# Evaluation Report 2.93

**MACROECONOMIC
IMPACTS OF
IMPORT SUPPORT
TO TANZANIA**

by
The University of Trondheim
**Centre for Environment and Development (SMU)**
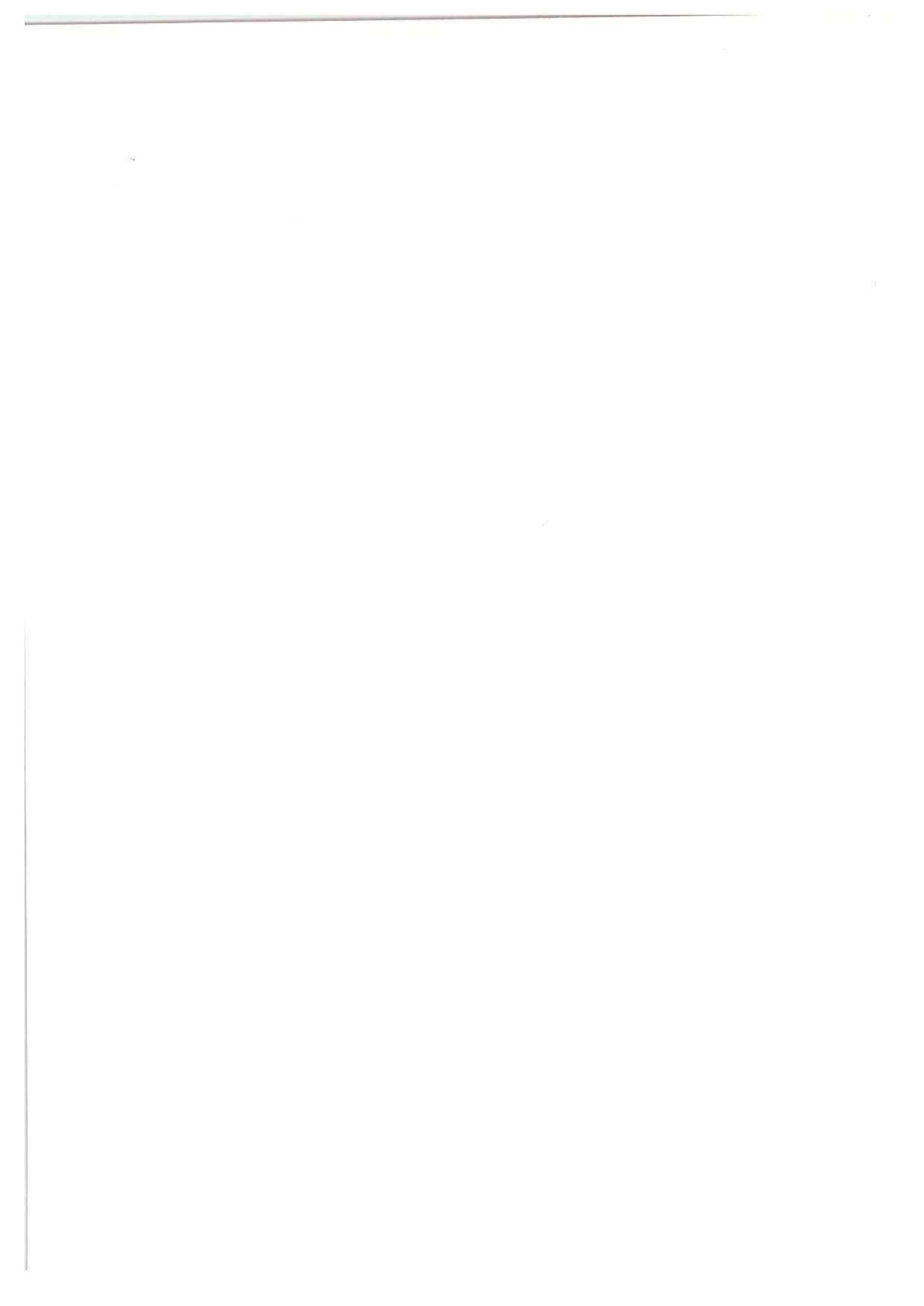
EVALUATION OF MACROECONOMIC IMPACTS OF IMPORT SUPPORT TO TANZANIA

Final Report

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30 August, 1993
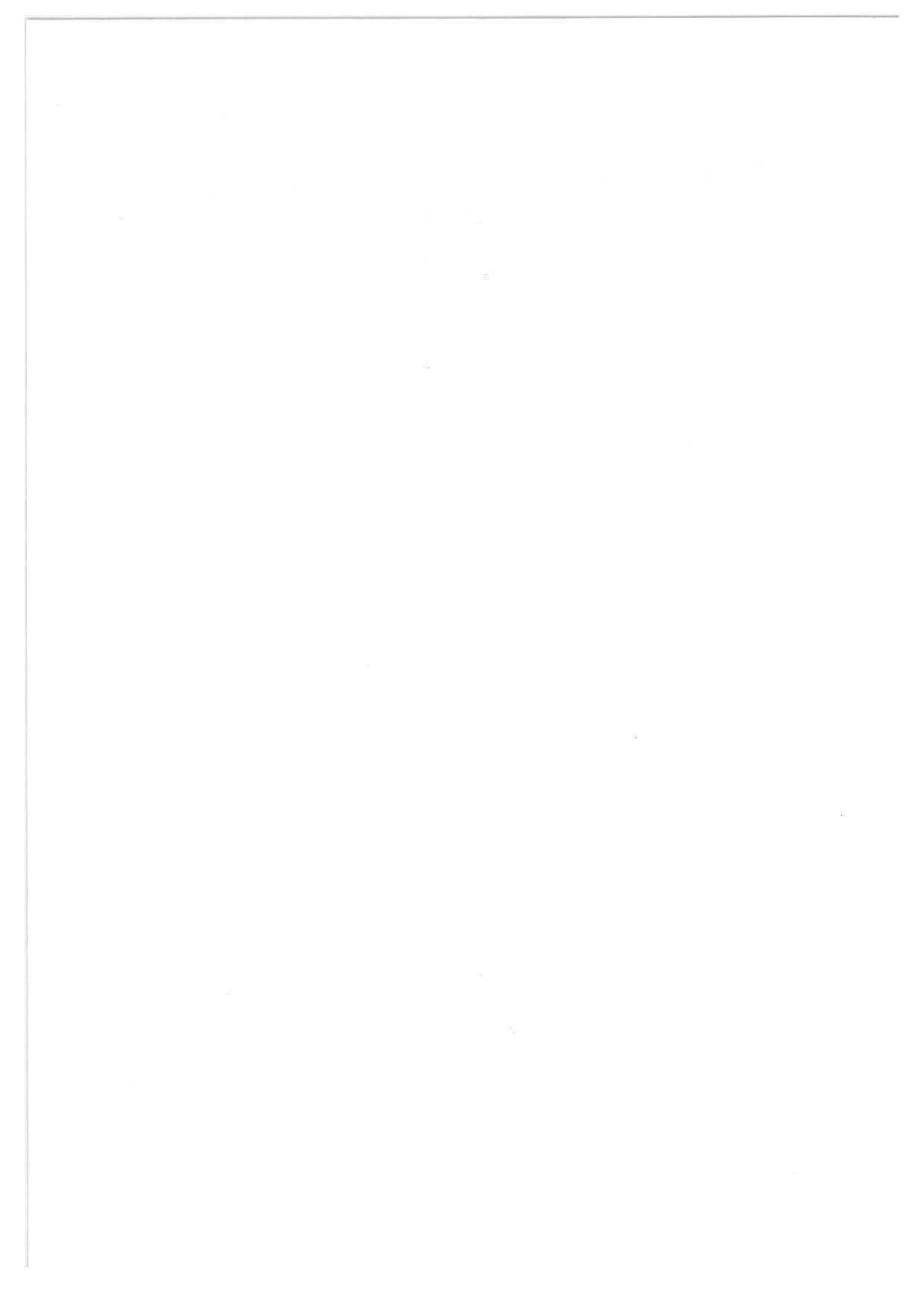
FOREWORD

The present study was commissioned by the Evaluation Unit with the Norwegian Ministry of Foreign Affairs to the Centre for environment and development, The University of Trondheim. The team members are:

Amit Bhaduri, professor, Indian Institute of Management, Calcutta; and professor Jawaharlal Nehru University, New Delhi.

Laurean Rutayisire, ass. professor, Department of Economics, University of Dar es Salaam.

Rune Skarstein, ass. professor and head of Division of development studies, Centre for environment and development, University of Trondheim (team leader).

The field work for the study was carried out from 3 March to 27 March, 1993. During our field work we enjoyed a good cooperation with professor Mark Wuyats and ass. professor Howard White, both from the Institute of Social Studies, The Hague, Netherlands, working in a parallel SIDA-financed team.

We wish to take this opportunity to thank all those who have assisted us at various stages of our work.

The NORAD Office in Dar es Salaam provided us with excellent office facilities and gave us indispensable information and assistance throughout our work in Tanzania.

We are also indebted to ass. professors M. S. D Bagachwa and A. Mbelle at the Department of Economics, University of Dar es Salaam, for helping us in collecting information and writing background papers for our study.

The processing of data and econometric estimates were carried out by Øyvind Anti Nilsen and Morten W. Lund at SINTEF Applied Economics, The Norwegian Institute of Technology. We would like to thank them for good cooperation and for making every effort in complying with our wishes.

In Dar es Salaam we got secretarial assistance from Ms. Amina Ally Karuma, and at the Centre for environment and development, Ms. Ingibjørg Jakobsdottir has carried out that difficult task. We wish to thank both of them for the skill and speed, combined with humour and patience, with which they have typed, and retyped, our often illegible manuscripts.

A Draft Report of the present study was finalised by end of May. We gratefully acknowledge comments from various people, too numerous to be mentioned individually, who commented on the Draft Report.

In this Final Report we have kept the mathematics in the text (in chapter 4), so that the more professional reader can more clearly examine the line of the argument. However, we have taken special care to explain the argument in words at each step. A reader who wishes to skip the mathematical part, will not miss in any way the main thread of the argument.

Finally, we would like to thank Mr. Jarle Hårstad and Mr. Håkon Hellebust in the Norwegian Ministry of Foreign Affairs for assisting us and providing valuable information at all stages of our work.

Trondheim, 30 August, 1993

Rune Skarstein
(team leader)

SCOPE OF THE STUDY

The terms of reference (TOR) for this evaluation dated January 7, 1993, presupposed a larger team and a duration of the study of 15 man-months. However, due to a later division of the evaluation into a Norwegian-financed and a Swedish-financed study, the number of the team members in this Norwegian-financed evaluation was reduced correspondingly, and the total duration of the study was reduced to 9 man-months.

The TOR emphasise rightly that, "the high level of import support are to a large extent linked to the Tanzanian economic reform programme supported by the World Bank and IMF". Moreover, the TOR advice that there is "a need to go beyond previous evaluations and address the impact of import support on the overall economy and its relevance to overall aid objectives", which implies, "emphasis on the macroeconomic issues" throughout the whole study.

In view of the shorter time of our evaluation, we discussed the emphasis with the Norwegian Ministry of Foreign Affairs. It was agreed that the limited time, with only one month field work per team member, did not permit any microeconomic or firm-level analysis based on surveys. It was furthermore agreed that the main emphasis of our evaluation should be on import support as a contributing factor to structural adjustment through liberalisation in Tanzania.

In the same vein it was agreed that we should use all available official data to arrive at an overall macroeconomic picture. As a consequence, the methodology of this evaluation is restricted to macroeconomic analysis of import support in the context of economic liberalisation, based on Tanzanian official data. However, it was also agreed, in accordance with the TOR, that we should compile systematically the nature and type of limitation of official data, so that future work along similar lines can proceed on a firmer basis.

By the end of August, after having finalised this study, we learnt that is has been decided to abandon the OGL and to create a unified, market determined foreign exchange system by September 1, 1993. This decision implies that donors' import support will be channelled directly into the unified market, and the Bank of Tanzania will sell foreign exchange to (and buy from) the commercial banks, the foreign exchange bureaus and the new affiliates of foreign banks. Import licensing will be abolished for all goods, except those on a short "negative list", which the government will control for health and security reasons, and eight selected luxury goods. This decision involves a decisive step in the liberalisation of the Tanzanian economy.

Against this background it appears to us that the TOR were quite wisely formulated when asking for a general analysis of the role of import support in the programme of economic liberalisation in Tanzania with emphasis on macroeconomic issues, instead of asking for a particular focus on the OGL. For that reason, the analysis in this study remains relevant even after the abandonment of the OGL system.

CONTENTS

LIST OF TABLES AND FIGURES

LIST OF ABBREVIATIONS

ADB	African Development Bank
bill.	billion (1000 million)
BOS	Bureau of Statistics
BOT	Bank of Tanzania
CASS	Current Agricultural Sample Survey
CIDA	Canadian International Development Agency
cif	cost, insurance, freight
CIS	commodity import support, i.e. administratively allocated commodity assistance and/or import support
CR	counterpart revenue
CRDB	Cooperative and Rural Development Bank
DAC	Development Assistance Committee (of OECD)
DNB	Den Norske Bank in Oslo
DRS	Debtor Reporting System (of the World Bank)
DSM	Dar es Salaam
EC	European Community
ERB	Economic Research Bureau (at the University of Dar es Salaam)
ERP	Economic Recovery Programme
ERP II	Economic and Social Action Programme
FAO	Food and Agriculture Organisation (of UN)
FCF	fixed capital formation
fob	free on board
forex	foreign exchange
FSAC	Financial Sector Adjustment Credit
FSRC	Financial Sector Restructuring Commission
FSU	Food Security Unit
GDP	gross domestic product
GFCF	gross fixed capital formation
GOT	Government of Tanzania
ICB	International Competitive Bidding
ICOR	incremental capital output ratio
IDA	International Development Association
IL	import licence
IMF	International Monetary Fund
IOCR	incremental output capital ratio
IRTAC	Industrial Rehabilitation and Trade Adjustment Credit
IS	import support (in general)
JEM	Joint Evaluation Mission (of SPA)
KILIMO	Ministry of Agriculture
LART	Loans and Advances Realization Trust
LC	letter of credit
LT	long-term
MDB	Marketing Development Bureau
MECCO	Mwananchi Egnineering and Construction Company
MEIDA	Metal Industries Development Association
MFA	Norwegian Ministry of Foreign Affairs
mill.	million
MRC	Multisectoral Rehabilitation Credit
NBC	National Bank of Commerce
NESP	National Economic Survival Programme
NGO	non-government organisation

NIC	National Insurance Corporation
NMC	National Milling Corporation
NOK	Norwegian kroner
NORAD	Norwegian Agency for International Development
NPF	National Provident Fund
ODA	official development assistance
OECD	Organization for Economic Cooperation and Development
OGL	Open General Licence
PBZ	People's Bank of Zanzibar
PER	Public Expenditure Review
PFP	Policy Framework Paper
PSI	pre-shipment inspection
PSRC	Parastatal Sector Reform Commission
RCU	Regional Cooperative Union
RUDEP	Rukwa regional integrated development programme
SAP	Structural Adjustment Programme
SEK	Swedish kronor
SFMU	Statistics and Farm Management Unit
SGR	Strategic Grain Reserve
SGS	Societé Générale de Surveillance
SIDA	Swedish International Development Authority
SIDO	Small Industries Development Organisation
SIP	Survey of Industrial Production
SPA	Special Programme of Assistance to Africa
TAC	Tanzania Audit Corporation
TACOSHILI	Tanzania Coastal Shipping Line
TAMCO	Tanzania Automobile Manufacturing Co.
TANELEC	Tanzania Electrical Goods Manufacturing Company
TANAA	Tanzania Agricultural Adjustment Programme
TCMB	Tanzania Coffee Marketing Board
TDFL	Tanzania Development Finance Limited
TFC	Tanzania Fertilizer Company
TIB	Tanzania Investment Bank
TISCO	Tanzania Industrial Services and Consultancy Company
TKAI	Tanzania Karatazi & Ass. Industries
TOR	terms of reference
TPCC	Tanzania Portland Cement Co.
TPSB	Tanzania Post Office Savings Bank
TSh	Tanzanian Shilling
UFI	Ubungo Farm Implements Factory
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
URT	United Republic of Tanzania
USAID	United States Agency for International Development
US $	United States dollar
VA	value added (contribution to GDP)
WB	World Bank
ZZK	Zana Za Kilimo
%	percent

EXECUTIVE SUMMARY

The serious balance of payments crisis which Tanzania faced in the early 1980s, was to a large extent created by internal policies. And, many of these internal policies had been supported by the donor community in the 1970s. Finally, the crisis forced Tanzania into negotiations with the IMF and the World Bank on a structural adjustment programme according to their prescriptions. It was through a long and complex political process that the Tanzanian government in 1986 accepted most of the requirements of the IMF and the World Bank which it had earlier resisted. By the early 1980s, the bilateral donors including Norway and Sweden, had decided to support IMF's recommendations to Tanzania; and since 1986, they have supported the IMF-style economic restructuring through liberalisation and market-oriented reforms which is being implemented (sections 1.1 and 1.2).

Tanzania's agreement with the IMF in 1986 resulted in an immediate sharp increase in foreign aid (grants and net concessionary loans), by more than 100% within three years, from a low of US $ 487 mill. in 1985 to US $ 982 mill. in 1988. Since then there has been a further increase in foreign aid, which reached US $ 1151 mill, i.e. 84% of merchandise imports and 45% of the gross domestic product in 1990 (cf. table 1.1). Most of the increase in foreign aid from 1986 onwards was in the form of import support.

2. Norway and Sweden have also devoted a considerable share of their aid to Tanzania to import support, which in recent years has accounted for an average of almost 40% of their total bilateral aid (cf. tables 1.2 and 1.3). In 1990/91, both countries started to channel most of their import support through the Open General Licence (OGL), which had been established in 1988 on the initiative of the World Bank. NORAD's and SIDA's reasons for this shift was to attain a more efficient and transparent allocation system for import support and to support more effectively the programme for economic restructuring through liberalisation (section 2.5).

The OGL represents a liberalised system of foreign exchange allocation, and it is closely linked to other liberalising measures, especially devaluations of the Tanzanian Shilling, with the objective of attaining an exchange rate determined by market forces alone, and liberalisation of foreign trade. Significant steps have been made in this direction through simplifying procedures (section 2.1) and unifying the official and the parallel market exchange rate (section 3.2). Nevertheless, significant weaknesses are also revealed. Importers have repeatedly claimed that the "first come, first served" principle has not been adhered to; nor has the BOT established as yet a publicly accessible system that will allow importers to verify that this principle actually is being followed. Moreover, there has been an uneven flow of foreign exchange from donors to the OGL, which has been further aggravated by delays in the preparation and submission of disbursement applications for OGL funds by the Tanzanian authorities.

In addition, there has been inadequate monitoring by the relevant Tanzanian authorities regarding full payment of counterpart funds under the OGL (section 2.4). However, this problem has been far less critical under OGL than for the administratively allocated commodity import support (section 3.5). On the whole, the weaknesses of the operation of the OGL are indications of an inadequately transparent system (section 2.4).

3. A main purpose of the analysis of chapter 3 has been to understand the various consequences of liberalising the foreign exchange market through the programme of import support. Decisive liberalisation of the foreign exchange market started with the Open General Licence (OGL) system for imports introduced in 1988, and proceeded rapidly through successive shortening of the "negative list" of imports under OGL and the establishment of licensed foreign exchange bureaus. The process has achieved already partially a major objective of narrowing significantly the difference in margins among official, parallel and bureau exchange rates (section 3.2). However, this tendency towards a unified exchange rate, has not been accompanied by a matching degree of transparency and liberalisation of the market for domestic credit. Two fundamental problems are identified in the report. First, there has been significant variation between import licences (IL) issued as proportion of letters of credit (LC) which also differs by categories of borrowers. This suggests (table 3.3) that bureaucratic discretion rather than financial market-based rule may still exert some influence on the issuing of import licences. Second, the restrictive domestic monetary policy through targeting both on money supply and

high nominal interest rate, has not been synchronised adequately with the process of liberalisation of the foreign exchange market. Our finding is that although the restrictive monetary polity stance has reduced the potential supply of credit, the actual supply of credit has largely tended to be demand-determined and has not been correspondingly squeezed due to the operation of mechanisms such as commercial banks' rediscounted borrowing from the Bank of Tanzania (section 3.4). While commercial banks have been able to lend in a somewhat less restrictive manner to selected borrowers despite the restrictive overall credit policy, there have been significant accumulated default on the cash cover on commodity import support (CIS) (table 3.6), which decreased significantly under OGL import support. Since default amounts to wrong selection of creditworthy borrowers as well as an implicit and discriminatory credit subsidy only to those borrowers (section 3.5), the existing domestic credit system again seems to point to some lack of transparency and bureaucratic discretion which may not be altogether in conformity with the liberalisation of the foreign exchange market through OGL import support.

In relation to domestic production, the liberalisation of the foreign exchange market is expected to improve capacity utilisation and efficiency, especially in the manufacturing sector through easier access to imported inputs. Here evidence is ambiguous (section 3.6). Capacity utilisation in firms supported by Norwegian and Swedish import support has not increased significantly, and there is some evidence to suggest (table 3.7) that public sector firms might have a better rate of capacity utilisation; but they also seem to have higher cash cover default rate (table 3.8). We hypothesise that this higher capacity utilisation may be partly due to the fact that the public sector firms have easier access to recurrent domestic credit for working capital, despite a higher default rate, i.e. a relatively "soft budget constraint" operating for public sector firms. At best, the marginal improvement in overall capacity utilisation in the manufacturing sector (see also tables 4.4 and 4.5, chapter 4) could be explained partly by the problems of inadequate demand which domestic firms in Tanzania are facing under a more liberalised import regime. They seem unable to stand up to the competition from foreign firms and, are losing steadily market share to foreign competitors, with the result that total manufacturing output was lower in 1986-90 than in the late 1970s and even the early 1980s (table 3.9). Our analysis, also pointed out (section 3.7) that this loss of the internal market by Tanzanian producers has not been compensated by any corresponding gain of the external market for exports, either for agricultural or for industrial products. Manufacturing exports in 1991 was around 61 million US dollars, compared to 63 million in 1987 and, even ignoring the declining terms of trade effect, the export volume of Tanzania's six major crops was at a lower level in 1989-91 compared to the crisis years of 1982-84 (section 3.7, table 3.10).

