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Question: Choose any one Sub-Saharan economy and, after examining movements in the net barter terms of trade for that economy, discuss the policy conclusions you would recommend.

Focus: Primary commodity terms of trade in Tanzania

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The net barter terms of trade for Tanzania and implications for export diversification

Introduction

Terms of trade movements, the desirability of trade diversification for developing countries, and the instruments through which diversification can be achieved have been debated since the 1950s.

In the first section of this essay I firstly outline the arguments in favour of diversification based on hypothesis about long run terms of trade movements and short term volatility and then outline arguments about the relative importance of quantities and terms of trade (prices) in determining export revenue changes.

In the second section I analyse data on movements in prices, quantities and revenues for Tanzania's principal primary commodity exports from 1960 to 1999 in the light of these arguments. I find that export prices have declined overall and have been very volatile. However, export volumes have been stagnant and have also been very volatile.

In the third section I draw policy conclusions. I propose that diversification out of primary commodities into manufacturing and services is an important long term strategy. However, expanding export revenues through primary commodities in the medium term can be a means to achieving this, and is achievable through expanding and stabilising primary commodity export volumes and dealing more effectively with price volatility.

Diversification debates

Diversification

In debates about export diversification in developing countries, it is important to specify what type of diversification is under discussion. Diversification out of primary commodities entails decreasing proportions of exports of primary commodities relative to increasing proportions of manufactured goods and services exports. Diversification within primary commodities entails exporting a greater number and variety of primary commodities and increasing exports of previously less important primary commodities.

Arguments about diversification out of primary commodities

What became known as the Prebisch-Singer hypothesis was first put forward in 1950. (Prebisch, 1950; Singer, 1950). This hypothesis stated that the relative prices of primary commodities to manufactures (the commodity terms of trade) decline in the long run.

Primary commodities consist of foods, metals, fossil fuels, fibres and other raw materials which are relatively unprocessed and are usually used as inputs into more sophisticated or refined final products before they are consumed.

The Prebisch-Singer hypothesis can be under-pinned by two propositions. First, that as incomes grow, people demand more processing and transformation of agricultural and mineral goods, rather than simply a greater quantity of these goods, i.e., that income elasticities of demand for primary commodities are low. Second, that primary commodities become over-supplied in world markets due to the learning time, institutional framework and investment required to create employment in manufacturing (Avramovic, 1992). Both these propositions may be extended to consider services – demand for services may grow more quickly than primary and secondary sectors as incomes grow and as communications allow more trade in services, and services may be under-supplied due to the skills required to develop service sectors, further decreasing the commodity terms of trade.

These propositions are not necessarily valid for all primary commodities generally. For example, as incomes grow, people may demand a greater variety of primary commodities, rather than greater processing. For example, horticultural goods (i.e. fruit, vegetables, ornamental plants) from developing countries such as Kenya have experienced increases in demand in developed countries (Jaffee, 1995). Long term demand for metals, fossil fuels and fibres depends very much on the path of future technological change. Different commodities are likely to experience very different changes in market conditions, as the technology of products and services to which they are inputs change and the technology of substitute inputs develops. Therefore a uniform decline the prices of all primary commodities is unlikely. However it is difficult to dispute that development has historically almost always entailed the expanding importance of manufacturing and services relative to agriculture and primary commodities. In the absence of world-wide agricultural subsidies and supports, the continuation of this pattern implies declining commodity terms of trade.

The net barter terms of trade are a price index of a country's exports divided by a price index of its imports. Declining terms of trade imply that a constant volume of exports will buy decreasing volumes of imports.

Since colonial times, many developing countries have specialised in primary commodities. The Prebisch Singer hypothesis predicts that declining commodity terms of trade combined with a continuation of this specialisation will mean declining net barter terms of trade for developing countries, and therefore advocates diversification out of primary commodities.

Declining net barter terms of trade does not necessarily imply declining export revenues if increases in export volumes more than compensate. This is the difference between net barter terms of trade and income terms of trade. Therefore the benefits from diversification out of primary commodities depend on the relative feasibility of i) increasing productivity in and volumes of primary commodities production, and ii) expanding the manufacturing and services exports, in both the short and long run.

Arguments about diversification generally

Many developing countries have a high export concentration not only in primary commodities, but in only two or three different commodities. Since the 1970s, primary commodities have been subject to very large price variability in the world market. The causes of this include varying demand in developed countries due to business cycles, fluctuating supply due to weather conditions, and speculation on commodity markets (Avramovic, 1992). While Pindyck and Rotemberg (1990) argue that commodity prices move together, Dornbusch (1985) argues that they move together in the long run but not the short run. This has brought forward arguments that production of a larger number of different types of primary commodities would prevent price movements causing large export revenue shocks.

