 1,000 people, and a 6-fold increase in other health workers to 6.4 per 1,000 population. It also assumes a reduction in other recurrent and capital spending on health to accommodate more spending on doctors and other health workers and keeping wage growth in the sector below nominal GDP growth. As in education, the exercise assumes an expansion of the private sector in health of 23 pp to 46 percent, alleviating some of the spending pressure on the government.

children per woman), it would only increase to 44.3 million (WB, 2024). Similarly, slower population growth could reduce by 1.2 percent of GDP the needed spending on public education. UNICEF (2023) estimates that under the current rapid population growth scenario, 285,250 children will enter the public education system each year, on average, over the next four decades. This would require hiring over 5,000 new teachers and building 4,500 classrooms per year, just to maintain the 2021 student-teacher ratio and accommodate the new students. Under a slower population scenario, the number of students would be reduced by almost a third, and so would the necessary resources (teachers, and classrooms) to maintain the status quo. Similarly, to be able to cover the population growth of about 1.9 million individuals per year, considerable investments in the health sector will be needed just to maintain the present level of services.

13. Improved spending efficiency would also help achieve better outcomes. Social spending is often not targeted to areas or populations where it is needed most. In education, there is a mismatch between the expansion of access and the outcomes in terms of student learning, due to teacher quality, school infrastructure and classroom resources. In health, more spending on preventive health services and community health workers could reduce the long-term burden on the healthcare system. Using digital tools for telemedicine and education, could help reduce service coverage in remote areas, particularly for medical specialties and specialized subjects such as science, math and English. The World Bank emphasizes the need for better public financial management in both sectors, including improving budget planning, monitoring, and execution to ensure spending is more effective and leads to better health and education outcomes (Box 1).

Box 1. World Bank Recommendations to Improve Spending Efficiency

The World Bank recommends better targeted policies to improve spending efficiency in the health and education sectors. **On education**, the WB recommends to i) steadily increase public spending over time, from its current level of about 3 percent of GDP to 4.2 percent, which is in line with peer countries as low spending levels are a key contributor to inefficiencies; ii) reallocate spending in favor of basic education, accompanied by improving management and oversight of service delivery to schools, and reducing subsidies for food and lodging in higher education and upper secondary education; and iii) strengthen access to both schools and teachers, by fostering smaller schools in rural areas and improving accessibility and teacher deployment to address severe imbalances across regions.

On health, the World Bank recommends improving primary health care service delivery, which is critical to increasing health system efficiency. Ensuring adequate financial resources for the sector is essential to improve healthcare infrastructure, guarantee availability of medical supplies, and hire and retain skilled healthcare professionals, especially for primary health care (PHC). Improving direct allocation of funds to PHC facilities will enhance infrastructure and medical supplies by using the *District Health Financing Facility* (DHFF) and *Facility Financial Accounting and Reporting System* (FAARS). Additionally, it is important to leverage UHI to expand health insurance coverage nationwide and ensure PHC coverage for all Tanzanians, with reduced out of pocket expenditures and equitable access. However, more resources are needed to support the enrolment and coverage of the low-income households. It is critical to invest in the training and continuous professional development of health workers, including community health workers (CHWs). Hiring more health workers to close the large gap, particularly at the PHC level, should also be a priority to ensure a PHC-driven service delivery, contain costs, and develop a more responsive health system. The government's plan to recruit and train 137,000 CHWs over the next 5 years is a step toward addressing the human resource gap, but it should be supported by adequate budget allocations and timely execution to ensure adequate distribution and expansion of coverage to targeted areas.

E. Policy Recommendations

14. Addressing Tanzania's demographic challenges requires accelerated education and health improvements through more and better targeted investments. Achieving a demographic dividend, where a favorable age structure boosts economic growth, requires policies that better align the amount and quality of critical social services, especially on education and health, with population growth (WB, 2024; UNICEF, 2023). To achieve this it will be critical to: i) increase budgetary allocation for education and health in line with demographic needs and the goals under *Vision 2050*; ii) rebalance spending toward current spending to expand the education and health workforce, and adequately supply health and education facilities with required materials (textbooks, medicines, equipment, etc.); iii) enhance training for educators and health workers particularly in rural areas to address geographical imbalances; iv) make use of digital tools to enhance learning and healthcare service delivery; and, v) encourage private sector expansion into both sectors to alleviate pressures and support efficiency gains. It will also be important to improve accountability and transparency in public spending, to ensure that resources are used effectively.

15. A comprehensive analysis of the role of foreign development assistance would be useful, especially in the context of the new geopolitical environment. As Official Development Assistance (ODA) is currently declining rapidly, it will be important to fully understand the impact on all social sectors, particularly in health, where most of ODA has been targeted, both on and off budget. This analysis should aim to identify opportunities for more efficient use of available resources, motivate increased domestic resource mobilization, and pool donor financing.

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