Our preliminary evidence presented in this report, therefore, tends to suggest that import support for liberalisation has not contributed, so far, to positive structural adjustments in the traditional manufacturing sector which is stagnating and losing out to foreign competition in Tanzania. However, whether import support for liberalisation can still help to create a new type of manufacturing sector in other branches of production, e.g. in the informal sector, remains to be seen, as there is very little hard evidence on this point (chapter 6). In short, there is more evidence so far, for the "destructive" effects of foreign competition than for the "creative" effects of import support on domestic industries in Tanzania.

4. Using a macroeconomic perspective, chapter 4 takes up the analysis from the point where chapter 3 left it. It begins by probing into the impacts on aggregate supply and demand of an import support programme sustained by foreign aid (section 4.2). We demonstrate analytically how the aid-recipient economy is able to use aid fruitfully in the short period usually only upto a certain point through import liberalisation. Beyond that point, however, more aid may, in some cases, become counter-productive by contracting aggregate demand for domestically produced goods (figure 1, section 4.2). This macroeconomic view also links up with the previous sectoral and micro-level analysis (of chapter 3, sections 3.6 and 3.7) which indicated the falling market share and a lower (compared to late 1970s and early 1980s) production by domestic firms in Tanzania in recent years.

However, our general analysis (see section 4.2, figure 2) also recognises that higher aid needs not always lead to the contraction of domestic demand, particularly if foreign aid drives strongly domestic investment. In such a case, aid could contribute invaluably also to the process of growth and structural adjustment of the economy in the longer run. This led our analysis of the recent growth process in Tanzania

through resource mobilisation and resource utilisation (section 4.3). Using the share of investment in national output as the index of resource mobilisation and the productivity of investment (i.e. additional output stream generated per unit of fixed investment or the incremental output capital ratio) as the index of resource utilisation, we came to two significant conclusions. First, improved resource utilisation accounts for most of the higher growth rate during 1986-90 (accounting for about 70 to 90%) compared to 1980-85. Second, the mechanism for resource mobilisation, (accounting for only 10% to 30% of the higher growth in the later period) has been relatively weak in Tanzania. Thus, higher investment needed for growth has increasingly come from foreign aid with very little matching domestic efforts at resource mobilisation (table 4.3). Moreover, detailed sectoral analysis of investment composition and capacity utilisation shows (section 4.4) that the improved resource utilisation is largely the result of better performance by the agricultural sector and, not by the manufacturing sector, despite the fact that the share of total investment going to agriculture has marginally fallen (table 4.6).

This led to our analysis of the nature of the problems facing the manufacturing sector (section 4.5). We came to the dismal conclusion that very low and falling labour productivity in most years (table 4.9) may be the crux of the problem. At such low labour productivity, Tanzanian manufacturing industries can generate profits only by depressing the real wage rate which is already close to subsistence (table 4.8). Thus, the restructuring of Tanzanian manufacturing sector needs to focus on labour productivity as the strategic variable. The pattern of investment, but not of output composition, also showed an almost dramatic shift in favour of the transport sector, both in terms of OGL allocations and total investment funds. This could imply that the macro productivity of investment (measured by the IOCR) is probably not that high in transport activities, but private profitability is high enough to attract a large proportion of OGL to that sector sections 4.3, 4.4).

5.   Having identified in chapter 4, domestic resource mobilisation as a major weakness in the process of economic growth in Tanzania, chapter 5 examines the relative roles played by the public (or government) and the private sector in resource mobilisation and especially, how the programme of import support influences their relative roles. It was found (section 5.1, table 5.2) that there has been a discernable change in the domestic pattern of financing of investment in the economy since the early 1980s. Until about 1983-84, the private sector was a net saver, while the government was a net dissaver indicated by its budget deficit. However, the pattern changed in later years, as both the government and the private sector became net dissavers, with foreign aid filling in the entire gap of excess spending by both sectors. There also seems to be a tendency for the private sector deficit to increase rather more rapidly than the government deficit in recent years (table 5.2) However, while government budget deficit has increased generally in absolute magnitude over time, it seems to have maintained throughout the 1980s, a rather steady proportion (about 1/3) of total government expenditure (table 5.3). Import support counterpart revenue has been used on an increasing scale since 1986 to cover government budget deficits (table 5.5), and there is some evidence to suggest that counterpart revenue may not only stimulate government expenditure level, but may also have become partly a "soft option" for the government. Instead of widening adequately the tax base for domestic resource mobilisation, the government seems to take increasing recourse to counterpart revenue accruing to it as a result of import support.

6.   In the course of the economic analysis presented in this report, several problems regarding the reliability and usability of official statistics were confronted. While chapter 6 provides a more detailed account of the statistical difficulties faced, the problem of reliability of data arises basically on three counts. First, there is the problem of inconsistency of estimates from alternative sources, e.g. SFMU and FSU estimates of agricultural output (section 6.1), or comparison of value added of the parastatals and the entire manufacturing sector in national income statistics (section 6.2). Second, there is the problem of identifiable gaps in the reporting of data. For instance, there is serious gap in the reporting of capital formation by the private sector in agriculture and, of all private sector activities in domestic trade and transport sector (section 6.6). In general, with expanding scope of activity by the informal sector, this error of reporting is likely to increase over time, unless special efforts are made to capture these activities statistically. Finally, statistical problems also arise from the use of unclear or confused categories. This is most sharply illustrated by our consideration of the balance of payments statistics of Tanzania (section 6.7), where systematisation of data requires prior use of transparent concepts.

Finally, it should be mentioned that, despite serious problems of the reliability of data, the range and coverage of statistical information in Tanzania are reasonably good. In turn, this allowed us to carry out some

in-depth economic analysis, and we believe that the results presented in this report are qualitatively robust, though subject to quantitative alternations. Thus, only those conclusions and results have been presented in this report which would hold qualitatively despite substantial revision of the quantitative data along lines suggested in chapter 6.

LESSONS LEARNT AND RECOMMENDATIONS

1. Import support through OGL and the accompanying liberalisation of the foreign exchange market has made significant progress in Tanzania in several directions. (a) It has simplified procedures for foreign exchange allocation (section 2.1), (b) reduced discrepancy between the official, bureau and parallel exchange rate over time (section 3.2) and, in general, reduced the dead-weight of unnecessary bureaucratic control.

2. Nevertheless, more detailed examination revealed that there have been unnecessary delays in dealing with applications for forex under OGL (section 2.4), lack of adequate monitoring and scrutiny resulting in default of full payments of counterpart funds, especially under CIS (section 3.5), but also, although to a much lesser extent, under OGL (section 2.4).

3. More detailed examinations (chapters 2 and 3) suggest the continuance of a non-transparent financial system, which may easily lead to discrimination that is detrimental to the economic development of Tanzania. The policy implication follows that a more transparent financial system based on clearly stated rules should be attempted. This requires separation of responsibility at various layers of the financial structure and corresponding accountability at each layer. In particular, this may be helped by making the commercial banks far more independent of the Bank of Tanzania, (except for normal regular inspection of the commercial banks by the BOT). Thus, domestic commercial banks should be entirely responsible and accountable for prior cash cover payment for each foreign exchange transaction by them, while they would also assess independently without interference from higher authorities the creditworthiness of each foreign exchange borrower. Over time, this would also help in differentiating the performances of different commercial banks, which seems difficult under the present system.

4. A critical element on which the longer term viability of a liberalised foreign exchange regime hinges, is the absence of speculative capital flights from Tanzania. Both economic considerations (section 3.8) as well as our examination of the balance of payments data (section 6.7) suggest that a well-devised system of control should receive high priority.

5. One of our major findings (chapter 4) has been the poor performance of Tanzania in terms of domestic resource mobilisation. The import support programme, despite having the beneficial effect of somewhat improving resource utilisation (sections 4.3, 4.4), seems to have offered a "soft option" of counterpart revenue to the government as an alternative to greater efforts at domestic resource mobilisation (chapter 5). However, in a more optimal policy regime, domestic resource mobilisation would have to be strengthened continuously by the import support programme. There is, therefore, pressing need to redesign policies for more effective resource mobilisation — both at the donars' and at the recipient's end. In particular, this may be achieved partly by linking foreign assistance (in some administratively simple and transparent way) to efforts at domestic resource mobilisation (e.g. level of direct tax collection and withholding assistance by the amount of default of counterpart funds for OGL until the relevant commercial bank is held accountable and action taken).

6. It also needs to be emphasised that the efficient maintenance of economic and social infrastructure like, roads, telecommunication, water-system, power, health and education are part of the overall process of domestic resource mobilisation and utilisation for development. A large dose of donars' support would undoubtedly be required for improving the economic and social infrastructure in the near future. Never-

theless, donars' support alone cannot ensure a functioning system of economic and social infrastructure, unless its maintenance is done properly by the Tanzanian authorities. There is a strong case for considering whether donors' funds for new infrastructural investment should be linked directly to the performance of existing facilities (e.g. new roads or telecommunications or power plants may not be funded by the donors, if the existing ones fall into near disuse due to lack of maintenance).

7. Import support, in so far as it also helps the process of economic liberalisation and structural adjustment in Tanzania, cannot be effective in the longer run in the manufacturing sector, unless it helps micro- or enterprise-level restructuring, so that some of the firms gradually become internationally competitive. However, one of the lessons learnt is that, often firms in Tanzania are not simply inefficient in terms of internal organisation, but they also operate in a highly unfavourable macro-environment. Thus, the extremely poor maintenance of economic and social infrastructure makes Tanzanian firms severely handicapped to face international competition. Nor, does it create a favourable climate for new investments. This problem is aggravated by the fact that foreign investors are exempted from import duties and sales tax on imported inputs, which implies a considerable competitive disadvantage for domestic firms.

8. There is also an additional problem associated with large scale general import support. It has often meant hasty and pre-mature liberalisation of imports, without giving adequate time to the domestic firms to adjust to international competition. This appeared analytically in our argument as the probable role of foreign aid in contracting the demand for domestic goods (section 4.2), and in the falling market share of domestic firms (section 3.6), while exports remain stagnant (section 3.7). Our policy recommendation is to subject the programme of import liberalisation to closer scrutiny, and generally proceed at a slower pace in those areas where domestic production capabilities exist. In the longer run, successful restructuring of industries in Tanzania cannot be guided by market forces alone, but has to be supplemented strongly by an active trade and industrial policy.

9. The lessons of the past in terms of government involvement particularly in the industrial policy in Tanzania are not encouraging. Nevertheless, the baby cannot be thrown away with the bath-water! An industrial policy cannot be done away with in Tanzania, because the government failed in the past. In our view, this requires a time-bound programme. Domestic firms, public and private, should be selected depending on the nature of the product and the past performance of firms, for being entitled to a limited period to both protection (tariff and/or non-tariff) and investment support for restructuring. The danger in this industrial strategy, given Tanzania's past experience, is far too obvious. Nevertheless, past mistakes may be avoidable, if again the system is made transparent on the basis of prior commitments by both the Tanzanian government and the donors. Thus, the time horizon for protection and investment support, which may also be gradually reduced over time, should be made clear beforehand (e.g. never exceeding 5 years), and the donors may withhold foreign assistance if the time-schedule is not strictly adhered to by the recipient government. In our view, despite all the dangers, a country in Tanzania's state of underdevelopment cannot develop competitive industries by simply relying on market forces. Government involvement in terms of an industrial policy is essential, and the role of the donors would have to be seen in that context. The policy of adhering to a strictly defined time schedule seems a feasible alternative worth trying.

10. Performance cannot be evaluated or monitored without reliable information. There is strong need to improve the quality of Tanzanian national income and related industrial and financial statistics, in order to make them useful instruments of economic monitoring and policy formulation (chapter 6). In particular, there is an urgent need to collect together reliable information for a viable and selective industrial policy, a work which has been commenced with the industrial restructuring studies. There is also a very strong case for making the balance of payments statistics more transparent (section 6.7), which is an improvement that should not imply any significant cost.

11. Finally, import support touches tangentially on two crucial aspects of the economic and social reality in Tanzania, particularly because import support through the OGL contributes to the general economic liberalisation. First, in so far as a focus of foreign assistance on poverty alleviation is concerned, integrated rural development schemes despite liberalisation still have a strategic role to play (section 2.6). In the industrial sector, the fundamental problem confronting Tanzanian manufacturing is low labour productivi-

ty (section 4.5). Tanzanian industry, in our view, cannot be made more competitive by any further reduction in real wage, which may actually have strong negative incentive effects. Thus, an indirect contribution to poverty alleviation could be made by focusing on ways and means to improve labour productivity in manufacturing, and thereby reducing unit labour cost of production, while at the same time protecting as much as possible the level of domestic employment. This is a further reason for following a more controlled and discriminating import liberalisation policy, discussed earlier.

Second, in a multiracial society like Tanzania with also sharp regional differences, import support contributing to a market-oriented strategy of liberalisation is almost certainly going to widen both regional, social and ethnic differences. For the tensions to be manageable, it is absolutely essential that the economic system acts transparently with fairness. Thus, instruments for economic intervention like selected protection and industrial policy, must be based on transparent rules and prior commitments by the government. Unless the system is also seen to operate on the basis of transparent rules in a fair manner, the regional and racial tensions may thwart the development process. It is our overall understanding that economic development in Tanzania is not possible without selective but crucial government intervention. But such intervention must aim at promoting strictly economic efficiency and not at discriminating simply in favour of particular social groups or regions. These are not easy tasks for any government. But they are all the more difficult without unambiguous support on the part of the donors who, therefore, have a critical supporting role to play.

1. The background

1.1 Features of the balance of payments crisis in the early 1980s

In the early 1980s, Tanzania faced a severe balance of payments crisis which was the combined result of both internal and external factors. Among external factors, the two successive oil shocks of 1973/74 and 1978/79 forced Tanzania to spend an increased share of foreign exchange receipts on oil imports. Also the break-up of the East African Community in 1977 had a detrimental effect on economic infrastructure and communications. The war with Uganda which broke out in November 1978, caused disruption in agricultural production and transport services and a sharp rise in imports of military equipment including fuel.

The contribution to the crisis by the internal factors appears even stronger: The ambitious investment programme of the 1970s, especially within the industrial sector (the Basic Industries Strategy), mainly financed by foreign aid, created a manufacturing sector which was a heavy net user of foreign exchange (forex). At the same time, agricultural export earnings (the major source of foreign exchange revenues) declined, partly due to declining export prices in forex terms, but mainly as a result of declining production of export crops. That decline could, in turn, be related to the government's policies, e.g. the strong overvaluation of the TSh subsequent to a long period of high inflation rates which eroded international price competitiveness steadily and, more significantly, the assignment to parastatal crop authorities of the monopoly right to the purchase of agricultural products and sale of inputs (cf. e.g. Havnevik, et al. 1988).

1.2 Tanzanian policy responses to the balance of payments crisis

In the late 1970s, Tanzania approached the IMF, requesting increased credits in order to bridge the widening balance of payments gap. After negotiations with the IMF, which started in 1978, were discontinued in late 1979 and then resumed in May 1980, an agreement was reached in August 1980 for a Stand-By Arrangement of SDR 179 mill., for the period up to May 1982. (Bank of Tanzania (BOT) 1981:61). However, Tanzania soon faced problems in meeting the conditionality and the performance criteria set by the IMF, especially on issues such as devaluation, interest rates, budget restraint, credit restraint and subsidies. As a consequence, drawings on the IMF credit were suspended after the first tranche was released in late 1980, and Tanzania did not reach a new agreement with the IMF before in August 1986. The loss of forex due to the suspension of the IMF credit was partly compensated by increased commercial borrowing, especially (net) suppliers' credits which amounted to US $ 165 mill. over the years 1980-1983 and contributed strongly to an increase in payment arrears from US $ 302 mill. in 1981 to 445 mill., which exceeded total export earnings by 30%, in 1983 (BOT 1986:13-14).

The National Economic Survival Programme (NESP) 1981/82-1982/83

As an alternative to the IMF policy requirements, the government of Tanzania (GOT) launched the NESP in 1981. The most important elements in the NESP were "export drive" to improve forex earnings, "judicious use" of forex to enhance capacity to earn/save forex, emphasis on agricultural production, control of government expenditures with strong prioritization on outlays stimulating production and meeting the basic needs of the society, and provision of incentive goods for workers and farmers.

However, the economic targets of the NESP, which were prepared under severe time pressure, were only vaguely specified, and so were the political measures needed to reach them.

The Structural Adjustment Programme (SAP) 1982/83-1984/85

The GOT seemed to have realized soon the shortcomings of the NESP, the most serious of which was possibly that it was not accepted either by the IMF or the World Bank. In an attempt to come to terms with the World Bank, the GOT jointly with the Bank appointed an "Advisory Group" which worked out the SAP, submitted to the GOT in May 1982.

In comparison to the previous NESP, the SAP specified more detailed targets as well as policy measures to reach them. Some of the policy measures also went some way to satisfy the IMF requirements, e.g. increased "controls over parastatal finances" and "liberalization of interregional trade in agricultural goods". However, the SAP did not come nearer either to the IMF or the World Bank requirements in matters such as devaluation, budget restraint and reduction of budget deficits, and removal of subsidies. In the end, neither of the Bretton Woods institutions accepted the SAP as an adequate basis for giving new credits to Tanzania. In the meantime, Tanzania's export earnings continued to fall, from US$ 614 mill. in 1981 to 383 mill. in 1983. Mainly as a result of this, the country's balance of payments crisis turned even worse, with the result that the value of imports was reduced by 37% within three years, from US $ 1384 mill. in 1980 to 870 mill. in 1983.

An indication of the strong pressure the GOT must have felt in those years is the fact that in 1984 it legalized "own funds" imports, a measure which had not even been suggested in the SAP. This meant allowing imports financed by illegally earned forex revenues from smuggling, capital flight, overinvoicing of regular imports, under-invoicing of regular exports, theft for forex, etc. Own funds imports constituted soon about 30 to 40% of total imports, a level they have kept since, contrary to the original expectation that these revenue sources would dry up within a couple of years.

The massive compression of imports faced by Tanzania during this period was, in addition to the short-fall of exports, due largely to a reduced inflow of bilateral aid. An increasing number of bilateral donors made it clear to the Tanzanian authorities that they would not increase and might even reduce their aid, until Tanzania had reached an agreement with the IMF. As a matter of fact, total grants to Tanzania net of technical cooperation grants were reduced by 45% from US $ 485 mill. in 1980 to 265 mill. in 1985, whereas total aid (including net concessionary loans) net of technical cooperation grants was reduced by 30%, from US $ 494 mill. to 345,5 mill. in the same period (cf. table 1.1).

From 1982 onwards, Norway and Sweden joined the donor community in their pressure to make Tanzania accept an agreement with the IMF. Sweden reduced its aid in US $ terms by 44% from US $ 87,2 mill. in 1980 to 49 mill. in 1985 (cf. OECD: Geographical Distribution ...., Paris 1985, 1988). In Norway, the Ministry of Finance recommended strongly that NORAD should take similar measures; however, the directors of NORAD refused to do so.

In the negotiations with the GOT, most bilateral donors did not seem to have made their own, independent assessment of the policies which the IMF tried to impose upon Tanzania in the early 1980s. On the other hand, the fact that virtually all bilateral donors in the early 1980s urged Tanzania to accept an agreement with the IMF, makes them partly responsible for the IMF policies the GOT has tried to implement since 1986.

The Economic Recovery Programme (ERP) 1986/87- 1988/89

In August 1984, the World Bank presented a Country Economic Memorandum on Tanzania (World Bank 1984). Part II of the memorandum was entitled "A Programme of Recovery". It is significant that most of the elements of the recovery programme proposed by the World Bank in 1984 are also found in the ERP of the GOT which was adopted two years later. The ERP may therefore be interpreted not only as an attempt to solve the economic crisis, but also an attempt by the GOT to accommodate the demands of the World Bank. Such a step seemed necessary in order to attain increased foreign aid from the World Bank as well as from most other donors. And indeed, the Bank did praise the ERP as an important step towards solving Tanzania's economic problems (cf. World Bank/Eastern and Southern African Office, 1986). Moreover, the ERP opened the avenue to the new agreement with the IMF which was signed in August 1986.

The ERP represented an important watershed in official Tanzanian policy by emphasising that the imbalances in the economy leading to acute crisis were mainly the responsibility of the Tanzanian authorities themselves: "... however caused, a country's economic problems are primarily its own responsibility" (URT 1986:i). Among the past policy mistakes, it emphasised "insufficient resources for agricultural development compared with the high priority given to industry", "inadequate producer incentives and marketing/distribution systems" in agriculture, "expansionary fiscal and monetary policies which added to inflationa-

Table 1.1 Foreign aid to Tanzania, Actual disbursements 1980 - 1990. Mill. US$

	1	2	3	4	5	6	7
Year	Net cons. loans	Grants	(Net) Total aid	Techn cooper. grants	Grants net of techn. cooper.	Total aid net of tecn. c ooper.	2 as % of 3
1980	8.5	657.7	666.2	172.6	485.1	493.6	98.7
1981	193.4	508.5	701.9	176.4	332.1	525.5	72.4
1982	193.8	490.2	684.0	181.2	309.0	502.8	71.7
1983	164.0	429.9	593.9	173.9	256.0	420.0	72.4
1984	128.3	429.5	557.8	138.7	290.8	419.1	77.0
1985	78.9	408.0	486.9	141.4	266.6	345.5	83.8
1986	33.8	646.8	680.6	163.4	483.4	517.2	95.0
1987	214.5	667.8	882.3	186.7	481.1	695.6	75.7
1988	172.2	809.5	981.8	210.2	599.3	771.6	82.5
1989	183.7	736.0	919.7	202.4	533.6	717.3	80.0
1990	252.7	897.9	1150.6	209.3	688.6	941,3	77.7
Total 1980-90	1623.8	6681.8	8305.6	1956.2	4725.6	6355.5	80.4

Source: OECD: Geographical Distribution of Financial Flows to Developing Countries, several issues, Paris

ry pressures and thus to the exchange rate's overvaluation", and "rapid growth in the government sector and related management problems".