Nissanke (1993) outlines the problems that can be caused by large fluctuations in export revenues. If a country has a floating exchange rate, this will fluctuate in line with export revenues causing an unstable environment for trade, and encouraging bubble speculation. Maintaining a fixed exchange rate during large export revenue fluctuations involves either import and export controls or large buffer foreign exchange stocks held by the central bank, which have large opportunity costs for developing countries. If producers receive windfalls and there are import restrictions, inflation can result (Deaton and Miller, 1996).

The irregular, non-cyclical nature of export price fluctuations make public and private saving and investment difficult to plan, as longer term trends are almost impossible to distinguish from short term variations. Optimism which turned out to be disappointed was a contributing factor to the present debt problems of many developing countries, and temporary booms perceived as permanent can cause Dutch-disease over-investment in commodity trade at the expense of non-traditional exports.

Attempts to analyse the empirical relationship between the direction of movement in the terms of trade and the volatility of terms of trade on GDP growth are fraught with problems, due to the large number of other interacting factors affecting growth. The data for these variables for African countries presented by Singer and Edstorm (1993) shows only a tentative negative relationship between volatility and growth. However, the low growth during the especially volatile period of the late 70s and 80s in many African countries can be linked to terms of trade volatility coupled with a range of other conditions.

The relative importance of quantity and price in export revenue changes

Authors such as James Riedel (1987, pp.17-19) and Svedberg (1990) have argued that price changes have received excessive attention and that increasing exports as a whole, both primary and processed, should be stressed in place of diversification. Riedel also argues that developing countries have comparative advantage in labour intensive primary commodities and should therefore concentrate in expanding production of those.

Svedberg presents evidence to suggest that the export revenues of developing countries have been decreasing or stagnating mainly due to export quantity performance.

He divides reasons for export revenue stagnation into external and internal factors, and attributes export revenue declines to internal factors. External factors consist of commodity market conditions and terms of trade, while internal conditions consist of trade policy affecting export quantities – import protection, export taxes and overvalued exchange rates. He shows empirically that changes in quantities have been more important than changes in prices in determining export revenue performance in African countries.

However, this neglects the effects of external conditions on the internal conditions. For example, a decline in export prices may cause stricter import licensing due to foreign exchange constraints, increased burden of export taxes in order to avoid declines in government revenue or overvalued exchange rates due to the problems of devaluing nominal rates without causing speculation.

Svedberg uses market share as an indicator of export performance. He shows that Africa on average has lost considerable market share during the last four decades in its export commodities, and he uses cotton in Tanzania as one of his examples. He points out that, of the 31 commodities listed on the Integrated Programme for Commodities, Africa's share in only eight has risen (these include tea, tobacco and sisal). Ng and Yeats (1998) calculate that if Africa had merely retained its 1962-64 share in the OECD market, its exports now would be 75 percent (\$11 billion) higher.

Data quality

Assessing the application of this debate to Tanzania necessitates accurate information about export prices and quantities, import prices and terms of trade. However, the data available is not of a high quality.

Trade data is often very unreliable in developing countries. Srinivasan (1994) explains that the data comes from two sources - customs information which records goods leaving and entering, and bank information which records transactions involving foreign exchange. These two sources often differ and are inaccurate. Firstly, there may be lags between delivery times and payments. Secondly, the price may not be decided at the time of delivery, so the estimated price at customs may be inaccurate. Thirdly, a foreign country importer may extend credit for purchase of goods inside the country, and the exporter may pay for this through charging a lower price, i.e. goods payments and interest payments are netted out rather than separated. Fourthly, there is widespread smuggling, especially when official trade involves the payment of taxes and duties. Fifthly, over and under invoicing can take place in order to avoid foreign exchange controls; for example an exporter may understate the value of the exports in order to keep some of the foreign exchange earned and not surrender it for national currency according to regulations.

In Tanzania customs checkpoints are established only at the three main ports. The Bank of Tanzania, the Bureau of Statistics and the Board of External Trade all collect data from this common source, but there are often discrepancies between their reports (Bol, 1992, p.6). These organisations then report data to multilateral institutions such as the World Bank and the Food and Agricultural Organisation.