In contrast to the SAP, the ERP announced decisive steps towards economic liberalization, e.g. step-wise devaluations of the TSh "aimed at gradually achieving an equilibrium exchange rate by mid-1988", reductions in the Government budget deficit, monetary and credit policies that would lead to positive real interest rates, immediate and substantial increases in producer prices of agricultural crops, a substantial reduction in the number of items under price control, and liberalization of internal (deconfinement) and external trade. Thus, most of the typical elements of an IMF "stabilisation package" were present in Tanzania's ERP. In this way, the ERP prepared the ground both for the agreement with the IMF and for a long range of policy measures transcending the ERP in the subsequent years.

We noted earlier that the NESP and the SAP were characterized by ambitious target-making without specifying measures to reach those targets. This also applies, although to a lesser extent, to the ERP. For example, the ERP targeted a strong increase of export earnings and a corresponding gradual reduction of the foreign trade deficit in the period 1986/87 - 1988/89. The target for accumulated merchandise exports in that period was US$ 1271 mill., but the actual figure turned out to be about US$ 1110 mill., falling short of the target by US$ 160 mill.(cf. URT 1989:4).

The ERP II ("Economic and Social Action Programme, 1989/90-1991/92"), which was launched in November 1989 (URT 1989), supplemented the ERP by putting more emphasis on the social (health, education) as well as well as economic infrastructure (water supply, roads etc.), while scaling down the ambitious foreign trade targets. The ERP II target for the growth of export earnings and imports implied that the merchandise trade deficit would continue to widen from about US$ 900 mill. in 1989/90 to 950 mill. in 1991/92 (URT 1989:31).

Reforms in the wake of the ERP and ERP II
Under continuous pressure from the IMF and the World Bank, and quite often also from the bilateral donor community, the GOT has, in many cases seemingly with little enthusiasm, continued to implement reforms which have both transcended the ERP and changed dramatically the economic landscape in the country.

The non-administrative forex allocation system under the Open General Licence (OGL) was introduced in February 1988 on the initiative of the World Bank. This forex facility was intended as a first step towards a market-based, unified forex allocation system in Tanzania. The OGL started with a rather restrictive "positive" list of items eligible for imports. That list was later replaced by a "negative" list covering about 40% of Tanzania's non-oil imports, which in April 1992 was shortened to cover about 20% of non-oil imports.

The result was a considerable liberalization of imports.

In early 1992, the Parliament adopted a new Foreign Exchange Act allowing Tanzanian residents to hold foreign currency accounts. The new law formed the legal basis for the operation of foreign exchange bureaus with completely market-based transactions of forex. The first such bureau was opened in April 1992. The GOT has also given green light to private domestic and foreign banks to open affiliates in Tanzania, and the first branch of a foreign bank is expected to be in operation before the end of 1993.

In 1991/92, the GOT completed liberalisation of domestic trade in agricultural goods (deconfinement) and legalized private ownership of cotton ginneries. At the same time, the main parastatal crop authority, the National Milling Cooperation (NMC) was considerably reduced in size and in number of employees, limiting its operations to commercial milling and management of the Strategic Gain Reserve (SGR).

A new Cooperative Act which became effective in September 1991, abolished Party and Government direct control of the cooperatives and allowed them to determine freely their membership, geographical coverage and activities. Moreover, from 1991/92 onwards, commercial banks were instructed by the Government to lend to cooperatives on a strictly commercial basis.

In order to implement privatization of parastatal companies, the GOT has established a Parastatal Sector Reform Commission (PSRC) with its own technical secretariat. Some big parastatal companies, among which Tanzania Portland Cement Company is the most prominent, have been privatized. In early 1993, the PSRC had completed negotiations for the privatization of three more enterprises, while negotiations were nearing completion for six companies.

As part of the financial restructuring programme, the GOT in 1992 established the Loans and Advances Realization Trust (LART). All nonperforming credits of the NBC and CRDB were transferred to the LART, and the GOT has issued securities to the banks to replace the underlying assets. The decision to transfer a nonperforming loan to the LART, entails the transfer of all other loans of the same enterprise, including those from other banks than the NBC and the CRDB, and the concerned enterprise is no longer eligible for any bank financing. As a consequence, any enterprise whose loans have been transferred to the LART, will be liquidated.

A central objective of the Civil Service Reform, which was announced in the 1992/93 budget, is a dramatic reduction in the number of civil servants. In 1993, the GOT is implementing the first phase of a three year "retrenchment plan", aiming at dismissing at least 10,000 of the reportedly about 50,000 identified redundant civil servants.

There can be little doubt that these and other reforms imply fundamental changes of the Tanzanian economy. On the other hand, the pace of reform appears to be rather uneven

and typically slower in some areas where reforms seem most urgent. For example, there is no indication of a change towards a more transparent remuneration system for civil servants and parastatal executives. A subsatantial part of the "salaries" of those people is still in the form of fringe benefits, such as "house maintenance allowance", "utilities allowance" etc. And even new fringe benefits are being introduced, as for example the "fuel allowance" in the TShs equivalence of 75 litres of petrol per week for parastatal executives and 50 litres per week for civil servants.

1.3 Norwegian and Swedish commodity import support (CIS) to Tanzania

It is now a matter of history that, strongly attracted by President Nyerere's policy expressed in the Arusha Declaration, Norway and Sweden became Tanzania's leading bilateral donors in the mid-1970s. In those initial years, Norwegian assistance went mainly to infrastructure development, especially rural roads and hydropower, whereas Swedish assistance became heavily concentrated on industry.

From 1980 to 1990 Norway accounted for 10.1% of total grants and 8.2% of total aid (net concessionary loans plus grants) to Tanzania, while the corresponding figures for Sweden were 14.2% and 11.4% respectively. In the same period, total Norwegian and Swedish aid to Tanzania, which is wholly in terms of grants, accounted for 24.4% of total grants to the country (cf. OECD: Geographical Distribution..., several issues).Thus, Norwegian and Swedish aid contributed considerably to the high grant component in total aid to Tanzania, which in the period 1980-1990 averaged more than 80% (cf. table 1.1).

Towards the end of the 1970s both SIDA and NORAD realized that Tanzania was not able to earn the forex which was necessary to cover the operating forex costs of already installed productive capacities, which had been largely financed by foreign project aid. In 1979, Norway, on own initiative, granted for the first time import support to Tanzania in the form of a cheque amounting to NOK 45.5 mill., to be used for any balance of payments purposes; and for the budget year 1978/79, SIDA after consultations with Tanzania granted the first commodity import support (CIS) of SEK 70 mill.

In the period 1980-1992, Norwegian import support (IS) amounted to NOK 2077 mill., accounting for an average of 37% of total Norwegian bilateral aid. The corresponding figures for Sweden in the same period were SEK 2279 mill. and 37.5%, respectively. Neither for Norway nor for Sweden was there any clear trend of change of the share of IS in total aid over the period (cf. tables 1.2 and 1.3).

In the 1980s, Swedish CIS was devoted mostly to the industrial sector, reflecting the fact that Swedish aid had been concentrated traditionally on Tanzanian industrialization in the 1970s and rehabilitation during the 1980s. Important recipients of Swedish CIS were Zana Za Kilimo (ZZK), Tanzania Karatazi & Ass. Industries (TKAI), Ubungo Farm Implements (UFI), Tanzania Portland Cement Co. (TPCC), Tanzania Automobile Manufacturing Co. (TAMCO), Small Industries Development Organisation (SIDO) and the Metal Industries Development Association (MEIDA). On the other hand, Norwegian CIS was heavily concentrated on fertilizers (TFC), import support for coffee producers (through TCMB) and for tyre Production (General Tyre), in addition to CIS to several NORAD funded projects such as TANELEC, Mbegani Fisheries Development Center, Sao Hill Saw Mill and TACOSHILI (cf. Skarstein et al. 1988a:126-144).

Table 1.2 Norwegian bilateral aid to Tanzania 1980-1992
Actual disbursements, NOK mill.

Year	1 Total bilat. aid	2 CIS[1]	3 IS through OGL	2 + 3 as % of 1
1980	218.1	82.1		37.6
1981	230.1	94.4		41.0
1982	335.0	147.5		44.0
1983	400.3	185.9		46.4
1984	378.7	111.3		29.4
1985	390.5	156.7		40.1
1986	531.2	214.1		40.3
1987	508.1	186.2		36.7
1988[2]	528.2	195.6		37.0
1989	396.7	101.1		25.5
1990	643.7	75.2	250.9	50.7
1991	554.6	5.9	208.0	38.6
1992[3]	510.1	22.4	40.0	12.2
Total 1980-1992	5625.3	1578.4	498.9	36.9

1) Includes considerable amounts of balance of payments support in the years 1980-1983.
2) NOK 20 mill. of Special Joint Financing of the MRC, which the BOT considers as contribution to the OGL, is apparently included in CIS.
3) Provisional. The low figure through the OGL is reported to be due to channelling of large resources to start-up of the Pangani Hydropower Project (Panagani II).
Source: NORAD archives DSM, March 1993, and NORAD, Oslo May 1993.

The allocation mechanism of CIS

CIS is administered by the Ministry of Finance, supported by a CIS allocation committee based in the Ministry, which includes representatives of the GOT and, in most cases, the donor agency. On the basis of recommendations from, among others, the Ministry of Industries, a priority list of CIS applicants is presented in the committee. In the case of Norwegian CIS, allocations are made after negotiations between the GOT and the donor.

In the early years the allocation criterion for CIS was intended to support increased capacity utilization in order to produce

Table 1.3 Swedish bilateral aid to Tanzania 1980-1992.
Actual disbursements, SEK mill.

Year	1 Total "country frame" (country budget)	2 Import support[1]	3 Import support through OGL	4 2 + 3 as % of 1
1979/80	316.0	82.0		25.9
1980/81	304.0	67.0		22.0
1981/82	466.0	161.0		34.5
1982/83	410.0	153.0		37.3
1983/84	489.2	155.5		31.8
1984/85	482.1	165.3		34.3
1985/86	424.1	231.4		54.6
1986/87	480.7	181.8		37.8
1987/88	441.2	175.6		39.8
1988/89[2]	483.4	183.5		38.0
1989/90	668.7	298.1		44.6
1990/91	533.7	64.4	123.0	35.1
1991/92	583.1	2.7	235.0	40.8
Total 1980/81- 1991/92	6082.2	1921.3	358.0	37.5

1) Includes, for some years, balance of payments support.
2) SEK 48 mill. of Special Joint Financing of the MRC in 1988/89, which the BOT considers as contribution to the OGL, is apparently included in the import support.
Source: SIDA, Dar es Salaam; March 1993, and SIDA: Sweden's Development Assistance in Figures and Graphs/Bistånd i Siffror och Diagram, several issues, Stockholm.

incentive goods and other "priority goods". Later on, more specific criteria were elaborated, viz. the (inverted) domestic resource cost ratio, net forex savings, employment creation and the financial viability of the CIS applicant, in addition to the importance of its activity for the economy as a whole. In the late 1980s, NORAD commissioned assessments of all applicants, using these criteria, and made its suggestions to Tanzania on that basis (cf. SINTEF Applied Economics, 1988 and 1989). All recipients of Norwegian CIS were supposed to pay full cash cover (counterpart funds) to the Treasury, but there was no mechanism to ensure that they would do so.

The allocation mechanism for Swedish CIS was somewhat different. The main reason for this was that Swedish CIS before the shift to the OGL consisted of two categories, viz. the "project-related" and the "free quota" or "flexible" CIS. Each category in the late 1980s accounted for about half of total Swedish CIS.

The "project-related" CIS is allocated mainly to projects which received Swedish support also in the investment stage, such as ZZK, TKAI, TAMCO and SIDO. In contrast to Norwegian CIS, these allocations have been made without assessments of the recipients, after negotiations between SIDA an the GOT, but with the last word left for SIDA.

On the other hand, the "free quota" CIS was allocated by the CIS allocation committee in the Treasury without any interference from SIDA. The "free quota" was in this regard more similar to general balance of payments support. An internal paper in SIDA, dated 05.03.90, complained that, "the flexible Swedish commodity import support seems to be the last chance for the most hopeless firms which have been rejected by all other donors."

The recipients of Swedish "project-related" CIS have to a large extent been exempted from paying cash cover, while recipients of "free quota" CIS were expected to pay full cash cover. The internal paper in SIDA referred to above, stated that SIDA attempts to "attain a rational allocation" of free quota CIS by "adhering strictly to the requirement of cash cover payment (this we do more than other donors)". However, as in the case of Norwegian CIS, there was no mechanism to ensure that cash cover would actually be paid. And, indeed, the cash cover default rate on Swedish CIS, averaging 51% in the period 1987/88-1992/93, was higher than the average for all donors and higher than the default rate on Norwegian CIS, as shown in chapter 3.5.

Evaluations of Norwegian and Swedish CIS

Broadly speaking, the evaluations of Norwegian and Swedish CIS which were undertaken from the mid-1980s onwards, were of two kinds. The first group of studies had a micro-economic focus. They were requested to investigate the utilization of CIS by one or a few specified beneficiaries which had also in most cases been financed in the project stage by the donor in question. Quite often, these recipients were joint ventures with firms from the donor country. For example, financial assistance to TANELEC was evaluated by NORAD in 1985 (cf. Skarstein et al. 1986), and an evaluation of CIS to the truck assembly plant TAMCO, a joint venture with SCANIA, was commissioned by SIDA in 1988 (cf. Carlsson and Yona 1989).

The second group of studies was of a more general nature, often having a broader or macro-economic focus. Thus, they attempted to assess the design of CIS, its actual implementation through all stages and its impacts on a larger group of recipients. The studies in this latter category made a close scrutiny of the process of administrative allocation and the procedures in the actual channelling of CIS (handling of applications, processing of import licenses and letters of credit, etc.), as well as assessments of its impacts, e.g. in terms of capacity utilization, employment, productivity, product quality, earnings/savings of forex, etc., on larger groups of recipients.

For example the Norwegian study commissioned by the Ministry of Development Cooperation in 1977 (Skarstein et. al. 1988a,b) found that manufacturing firms having received most Norwegian CIS in the years 1984-87, had a higher rate of capacity utilization than firms having received less CIS. But it also showed that firms receiving most Norwegian CIS, were net users of forex, whereas firms which had received no Norwegian CIS at all, were net earners/savers.

The Norwegian study also analysed some implications of the large and increasing inflows of cash cover to the Ministry of Finance for public finance, money and credit. It was pointed out that cash cover payments, which in 1986/87 had reached 16.3% of total government expenditure, had to a

large extent replaced government borrowing, and the report expressed the fear that the government could become "permanently dependent" on import support as a "source of recurrent revenue".

On the other hand, most studies showed that there was no systematic collection of cash cover. Some firms would pay full cash cover, others would pay some, and a large number which were given "high priority" by the GOT (almost without exception parastatals), would pay nothing. Neither NORAD, SIDA nor any other bilateral donor succeeded in establishing a mechanism to ensure cash cover payments by all recipients. It will be seen in chapter 3.5 of this report how cash cover defaults on CIS have continued to accumulate until recently.

Finally, the Norwegian report of 1988, in line with most other evaluations conducted at that time, voiced strong criticism of the system of administrative allocations of CIS, mainly because of its apparent arbitrariness, discrimination among different applicants, lack of transparency and inefficiency. The Norwegian study recommended that IS should instead be channelled through the new market-based Open General Licence (OGL) which the World Bank had proposed in early 1987 and for which it was seeking co-financing from bilateral donors. Norway followed this recommendation. Between 1989 and 1991, an almost complete shift from the system of administrative allocation to the OGL took place. Sweden made a similar shift to the OGL, with the first Swedish allocation of SEK 123 mill. channelled to this facility in the budget year 1990/91 (cf. tables 1.2 and 1.3).

Since 1990, Norway and Sweden have continued to grant CIS only to some selected recipients, most of whom they had also supported in the investment stage, e.g. TPCC, SIDO and MEIDA (SIDA-supported) and Sao Hill Saw Mill, TACOSHILI and TCMB (NORAD-supported).

2. The Open General Licence (OGL)

It was already pointed out in the preceding chapter that the "new" OGL scheme (as distinguished from a similar scheme operating in the late 1970s), introduced in February 1988, expanded gradually its scope of operation. A "positive" list of 41 eligible items for imports which was expanded further in 1989, was replaced by a "negative" list covering about 40% of Tanzania's total non-oil merchandise imports. In April 1992, the negative list was shortened even more to cover about 20% of total non-oil imports.

2.1 Procedure of access to the OGL

Under the OGL, each application submitted by an importer has to bear a "floor" value of not less than the equivalent of US $ 5,000, while no upper "ceiling" to the import value exists now. However, import orders of US $ 1 mill. or more have to satisfy international tender requirements, made in accordance with the International Competitive Bidding System (ICB). When submitting an application of less than US $ 1 mill., the importer is generally required to support it with price quotations or proforma invoices from at least three different potential suppliers. Sourcing of the imports under the OGL facility is confined to the World Bank member countries.

The Bank of Tanzania's (BOT) issuance of import licence (IL) is expected to be automatic, provided the application conforms to the eligibility of goods and the other requirements. On the basis of the IL which is valid for six months, a letter of credit (LC) is to be established by either the National Bank of Commerce (NBC), The Co-operative Rural and Development Bank (CRDB) or the People's Bank of Zanzibar (PBZ). This is done under the condition that the importer has paid the TShs cash cover (counterpart value) at the prevailing official exchange rate to the commercial bank in question. However, importers can borrow TShs from the commercial bank at the prevailing interest rate to pay the cash cover. On the other hand, and the commercial banks are required to remit the cash cover immediately to the BOT.

The OGL is intended to work according to the principle of "first come, first served", and presumably, for reasons of transparency and speed, it is assumed that there should be no administrative assessment of an applicant, provided the application fulfils the general requirements of the OGL.

2.2 Funding of the OGL

In its first year of operation, the OGL facility was funded by a World Bank/IDA credit under the Multisectoral Rehabilitation Credit (MRC), which together with co-financing amounted to US $ 301 mill.. In 1989, the funding was extended by the World Bank/IDA Industrial Rehabilitation and Trade Adjustment Credit (IRTAC), which together with co-financing amounted to about US $ 243 mill. In June 1990, the funding was replenished with the World Bank/IDA credit for The Tanzania Agricultural Adjustment Programme (TANAA), which supplemented with co-financing and parallel financing, from among others Norway and Sweden, amounted to US $ 398 mill.

In November 1991, the OGL funding received its latest replenishment so far, through a Financial Sector Adjustment Credit (FSAC), which together with co-financing and parallel financing amounted to about US $ 276 mill.. Of this amount, only US $ 144 mill. had been released by the end of 1992, mainly because the World Bank/IDA has withheld the second tranche of the FSAC, claiming that Tanzania has not fulfilled the conditionality of the FSAC, in particular that the CRDB had not been restructured according to the credit agreement. Therefore, from its inception until November 1991, total external funding of the OGL amounted to US $ 1218 mill., of which US $ 1086 mill. had actually been released by the end of 1992 (cf. also table 2.1). In addition to these external resources, Tanzania made some contribution to the OGL funding from its free forex, amounting to US $ 48.9 mill. by mid-1992.

By the end of 1992, the OGL had dried up more or less completely, and a large number of ILs uncovered by LCs had piled up with the commercial banks. This involves a quite uneven flow of forex to the firms, and there is serious danger that the "first come, first served" principle will not be adhered to when disbursements of OGL forex are resumed, a problem that importers according to the SPA reports (c.f. ch. 2.4) have repeatedly complained about.

2.3 Imports under the OGL

Because of lack of data it is difficult to estimate the actual value of imports financed by OGL funds. While the BOT keeps good records of the ILs issued, the import purchases are based on LCs opened by the commercial banks. After several unsuccessful attempts to get data on actual annual disbursements of OGL funds, we were left with the impression that these figures are not exactly known to the BOT. The reason for that may either be inadequate reporting from the commercial banks to the BOT on LCs opened, or a bad record keeping of LC information in the BOT, or a combination of both. This deficiency has also been pointed out in audit reports from the Tanzania Audit Corporation (TAC).

With regard to the OGL, the BOT could provide us with data on ILs and LCs, respectively, only for January-October 1991 and January-October 1992. For these two periods the LCs opened amounted to 82% and 53% of the ILs issued, respectively. In other words, there was a sharp fall in the LC/IL-ratio from 1991 to 1992, which was probably mainly due to the fact that the OGL funding gradually dried up in 1992. For the years prior to 1991, the LC/IL-ratio was most likely at least as high as in 1991.

Table 2.1 External funding of the OGL, 1988-1991. Commitments in Mill US $

1988:

World Bank/IDA1) credit (MRC2))	147.4
Credit from ADB3)	25.0
Joint financing from Norway	3.0
Joint financing from Sweden	7.0
Co-financing/joint financing from other bilateral donors	118.7
Sub-total US $ mill.	301.1

1989:

World Bank/IDA credit (IRTAC4))	182.1
Credit from ADB	18.0
Co-financing from bilateral donors	42.6
Sub-total US $ mill.	242.7

1990:

World Bank/IDA credit (TANAA5))	212.0
Co-financing from Norway	74.7
Parallel financing from Sweden	50.0
Co-financing/parallel financing from other bilateral donors	61.6
Sub-total US $ mill.	398.3

1991:

World Bank/IDA credit (FSAC6))	200.0
Credit from ADB	18.0
Parallel financing from Sweden	10.0
Co-financing/parallel financing from other bilateral donors	47.8
Sub-total US $ mill.	275.8

Grand total, US $ mill	1217.9

1) IDA - International Development Association, sister organisation of the World Bank giving concessionary credits.
2) MRC - Multisectoral Rehabilitation Credit.
3) ADB - African Development Bank. Regional development bank for Africa, est. 1963 which about 50 African countries as members. Headquarters in Abidjan, Ivory Coast.
4) IRTAC - Industrial Rehabilitation and Trade Adjustment Credit.
5) TANAA - Tanzania Agricultural Adjustment Programme.
6) FSAC - Financial Sector Adjustment Credit.
Note: The dates refer to credit commitments made by the World Bank/IDA. Parallel financing/co-financing from bilateral donors may have been pledged at later dates.
Source: Bank of Tanzania, March 1993.

In order to make an approximate estimate of OGL-funded imports for each of the years 1988 to 1992, we assume that the LC/IL-ratios observed in January-October 1991 and 1992, respectively, apply to the whole of those years. Moreover, on the basis of estimated released OGL funds and values of ILs on OGL funds published by the GOT, we arrive at an estimate of the average LC/IL-ratio for the years 1988 to 1990 of 93.5%. The estimated figures of OGL-funded imports in table 2.2 are based on these assumptions. The estimates in table 2.2 show that the OGL accounted for an average of about 17% of total merchandise imports in 1988-1992, while CIS accounted for about 10% in the same period. Moreover, while the OGL increased its share in imports financing from about 4% in 1988 to 27% in 1991, the share of CIS decreased from 14% to 4.5% during the same period.