Up to 1994, Tanzanian regulations required exporters to sell the foreign exchange they earned for Tanzanian shillings at fixed rates, and importers could not buy foreign exchange except through a government license. To avoid this, exports are under-invoiced and imports are over-invoiced to retain funds abroad, while the reverse is practised to bring funds back. Imports are also under-invoiced in order to avoid import duties. Musonda (1995, pp.30-31) illustrates this through the lack of consistency between Tanzanian and Kenyan import and export data. Yeats (1990) shows that trade data for Sub-Saharan Africa generally often does not triangulate, i.e., Tanzania's export data may not be the same as other countries' data for imports from Tanzania. Smuggling is also widespread in Tanzania and Bol (1992, p.6) estimates that \$200m to \$600m of foreign exchange is earned through smuggled exports.

Tanzanian primary commodity exports

Tanzania's traditional exports, in rough order of importance, are coffee, cotton, cashew nuts, tobacco, tea, sisal, cloves, gold and diamonds. The following charts analyse available data on the quantities of these agricultural goods that were exported, the prices received by exporters and the value of exports from 1960 to 1999. World export quantities, and Tanzanian export quantities and values are sourced from the Food and Agricultural Organisation, and prices are computed by dividing value by quantity. Market shares are derived from dividing the Tanzanian export quantity by the world export quantity.

The deflator used for export prices and values is Grilli and Yang's price index of developing country imports. It is taken from export price data of developed countries to developing countries, and therefore is not specific to Tanzania. It is available from 1969 only.

As a measure of variability I have used the median year-on-year percentage change (MYC). A variable changes by more than the MYC in half the years in a series. In any year, the variable is as likely to vary from its previous year's value by more than the MYC than to vary less. This measure is preferable to the standard deviation, as the standard deviation accounts for long run variability by showing the difference from the average, while the MYC concentrates on the yearly variability.