The sectoral distribution of the utilisation of OGL funds for the periods January - March 1990 and January - October 1992 is shown in table 2.3. It appears that industry and transport have increased their shares in total OGL funding considerably from the first to the second period. Nevertheless, this can present a misleading picture in so far as quite an important sector, viz trade, is not included in the information from the BOT. In the NBC we were informed that a "considerable share" of the LCs on OGL funds established in 1992, was for private trading firms. Moreover, a sample study of firms (62 respondents out of 100 sampled) having received Norwegian IS channelled through the OGL, showed that 37% of the respondents were trading companies or had trading as one of their regular activities. For the private firms, the corresponding share was more than 45% (Mbelle and Karamagi 1992:44). There is hardly any reason to believe that the share of traders among beneficiaries of OGL funding in general should be dramatically lower than that of recipients of Norwegian IS through the OGL. This suggests that the data in table 2.3 might better be interpreted as based on "types of goods" rather than "utilising sectors", a question that we did not succeed in getting clarified from the BOT. In any event, private traders cannot be covered by the item "others" in table 2.3.

Table 2.2 Estimated OGL funded imports and commodity import support (CIS) 1986-1992. US $ mill.

Year	OGL[1]	CIS[2]	Total merchandise imports, c.i.f (Im.)	OGL as % of Im.	CIS as % of Im.
1986	-	104.8	1048	-	10.0
1987	-	122.6	1150	-	10.7
1988	46.5	167.7	1192	3.9	14.1
1989	156.6	203.6	1230	12.7	16.6
1990	289.8	156.9	1364	21.3	11.5
1991	386.0	63.3	1409	27.4	4.5
1992	256.0	64.1	ca. 1520[3]	16.8	4.2
Tot. 1988-92	1134.9	655.6	6715	16.9	9.8

1) Including the contribution from Tanzania's "free resources" of forex to the OGL, totalling US $ 48.9 mill. by mid-1992. For 1988-1990 it is assumed that the LC/IL-ratio was 93.5% in each year. For 1991 and 1992 the share of LCs in the months January-October has been used to estimate the total value of LCs resulting in imports, on the basis of the value of ILs in those years.
2) The total value of ILs as registered by the BOT, which may exceed actual imports.
3) Provisional estimate, cf. Min. for Finance: Budget Speech for Financial Year 1992/93, DSM 1992:69
Source: Bank of Tanzania, Directorate of Import Licensing, March 1993.

Table 2.3 Sectoral utilisation of OGL funds. Percentage distribution of LCs established

	Jan.-March 1990	Jan.-Oct. 1992
Agriculture	11.6	10.0
Industry	30.8	45.2
Transport	7.7	21.7
Medical services	6.5	7.6
Public services	5.5	8.9
Petroleum	13.1	3.2
Others	24.8	3.4
	100.0	100.0

Source: Mbelle, Karamagi and Kilato 1990; and Bank of Tanzania, March 1993.

Another sample study (70 firms) of OGL beneficiaries in general showed that more than 70% of all traders in the sample ranked the OGL on top in terms of preference among the different forex "facilities", including "own funds", whereas only 37.5% of all manufacturers ranked the OGL on top (Mbelle et al. 1990:33). The authors hold that, "It is not surprising that most traders prefer OGL" (ibid). Their explanation for this is that traders are more in need than manufacturers to get the imported goods on a short notice, and, "Traders ... dispose of the imported goods soon after arrival (in some cases we learnt of the trader having already accepted cash advances to the tune of the letter of credit value)" (ibid.).

The payback period of capital is generally far more "flexible" in trade than in manufacturing. Thus, traders can more easily increase profitability by shortening the turnover time of capital. The fact that the OGL is relatively speedy and "efficient" (ibid.) and less time consuming may be a reason why this facility seems to attract traders to such a large extent.

A further explanation for the appearently high share of private traders and the traders' high preference in the utilisati on of OGL funds, may be that the "negative list" now has a rather moderate size, making a wide range of goods, including comsumer goods, eligible for imports with OGL funding. A supplementary explanation may be that the import procurements are becoming the specialisation of wholesale trading companies with their headquarters in Dar es Salaam. This is corroborated by the fact that nearly 90% of the LCs opened for the utilisation of OGL funds have been for beneficiaries located in Dar es Salaam. (Mbelle et al. 1990: 44; field information from NBC and BOT, March 1993).

Table 2.3 shows that from 1990 to 1992 transport increased its share in OGL funding by a factor of 3. Quite consistent with its rising share in total OGL funding, transport equipment has also, according to data provided by the BOT (March 1993), raised its share in Tanzania's total imports, from an average of 9.6% in 1981-85 to 18.1% in 1989-91, and as much as 24% in the single year 1991. Correspondingly, the transport sector's share in total investment rose dramatically, from 23% in 1981-85 to more than 38% in 1989-91, whereas the sector's share in GDP declined from 6.5% in 1981-85 to 5.6% in 1989-91 (cf. table 4.6). The high and rising share of investment in transport suggests a high private profitability in that sector (cf. ch. 4.3).

The distribution of OGL funds on ownership lines does not appear to have changed notably since its inception. According to data provided by the BOT (March 1993), the private sector has received 68-69%, the parastatal sector about 27%, and the government 4-5% of total OGL forex allocations. Especially the fact that the parastatal sector has maintained an almost constant share in total OGL funding is somewhat surprising in view of the fact that liberalisation of the economy is intended to ensure a relatively more rapid growth of private sector activities.

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2.4 Operational problems with the OGL facility

A wide range of problems and deficiencies in the operation of the OGL facility have been elaborated upon in the reports from the Joint Evaluation Mission (JEM) of the Special Programme of Assistance to Africa (SPA), as well as in the audit reports on the various funding components of the OGL from Tanzania Audit Corporation (TAC). We will therefore selectively describe some of the problems which are most relevant to our report.

One main problem from the importers' point of view has been the long delays by the commercial banks in opening LCs after ILs had been approved by the BOT. Moreover, importers repeatedly complained that LCs have not been issued on the "first come, first served" principle, and that there are no means to verify whether the principle was being followed. In short, there is a problem of transparency in applying the "first come, first severed" principle.

In order to rectify the problem of inordinate delay, an agreement was made between Tanzania and the SPA-JEM that from December 1992 onwards, importers should apply for ILs and LCs together through the commercial banks. Commercial banks on the importer's behalf will then submit the IL and LC to the BOT for simultaneous approval. Importers will be notified within five working days after acceptance by the commercial banks of the IL and LC applications as to whether their applications have been rejected by the BOT. In the event of OGL forex not being available, the commercial banks and the importer would be immediately notified by the BOT. This new system is expected to be activated as soon as OGL funds are released again.

To improve the transparency of the allocation of ILs/LCs, the BOT intends initiating a publicly accessible system that will allow importers to verify that the "first come, first served" principle is being followed. According to the information we received during our field work in Tanzania, no action had so far (until March, 1993) been taken on this issue.

The problem of cash cover (counterpart funds) defaults or delays on OGL forex to the Treasury is far less acute than in the case of CIS cash cover (cf. chapter 3.5). However, this problem has not been avoided altogether. In the OGL system, the commercial banks are required to remit cash cover to the Treasury through the BOT as soon as the LC is opened, while it becomes the sole responsibility of the commercial banks to collect the cash cover from importers. However, large arrears in cash cover payments from the commercial banks to the BOT have emerged.

Due to lack of complete records, neither the BOT nor the commercial banks could provide accurate accounts of these arrears until recently. According to a directive given during the SPA-JEM meeting in October 1992, the BOT was supposed prepare a statement for the scrutiny of the TAC on counterpart funds, recovered and outstanding as at 31.12.92. A revised statement was submitted to the TAC on 01.03.93, which is summarised in table 2.4.

It should be noted in this context that TAC commented:
" We observed that the Bank (i.e. BOT) did not have a system of reconciling the position of outstanding conterpart funds for OGL expenditere vis-a-vis that as per the books of the commercial banks ... on a regular basis, viz. quarterly. Consequently, the balances of counterpart funds owing from the commercial banks as shown below had not been reconciled with the corresponding balances as per the books of the commercial banks with a view to ascertaining reasons for differences if any".

Table 2.4 Counterpart funds owing from the commercial banks as at 31.12.92

From:	TShs mill.	US $ mill.
National Bank of Commerce (NBC)	11482.7	58.2
Cooperative & Rural Development Bank (CRDB)	5090.6	25.8
People's Bank of Zansibar (PBZ)	1126.2	5.7
Total	17699.5	89.7

Note: The values in TShs have been converted to US $ by using average annual official exchange rates and by assuming the same default rate in all years and for all three banks.
Source: TAC: Audit Report of IRTAC, TANAA and FSAC, 17th March 1993.

In other words, the figures in table 2.4 are solely the information of the BOT. According to these figures, the accumulated cash cover defaults of the commercial banks by the end of 1992 amounted to about US $ 90 mill. or 7.9% of total OGL disbursements up to that date. Compared to the defaults on CIS cash cover, this is a quite modest figure (cf. chapter 3.5). Moreover, it should be kept in mind that OGL cash cover defaults are by the commercial banks, whereas CIS cash cover defaults are by the forex recipients, i.e. the firms purchasing the forex. Therefore, in contrast to the CIS cash cover defaults, the OGL defaults do not necessarily imply that firms are given discriminatory credits (cf. chapter 3.5).

According to both TAC's Audit Report of TANAA of August 1992 and the SPA-JEM Report of Oct./Nov. 1992, the commercial banks failed to pay the full cash cover to the BOT on time because of their "high indebtedness" and "under-capitalisation". Moreover, "delays are occasioned by a big number of commercial banks' branches which have to collect the counterpart funds from importers and intimate the commercial banks' headquarters of the position, so that such funds can be consolidated and remitted to Bank of Tanzania..." (TAC: Audit Report of TANAA, Aug. 1992). In brief, part of the defaults may actually be repayment "in the pipeline".

Nevertheless, technical complexities, compounded by lack of adequate monitoring of cash cover payments on the part of the BOT seem to have contributed to the problem. In the case of the special account system used by the bilateral co-financing donors and partly by the World Bank/IDA, where

the BOT would open forex accounts in foreign commercial banks, the commercial banks in Tanzania are required to pay cash cover through the BOT. In that case, the monitoring of cash cover payments by the BOT should be straightforward.

On the other hand, in the case of the special commitment system, where the World Bank pays the suppliers directly from its own account, cash cover payments are supposed to be made directly from the commercial banks to the Treasury. Hence, the BOT has not been in a position to monitor these payments. Moreover, the SPA-JEM of Oct.-Nov. 1993 noted that, "Treasury also is not monitoring these accounts on a regular basis".

Neither has the BOT been a position to monitor cash cover payments by the PBZ to the Zansibar Treasury. And finally it has turned out that, "commercial banks have not been applying consistent rates of exchange" when collecting cash cover from importers, and, "as a result, full recovery is not being made to the BOT" (SPA-JEM, Oct./Nov. 1992).

In order to come to grips with the problem, Tanzania has agreed with the SPA-JEM on a new cash cover payment mechanism effective from December 1992. According to that agreement, the commercial banks will have to present to the BOT a list LCs that they would like opened, and at the same time they will have to pay the corresponding cash cover amount up-front to the BOT at the official exchange rate prevailing on that day. The BOT will then instruct the correspondent banks abroad holding the special accounts to confirm and pay upon maturity those LCs for which cash cover has been paid. There will be no physical movement of forex from BOT's accounts to the local commercial banks' accounts at the correspondent banks. In the event of underutilisation of LCs opened, monthly reconciliation of the special accounts will facilitate a transfer from the BOT of the equivalent amount in TShs back to the commercial banks. Also for those large LCs which the BOT submits to the World Bank for issuance of special commitments, the commercial banks will henceforth have to pay cash cover through the BOT up-front.

On paper, this mechanism should represent an improvement. Nevertheless, it remains to be seen how it works in practice, because the mechanism appears unnecessarily complicated, perhaps due to its attempt to reach a compromise between divergent interests.

Finally, it should be noted that problems are caused by the uneven flow of funds into the OGL special accounts. The main reason for this are the conditionality requirements by individual donors for release of funds, in particular the refusal of the World Bank/IDA to release the second tranche of the FSAC, noted in chapter 2.1. An additional reason, however, has been the inordinate delays in the preparation and submission of disbursement applications due to inefficiency in the Treasury. In order to alleviate this latter problem, the Treasury has permitted the BOT, effective from December 1992, to sign disbursement applications on its

behalf. In addition, the BOT is expected to provide the World Bank and the co-financing donors with monthly reconciliation statements for the special accounts..

2.5 Norway's and Sweden's support to the OGL

Norway's and Sweden's decisions to channel almost all their IS to Tanzania through the OGL seem to have been motivated broadly by two considerations. One consideration was their desire to use a more efficient and transparent allocation system involving less administrative costs; another was their objective to support more effectively structural adjustment through liberalisation of the economy.

In NORAD's allotment document (bevilgningsdokument, BD: AFR 21/90), dated 05.09.90, it is stated that, "the starting point" of NORAD's considerations is "to what extent OGL is a more effective system for channelling IS to Tanzania compared with an administrative allocation procedure". It is further argued that, "the OGL system is supposed to be less prone to corruption. The system is also more effective with regard to payments of counterpart funds. Another factor in favour of allocation through the OGL is that Tanzania should be relived of the extra administrative burden of relating to several allocation systems and donors with regard to import support, so that they can rather concentrate their efforts on improving a unified system of foreign exchange allocation".

The Swedish decision seems to have been motivated by dissatisfaction both with the "project-related" and the "free quota" component of Swedish CIS to Tanzania. An internal SIDA document, dated 05.03.90 noted that (industrial) rehabilitation projects had received most of the "project-related" CIS and been "exempted from cash cover payments". It was added that, "in hindsight it may be said that these projects should never have received import support, and in any event they should not have received such support for rehabilitation purposes. These enterprises have been extremely favoured by converting cash cover into share capital".
With regard to the "free quota" component of Swedish CIS, the same document stated that this kind of support, "is the last chance for the most hopeless enterprises which have been rejected by all other donors". The document concluded by recommending a "relatively large" Swedish support to the OGL of "at least" 10 mill. US $ in 1990/91.

In their most recent policy document on import support, SIDA emphasised that, "the prime aim of import support is to support a programme of economic reform in the recipient country", adding that, "Import support is normally extended only to countries that undertake economic reform programmes that have been approved by the IMF and/or the World Bank" (SIDA 1993a:19). Hence, Swedish IS has become strongly linked to the World Bank/IMF programmes of structural adjustment through economic liberalisation. This basic policy orientation is not changed by SIDA's reservati-

on that, "Sweden shall always make an independent assessment of the situation (in the recipient country) and may, under certain conditions, choose to continue the programme despite suspension on the part of the World Bank" (ibid.).

The Norwegian support to the economic liberalisation programme of the Bretton Woods institutions is somewhat less explicit. NORAD's allotment document BD:AFR 21/90, of 05.09.90, presents the main features of TANAA, adding that a further precondition for the World Bank/IDA's TANAA credit is fulfilment of the objectives of the extended ERP: "This concerns macroeconomic measures, such as depreciation of the local currency, a restrictive credit policy and strengthening of the government budget". The document adds that, "With the policy objectives of depreciations in order to attain purchasing power parity and deregulation of domestic markets, OGL will in the longer term be an instrument for the transition to an open foreign exchange system. (...) The OGL system is therefore in line with the long-term objectives of the economic recovery programme, where market-mechanisms shall increasingly be used in order to attain a more efficient resource allocation."

The document emphasises that since NORAD's support to the OGL is linked to the first tranche of TANAA, it is not tied to the World Bank's conditionality. But on the other hand, it is admitted that, "if the co-financing model is to be maintained in the future, that implies indirectly a requirement that Tanzania implements the policies we have referred to". And it is added that, "if these policies are not carried out, then an open allocation of foreign exchange will imply subsidies to the recipients without any control as to whether they are socially efficient producers." In other words, NORAD acknowledges that their support to the OGL also signifies support to the economic liberalisation programme of the Bretton Woods institutions.

By the end of 1992, Norway's contribution to the OGL accounted for 6.4% of the total OGL commitments and 7.2% of actual disbursements (released funds). The corresponding shares of Sweden were 5.5% and 6.2%, respectively (cf. table 2.1). In the years 1990-92, 83% of total Norwegian IS was channelled through the OGL, whereas the corresponding figure for Sweden for 1990/91 - 91/92 was 84% (cf. tables 1.2 and 1.3). The Norwegian contribution to the OGL is, as already noted, a co-financing of the Tanzania Agricultural Adjustment Programme (TANAA), while the Swedish contribution is a parallel financing (OGL II) of the same programme.

The Norwegian contribution was linked to the first (start-up) tranche of the World Bank/IDA credit to TANAA, which implied that the Norwegian grant was not tied to the conditionality (of the second tranche) of the World Bank/IDA credit. The Norwegian allocation is transferred to the Trust Account of the World Bank/IDA with Norges Bank. Further, a forex account of the Bank of Tanzania (BOT) has been opened with Den Norske Bank (DNB) in Oslo, which is empowered to administer that account. On

receiving copies of LC approved by the BOT, proforma invoices and other relevant documents, DNB will confirm the LC through the commercial bank of the exporter. Furthermore, on receiving the invoice and the shipment documents, DNB will pay out the invoice amount to the exporter's bank, drawing on BOT's forex account. On the other hand, the World Bank will transfer funds from its Trust Account in Norges Bank to BOT's forex account in DNB on receiving disbursement applications from the GOT, which are now signed by the BOT. This arrangement involves three agreements: one between Norway and Tanzania, one between Norway and the World Bank/IDA and one between the World Bank/IDA and Tanzania.

This may be contrasted with the Swedish parallel financing, which corresponds to what has been termed OGL II. It does not involve the World Bank/IDA at all. The Swedish contribution is deposited on the Swedish government's cheque account with the Bank of Sweden until it needs to be used. The importer's bank in Tanzania (i.e. the NBC, the CRDB, or the PBZ) opens a LC in Nordbanken, Stockholm, for account of the exporter. Nordbanken then confirms the LC via the commercial bank of the exporter. After shipment, the exporter presents the shipping documents to Nordbanken, which examines them and pays out the invoice amount to the exporter's bank. Only when Nordbanken has paid out the invoice amount, does SIDA disburse the corresponding currency amount from the Swedish government's cheque account with the Bank of Sweden to Nordbanken.

By its very nature, this parallel financing is not tied to the World Bank/IDA conditionality at all. However, SIDA has established conditionality in their agreements with Tanzania, the latest of which was signed on 27.03.92. These agreements emphasise that the purpose of Swedish import support is, "to support Tanzania's economic reform programme as ... agreed between Tanzania, the World Bank, the IMF and donors". By and large, SIDA also adheres to the World Bank rules regarding procurement, preshipment inspections, auditing and reporting (cf. SIDA 1993a).

2.6 Major aspects of the Tanzania Agricultural Adjustment Programme (TANAA)

It should be emphasised that TANAA is not an isolated programme for agricultural restructuring, but an integral component of the overall programme for structural adjustment through liberalisation supported by the IMF and the World Bank. Hence, Norwegian and Swedish IS to TANAA, channelled through the OGL, is intended to support a general programme of economic restructuring through liberalisation. However, because NORAD and SIDA chose to join TANAA, we will give a more detailed description of this particular programme.

The main purpose of the policy and institutional changes associated with TANAA has been to move away "from

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Government-administered monopsonistic marketing channels and pricing regimes towards more competitive multi-channel marketing systems with prices largely determined by market forces. The envisaged changes would involve a dramatic reduction in Government involvement in crop and input marketing and the active encouragement of other channels, including a much larger role for the cooperatives and other private entities" (World Bank, 1990a:19).

More specifically, TANAA aims at full liberalisation of the marketing channels for food grains. Private and cooperative traders would then have the right to set up buying posts at the village level, and to trade foodgrains freely throughout the country. The GOT would still announce producers' prices, but these would only serve as indicative prices, and no government intervention would be undertaken in general to defend them. The consumer price of maize would no longer be controlled either.

These measures require a complete restructuring and downgrading of the National Milling Corporation (NMC) to fit its less important role. The NMC is left with "providing basic marketing services" and administering the Strategic Grain Reserve (SGR). For this task NMC is to be paid a fee limited to the direct cost of handing, storing and transporting SGR stocks.

The SGR is to be operated both as a food reserve and as a buffer stock. It will thus contain two elements: the "core SGR" for food security and the buffer stock for price and inventory stabilisation. The upper limit for the buffer stock has been set at 50,000 tonnes, on the top of the 100,000 tonnes of the core SGR. Nevertheless, NMC's operations of the SGR/buffer stock is expected to be "basically price-driven, instead of being utilised to affect market prices": Trigger prices for purchases or sales are to be defined each year according to specified rules.

Cooperatives, farmers' associations and private traders were intended to be supported by TANAA in terms of enhancing their commercial capability and efficiency, as well as their access to credit. Also a programme for financial restructuring of the cooperative unions has been included. According to this programme, unviable cooperatives should be liquidated and Party/government control over the unions should be abolished, so that the unions should be free to define their activities, geographical coverage and membership. Moreover, the GOT has committed itself to assist primary societies to hold free elections and redefine their relationships with the unions.

With regard to export crops, the intention is to achieve complete liberalisation of the marketing channels for coffee, cotton and cashewnuts, which together account for approximately half of Tanzania's total exports. This implies that the marketing boards would have to be removed from directly owning, purchasing and selling coffee, cotton or cashewnuts. Moreover, Regional Cooperative Unions (RCUs), Primary Cooperative Societies, private estates and farmers' associations would be granted the right to sell their commodities on the world market under their own name.

In a similar process of liberalisation, the cotton ginneries are to be allowed to be operated by private industrial companies with a wide range of shareholders, quite independently of the RCUs and without government interference. They should be free to decide to market domestically or to export. Moreover, investors should be allowed to establish and operate new ginneries without any restriction.