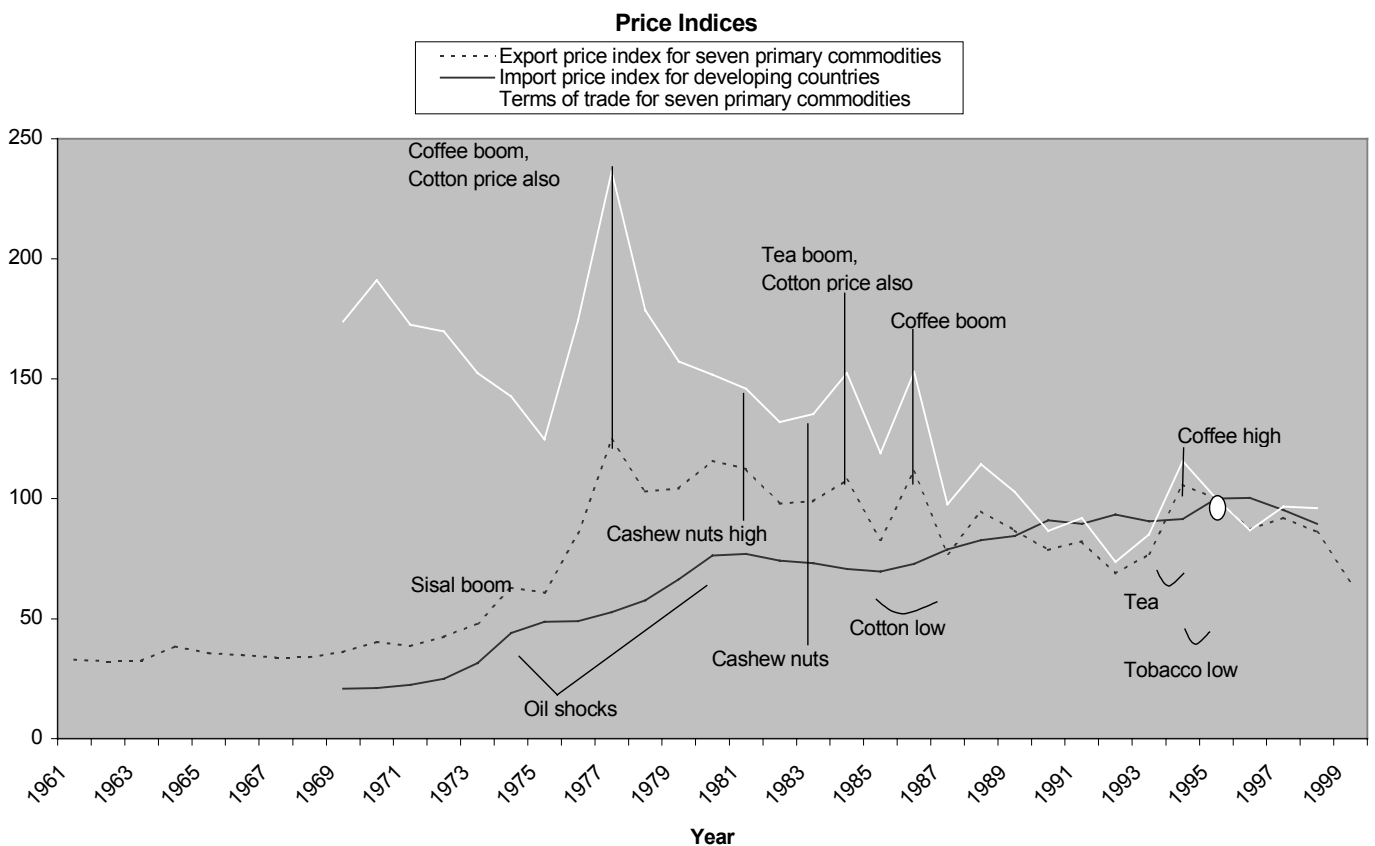
Export good	Importance as source of export revenue	Quantity exported	Price of exports (USD)	Value of exports (USD)
Coffee	<p>World market share</p> <p>Coffee is very important to Tanzania, giving export revenue of \$119m (1998).</p> <p>Tanzania has had between 0.7% and 1.7% world market share over the last four decades.</p>	<p>The quantity of coffee exported increased during the 60s and early 70s. Since then it has fluctuated (MYC 14%), but does not show a trend up or down.</p>	<p>The world price of coffee has been extremely unstable, especially since the 70s (MYC 10%). It was very high during the 77-79 coffee boom (due to a frost in Brazil), and again in 1986. It was very low in 74-75 and in the early 90s. A trend in the real price is difficult to discern among the variation, but it may be fluctuating around a lower average value in the 90s than the 60s.</p>	<p>The real value of coffee exports has also been extremely variable, and also seems to be shifting downwards.</p>
Cotton	<p>Cotton is also very important, earning \$130m in 1997 and \$48m in 1998.</p> <p>Tanzania does not have much market power, comprising between 0.6% and 2.1% of world exports during the last four decades.</p>	<p>The quantity of cotton exported was broadly increasing in the early 60s. In the 70s and early 80s it decreased due to villagisation, falling producer prices, and cotton areas switching to rice and maize. (Gibbon, 1998, p.6). In the late 80s and 90s it increased again and then dramatically fell in 1998 and 1999 due to El-Nino rains. However there have been large fluctuations within these trends (MYC 17%).</p>	<p>The nominal price of cotton exports has been fluctuating (MYC 10%) around the same level since the mid 70s, which means that the real price has fallen. In 1999 the <i>nominal</i> price fell to its lowest point since 1972.</p>	<p>The real value of cotton exports was broadly falling up to the mid eighties and then increasing in line with quantity increases until the quantity and price falls of 1998 and 1999.</p>

Export good	Importance as source of export revenue	Quantity exported	Price of exports (USD)	Value of exports (USD)
Cashew nuts	<p>World market share</p> <p>Cashew nuts are quite important, earning \$92m (1997). They are mostly grown in the Southern region.</p> <p>Market share has mostly been around 40%, but large variations in both Tanzanian and world output mean that it was over 90% in the late 70s and less than 10% at the turn of the 90s. Tanzania has lost market share to India, Brazil and Vietnam. www</p>	<p>The quantity of cashew nut exports increased substantially during the 60s, and then fell even more dramatically during the late 70s due to Powdery Mildew Disease, lack of institutional support and low producer prices. During the 80s they fluctuated below 60s levels. After a government led promotion programmes were set up they recovered dramatically during the 90s surpassing 70s levels.</p>	<p>Prices of cashew nuts have been extremely variable with a MYC of 16%. It was especially variable during the 80s, with a large boom in 1982. Overall nominal prices are increasing and the real price is not decreasing.</p>	<p>Real export values follow the trends in quantities exported, and reflect the 80s price variability.</p>
Tobacco	<p>Tobacco exports were \$57m in 1999.</p> <p>Tanzania's share in the world market has varied between 0.1% and 1%.</p>	<p>The quantity of tobacco exported increased steadily until the mid 70s. It then stagnated until the 1990s, when it increased substantially.</p>	<p>The nominal price of tobacco increased during the 60s and 70s and has been fluctuating around the same level since then, which means falling real prices. The price is quite variable with a MYC of 13%.</p>	<p>Real export values were low during the 80s relative to both the 70s and the 90s.</p>
Tea	<p>Tea exports are valued at \$30m (1998).</p> <p>It has a very small but growing world market share, from 0.5% in 1961 to 2% in 1994.</p>	<p>Quantities of tea exports steadily increased until 1978, stagnated for the next decade except for 1983, increased a lot in the early 90s and have remained at high levels since. Tea, unlike coffee and cotton, has a large domestic market and therefore increased exports could reflect switching to exports rather than increases in production. Exports have been much less variable than for other crops (median year on year percentage change is 7%).</p>	<p>Prices are becoming increasingly variable, with a MYC of 11%. There were price booms in 1984 and 1993/94, but otherwise nominal prices fluctuate around a stagnant level, meaning that real prices show a substantial downward trend.</p>	<p>There are large variations in export value and it is difficult to discern any long term trend.</p>

Export good	Importance as source of export revenue	Quantity exported	Price of exports (USD)	Value of exports (USD)
Sisal (used to produce twine and rope)	<p>World market share</p> <p>Sisal was as important as coffee and cotton to Tanzania in the 60s and 70s. However, now it is less so, earning export revenue of \$7m in 1998.</p> <p>Tanzania used to have about 30% market share in the 60s. World exports fell dramatically, but Tanzania's fell more still, so its market share dropped to 5% in the 80s. It is creeping up to about 20% now.</p>	<p>The most noteworthy trend in sisal exports have been the dramatic falls in quantities exported from the 60s until the mid 80s, and the lack of recovery since.</p>	<p>There was a price boom in 1974 and a trough in 1987. No long term price trend is visible. Tanzania has significant market power in sisal, and it is the principal world exporter. There has been decreasing world demand for sisal (which is used to make ropes) due to the increasing availability of the synthetic substitute Polypropylene (NT p.42). Therefore the decrease in quantity exported contributed to the fact that the price did not dramatically decrease. The MYC was 15%, but most of the changes were downward.</p>	<p>The value of sisal exports has fallen dramatically along with decreases in the quantity of exports.</p>
Cloves	<p>Cloves are of decreasing importance to Tanzania, earning export revenue of \$6m (1998). They are mostly grown in Zanzibar.</p> <p>In cloves, Zanzibar used to have about 60% market share in the 60s, but now has about 10%.</p>	<p>Clove export quantities exhibit a notable cyclical pattern of length about five years, from the late 60s until the early 90s. The cycle was dramatic, with a median year on year percentage change of 41%. The cycle was around a downward trend, although there was a slow recovery in the 1990s.</p>	<p>Cloves are produced in Zanzibar, which has some market power. Nominal prices increased up to 1980 and decreased thereafter, producing a steep decline in real prices. <i>Nominal</i> prices are now similar to 60s levels. The price is quite variable with a MYC of 11%.</p>	<p>Real export values reflect the cyclical production and the downward trends up to the 90s, and have been stable at low levels since.</p>

Detailed data for the mineral sector is not readily available. Gold and diamonds are the most important mineral exports. Widespread smuggling has meant that official exports are a fraction of actual exports. Recent incentives to divert exports into official channels have caused dramatic rises in recorded gold exports. (NewAfrica.com) Diamonds were 4.2% of exports in 1976 (Ndulu & Lipumba, 1990, p.235), but then declined due to exhaustion and lack of equipment.

Deciding weights in order to combine the prices of the above seven exports into an index is not straightforward, as their relative importance changes. I weighted them by the average quantity exported from 1980 to 1999. The base year of the index is set to 1995, in order to correspond with the import price index. The following chart illustrates this export price index, the Grilli and Yang import price index, and the export price index divided by the import price index which is the net barter terms of trade for these commodities.



Did market shares decline?

Ng & Yeats (1998) compare the market shares of African countries in the 62-64 period and the 91-93 period in their study. For Tanzania, however, assertions about the three most important exports - coffee, cotton and cashew nuts – are highly sensitive to the start and end year chosen, and the differences in market share year on year are often larger than the differences over decades.