TANAA also prepared the ground for liberalisation of agricultural input supply, distribution and pricing, including deconfinement of fertilizer distribution. It was stated that "the long-term objective would be for cooperative unions, farmers' associations, large estates and licensed traders to freely distribute inputs nationwide and to import them, either availing themselves of the OGL facility or obtaining them directly from donors" (World Bank 1990a: 31). It is hoped that this would make the producers free to procure their inputs from any source of their choice. Within the seed industry, the GOT is expected to grant licences to a multiplicity of companies, including private ones, "openly competing with each other". The regional distribution of fertilizers would also be deconfined, with the Tanzania Fertilizer Company (TFC) retaining only the wholesale importing and distribution function. The fertilizer subsidy is recommended to be reduced to no more than 40% of the import price in 1992/93 and further to a maximum of 20% in 1994/95.

With regard to public expenditure in agriculture, the background document for TANAA claims, with reference to The Public Expenditure Review (PER), that, "too many small and dispersed agricultural projects were being implemented by the public sector, usually with support from donor countries. The economic profitability of many of these projects was uncertain if not negative, thus misusing scarce domestic and donor resources" (World Bank 1990a:33). It further advised the government to screen the 166 different agricultural projects, "to eliminate the most obvious cases and carry out an evaluation of the remaining projects". An action plan for these measures also "acceptable to IDA" had to be adopted by the GOT before the release of the second tranche of the TANAA credit.

The foregoing presentation indicates that TANAA is not solely a programme for "agricultural adjustment" in terms of abandoning the monopolies of crop authorities and Party/government control over cooperatives. While it intends establishing a system of free private trading of agricultural products and inputs under a liberalised pricing regime, it also proposes a profound reorientation of rural development policies which have been supported by many bilateral donors. In the Public Expenditure Review, the World Bank had emphasised that government resources should be "shifted from the state farming sector to support programs for smallholder agriculture" (World Bank 1989:32). However, the implicit conceptual reference of TANAA seems rather to be the American farmer model which requires "economic

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profitability" from every individual project (cf. World Bank 1990a:33). It goes without saying that many integrated rural development projects supported by bilateral donors in Tanzania, as for example the Rukwa regional integrated development programme (RUDEP) supported by NORAD, were not undertaken for the sake of "economic profitability"of each single project, but involved wider social and economic development objectives. There is little reason to expect that the World Bank/IDA should discuss the implications of TANAA for rural development policy. However, it is remarkable that the co-financing bilateral donors have not apparently raised this important issue so far, despite the fact that over the years they have committed substantial resources for integrated rural development programmes.

With regard to implementation, TANAA has an uneven record, as indicated e.g. in the Policy Framework Paper for 1992/93 - 1994/95 of October 1992. The general impression one gathers is that, those elements of the programme which had to be completed before the release of the second tranche of the TANAA credit, were generally implemented, while many other elements have been delayed. This may indicate that the Tanzanian authorities have not been unreservedly enthusiastic about the programme; but at the same time, they also wanted to secure the credits and grants linked to TANAA, without directly opposing the donors' proposals.

Finally, it should be noted that TANAA is part and parcel of the whole "packet" of restructuring and adjustment programmes in the wake of the ERP, of which the most essential were described in chapter 1.2 above. The adjustment programmes with the most direct implications for TANAA, are the Financial Sector Reform (linked to the Financial Sector Adjustment Credit), the Parastatal Reform and, the Civil Service Reform Programme. The World Bank and the IMF advocate a drastic and comprehensive programme for economic liberalisation at a high speed. Nevertheless, its particular implications in terms of TANAA for integrated rural development policies do not seem to be entirely clear to the co-financing bilateral donors. There is a strong case for examining the issues involved carefully, before embracing enthusiastically liberalisation as a panacea for all rural problems.

3. The efficiency of the OGL and the role of credit allocation in the process of economic liberalisation

3.1 Introduction

Central to the economic adjustment and restructuring programme which has been agreed between the International Monetary Fund, the World Bank and the Tanzanian Government, are two critical elements. First, in involves scaling down the role of the State both as an economic actor and as a regulator of economic processes in various ways. Second, it conceives of a strategy where the restructuring of the whole financial sector, especially of the system of foreign exchange allocation, plays a pivotal role. Needless to add, these two aspects of the economic adjustment and restructuring programme are not independent of one another. However, on a practical level, the separation between those two aspects is important, because donor assistance as well as influence on the direction and pace of change in the Tanzanian economy operate most directly through the availability of foreign aid, which determines to a large extent the import capacity of the economy and consequently, other macroeconomic variables.

Both the commodity import support (CIS) and the open general license (OGL) were designed to improve foreign exchange allocation. The criteria for the efficient allocation and utilisation which the Government's ERP and Policy Framework Paper (PFP) documents articulate and which donors have also emphasised (SPA Report 1991), stress the need to ensure that the enterprises with access to foreign exchange are efficient in both economic and financial terms. Moreover, the allocation facilities are intended to increase the output of the agricultural sector by providing for imports of agricultural intermediate inputs, by easing of constraints on the processing of agricultural crops, and the supply of incentive goods. If the allocative system is to operate smoothly, it must also get rid of the high transaction costs of dealing with the administrative allocation of foreign exchange. Stated more directly, the emphasis is on better performance of donor support by moving towards a foreign exchange allocation system which is more transparent and open to all, so that the more efficient users of foreign exchange may gradually out-compete the less efficient ones.

Stated in general terms, the above criteria for foreign exchange allocation are undisputable. However, the policy measures adopted have not been entirely complementary. In particular, the results of our analysis indicate a significant discrepancy between liberalisation of the foreign exchange allocation system and the credit policy adopted. Furthermore, the results indicate that the premature exposure of domestic manufacturing firms to international competition which in part has been implemented through a rapid pace of liberalisation of imports as the OGL negative list has been shortened, has had a negative impact on capacity utilisation. There is also the need for a closer scrutiny of the link between the "efficient use" and the private profitability in a more liberalised foreign exchange regime.

The remaining part of this chapter is organised as follows. Section 3.2 reviews the measures which the authorities in Tanzania have adopted in order to liberalise the foreign exchange allocation system. This leads to an examination of the question as to how much the liberalisation of the foreign exchange allocation system has improved transparency and widened non-discriminatory access to foreign exchange. This is done first, by examining in section 3.3 the interrelated issue of the measures which have been adopted in order to liberalise the financial sector for domestic credit in Tanzania. The following sections 3.4 and 3.5 assess the domestic credit policy which has been intended in a more liberalised financial sector.

The main purpose of the remaining two sections 3.6 and 3.7 is to analyse the link between foreign exchange allocation and the domestic production structure. In section 3.6, the liberalisation of the foreign exchange allocation system, by switching to a much shorter OGL negative list, is examined in order to determine the impact of exposing domestic industries rapidly to international competition. The combination of credit squeeze and severe competition from imports are shown to have had a negative impact on the manufacturing firms' capacity utilisation. Section 3.7 carries this analysis further to examine the relationship between a more liberalised foreign exchange and foreign trade regime and the export preformance of the economy. Finally, section 3.8 examines the link between economic liberalisation and the pattern of investment in the domestic economy.

3.2 Liberalisation of the foreign exchange allocation system in Tanzania: Mirage or reality?

Measures to liberalise the foreign exchange allocation system in Tanzania can be viewed as having been decisively initiated in 1988 when the Government introduced the OGL system for imports. Prior to this, in 1984, the Government had introduced Export Retention and Own Funds Import schemes which could be viewed as hesitant earlier steps towards the same objective. However, as already mentioned, these early steps were also largely forced by the economic circumstances rather than as deliberate policy decisions to liberalise (chapter 2).

In January 1991, the Government proceeded further with foreign exchange liberalisation policy, when it decided to switch from the OGL positive list to an OGL negative list. Since then the OGL negative list has been progressively shortened which has also implied broadening the range of

import items under the Export Retention and Own Funds import schemes. Since imports through Export Retention and Own Funds import schemes may evade taxation and therefore enjoy an import subsidy relative to imports through the OGL facility, pre-shipment inspection (PSI) for tax assessment was introduced in October 1992. The coverage of pre-shipment inspection was widened in early April 1993, when the minimum import value subject for pre-shipment inspection was lowered from US $ 5,000 to US $ 2,000. Thus, attempts are being made to reduce tax evasion, while liberalising the foreign trade sector.

The liberalisation of the foreign exchange allocation system took an almost dramatic turn with the Government's passing of an act in March 1992, which empowered the Bank of Tanzania to issue licence to any entrepreneur for entering the exchange bureau business. The data in table 3.1 indicates developments in the exchange bureaus which have been licensed since April 1992 and are in operation in the country's most important business centres.

Table 3.1 Developments of exchange bureaus

	No. of bureaus		No. of bureaus as % of total		% Share of the market*	
Ownership	21.04.92-21.09.92	02.08.92-27.09.92	21.04.92-21.09.92	02.08.92-27.09.92	21.04.92-21.09.92	02.08.92-27.09.92
NBC	7	7	33	22	76	69
Private	14	24	69	78	24	31
Total	21	31	100	100	100	100

* The share is computed as the total purchases and sales of foreign exchange expressed in US $ as a ratio of the grand total of the buying and selling of foreign exchange in the bureaus, all expressed in US $.Source: Computed from Bank of Tanzania Data, March 1993.

As the figures in table 3.1 show, the number of exchange bureaus which have come in operation has greatly increased. By permitting an increasing number of privately owned bureaus, the licensing system has been reducing steadily the market power of the National Bank of Commerce (NBC) in dealing with foreign exchange. At the same time the market forces of demand and supply have been playing a larger role in the determination of the exchange rate, as more privately owned bureaus continue to be licensed. This has also, so far, resulted in a persistent devaluation of the TSh relative to the US $. The figures in table 3.2 below indicate trends in the official and parallel market exchange rates of TShs to the US $.

As is noticeable in the table, the cumulative official rate of devaluation of the TSh has been much higher than the rate at which the shilling has depreciated in the parallel market. Consequently the premium has narrowed remarkably from 405 % in 1986 to 34% in February 1993. The figures in table 3.2 also show that after the exchange bureaus came into operation in April 1992, the parallel, bureau, and the official exchange rates are tending to converge. It may be maintained validly that the objective of exchange rate unification is being achieved through a combination of policies of official exchange rate devaluation and the licensing of private exchange bureaus simultaneously.

While the foreign exchange allocation system in Tanzania has been appreciably liberalised, it does not automatically follow that the pattern of access to foreign exchange by different groups of importers has changed correspondingly. The data provided by the BOT (March, 1993) suggests that the distribution of OGL funds (LCs) on ownership lines has not changed notably since its inception. Thus the private sector has received a share of about 69%, the parastatal sector about 27% and the Government 4-5% of total OGL forex sales. It deserves emphasis here that LCs rather than ILs may be better indicator of access to foreign exchange by the different groups. Because, for all the three groups the portion of forex allocations (ILs) that they were able to actually purchase by establishing LCs, declined significantly from 1991 to 1992 (see table 3.3). A main reason for this was the drying up of the OGL fund, as IDA did not release the second tranche of the FSAC in 1992 (cf. chapter 2.1), resulting in an accumulation of uncovered ILs with the commercial banks. Since the cumulatively higher rate of devaluation of the TSh has meant at the same time a sharp increase in the TSh cash cover equivalent for any given quantum of foreign exchange, availability of domestic credit also probably had a strong impact on the access to forex through LCs issued against ILs. Thus, the question of domestic credit policy cannot be separated altogether from the question of access to foreign exchange by different groups.

Table 3.2 Trends in the official and parallel market exchange rates in Tanzania.TShs/US$, period averages

Year	Official TShs/US$	Parallel TShs/US$	Bureau TShs/US$	Diff. betw. parallel and off. as % of off.	Diff. betw. bureau and off. as % of off.
1984	15.79	57.08	n.a.	273	n.a.
1985	17.47	100.80	n.a.	477	n.a.
1986	32.70	165.00	n.a.	405	n.a.
1987	64.26	180.00	n.a.	180	n.a.
1988	99.29	210.00	n.a.	111	n.a.
1989	143.38	245.10	n.a.	66	n.a.
1990	195.06	309.10	n.a.	59	n.a.
1991	219.16	384.50	n.a.	74	n.a.
Jan.-Mar. 92	243.33	423.30	n.a.	64	n.a.
Apr.-Jun. 92	296.84	420.00	400	41	35
Jul.-Sept. 92	321.21	421.70	410	31	27
Oct.-Dec. 92	328.30	426.70	417	30	27
Jan.-Feb. 93	340.00	455.00	430	34	26

Source: Bagachwa 1993.

3.3 Liberalisation of the financial structure in Tanzania

Along with the process of liberalisation of the foreign exchange market, the authorities in Tanzania are currently engaged in carrying out measures to liberalise the domestic financial sector. The measures that are being adopted are a follow-up of the recommendations of the Financial Sector Restructuring Commission (FSRC) which was appointed by the President to enquire into the monetary and banking system

in Tanzania. The FSRC completed its study in 1990. Among its recommendations to the Government the following figure prominently: the need to introduce effective competition in banking by permitting entry of other banks; restructuring the existing commercial banks; and allowing the banks to diversify their activities.

In 1991, The Banking and Financial Institutions Act was passed, allowing for the entry of new private domestic and foreign banks and financial institutions. At least one new commercial bank, The Standard Chartered Bank Tanzania Ltd., which is owned by the London-based Standard Chartered Bank Africa, is in the process of being established.

The Banking and Financial Institutions Act 1991 does furthermore provide for the restructuring of the existing banks which are wholly Government owned. The restructuring exercise provides for the recapitalization of the banks by transferring their non-performing loans to the newly created Loans and Advances Realisation Trust (LART). The FSRC estimated that the non-performing loans of the commercial banking system, consisting of three commercial banks — the National Bank of Commerce (NBC), the Cooperative and Rural Development Bank (CRDB), and the Peoples Bank of Zanzibar (PBZ) — amounted to TShs 68.5 billion by the end of December 1989. Undoubtedly, in 1993 they would be much more. The FSRC also underscored the great danger of undercapitalization of the banks and the need to provide for additional equity capital. According to the Policy Framework Paper (PFP, Sept. 1992) the recapitalisation of the banks is planned to be completed by October, 1993. However, whether the recapitalization can be accomplished as planned, remains to be seen.

It is worth recalling that the process of credit intermediation in Tanzania continues to be dominated by the activities of the existing banks and non-bank financial institutions which are wholly government owned. The three commercial banks, NBC, CRDB and PBZ, by their establishment acts, are expected to provide short term loans from their mobilisation of deposits. Alongside, there are non-bank financial institutions or development banks, which by their establishment, acts are expected to provide long-term finance. The development banking sector consists of the Tanzania Investment Bank (TIB), and the CRDB as well as the Tanzania Development Finance Limited (TDFL), which is partly owned by the Tanzanian Government and partly by multinational capital.

Neither the TIB, CRDB nor TDFL operate like capital market institutions. According to the Companies Ordinance, neither privately owned undertakings nor public companies (Government owned) are allowed to float their shares to the public for subscription. The PFP of September 1992 recommends the amendment of the Companies Ordinance to be completed by the end of 1993. However, like the recommended recapitalalisation of the commercial banks, this too is awaited. Meanwhile, the existing Companies Ordiance has prevented legally the development banks from mobilising long-term finance by operating in primary and secondary security markets. Thus,

the sources of funds of the development banks have depended heavily on foreign loans and grants. In some cases the funds have been earmarked, which reduced the development banks to serving merely as loan agents (Rutayisire, 1992a, 1992b).

Non-bank financial institutions in Tanzania also include the National Insurance Corporation (NIC), the National Provident Fund (NPF) and the Tanzania Post Office Savings Bank (TPSB). Ideally these financial institutions should also constitute part of the capital market. However, again by the acts of their establishment the NIC, NPF and TPSB have been required legally to invest their mobilized savings only in Government securities. Thus, they too have been prevented from operating in primary and secondary financial markets. The overall result has been an exceptionally rigid domestic financial structure which involves the commercial banking system, the development banking sector as well as other non-bank financial institutions. The current programme of financial sector restructuring intends overcoming some of these rigidities.

Table 3.3 Value of letters of credit (LCs) on OGL as % of value of import licences (ILs), Jan.-Oct. 1991 and Jan.-Oct. 1992 for different ownership groups

	Jan.-Oct. '91	Jan.-Oct. '92
Private	85.4	51.5
Parastatal	80.6	62.0
Government	53.0	36.0
Total	82.4	53.1

Source: Bank of Tanzania, March 1993.

3.4 Monetary and credit policy during the liberalisation process

Within the aegis of the ERP and PFPs, the Government of Tanzania has the stated objectives of achieving a positive per capita real GDP growth and equilibrium in the balance of payments in addition to reducing drastically the rate of inflation. In order to combat inflation, three instruments of monetary policy have been applied more or less simultaneously. The first policy instrument to be used, has been the setting of an overall ceiling to the growth rate of money supply. In turn, this has required reducing the government budget deficit, which is financed by borrowing from the banking system. The ceiling on the growth rate of money supply and credit was set at 15-20% during the ERP period 1986/87-1988/89, and 14% in 1990-92.

The second instrument of monetary policy has been the raising of interest rates. Commercial banks have been required to ensure that the interest rates on deposits are positive in real terms, which has also implied higher lending rates. The highest lending rate has been set at 31%, while the inflation rate as calculated in the National Accounts statistics had come down to about 20% in 1992. The third instrument of monetary policy which has been applied, is the raising of the minimum reserve requirement from a weighted average ratio of 0.4% on all deposits to a ratio of 3%. It needs to be emphasised that all the

three instruments of monetary policy work in the same direction. A lower budget deficit financed by the banking system, higher interest rate as well as raised minimum reserve ratio for commercial banks should together result in a contractionary domestic monetary regime.

The extent to which the more contractionary monetary policies have actually influenced the expansion of credit is examined first with reference to data provided in table 3.4.

The ability of commercial banks to increase domestic credit which also determines the supply ceiling to domestic credit, is measured usually by the money multiplier operating on the monetary base. Thus the ability to extend credit becomes greater, as the money multiplier and the monetary base increase. The converse also holds. While the raising of the reserve ratio from less than 0.5% to 3% in 1988 had a depressing effect on the money multiplier, figures in table 3.4 suggest that the decline has been probably more than compensated by the increases in the monetary base throughout the period. The increases in the monetary base can be linked in turn with the extent to which the commercial banks have been able to borrow from the Bank of Tanzania (BOT) through rediscounting. Such access to borrowing is indicated by the ratio of the banks' rediscounting borrowing to the banks' reserves at the BOT. As the figures in table 3.4 indicate, the ratio has increased all through since 1986 except in 1990. The feedback from the banks' rediscounting borrowing to the expansion in the monetary base has enabled the banks to increase their lending considerably. This is indicated in the last column of table 3.4, as well as in the 5th column showing the banks' lending to deposit ratio which all through since 1986 has been higher than unity.

Table 3.4 Some indicators of credit policy stance in Tanzania, 1980-90

Year	Reserve ratio	Money multiplier	% increase in monetary base	Ratio of banks' rediscounts to banks' reserves	Bank loans/ deposit ratio*	% increase in bank loans
1980	0.004	3.29	28	0.90	0.62	7.8
1981	0.004	3.10	28	0.88	0.63	15.5
1982	0.004	3.06	20	0.80	0.59	12.0
1983	0.004	3.54	41	0.42	0.53	11.1
1984	0.004	2.87	31	0.37	0.54	19.4
1985	0.004	3.06	22	0.01	0.66	37.1
1986	0.004	2.74	36	1.40	0.90	58.8
1987	0.004	2.68	41	6.39	1.42	98.8
1988	0.030	2.80	33	8.47	1.39	33.5
1989	0.030	2.80	24	10.25	1.52	45.3
1990	0.030	2.90	41	3.25	1.43	36.3

Notes: * Deposits excluding banks' reserves
Source: Computed from Bank of Tanzania: Economic and Operations Report (several issues).

It would appear from the above figures that the contractionary credit policy which was intended, has not been effective in so far as the ceiling to bank lending is concerned. Nevertheless what matters in reality, is not the supply ceiling to potential bank credit, but the actual amount lent, within that ceiling. Actual lending is determined in turn by the demand for credit from eligible (i.e. creditworthy) borrowers. Or, as recognised in modern monetary theory, money supply is at least partly endogenous. Thus the last column in table 3.4 shows that there has been only a modest reduction in the growth rate of banks' lendings since 1987, despite the fact that the supply ceiling to credit might not have been squeezed proportionately.

The figures in table 3.5 indicate the disaggregation of commercial banks' lending by economic sectors and by ownership categories. The disaggregation by economic sectors indicates that a rising share of credit, from 13% in 1980-85 to 19% in 1986-90, has gone to trading activities. Since these trading activities exclude agricultural marketing, it cannot simply be explained by the increasing privatization of the marketing of agricultural produce. However, the share of loans for agricultural marketing has also declined simultaneously from 61% in 1980-85 to 47% in 1986-90, perhaps reflecting the decreasing role of the crop authorities and subsequently the cooperatives in agricultural marketing.

On the other hand, it can be seen from table 3.5, that the sharpest decline has been in the share of the government in total asset portfolio — from 38% in 1980-85 to 9% in 1986-90. But at the same time, public enterprises command the lion's share, which has increased considerably from 40% in 1980-85 to as much as 57% in 1986-90. Also the share of private enterprises has increased. Nevertheless, private enterprises still continue to be a marginal player, accounting for only about 15% of total asset portfolio, compared to nearly 60% by public enterprises in recent years. Thus, so far there has been no significant reallocation of bank credits in favour of the private business sector. This is also consistent with the fact that the private sector has not increased its share in OGL funding since its inception in 1988, as such an increase should have necessitated higher borrowing.

We may therefore conclude that only the government sector has lost out massively in terms of bank credit. However, this is more in appearance than in reality. Because, as we shall see in chapter 5, this loss of bank credit has been more than compensated by the revenues received by the government as import support counterpart funds since 1986.