The following table illustrates this:

Tanzania export quantity as a percentage of world export quantity over three year periods

	Coffee	Cotton	Cashew Nuts	Tobacco	Tea	Sisal	Cloves
1962-1964	1.0%	1.1%	29.2%	0.1%	0.7%	35.3%	58.5%
1991-1993	1.2%	1.1%	16.2%	0.4%	1.6%	5.0%	7.8%
1995-1997	1.1%	1.4%	42.2%	0.7%	1.8%	15.1%	12.6%

Tanzanian market shares did decline in sisal and cloves, however, it is difficult to say whether there has been a long term decline in market share in other commodities.

Cotton lost considerable market share in 1998 and 1999.

It is important to note that increased processing of raw commodities may show up as declines in raw exports. While direct data on processed primary commodity exports is unavailable, the ratio of non-traditional exports to traditional exports has increased overall, increasing in the 1970s, declining during the early 80s, recovering during the late 80s and falling in 1991 (Ndulu & Lipumba, 1990, p.235).

Overall, while primary commodity export volume performance cannot be said to show clear declines, there have not been dynamism and growth either.

Did the net barter terms of trade decline?

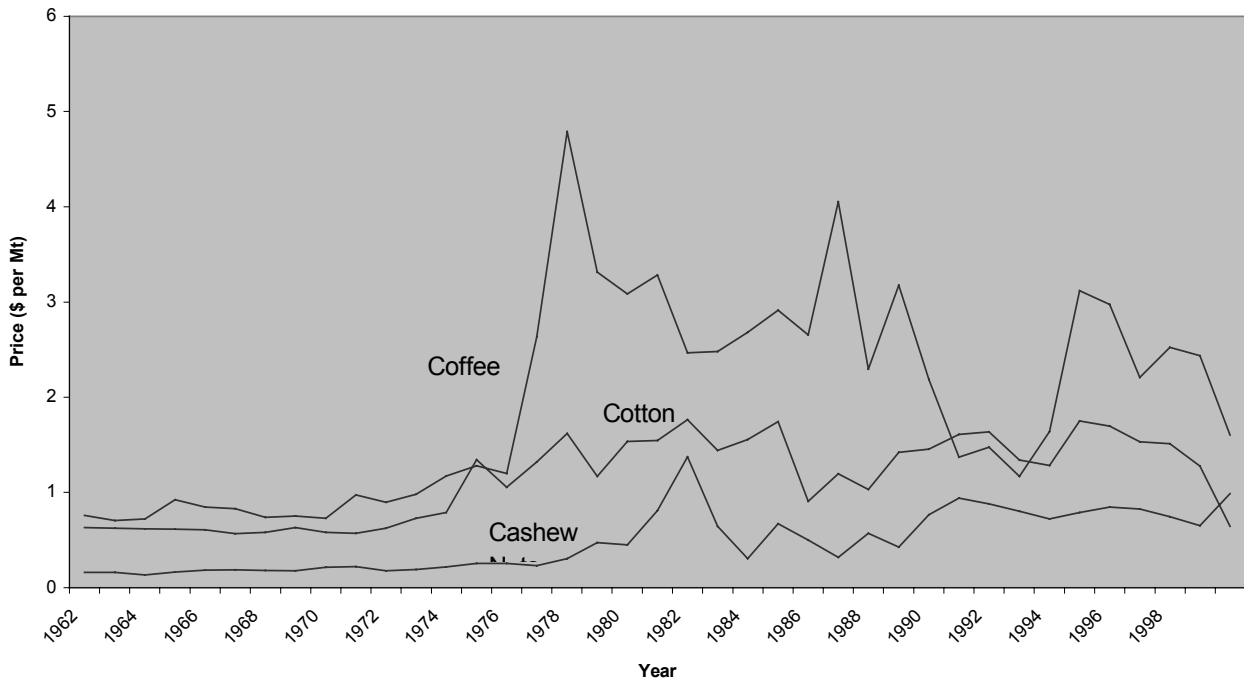
The net barter terms of trade for these commodities has fallen. It could be proposed that during the oil shocks and the turbulence of the 1980s the terms of trade shifted downwards and are now fluctuating around a lower level rather than declining (Kanaan, 2000, p.31). However the fact remains that 1969 import prices were 21% of their 1995 level, while 1969 export prices were 36% of their 1995 level, which shows that import prices have risen considerably more than export prices. This suggests that the Prebisch Singer hypothesis may apply to these commodities.

Ndulu & Lipumba (1990) show that, of the fall in export value of 3.4% from 1960 to 1985, quantities fell by 3% and prices fell by 0.3%. However, for certain periods prices were a significant component e.g., from 1977 to 1985 value fell by 12%, due to quantities falling by 6.7% and prices falling by 5.2%. (p.239)

What caused export revenue shocks?

Prices were very variable, even allowing for rises in one commodity price compensating for falls in another. The median year on year change of the export price index is 10%, i.e., in half of the years, the price index had varied more than 10% from its previous year's level. This is less than the MYC of the individual commodities, as would be expected if fluctuations are not always in the same direction. The following chart illustrates that the prices of the three main exports can be seen not to be moving together, contradicting Pindyck and Rotemberg (1990). This supports the proposition that diversification within primary commodities can help to smooth fluctuations to some extent.

Nominal prices



However, the year-on-year variability of quantities exported was greater than for prices. This points to domestic weather conditions rather than competitor weather conditions, developed country demand or speculation, as a prime cause of short term export revenue changes. Different conditions in different areas affect different crops. It is clear that some diversification within regions as well as nationally, choosing less sensitive crops and seed varieties and setting up irrigation systems, are important in reducing dependence on natural conditions and therefore vulnerability to revenue shocks.

Variations in quantity may in some degree be a response to variability in prices. However, the prices facing farmers are not the same as the prices facing exporters and marketing boards in the world market, as producer prices have been stabilised and kept low relative to world prices through marketing boards and overvalued exchange rates before the successive liberalisations of 1985-1995 (Ndulu and Lipumba, 1990; Kanaan, 2000, p.30; Deaton and Miller, 1996, p.165). However, overall, declining terms of trade have been reflected in declines in producer prices between 1966 and 1984 (Ndulu and Lipumba, 1990, p.240).

Prospects for increasing traditional exports

Tanzania's low world market shares in a number of commodities means that substantially increasing quantities would be unlikely to push down prices. It is very difficult to predict future trends in the world markets for Tanzania's export commodities. Increasing incomes are likely to mean increasing demand, but whether this will be at a large enough pace to keep commodity prices high relative to manufactures prices is not certain. Increasing incomes may mean more demand for variety and "luxury" foods which may benefit cashew nuts and cloves. Cotton and sisal are in competition with synthetic oil-derived alternatives (polyester and polypropylene) and so may be affected by these technologies as well as by the price of oil. Much will depend on developments in South American coffee, East Asian cashew nut and US cotton sectors. There is a high degree of uncertainty over future prices and price forecasts such as those produced by the World Bank have been very inaccurate for cotton and coffee (Deaton & Miller, 1996, p.117).

At present 16% of cultivable area in Tanzania is cultivated. Over 4 million ha in Tanzania is suitable for coffee production, out of which only 35% is under coffee cultivation (NewAfrica.com). The potential for irrigation development is estimated to be 2% of the cultivable area based on soil and water availability. At present there is irrigation of between 14 and 24% of the potential, of which most is for small-holder rice production rather than export crops (FAO). Irrigation has the potential to stabilise harvest levels as well as facilitate the use of fertiliser and increase yields. It is evident that natural resources are not a barrier to an increase in Tanzania's shares of the world market in traditional exports, and appropriate technology has considerable scope to allow expansion.

State marketing institutions were dismantled during the 1980s. Marketing board monopolies had advantages of economies of scale, linkages between credit and marketing functions which reduce lending risk and increase credit availability, and being state controlled, being an instrument through which producer prices could be smoothed. However, they also had large inefficiency problems, paid low prices to farmers and absorbed large state subsidies. Private marketing chains are now developing but suffer from a lack of purchasing capital as foreign importers are less willing to extend credit to unknown and unestablished export traders.

Primary commodity exports and export diversification

Long term reliance on a few primary commodities does not compare well with diversification, both within primary commodities and out of primary commodities into manufacturing exports. These have greater long term potential for positive terms of trade movements, output and price stability, and productivity growth through economies of scale and forward and backward linkages. Comparative advantage is not exogenous but created, and if developing countries are to become competitive in high value sectors, support for the development of dynamic cumulative advantage in these sectors is necessary. Developing these sectors, however, requires access to large amounts of amounts of foreign exchange to finance investment and imported inputs. Therefore the expansion of primary commodity exports is complementary to, rather than an alternative to, diversification.

Bol considers horticulture (emulating Kenya's success in this sector), tourism, and processing of cotton, sisal, fish and timber as the most promising areas for increased non-traditional export expansion in Tanzania. Investment in non-traditional export sectors increased between 1986 and 1990, but this was mainly due to an increase in the prices of imported capital goods rather than an increased volume of investment (Bol, 1992, p.25).