3.5 Discriminatory credits through defaults on CIS

The availability of domestic credit is linked directly with access to foreign exchange through the cash cover or counterpart funds scheme. However, the link may be weakened by the extent to which the foreign exchange allocation system has allowed importers access to foreign exchange without paying full cash cover. This also implies that the default rate on counterpart funds becomes an alternative measure of implicit credit, which has been allowed to the beneficiaries. Thus, in the discussion on the foreign

Table 3.5 Commercial banks lending by major recipients and by public and private sectors in Tanzania, 1970-90. Percentages distribution

Period	Marketing of agric. produce[1]	Mining and manuf.[1]	Trade except agric.[1] marketing	All other loan portfolios	Gov't[2]	Public enterpr[2]	Private enterpr.[2]	All other asset portfolios
1970-73	28	17	25	30	16	42	27	15
1974-79	31	29	13	27	26	49	10	15
1980-85	61	8	13	18	38	40	7	15
1986-90	47	17	19	17	9	57	15	19

1) Percentage distribution of loan portfolio.
2) Percentage distribution of total asset portfolios.
Source: Computed from Bank of Tanzania: Economic and Operations Report (several issues).

exchange allocation system in Tanzania, it is not always emphasised that the default rate on cash cover has partly been an "adjusting variable", i.e. it has adjusted partly to the contradictory pulls of a tighter domestic credit policy coupled with liberalisation of access to foreign exchange. This also means that the usual "creditworthiness" criterion presumably used by commercial banks for advancing loans may interfere at times with the market-oriented foreign exchange allocation. It becomes a two-tier system, in which some of those who qualified as foreign exchange users may not qualify for domestic credit. This may result in contradictory signals to domestic credit allocation and foreign exchange allocation which needs to be eliminated in the Tanzanian context, rather than only a mechanistic emphasis on full cash cover recovery. Because, upfront, a full cash cover system will indirectly assign power to the commercial banks to decide on who would be the actual users of foreign exchange through access to domestic credit, while on the surface an OGL system would be used to allocate directly the foreign exchange.

Table 3.6 Default rates on commodity import support to Tanzania. Defaults as % of total forex sales.

Donors	1987/88	1988/89	1989/90	1990/91	1991/92	1992/93	Cumulatively 1987/88-92/93
Norway	32	29	47	62	n.a	90	44
Sweden	55	33	50	61	51	n.a	51
Other Donors	43	38	54	55	46	62	49

Source: Computed from data provided by Ministry of Finance, March 1993.

Looking at the actual pattern of defaults, the responsibility lies with the commercial banks under the OGL arrangement. Moreover, as already mentioned (section 2.4), the OGL cash cover default is probably much less, of the order of 8%, as compared with about 50% cash cover default on CIS (see table 3.6). However, since the relative importance of CIS in the total import bill is decreasing over time, while that of OGL imports is increasing (see section 2.3, table 2.2), the present system is becoming more transparent in locating mostly the mechanism of default in the commercial banking system with the extension of OGL. However, since the commercial banking system has been entirely govern-

ment-owned so far, with virtually no independence from BOT, the distinction between the responsibility of the central bank (BOT) and that of the commercial banks may be more theoretical than operational. The cash cover default issue may thus point to the deeper structural problem of the total dependence of commercial banks on the BOT.

Although CIS is increasingly of lesser quantitative importance in the total import bill, the accumulated defaults on CIS cash cover can be taken as an indication of failure in the monitoring of the financial system. The figures in table 3.6 indicate cash cover default rates on commodity import support (CIS). The overall default rates are very high. It also appears that the average cash cover default rate on Swedish CIS has been marginally higher than the average, whereas the opposite is the case for Norwegian CIS.

According to data provided by the Ministry of Finance (March 1993), total accumulated CIS cash cover defaults amounted to TShs 65 billion by February 1993. For comparison, this amount, which corresponds to US $ 220 mill. at the average official exchange rate in 1992, is 3 times higher than total value added of the manufacturing sector in Tanzania in 1991. The highest accumulated default for the period 1987/88 - 1992/93 in absolute terms was on Dutch CIS, with TShs. 11.8 billion (48% default rate), followed by Sweden with TShs. 11.2 billion (51%), Canada with TShs. 5.7 billion (45%) and Norway with 5.7 billion (44%).

The Tanzanian government agreed with the SPA-JEM of October-November 1992 that importers who had defaulted on their CIS counterpart funds, "should be denied access to the OGL system". For that purpose, the Ministry of Finance has prepared a blacklist of such importers, from which the data we presented above, has been reproduced.

There can be no doubt that the defaults on CIS cash cover have involved large discriminatory credit subsidies which may have created considerable distortions especially within the manufacturing sector. However, an indiscriminate blacklisting of the defaulters with regard to access to OGL funds may involve serious problems.
A first problem is that it was not always clearly stated in the agreements between the bilateral donors and Tanzania that full cash cover should be collected. And to the extent that

the agreements included such a clause, it was the sole responsibility of the Ministry of Finance to collect cash cover year by year, which, if put into practice, would have avoided the large defaults accumulated over many years.

A second problem is that many firms have accumulated so high CIS cash cover defaults that they would need several years to repay their debt, if they are capable of doing that at all. Since CIS is now being phased out and these firms are blacklisted with regard to access to OGL funds, they will be effectively excluded from importing necessary intermediate goods for a long period of time. Therefore, many former CIS recipients may have to close down their activities, although they may be quite viable companies in other respects. Against this background, the method of indiscriminate blacklisting of CIS cash cover defaulters with regard to access to OGL funds may be considered problematic.

3.6 Credit squeeze, import liberalisation and capacity utilisation

The measures to liberalise the forex allocation system and the measures to restrict the availability of domestic credit interact to determine the performance of firms from the supply side, in so far as availability of inputs are concerned. Thus, freer access to foreign exchange is likely to help firms to meet their essential imported input requirements. And, the extent to which their utilisation of installed capacity had been constrained previously by the lack of availability of essential imported inputs, the liberalisation of imports under OGL would contribute to improving the degree of capacity utilisation. However, the extent to which the enterprises obtain foreign exchange may also be conditional on the availability of domestic credit, as we pointed out in the last sections, primarily due to the operation of the cash cover scheme. Thus, in addition to the fact that domestic credit availability may be directly important in financing the (non-imported) working capital requirements of a Tanzanian enterprise, the availability of domestic credit might also indirectly affect its capacity utilisation through influencing its access to foreign exchange. Table 3.7 presents rates of capacity utilisation for public and private firms which received Norwegian and/or Swedish CIS in the period 1987/88-1991/92.

The table shows that through 1991-92, the rate of capacity utilisation for more than 77% of all the firms has been less than 60%. However, the data underlying table 3.7 shows distinctly lower average rate of capacity utilisation for the private sector firms than for the public sector ones, viz. 23% and 51% respectively. (For the manufacturing sector as a whole, the corresponding figures were 38.5% for private firms and 32% for public firms in 1991-92, cf. table 4.5 in chapter 4.4.)

Moreover, table 3.7 shows that the percentage of private firms operating at less than 60% capacity utilisation increased from 79% in 1991 to 92% in 1992. On the other hand,

the percentage of public firms operating at above 60% capacity utilisation increased slightly from 1991 to 1992 (cf. table 3.7). It would thus appear that the higher default rate on CIS, working as an implicit credit subsidy in the public sector may have had some favourable effect in raising the rate of capacity utilisation in that sector.

Table 3.7 Capacity utilisation rates of manufactoring firms which received Norwegian or Swedish CIS in 1987/88-1991/92

Capacity utilization rate %	No. of firms as % of total firms		% of public firms		% of priv. firms	
	1991	1992	1991	1992	1991	1992
0-20	19	19	17	16	21	22
20-60	58	60	57	49	58	70
60-100	23	21	26	35	21	8
	100	100	100	100	100	100

Note: The sample involves 47 manufacturing firms which have been among the beneficiaries of Norwegian and/or Swedish CIS. Of these, 21 firms (44%) are public (parastatals or cooperatives) and 26 (56%) are private.
Source: Computed from the Ministry of Finance and Central Bureau of Statistics data, March 1993.

Table 3.8 Default rates and rates of capacity utilization of maufacturing firms which received Norwegian or Swedish CIS in 1987/88-1991/92

Default % rate[1]	No. of firms as % of total firms[2]	No. of public firms as % of total firms	No. of private firms as % of total firms	Capacity utilization overall %	Capacity util. publ. firms %	Capacity util. priv. firms %
80-100	12	4	8	24	0[3]	24
60-80	12	12	0	40	40	n.f.
40-60	8	0	8	28	n.f.	28
20-40	16	12	4	51	53	65
0-20	52	16	36	36	52	22

Notes:
1) The ratio of outstanding cash cover to the shillings equivalent of the CIS allocated to each firm is taken as a measure of the default rate.
2) The same sample of firms as in table 3.7.
3) There has been one public firm in this default rate interval. The firm has defaulted on the entire forex allocated to it and has since 1992 closed down production.
d) n.f. implies that no firms have defaulted at the indicated default rate.
Source: As table 3.7.

From table 3.8 it can be seen that 67% of the firms with an accumulated CIS cash cover default rate of more than 60% in 1987-1992, belonged to the public sector which represented only 44% of all firms in the sample. Thus the figures in the table indicate, that there has been far more high defaulting public firms than private ones. From this, it might plausibly be inferred that public firms have been granted in general more implicit credit on CIS than the private firms. The figures in table 3.8 also seem to suggest that public firms with high default rates enjoyed high rates of capacity utilisation in many cases. In the case of private firms the situation seems more or less the opposite. A probable reason may be that the public sector firms operated under a "softer budget constraint" - to borrow a phrase from Kornai - through their ability to default partially. Operating in general under a "harder budget constraint", the private sec-

tor firms which were able to meet their cash cover requirements, by and large also happened to be better performers in terms of capacity utilisation. Thus, table 3.8 may be indicative, on the whole, of the different nature of the budget constraint faced by firms in different ownership categories in Tanzania.

Nevertheless, it is somewhat over-simplistic in terms of economic logic to expect that the liberalisation of foreign exchange allocation alone would increase substantially capacity utilisation of private firms. Because, that emphasises only one of the supply side constraints, i.e. of imports of essential raw materials, faced by the enterprises.

Firms in Tanzania have also faced several other supply side problems including a situation of restriction on domestic credit and high interest rates on borrowing. Perhaps, even more serious is the problem of serious mal-functioning of economic and social infrastructure like telecommunications, electricity and water supply, which are essential for the smooth operation of manufacturing business, but which are often in a miserable state in Tanzania.

It is seldom emphasised in the liberalisation debate that the same enterprise may face diametrically opposite problems on the supply and on the demand side. Thus, as import liberalisation eases some supply constraints, it also exposes the firm to foreign competition and, usually reduces the size of its market.

This important point relating to the contradictory aspects of foreign exchange and trade liberalisation on the supply and on the demand side is often overlooked. As a result, in a liberalised foreign exchange regime the net effect on capacity utilisation, on balance, can go either way. However, in an industrially backward economy like Tanzania, the short-run effect is very probably a significant degree of reversal of import substitution industrialisation, where the negative demand impact may become the binding constraint for many firms, especially in the tradable manufacturing sector, despite better provision of imported raw materials.

To capture quantitatively this adverse demand effect of import liberalisation, the change in the market shares of domestic firms can be taken as a measure of their exposure to competition. This indicator has been computed for the entire manufacturing sector in Tanzania and is presented in table 3.9 below. The table shows that the market share of domestic manufacturing industry has decreased quite drastically following the liberalisation of imports. Moreover, the table shows that manufacturing value added in the liberalisation period 1986-1990 was considerably lower than in 1974-79, and even lower than in the crisis years 1980-85. However, the data is indicative and not conclusive regarding the "demand-squeeze" faced by domestic firms, in so far as it indicates falling market share but no dramatic decline of the total market size in 1986-90 compared to the preceding period.

Table 3.9 Market shares of domestic manufacturing industry, 1970-1990

Period	Market share* in %	Indices of man. value added et constant (1976) prices. 1970-73 = 100
1970-73	61	100
1974-79	67	128
1980-85	72	113
1986-90	36	109

* Market share is calculated as the ratio of the manufacturing sector's value added to value added plus imports of consumer goods, all in current prices.
Source: Computed from the National Accounts, Bank of Tanzania, Trade Statistics Reports (several issues), and Hali ya Uchumi/Economic Survey (several issues).

Nevertheless, available data indicates that there is a serious stagnation and reversal of import substitution within the relatively technology-advanced industries which grew up in the 1970s, to a large extent supported by foreign aid. It can be argued that this process is to some extent compensated for by the growth of informal sector industries (cf. chapter 6). However, manufacturing industry within the informal sector is technologically extremely backward and of a simple handicraft type, mostly with less than 5 employees in each unit. In our view, it is implausible to believe that the informal sector industries can play the role of a "dynamic centre" of industrialisation in Tanzania.

While there can be little doubt that the demand conditions faced by domestic manufacturing firms deteriorated sharply since import liberalisation at a rapid pace began in 1988, it is widely hoped that exposure to foreign competition will force most of them to improve efficiency for survival over time. This Schumpeterian argument of "creative destruction" in a market economy may turn out to be over-simplistic in the present Tanzanian context, for two reasons. First, with very poor economic and social infrastructural facilities (e.g. water-supply, electricity generation, road conditions, telecommunications, banking system etc.) even relatively efficient domestic firms are at a great disadvantage to compete in an open economy. Until these infrastructural facilities are brought to a minimal functioning level, from the point of view of the individual firms, the microeconomic preconditions for the working of a competitive market mechanism for "creative destruction" can not be expected to be in place in Tanzania. Second, the pace of import liberalisation needs to be coordinated with an industrial policy for the restructuring of inefficient domestic industries. But such structural adjustments take time.

Thus, depending on the nature of industry and of product, domestic firms need to be given a well-defined time-horizon for restructuring, and during this period their domestic market needs to be liberalised only in a controlled and carefully time-phased manner. In any case, unless the pace of import liberalisation is more carefully synchronized with an effective industrial policy at home, the whole process may turn out to be simply "destructive" and, in no way "creative" for the domestic industrial sector. This real danger needs to be avoided so that indiscriminate de-industrialisation due to sudden exposure to international competition without preparation

through an industrial policy, does not proceed in the name of "liberalising" the economy of Tanzania.

We have argued that a major reason why economic liberalisation has not, so far, resulted in any appreciable upswing in Tanzanian manufacturing industry is the dismal performance of economic and social infrastructure. And these facilities cannot be improved simply by economic liberalisation alone. This problem is aggravated for example by the fact that foreign investors, due to economic liberalisation, are exempted from import duties and sales tax on imported inputs, which implies a considerable competitive disadvantage for domestic manufacturing firms.

3.7 Economic liberalisation and export performance

An important objective of the economic liberalisation programme, combined with substantial devaluations of the TSh, is to improve the export performance of the economy and enhance the diversification of exports. With regard to the manufacturing sector, the basic idea is that liberalisation will create stronger competitive pressure which in turn should lead to increased efficiency. Combined with the price incentive created through devaluations this should stimulate manufactured exports and hence a diversification of exports.

However, a sudden and premature exposure of domestic manufacturing firms to international competition may also cause industrial stagnation or even, in the worst case, trigger off a process of de-industrialisation. And indeed, there are some early signs of such an adverse development in Tanzania. As was shown in chapter 3.6, the market share of domestic manufacturing industry fell from 72% in 1980-85 to 36% in 1986-90, while value added fell from an index of 128 in 1974-79, to 113 in the crisis years 1980-85 and further to 109 in 1986-90 (cf. table 3.9). Moreover, the share of manufacturing industry in total GDP at current prices continued to fall, from 7.4% in 1987 to a historical low of 3.6% in 1991. At constant (1978-prices) this share remained unchanged, at 8%, in the same period (cf. Nat. Acc. of Tanz. 1976-91; pp. 10-12).

Also the export performance of manufacturing industries seems rather uncertain so far. In 1989 and 1990, the value of manufacturing exports as a share of the total value of merchandise exports rose above previous levels, to 24.1% and 26% respectively. However, this increase was to a large extent due to the fact that the export value of traditional crops declined by 11% from 1988 to 1990 because of a dramatic fall of prices, especially of coffee (cf. table 3.10). In 1991, the share of manufacturing exports in total export value declined again to the level of 1987; and the value of manufacturing exports in 1991 was only US $ 60.9 mill., compared to 63.0 mill. in 1987 (cf. table 3.10, and Min. of Finance: Budget Speech for 1992/93, DSM 1992: 74).

With regard to agriculture, the World Bank argues that liberalisation and privatisation of marketing in accordance with TANAA will result in a more efficient marketing system retaining smaller marketing margins and thus passing on to the producers a larger share of final prices. Combined with devaluations of the TSh, this should give producers of export crops a strong incentive to increase their output, with the result that Tanzania should increase its agricultural exports and hence exploit better its comparative advantage in international trade.

So far, there is no sign that such a process is taking place. Table 3.10 shows that the export volume of Tanzania's six major export crops was not at a higher level in 1989-91 than in the crisis years 1982-84, in spite of the fact that the real devaluation of the TShs. (in terms of US $ per TShs) amounted to more than 70%. On the other hand, due to a dramatic price decline of 33% between 1986 and 1991 (mainly caused by coffee), the export value in US $ terms of these crops was 28% lower in 1991 than in the crisis year 1984.

Tanzania accounts for only small shares of total world exports of the commodities shown in table 3.10. Therefore, the prices Tanzania acquires on the world market are not much affected by changes in its own volume of exports, although the price and income elasticities of these commodities are very low. However, on advice from the IMF and the World Bank, several countries competing with Tanzania on the world market have tried to ease their balance of payment crises through an export drive. That was a main reason e.g. for the collapse of the International Coffee Organisation in 1989, and the subsequent dramatic decline of world market prices of coffee, Tanzania's major export crop accounting for 28% of the total value of merchandise exports in 1989.

The average export price of Tanzanian coffee dropped by 37% within one year, from US $ 2164 per tonne in 1989 to US $ 1370 in 1990. That price fall, which took place from a historical low, caused a loss of export revenues of almost US $ 50 mill. only in 1990. In addition, there were considerable price declines for tea and cashewnuts.

The World Bank's recipe of agricultural export drive as a component of structural adjustment in countries such as Tanzania suffers from a serious fallacy of composition. Because the price elasticity as well as the income elasticity of tropical primary commodities are typically low, an overall export drive and/or struggle for world market shares by several countries at the same time lead invariably to price collapses and corresponding economic losses for the majority of countries in question.

Table 3.10 Indices of agricultural and industrial export performance 1981-1991

| Year | Real exchange rate US\$/TShs[1] | Indices of real exchange rate (1984=100) | Six major export crops[2] | | | | Value of manuf. exports as % of tot. merch. exports |
			Export vol. indices (1984=100)	Export unit value indices, US\$ (1984=100)	Export value indices, US\$ (1984=100)	Export value as % of tot. merch. exports	
1981	0.1742	98.8	136.0	92.9	126.3	61.2	10.0
1982	0.1862	105.6	112.1	83.8	93.9	60.6	9.1
1983	0.1873	106.2	102.8	88.9	91.4	64.5	11.6
1984	0.1764	100.0	100.0	100.0	100.0	69.0	8.5
1985	0.1988	112.7	83.4	87.8	73.2	68.4	11.4
1986	0.1376	78.0	92.5	105.5	97.6	75.3	11.2
1987	0.0883	50.1	99.6	75.4	75.1	57.9	18.3
1988	0.0727	41.2	103.1	81.2	83.7	60.3	19.4
1989	0.0607	34.4	100.7	78.8	79.4	56.0	24.1
1990	0.0510	28.9	112.5	66.3	74.6	50.1	26.0
1991[3]	0.0445	25.2	102.7	70.0	71.9	58.4	18.5

1) Nominal official exchange rate divided by the weighted consumer price index for industrial (OECD) countries and multiplied by the consumer price index for Tanzania.
2) Coffee, cotton, sisal, tea, tobacco and cashewnuts, accounting for an average of 62% of the total value of Tanzania's (Mainland) merchandise exports in the period 1981-1991.
3) Provisional estimates of exports.
Sources: Bagachwa 1993; and Tanzanian Economic Trends Vol. 5, Nos. 1-2, July 1992.

3.8 The consequences and sustainability of a market-based foreign exchange regime

A less segmented forex market with a dominant or "single window" facility for all potential forex users entails two fundamental economic propositions:

(a) a uniform price for all potential forex users and,

(b) a market-guided, if not entirely market-determined system for determining that uniform price of forex.

Theoretically, the most important aspect of moving from an administrative to a market-based regime of foreign exchange lies in moving from a system of quantity rationing of foreign exchange to a system of price rationing. In other words, the price of forex must be set by the market forces of demand and supply at such a level that, only those potential users who can pay that price are given access to it, irrespective of the uses they make of that forex. As already pointed out, (section 3.4 and 3.5) this can be achieved only if the competitive operation of the foreign exchange market is supplemented by the competitive operation of the domestic credit market. Such a market-based system has the obvious advantage of greater transparency and administrative simplicity which, in turn, reduces various unproductive "rent-seeking" activities generated by a heavily controlled foreign exchange system. Nevertheless, the economic consequences of a unified, market-based foreign exchange system would be determined ultimately, not by these administrative considerations but by how efficiently such a liberalized forex market performs over time.

In terms of standard economic theory, this allocative efficiency would depend on how closely the social return on forex investment coincides with the private return in a fully liberalized forex market. More operationally, the social and the private rate would tend to coincide if the pattern of foreign exchange use dictated by the market resembles closely the pattern considered socially desirable.

It is not always emphasized in the debate for liberalizing the forex market in Tanzania that achieving such allocative efficiency in that market requires assured long-term supply or availability of forex on a sufficient scale in relation to demand in order to stabilize expectations. It is somewhat oversimplistic to assume that the problem of any significant and unanticipated reduction in forex supply in relation to demand can be solved by simply continuing to devalue the TSh. (i.e. price-rationing). Resorting to frequent devaluations of the local currency can lead to a vicious spiral (well-known from many experiences in the developing world) of speculative capital flight leading to further devaluations which make the liberalized forex market mechanism unsustainable over time. It is, therefore, urgent to formulate a policy of the extent and methods of capital control which will be able to sustain a liberalized forex regime in Tanzania. A well-devised policy of capital control to discourage capital flight should be viewed as a necessary instrument for unifying the forex market, until such time as the severe constraint of foreign exchange on the Tanzanian economy begins to relax.

An exclusive price-rationing of forex in a structurally distorted economy like Tanzania could also create other problems which need to be faced. A high price of forex along with a high (nominal) interest rate policy in the domestic credit market would tend to make only exceptionally high-return and quick turn-over investment projects economically viable and creditworthy for commercial banks as well as for private investors. These high-return investment projects

may typically tend to have either a strong speculative element, e.g. real estate speculation or emphasise quick yield, e.g. transport business, trade and commerce etc., which also escape tax collection, and similar "informal" commercial activities. Unless special attention is paid, in a regime of liberalised imports with a highly devalued exchange rate and high nominal interest rate, only such a range of "investment" activities which contribute relatively little to the long-term growth in the productive capacity of the economy may be encouraged.

As already seen (table 3.5), lending by the commercial banks has tended to favour "trading activities" even excluding agricultural marketing. Similarly, our earlier discussion of sectoral utilisation of OGL funds (section 2.3) indicates a dramatic increase in the importance of the trade and transport sectors in OGL funding. The transport sector increased sharply its share in LCs established for OGL funding from 7.7% in 1990 to 21.7% in 1992. While these statistical facts may only provide "circumstantial evidence", there is a real danger that a price-rationed, apparently free foreign exchange market would not necessarily encourage a viable production structure over time. In other words a severe price-rationing in the forex market may encourage a peculiar process of "adverse selection" of socially not the most desirable projects, as speculative, high-return and quick-yielding projects tend to get selected in response to the high price of forex. This would not only distort the pattern and content of the growth process over the longer run, but may even contribute to weakening the domestic financial system.

To sum up the discussion of this section, the movement towards a unified and market based regime of foreign exchange in Tanzania is not going to be easy. Although it is both desirable and necessary to reduce the rent-seeking activities through greater transparency and accountability in the allocation of forex, this process of liberalization of the forex market may be frustrated, unless at least the following three preconditions are satisfied
  • a long-term commitment on the part of the donors about sufficient availability of forex in relation to demand to stabilize expectations.
  • a well-devised system of capital-control to discourage speculative vicious spirals of "capital flights" that may be triggered off.
  • a recognition that price-rationing alone in the market may fail to do the job efficiently by encouraging "adverse selection" of speculative investment projects. Thus, additional instruments of policy, e.g. corrective incentives through taxes and subsidies may be needed to rectify the adverse bias that may arise from operating through price-rationing in the foreign exchange market. Government intervention, especially in import rationing and subsidising socially desirable private or public investment projects should be a complementary and supportive process to liberalising the foreign exchange and domestic financial market. In the absence of such a private sector-friendly, but active role by the government, an indiscriminate liberalisation process may distort rather than help the process of economic development of Tanzania.

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4. The impact of import support on the process of economic growth and development

4.1 An introduction to the main issues

It was already noticed in the last chapter (see especially 3.6 to 3.8) that the programme of import support and the accompanying process of liberalisation of the Tanzanian economy has created for business enterprises two contradictory tendencies. For the producing units in various sectors of the economy, a more liberalised trade and foreign exchange regime has had some distinct advantages. For the manufacturing firms, it has meant easier access to essential raw material imports as well as better quality imports in many cases. For the agricultural producers, it has not only meant easier imports of agricultural inputs, but perhaps even more importantly in the Tanzanian context, it has provided the peasantry with some important consumer goods of a wider range and better quality. The availability of these imported consumer goods has created stronger incentive for the peasants to produce more and trade their agricultural products against these so-called "incentive goods". (There is distinct impressionistic evidence we gathered in March 1993, of better clothing, availability of processed food and consumer durables like bicycles and radios in the countryside).

Even more spectacularly, the trading activities have expanded, with a wide range of imported items now on display in the city markets. Indeed, the statistical evidence presented earlier (see tables 2.3 and 3.5, and section 3.8), which suggested a rapid growth of private trade and transport business, point to the growing importance of the service sector: Thus, although in a differential manner, the producing units in all the three major sectors of the economy — the primary (agriculture), the secondary (industry) and the tertiary (services) — have benefited from the more liberalised import and foreign exchange regime. Needless to add, consumers throughout the economy also benefit through the availability of a wider range of better quality goods, often at a competitive price.

Nevertheless, this advantage must be set against a possible disadvantage of liberalisation in terms of its contractionary effect on demand for domestically produced goods as a result of increased availability of more competitive imported goods. Liberalisation of imports — the pace of which is governed largely by the quantum of foreign assistance received by Tanzania — also means exposing domestic firms to the competition from foreign producers. The hope underlying broad-based import liberalization is that such competition from foreign producers would make domestic production "ultimately" more efficient, i.e. competitive

enough to survive vis a vis foreign producers. Nevertheless, as already argued (sections 3.6 to 3.8), such hopes may fail to materialise because, it may lead simply to an overwhelming number of bankruptcies and "deaths" of firms without new births. The Schumpeterian process of "creative destruction" which is supposed to be the life-force of dynamic capitalism, would then only reveal its "destructive" but not the "creative" aspect. This is particularly likely in the context of Tanzania, where the efficiency of the domestic firms is not determined only by factors internal to the firm like managarial ability, organisation and labour discipline etc., but also by factors external to the firm, e.g. social and economic infrastructure. Domestic firms in Tanzania are particularly handicapped vis-a-vis foreign competition due to these external factors.

Since the process of liberalisation of trade and the foreign exchange market has to be sustained, at least partly in the short run, through the inflow of foreign financial assistance — "aid" in various forms of grants and concessionary loans — the quantum of aid/assistance plays a similar contradictory role in terms of supply and demand. From the point of view of aggregate supply, a higher inflow of aid, may raise the short-term production level and capacity utilisation of the economy by increasing access to essential raw material imports, augmenting supply of "incentive goods" etc. already mentioned. In the longer-term, it also enhances the production capacity of the economy by creating new capacity through investments. However, at the same time, higher foreign aid may also tend to depress demand. Analytically, it reduces the requirement of domestic savings to finance any given level of investment, in so far as part of the investment is financed partly by foreign inflows. This weakens the Keynesian "multiplier mechanism" for the generation of domestic aggregate demand through the equality between investment and domestic savings.

So long as export remains relatively low, foreign aid/assistance as balance of payments support is necessary to sustain import liberalisation. But it contains the contradictory possibilities of enhancing production through higher import capacity on the one hand and, depressing aggregate demand and the size of the home market on the other. These contradictory roles of aid in the short run have not been recognised clearly in the existing analytical literature of the "macroeconomics of aid". Therefore, we have found it necessary to develop and incorporate an analytically transparent macroeconomic model, where the possibilities of these contradictory effects are captured sharply. The macroeconomic model on the short-term contradictory effects of foreign aid is presented in the next section 4.2.

In the longer run, there is the additional problem of the sustainability of a liberalisation programme. The process of liberalisation is supported by foreign assistance in the hope that it would make the economy efficient enough to become self-sufficient, so that such assistance would become unnecessary in the longer run. For this optimistic scenario to materialise, the economy has to improve its economic effi-

ciency over time, both with respect to the utilisation and mobilisation of resources. Only a continuous synergy between improved resource utilisation and mobilisation can raise the long-term trajectory of self-sustained economic growth, and reduce over time the dependence on foreign aid in Tanzania. Section 4.3 sets up the necessary macroeconomic framework to examine the relative contribution of resource mobilisation and utilisation on the longer term growth process in Tanzania to draw some analytical and empirical lessons. They also identify some specific quantitative aspects of the vulnerability of the Tanzanian economy, especially in terms of its tendency towards "aid-dependence". The behaviour over time of some strategic macroeconomic variables underlying the growth process which throw further light on the question of resource utilisation and mobilisation in Tanzania are analysed in the next two sections 4.4 and 4.5. They include an analysis of the macroeconomic productivity of investment and of labour, and their distributive implications over time during the process of economic growth. From this point of view, it is also instructive to examine how import support contributing to the recent liberalisation drive has changed the nature of the interaction between some of these strategic macroeconomic variables.

4.2 Possible short-term impacts of oreign aid through import support: an analytical framework

Foreign "aid" in its various forms of grants and concessionary finance is negotiated between the donors, multilateral institutions and the recipient country. However, from the point of view of a recipient, developing country like Tanzania, the annual quantum of such foreign aid is largely exogenous, i.e. it is a given datum to which other strategic macroeconomic variables need to adjust because the country has relatively little control over its quantum. Therefore, it becomes analytically worthwhile to examine how exogenous variations in the level of aid might affect the other macroeconomic variables in the economy with existing productive capacities more or less given in the short run (because capital investment is assumed to take time beyond short-term to mature). This is the purpose of this section.

Since the aid inflow is highly concessional (cf. table 1.1), its debt servicing obligation may be assumed to be negligible for the recipient. The income-expenditure balance for the recipient open economy is written as,

$$I + E = S + M \qquad (4.1)$$

I = gross investment, E = exports of (non-factor) goods and services, S = gross domestic savings and M = imports of (non-factor) goods and services. (4.1) could also written as,

$$I - S = M - E = A \qquad (4.2)$$

where, A = "aid flow". Note that A is to be interpreted as net of external debt servicing cost Z on current account. Thus,

$$(M + Z) - E = A + Z \qquad (4.3)$$

which implies current account deficit of the balance of payments on the left hand side and gross inflow on the right hand side. In developing economies dependent strongly on commercial borrowing (e.g. some Latin American countries), the distinction between (4.2) and (4.3) arising mostly from external debt servicing cost, is quantitatively important. That distinction, although theoretically equally valid, is of less quantitative significance in economies such as Tanzania that now depend heavily on "aid" i.e. highly concessional inflows (cf. table 1.1).

It is important to note that in the case of an economy receiving mostly aid, the usual idea of a "debt trap" does not hold. This is because, the debt trap operates through debt service obligations, i.e. the debt trap tightens as a country needs to borrow more and more in the international capital market simply to meet its debt servicing obligations. "Aid-dependence" is different from this type of external debt trap, simply because it does not operate primarily through the debt-servicing obligation.

The dependence of an economy on aid arises from the effects that aid exerts as an exogenous variable on the supply and on the demand side of the macroeconomy. On the supply side, higher aid flow enhances the import capacity of the economy to relax supply side constraints. In so far as the economy requires some minimal non-competitive recurrent or maintenance import per unit of production, while operating well below its installed capacity level, higher capacity to import essential intermediate inputs implies higher permissable production level in the economy through higher capacity utilisation in the short-run. On the other hand, the contradictory macroeconomic effect of aid arises on the demand side through the usual multiplier process. The first equality in equation (4.2), rewritten as

$$I - A = S \qquad (4.4)$$

shows that, for any given (exogenous) level of investment, a higher aid level means lower domestic savings (S). On the Keynesian assumption that savings is an increasing function of income, this also means that higher aid entails lower income from the demand side. Below we examine these effects in more detail.

In the general case, the level of aid (A) would affect both consumption (and therefore savings, S) and investment (I). Several different influences might operate on both investment and saving due to variation in the level of foreign aid.

Because of some tying of aid to specific investment projects by the donors and counterpart expenditure by the recipient government to cover the local component of investment costs, as well as greater availability of imported machinery, it is likely that an increase in the level of aid would simulate investment, i.e.

$$\frac{\delta I}{\delta A} \equiv I_A > 0$$

The effect of aid on savings is more difficult to predict apriori. It may depress savings by stimulating consumption through greater availability of imported goods on the one hand. However, it may also stimulate savings by redistributing income (generated by aid) in favour of the richer classes with a higher savings propensity. With these various opposing tendencies at work, we would not expect the net impact of aid on savings to be very large, i.e.

$$\frac{\delta S}{\delta A} \equiv S_A \approx 0$$

In addition, both savings and investment would be normally increasing functions of income, (Y),

$$\frac{\delta S}{\delta Y} \equiv S_Y > 0$$

and

$$\frac{\delta I}{\delta Y} \equiv I_Y > 0$$

Equation (4.4) is written in the general case where both savings and investment are influenced by income (Y) and aid (A) in the manner specified above, i.e.

$$S(A, Y) = I(A, Y) - A \qquad (4.5)$$

By total differentiation,

$$S_A dA + S_y dY = I_A \cdot dA + I_y \cdot dY - dA$$

By collecting terms, the slope which determines the size of the "aid-multiplier" on aggregate demand becomes,

$$\frac{dY^d}{dA} = \frac{I_A - S_A - 1}{(S_Y - I_Y)} \qquad (4.6)$$

Since the denominator of (4.5) would be positive under the assumption of "stability" of the Keynesion income adjustment process, $S_y > I_y > 0$, the sign of dY/dA is the same as that of the numerator on the right hand side of (4.5),.i.e. the sign of $(I_A - S_A - 1)$. Thus, except in the case where, $I_A > 1$, implying that an extra dollar of aid stimulates more than one dollar worth of investment, we may expect this sign to be negative. Consequently, our presupposition about the role of aid in contracting demand is likely to hold, so long as (i) investment is not driven very strongly by aid, i.e. $I_A \leq 1$ and, (ii) higher aid does not reduce savings too sharply, i.e. S_A remains negative or, a relatively small positive number.

Turning to the supply side, we assume that supply depends on the degree of capacity utilisation. In the short run, the feasible degree of capacity utilisation is assumed to be determined by the ability of the economy to import the essential (i.e. "non-competitive") raw materials and intermediate inputs. If r units of imported raw materials and intermediate inputs are (directly and indirectly) needed to produce one unit of domestic output, then up to the level of full capacity utilisation, aggregate supply, Ys, is determined by the simple relation,

$$Y^S = \frac{1}{r} M^r$$

where, Mr = imported essential raw material and intermediate inputs. More generally, when installed capacity in the short period is also explicitly recognized,

where,

$\overline{Y}$ = full capacity output in the short period. When this entire capacity to import is devoted exclusively to procuring only essential imported raw materials and intermediate inputs, equation (4.7) can be used to define the short run maximum production level of the economy from the supply side, i.e.

$$Y^s_{max} = Min \left[\frac{E+A}{r}, \overline{Y} \right]$$

since, $M^r_{max} = E + A$ by assumption.

This way of viewing the short-run supply side also helps to dramatise an economic tension in the use of limited foreign exchange which has been acute in the past in Tanzania. A higher utilisation of existing capacities through the import of essential raw materials and intermediate goods also means a lower rate of new capacity creation through the imports of final investment goods. In turn it slows down the pace of structural adjustment, but maintains a higher level of current production.

Without entering into the problem of how this tension between utilisation of existing capacity and creation of new capacity is resolved in different regimes of foreign exchange management, it suffices for our purpose here to assume that a certain proportion of the total import capacity gets devoted to procuring intermediate inputs, and the remaining proportion to the purchase of final investment and consumption goods. If λ is the proportion of import

capacity devoted to importing intermediate raw materials, then definitionally

$$\lambda = \frac{M^r}{E+A}, \qquad 1 > \lambda > 0$$

so that (4.7) becomes,

$$Y^S = Min\left[\frac{\lambda(E+A)}{r}, \overline{Y}\right], \qquad 1 > \lambda > 0$$

The aggregate supply curve in (4.8) has a positive slope λ/r in the (A, Y) plane until full capacity is reached. At that point, the supply curve turns horizontal, because more imports of intermediate inputs cannot raise production as the economy hits its capacity constraint in the short period. This specification of the supply curve in (4.8) together with the specification of the of the aggregate demand curve in (4.5), whose slope is defined locally from (4.6), permit us to analyse how the level of economic activity is determined through the interaction between demand and supply in response to variations of the exogenous flow of foreign aid. In order to do this, we put together the considerations on the demand as well as on the supply side to see how the level of economic activity may be affected by the level of aid in the short period. Since the binding constraint on the level of economic activity determining actual income would operate either from the demand or from the supply side, we write

$$Y = Min\left[Y^d, Y^s\right] \qquad (4.9)$$

where, Y = level of actual output, and Y^d and Y^s are defined from equations (4.5) and (4.8), respectively.

As already pointed out, the supply curve, Ys, is positively sloped in the (A, Y) plane until full capacity output is reached. On plausible apriori assumptions discussed earlier the demand relation, Yd given from (4.5) and (4.6) in the same plane, is likely to be negatively sloped. In accordance with equation (4.9), demand and supply considerations together determine the locus of the actual output level, Y, at different levels of foreign aid, A. This is shown in figure 1 by the more heavily shaded line.

Figure 1: Actual income in relation to the level of foreign aid (when aid depresses aggregate demand)
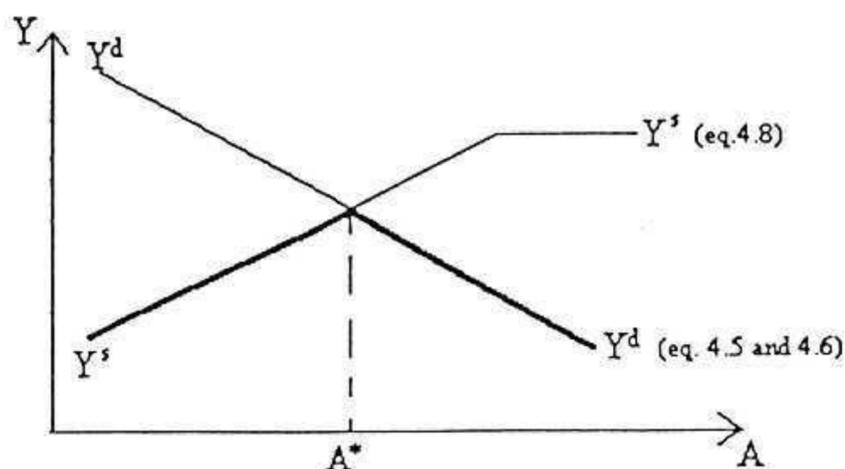
Probably the most interesting aspect of figure 1, is the emergence of an economic regime in the short period, in which a higher level of economic aid beyond A* turns out to be counter-productive. It depresses instead of augmenting the level of income. The reason, as already argued, is the impact of a higher level of aid in depressing the level of aggregate demand through the usual multiplier mechanism, in situations where the demand constraint is already binding (i.e. to the right of A* in figure 1). Put differently, when domestic production is restricted by the size of the domestic market and exports are given in the short period, an additional dose of foreign aid may actually reduce production by contracting domestic demand further despite the fact that it raises the potential supply of the economy. This also seems to provide a short period analogue to the more intuitive idea that the injection of foreign aid beyond the "absorptive capacity" of the recipient economy (i.e. A*) may be counter-productive.

A different situation arises when higher aid stimulates aggregate demand, i.e. the slope estimated from equation (4.5) is positive. This case may plausibly occur when a great deal of aid is tied to specific investment projects with considerable supporting local currency investment by the recipient government, with the result that aid stimulates investment very strongly, i.e. IA > 1 in equation (4.6).

Figure 2: Actual income in relation to the level of foreign aid (when aid stimulates aggregate demand
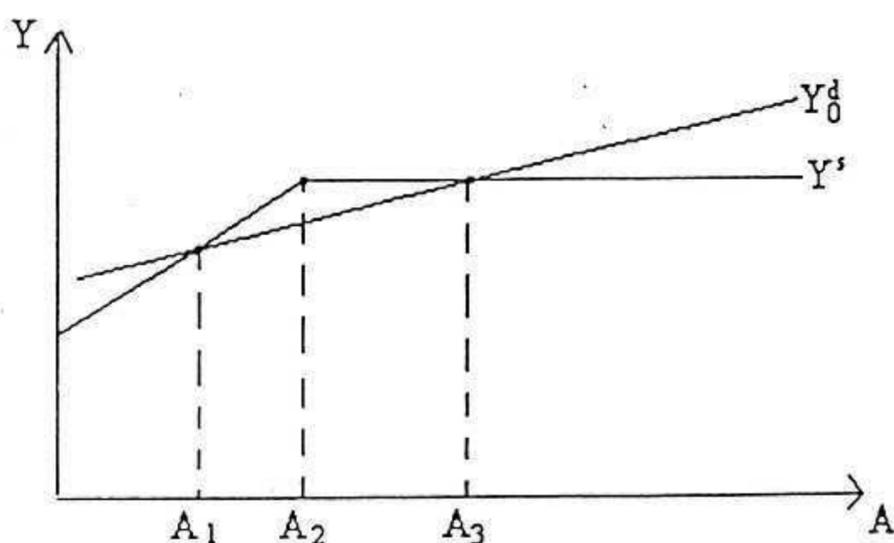
In terms of reliability, coverage and the (usable) length of the time-series (i.e. number of observations), the available macroeconomic data in Tanzania has many problems. Therefore, the preceding model is difficult to "test" empirically with Tanzanian data. Nevertheless, some tentative econometric exercises were attempted in order to ascertain the plausibility of the apriori assumptions entailed in the formal (algebraic) model in the case of Tanzania. The results, although preliminary and tentative, are reported here briefly, as they may be suggestive of some peculiarities in the structure of the Tanzanian economy and help future research.

Experimenting with both fixed (1976) and current price time series data on national accounts for 1980-90, we had two rather unexpected results.

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1) Investment did not have any significant association with GDP (i.e. the acceleration-type relation was negligibly weak), but it was found to be very strongly and, almost entirely driven by foreign aid. Thus

$$I = 2574 + 1.07A, \quad R^2 = 0.98$$
$$(25.02)$$

which is significant at a 0.1% level of confidence. Accordingly we set,

$$I_A = 1.07 \text{ and } I_y = 0.$$

2) Somewhat unexpectedly, the association between savings and aid, in many specifications of the model, turned out to be positive. However, in single and multivariate regressions the association never went beyond 5% level of significance (nor was the R^2 higher than 0.3). Tentatively, we set $S_A = 0.66$ from the econometric experiments, while (leaving out the "outlying" year of 1988), we obtained an estimate of the "marginal propensity" to save of about 9% ($R^2 = 0.75$), i.e. $S_y = 0.09$.

3) On the supply side, the proportion of import bill devoted to raw materials was fairly steady at around 39%, while the import content of domestic production was .09, i.e. the estimated parameter values were, $\lambda = 0.39$ and, $r = 0.09$.

Using these estimates, one additional "unit" or TSh of aid is estimated from (4.6) to lead to a decrease in aggregate demand of about TSh 6.6. But one additional TSh of aid is also estimated from (4.8) to lead to an increase in aggregate supply of about TSh 4.3. Whether aid actually increases or decreases aggregate income (GDP) would depend on whether the economy is supply-constrained or demand-constrained. We only need to stress that, while the Tanzanian economy was almost certainly constrained by lack of essential supplies of imported raw materials until recently, liberalised imports and foreign exchange market supported by a strong increase in foreign aid has now relaxed this constraint significantly. Therefore, continuing large scale import support needs to take more seriously the demand constraint, i.e. a possible negative impact on demand for domestically produced goods through liberalisation of import and foreign competition, sustained largely by foreign aid.