Complimentarities and trade-offs

A positive export environment is conducive to exports of both traditional and non-traditional exports. For example, streamlining export bureaucracy is important so that exporters can apply to one agency rather than several for permits and licences. Transport and communications are necessary for the development of both traditional and non-traditional exports (Bol, 1992, pp.43-47). Policies directed towards increasing the availability of market information and the development of skills in production technology and marketing need to be sector-focused but can be complimentary to other sectors.

However, government finance for projects supporting sector specific technology and marketing development is limited. There are also trade-offs in import policies. An overly restrictive import policy can reduce the availability of cheap consumer goods as incentives for expanded agricultural production. On the other hand, protecting infant domestic industries from import competition can help them develop and gain experience in the domestic market before expanding exports. The textile industry in Tanzania collapsed during the liberalisation of the early 1990s (Gibbon, 1998, p.10). This sector may benefit from protection in the domestic market linked to export performance while it recovers.

Trade policy

Therefore while some import protection for domestic manufacturing industries may have more immediate costs than benefits for the primary commodity export sector, it can be justified through appeal to the disadvantages of declining and volatile terms of trade in primary commodities and therefore the advantages of diversification. The negative effects of import protection on primary commodity exports can be minimised through i) confining import protection to a few key sectors ii) supporting primary commodity processing sectors which increase domestic demand for raw primary commodities, iii) clearly linking support for protected industries to growth in productivity and exports in order to obtain maximum benefit from the policy iii) prioritising foreign exchange towards key imports of capital goods and important inputs for the manufacturing and agricultural sectors.

Regional trade blocks can be an important instrument, as they expand the size of export markets without exposing infant industries to world levels of competition.

In 2000 Tanzania withdrew from COMESA, in order to avoid the detrimental effects of competition with economies such as South Africa. However, in 2001 Tanzania, Kenya and Uganda have revived the East African Community (previously existing 1960s-1977), which plans to facilitate co-operation in many areas, to harmonise trade regulations and to set up a customs union over the next four years. (BBC) This block is likely to be more appropriate to Tanzania's trade needs due to lower transport costs, a larger market than in Tanzania and similarities in market structure enabling production for domestic market to be more easily expanded into export. (Bol, 1992, pp.43-47)

International measures to improve Tanzania's trade position include the freedom to implement appropriate policies. For example, a subsidy for horticultural and manufactured exports was introduced in 1981, but abolished in 1986 due to IMF pressure. (Mosunda, 1995, p.33) Changes in EU policy mean that preferential access to the EU market is becoming conditional on import liberalisation. Flexibility in the World Trade Organisation must be expanded so that Tanzania can avail more of the Generalised system of preferences, as at present limited coverage of agricultural goods, preference ceilings and rules of origin mean that only a quarter of developing country exports receive preferences (UNCTAD, 1994).

Measures to reduce the effect of price volatility

The level and stability export revenues from primary commodities are very much affected by domestic production levels and technology. However, to mitigate the effects of price volatility, domestic and international policies are needed.

The EU funded Stabex scheme was set up in 1975 and designed to help primary commodity exporting countries cope with fluctuations in export revenues. However, in the 1980s, its support became conditional on funds being used to support production in the commodity sector experiencing a decline and so prevent the use of funds for investments in manufacturing or diversification. (Hewitt, 1993) In addition, funds available through this scheme fell. International provision of large funds to mitigate terms of trade and natural shocks and the associated balance of payments and investment planning problems would contribute greatly to Tanzania's ability to benefit from its primary commodity exports.

In addition, access to financial institutions and instruments, by farmers, storage businesses and exporters would help deal with the risk involved in primary commodity production, smooth consumption and facilitate saving and continuous productive investment rather than over-investment in unproductive activities followed by under investment in important activities.

Conclusion

Tanzania's terms of trade for its primary commodity exports have shown volatility and overall declines and support the need for long term trade diversification. However, in order to achieve this, large amounts of foreign exchange are needed, and better established export sectors such as primary commodities are in a position to achieve this. Expansion of primary commodity exports is a means to long run diversification.

Some policies such as import protection policies, exchange rate policy, and subsidies and government finance for support programmes involve trade-offs in their effects on primary commodity export expansion and long run diversification. However, by achieving maximum effectiveness of support for long run diversification with minimum detrimental effects on primary commodity exports, together with emphasising policies which are complimentary to both, can be successful, especially if supported by international financial aid and international mechanisms to deal with price instability.

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