4.3 Resource mobilization and utilisation in the long-term process of economic growth in Tanzania

The link between foreign capital inflow, investment and growth can operate in different ways depending on the macroeconomic structure of the economy. However the fact that both the donors and the recipient country agree, at least in the case of Tanzania, to the important role of foreign aid in development, seems to point to their common understanding of the critical bottleneck of "capital shortage" in the process of development. As already pointed out in the last section 4.2, net foreign aid inflow can contribute directly to relaxing the external constraint on the supply side by allowing easier access to imported intermediate inputs which may lead to higher capacity utilization in the short run. However, it was also pointed out that, for any given level of investment, a higher level of aid could have a depressing effect on aggregate demand.

Over time, and in the longer run context of economic growth these two contradictory short-term aspects of foreign aid appear in a somewhat different light. In the longer run, foreign capital inflow not only helps on the supply side by achieving higher utilisation of existing capacities through easier access to imported intermediate inputs, but it also helps in creating new capacity through investments in fixed capital. At the same time, if the higher inflow of foreign capital leads to a correspondingly higher rate of investment, then the economy reaches a higher trajectory of growth, instead of experiencing the depressing effect of aid on aggregate demand. These ideas on the long-term growth process in a capital-constrained economy may be given a more precise formulation by using two coefficients, one for resource utilisation and the other for resource mobilisation, which interact in the process of economic growth.

The extent of resource mobilization can be captured very approximately through the share of investment in GDP. Investments, in turn, consist of domestic savings and net foreign savings inflow into the economy. This follows from our earlier equation (4.1), i.e.

$$I + E = S + M$$

or,

$$I = S + (M - E) = S + A$$

where, I = investment, S = domestic savings, E = exports, M = imports and, A = net foreign savings inflow to cover the trade deficit, which is assumed equal to net foreign aid. Thus, it is the ratio of domestic savings to GDP which is a more appropriate index of the domestic effort at resource mobilisation.

The observed value of the incremental output capital ratio (IOCR) provides, on the other hand a rough quantitative index of the utilization of resources which are mobilized for investment. Thus, one way of interpreting the growth equation, familiar from the Harrod-Domar formulation, is to view the growth rate of GDP as a resultant of the efforts at mobilization and utilization of resources. More formally,

$$g_t = \frac{\Delta Y_t}{Y_{t-1}} = \frac{\Delta Y_t}{I_{t-1}} \cdot \frac{I_{t-1}}{Y_{t-1}} = b_t \cdot n_{t-1} \quad (4.10)$$

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where, the rate of growth of income (GDP) is defined as,

$$g_t = \frac{\Delta Y_t}{Y_{t-1}} = \frac{(Y_t - Y_{t-1})}{Y_{t-1}}$$

$$b_t = (1/ICOR) = \Delta Y_t / I_{t-1}$$

and,

$$n_t = \frac{I_t}{Y_t} \equiv \frac{I_t}{F_t} \cdot \frac{F_t}{Y_t}$$

By logarithmic differentiation and ignoring second-order terms, equation (4.10) can be rewritten in terms of elasticities as

$$\frac{\Delta g_t}{g_t} = \frac{\Delta b_t}{b_t} + \frac{\Delta n_{t-1}}{n_{t-1}}$$

or:

$$1 = \left(\frac{\Delta b_t}{\Delta g_t} \cdot \frac{g_t}{b_t} \right) + \left(\frac{\Delta n_{t-1}}{\Delta g_t} \cdot \frac{g_t}{n_t} \right) \qquad (4.11)$$

Thus, variations in the growth rate are decomposed statistically in (4.11) into variations in the share of investment (n) and in IOCR (b), when the cross-term is ignored as second order small.

In order to estimate the statistical contribution of resource utilisation to the growth process, we first estimate the incremental capital output ratio (ICOR), whose inverse (IOCR) appears as the parameter b in equation (4.9) and (4.11). Table 4.1 provides time-series estimates of the incremental capital output ratio, for the economy as a whole as well as for manufacturing, transport and agriculture, at constant (1976) prices during the decade 1980-90.

The most striking feature of table 4.1 is the abnormally poor performance of manufacturing, where higher investment was associated with a declining output level to result in observed negative ICOR until 1986. Since then the ratio has turned positive, although by international standards, it remains very high. In contrast, agriculture presents a picture of steadily declining incremental capital output ratio throughout the last decade.

The relatively large and rising share of investment in the transport sector (table 4.6) as well at its rising and high share in OGL import funding (table 2.3) suggest a relatively high private profitability in that sector. Nevertheless, the percentage contribution of the transport sector to GDP has actually declined over time, implying an exceptionally high ICOR which has, moreover, increased in all years 1986 to 1990 (table 4.1).

The large investments in the transport sector combined with its relatively modest contribution to GDP, tend to suggest that imported transport equipment is being poorly utilised due to the malfunctioning of the transport infrastructure. This may be a case of relatively high private profitability, which attracts investment to the transport sector, along with relatively low social productivity which is reflected in its modest contribution to GDP. As will be shown in chapter 6, the inclusion of informal activities does not improve the social productivity of investment in the transport sector.

Using table 4.1 as well as the national income statistics, table 4.2 computes the behaviour over time of the two parameters — the incremental output capital ratio (b) and the share of investment in GDP (n) at 1976 prices. By virtue of equation (4.10), the growth rates of GDP at 1976 prices are also implied. Since bt and nt are computed on a three-year average to reduce "seasonal" fluctuations and other statistical error, the computed growth rates of GDP deviate, but

Table 4.1 Computed incremental capital output ratios (ICOR)

Year	Aggregate economy	Manufacturing	Transport	Agriculture
1980	13.6	- 11.4	- 101.8	2.9
1981	25.5	- 7.7	73.7	2.5
1982	- 32.5	- 7.4	- 10.9	2.8
1983	44.4	- 17.6	- 20.8	1.8
1984	19.1	- 16.7	- 19.3	1.3
1985	7.8	- 36.1	139.2	1.3
1986	7.5	- 55.9	47.0	1.2
1987	7.3	36.7	53.9	1.0
1988	7.5	15.4	54.8	0.6
1989	8.7	28.9	90.9	0.4
1990	9.5	39.0	108.0	0.4

Note: Estimates with three years moving averages for value added and fixed capital formation and one year lag between investment and increment in output. All figures at constant (1976-) prices.
Source of data: National Accounts of Tanzania, 1976-1991.

only insignificantly, from actually observed values, showing rough consistency of our estimates of b and n with observed figures.

It is clear from table 4.2 that, from a virtually stagnant economy in the first half of the 1980s, the economy was able to raise the growth rate to over 4% per year in 1986-1988. Although this improvement in the growth rate was a result of both better resource utilization, measured by the IOCR (b) and improved overall resource mobilization, measured by the share of investment in GDP (n), the former (b) was far more significant quantitatively in accounting for the higher growth rate.

Thus, the annual growth rate increased from an (unweighed) average of 1% during 1981-85 to 3.9% during 1986-90, while on the same (unweighed) basis the average annual share of investment increased from 24% to 31% in a comparison between the two periods. From equation (4.11), this implies that only about 10% of the variation in the growth rate between the two periods is statistically accounted for by variation in n, i.e. the higher share of investment in the later period (1986-90). The remaining 90% of the higher growth rate is accounted for by the higher value of the IOCR. (i.e. parameter b) in that period, treating variation in b as a residual in formula (4.11). If instead, improvement in the marginal output-capital ratio from an average of 0.0422 to 0.1246, amounting to an increase of 195 %, is considered between the two periods, then about 67% of the improvement in the growth rate of the latter period is explained by variation in b. In brief, from nearly 70% upto 90% of the improved growth performance in the latter period is accounted for by a higher value of the IOCR, reflecting better utilisation of resources. Obversely, depending on how the cross-term is treated, from only 10 to up to 33% is accounted for by higher mobilisation of resources, i.e. the parameter n.

More strikingly, even the relatively meagre contribution of the total domestic and external resource mobilisation parameters (n) to the growth process is an over-estimate, in so far as the domestic resource mobilisation component has been even weaker. Table 4.3 presents the relevant data.

Thus, table 4.3 in conjunction with table 4.1 capture in a rough quantitative manner two interrelated phenomena which deserve special attention. First, since the strong increase in import support from around 1986 onwards, there has been a distinct improvement in the utilization of resources per unit of investment measured by the ICOR. However, this must be coupled with a second aspect of the problem. The process of resource mobilization has also become more dependent on foreign capital inflow (including aid) since import support surged in 1986. The relatively easier availability of foreign resources has not been matched by corresponding domestic resource mobilisation efforts. In short, the improvement in resource utilization noticeable since the initiation of general import support through OGL seems to have been obtained only at a disproportionately high cost of dependence on foreign aid and other foreign capital inflows.

Macroeconomically, such a process of growth driven by foreign aid implies a mechanism in which resources for investment are being more efficiently utilised, reflecting lower ICOR, but there has been a failure to mobilize these recent productivity gains as incremental domestic savings for financing higher levels of investment. This weak macroeconomic feedback from more efficient resource utilisation to better domestic resource mobilisation can be identified as one of the most vulnerable aspects of the recent process of growth as well as economic liberalisation since 1986 in the Tanzanian economy. This process carries with it a very real danger of continuing dependence on aid, because neither the momentum of growth nor the pace of liberalisation

Table 4.2 Computed growth rates of GDP on the basis of IOCRs and investment ratios

Year	Incremental output capital ratio (b)	Share of investment in GDP (n) %	Computed growth rate of GDP % per year
1980	0.074	25.7	
1981	0.039	24.9	1.0
1982	- 0.031	22.8	- 0.8
1983	0.023	22.8	0.5
1984	0.052	24.2	1.2
1985	0.128	27.6	3.1
1986	0.133	30.6	3.7
1987	0.137	31.4	4.2
1988	0.133	32.0	4.2
1989	0.115	33.8	3.7
1990	0.105	35.4	3.6

Sources:The Economic Survey, 1991; and table 4.1 above in the text. (Three years moving averages).

through import support can be sustained without increasing volumes of aid, unless efforts at domestic resource mobilisation are strengthened substantially.

Table 4.3 Pattern of resource mobilisation: net foreign capital inflow and domestic savings 1982-91 (in percentages)

Year	Share of foreign inflow in fixed capital formation	Share of domestic savings in fixed capital formation
1982	26	74
1983	26	74
1984	30	70
1985	28	72
1986	48	52
1987	67	33
1988	77	23
1989	100	negligible
1990	81	19
1991	82	18

Sources: National Accounts of Tanzania 1976-1991 and BOT: Economic and Operations Report, various issues.

4.4 Productivity of investment and efficiency considerations in the process of growth and liberalisation

Although it has not been explicitly emphasised so far, the inverse of the ICOR i.e. the incremental output capital ratio, IOCR = 1/(ICOR), measures in a theoretically crude but empirically tractable way, the macroeconomic productivity of investment in the economy. Because, it captures in a simple way the incremental output flow per annum which results from a unit of investment in fixed capital. Thus, the parameter b, which was estimated on an annual basis in table 4.2 for the entire decade 1980-90 can be interpreted economically as showing approximately the time behaviour of productivity of investment in the Tanzanian economy. It would be evident from that table that, during the second half of the 1980s Tanzania maintained a distinctly higher overall productivity of investment of over 10%, compared to the first half (up to 1984), when the productivity of investment was, on average, less than 5%.

It is not commonly emphasised that the factors influencing the macroeconomic productivity of investment measured by the IOCR are many. Unless sufficient caution is exercised and these factors are taken systematically into account, it becomes misleading to use the macroproductivity of investment (i.e. IOCR) as an indicator of the "productive efficiency" of the economy. Analytically, this marginal ratio derives its importance from the underlying macroeconomic presupposition that the capital constraint is the most acutely binding one on the economy, and the process of economic growth is propelled basically through investments. While there is much to criticise in this somewhat oversimplistic view of the growth process, it must also be remembered

that in a capital-poor economy like Tanzania this may be a plausible first economic approximation, leaving out social and political factors. This also means that the productivity of investment (IOCR) deserves special attention.

At an empirical level, the incremental output-capital ratio, is influenced by at least three major economic factors.

1. The sectoral composition of investment. Thus, changes in the sectoral composition of investment would entail changes in the IOCR. More formally,

$$\frac{1}{ICOR} = b \equiv \frac{\Delta Y}{I} \equiv \frac{\Delta Y_1}{I_1} \cdot \frac{I_1}{I} + \frac{\Delta Y_2}{I_2} \cdot \frac{I_2}{I} + \ldots + \frac{\Delta Y_n}{I_n} \cdot \frac{I_n}{I}$$

or,

$$b = \Sigma b_j w_j, \qquad \sum_J w_j = 1 \qquad (4.12)$$

Where, $b_j = (\Delta Y_j / I_j)$ = sectoral inverse of, ICOR and $w_j = (I_j / I)$ = sectoral investment share.

2. The IOCR will be influenced by the rates of capacity utilization. The technological ratio relates to capacity output, while the statistically observed ratio relates to actual output figures. Thus, the IOCR or the parameter b will increase with capacity utilization.

3. The IOCR will be influenced by the time-lag between investment expenditure and incremental output flow. The technological ratio would incorporate this gestation-lag, but the statistical ratio may be (or usually is) arbitrarily lagged, e.g. by one year, as in the computations presented in table 4.1.

In view of table 4.1, 4.2 and formula (4.12) we may now see how the different influences operated on the overall IOCR in Tanzania. A large volume of investment, started during the late 1970s and early 1980s in Tanzania, made the negative effect of gestation period strong, reducing the IOCR in the early 1980s, as uncompleted projects without yield absorbed much of the investment, especially in manufacturing as construction-in-progress. At the same time, the bias in the composition of investment was in favour of manufacturing and against agriculture. The same bias continues even to date and the improvement in the IOCR is accounted for significantly by a steady lowering of ICOR within the agricultural sector and, not by a shift of investment (statistical weight, wj) in favour of agriculture in recent years. Table 4.6, shows that in manufacturing industry, wj increased from an average of 24.2% in 1981-85 to 28.4% in 1989-91. Thus, productivity of investment in industry in the period 1989-1991 compared to 1981-1985 rose primarily because of an increase in wj (cf. table 4.2). By contrast, average wj for agriculture declined significantly, from 10.7 to 2.9%, between the two periods (table 4.6), while the sectorial productivity of investment rose sharply between the two periods (cf. table 4.1). (On the other hand, investment in agriculture is underreported, because the

Bureau of Statistics includes mainly investments in agricultural parastatals and private estates/plantations, leaving out peasant agriculture almost entirely. This may imply that the decline of wj between the two periods is somewhat exaggerated.)

The value of the IOCR is influenced strongly by the degree of utilisation of capacity. However, capacity utilisation is a concept which applies reasonably accurately to only the industrial sector. In Tanzania, the low weight of manufacturing in GDP (around 4% at current prices and 8% at constant (1976-)prices) is coupled with a much higher weight of manufacturing investment in total investment (cf. table 4.6). Thus, some increase in manufacturing output since 1987 which made the IOCR in manufacturing (see table 4.1) positive helped in pulling up the overall ratio significantly through the high statistical weight of manufacturing investment in total investment (see equation 4.12 and table 4.6). It seems probable that, as the sectoral investment composition shifted away from "basic industries", and less fresh investment projects were started since the mid 1980s to reduce the proportion of construction-in-progress, the observed ICOR also assumed lower value in recent years through all the three channels, i.e. higher capacity utilization, higher investment share for less capital-using sectors and, a reduction in the average gestation-period through starting fewer fresh investment projects.

The implications of this analysis of the reduction in the ICOR, implying an increase in the overall productivity of investment are at least two. First, the observed reduction in the overall ICOR may not be simply due to higher capacity utilization brought about by the import support programme since 1986. Quantitatively speaking, the improvement in

capacity utilization in manufacturing cannot even account for a significant part of the lower ICOR. This is also indicated by the data in table 4.4, showing rates of capacity utilisation for selected industrial subsectors. For the group of industries as a whole, the rate of capacity utilisation rose rather modestly, from 26.5% in 1986 to 37.3% in 1991. It could be argued that the figures in table 4.4 do not reflect the actual development since it mainly includes only parastatal and cooperative firms (which are generally owned by parastatals). Hence, the rate of capacity utilisation may have increased more in private industry. But there is no data available on rates of capacity utilisation for the industrial sector as a whole over several years. However, the Bureau of Statistics has compiled capacity data for a sample of 332 industrial firms, including private, parastatal and cooperative establishments, for the years 1991 and 1992. The results of our computations of the rates of capacity utilisation based on that se of data are shown in table 4.5.

The data in table 4.5 indicates that the average rate of capacity utilisation in private manufacturing firms is not distinctly higher than in parastatals and cooperative firms combined. And, the figures for parastatal/cooperative firms are consistent with the figures for the smaller sample in the same group shown in table 4.4. Moreover, the rather low rate of capacity utilisation in private firms in 1991/92, suggests that there could not have been any considerable increase in capacity utilisation in these firms in the preceding years.

Second, it also deserves emphasis that the extent to which ICOR was lowered by not starting a large number of fresh investment projects after the early 1980s, this lower value of ICOR may be a somewhat transient phenomenon. It may

Table 4.4 Rates of capacity utilisation (%) for selected industries, 1982-1991

	1988-weights	Average 1982-84	1985	1986	1987	1988	1989	1990	1991
Textiles	337	35.9%	29.5%	22.4%	21.7%	21.6%	22.9%	29.0%	30.0%
Leather products	44	31.2	17.7	16.6	11.5	9.6	8.6	12.0	14.0
Cement	46	24.8	27.6	31.9	36.2	44.1	43.7	49.2	48.0
Cigarettes	81	71.9	47.5	49.0	45.5	49.6	50.7	66.7	68.0
Soft drinks	42	n.a	16.0	15.6	16.2	20.6	17.2	31.0	22.2
Beer	32	51.5	59.0	50.5	45.5	41.0	41.6	34.9	39.0
Cooking oil & fa	64	n.a	13.0	10.0	13.0	20.0	15.7	26.2	38.4
Tyres & tubes	36	35.4	29.8	43.0	52.3	51.6	59.7	55.0	49.0
Matches	n.a	n.a	58.4	61.3	45.9	26.6	51.0	87.6	104.6
Iron sheets	73	46.0	51.5	19.6	38.5	34.2	47.1	50.5	54.4
Rolled steel	43	32.3	54.1	38.0	32.2	35.0	51.1	30.4	25.2
Paints	11	8.9	13.2	16.1	23.0	20.1	20.8	21.1	24.5
Weighted average	809 (703)	40.1%	32.8%	26.5%	27.8%	28.8%	31.3%	36.2%	37.3%

Note: Own estimates. Some products/industries for which capacity data does exist, viz. fertilizers, shoes and hoes/ploughs, have not been included for the following reasons: The rated capacity of the Tanzania Fertilizer Company is purely notional; its machinery has been dilapidated for many years. The same pertains to a somewhat lesser degree to the Morogoro Shoe Factory. With respect to hoes and ploughs, imports have been included in production data, so that domestic production is overestimated in the statistics.

Sources of data:Minister of Industries and Trade: Budget Speech for the 1985/86 Financial Year and the 1992/93 Financial year, respectively; BOT: Economic and Operations Report for the Year ended June 1991; Planning Commission/Bureau of Statistics; Industrial Commodities Quarterly Report 1992:2, DSM Dec. 1992. Weighted averages have been estimated on the basis of gross output data for 1988, derived from Bureau of Statistics; Survey of Industrial Production 1988 with weights reflecting value of full capacity output in that year.

not be altogether compatible with the longer-run structural adjustments needed for the Tanzanian economy. Thus, it would be premature to interpret the decline in ICOR entirely as any sustainable improvement in the macroeconomic productivity of investment. At the same time, there have been significant changes over time in the sectoral composition of output and investment, as reported in table 4.6.

Table 4.5 Rates of capacity utilisation in manufacturing industry by company type, 1991 and 1992. %

	1991	1992
Private	40.0	36.9
Cooperative	47.4	45.5
Parastatal	29.9	30.7
Cooperative + parastatals	31.9	32.4

Source of data: Bureau of Statistics, DSM, March 1993. Estimates by SINTEF Applied Economics.

Table 4.6 provides a summary view of the changing composition of output and investment by the major sectors of the economy, as a comparison of averages of the three periods 1981-85, 1986-88 and 1989-91. It will be seen that, (i) There is no systematic relation between sectoral output weights and sectoral investment weights, i.e. the sectors which contribute most to GDP do not typically receive a correspondingly high share of investment. (ii) Defined in this sense, the "bias" against the agricultural sector increased in the periods 1986-88 and 1989-91, when agriculture received actually a much lower share of investment. Thus, the general import support programme did not apparently attract investments towards agriculture, away from other major sectors; nor does any changing composition of investment in favour of agriculture explain statistically the lower overall ICOR. (iii) Despite this, Tanzanian agriculture performed remarkably well by expanding its share in GDP by more than 4 percentage points from 1981-85 to 1989-91. It contributed to the reduced aggregate ICOR by expanding output at very little investment cost. This implies that improved productivity of investment within the agricul-

tural sector rather than intersectoral changes in the pattern of investment has been an important contributory factor to increasing the overall productivity of investment, as measured by the IOCR. However, in so far as this was due to better weather conditions, this may not be maintainable on the long-term basis.

Table 4.6 also shows that the manufacturing sector increased its share in total investment by 4 percentage points between the first and the last period, at the same time as the share of manufacturing in total GDP actually declined. It should also be noted that transport increased its share in total investment by as much as 15 percentage points between 1981-85 and 1989-91. This is consistent with the strong increase of transport in total OGL funding in recent years (cf. table 2.3); and it represents another indication that the economic liberalisation has stimulated heavily "speculative" investments in sectors such as transport, which promise high, short-term returns.

It has been pointed out already that the productivity of investment (measured by IOCR) deserves special attention under the assumption that the economy is capital-constrained. In other words, if the crucial bottleneck is identified as that of "investible resources", then special attention has to be given to the productivity of those resources. Nevertheless, this apparently "common sense" view needs to be modified for at least two important reasons. First, "investible resources" consist of a bundle of heterogeneous physical inputs, which are valued at some (market) prices to yield a nominal or financial measure of the amount of investment. Therefore, the productivity of investment is not an unambiguous concept, as it involves the productivities of different items in the heterogenous bundle of physical resources used for investment. In particular, both labour and various material, non-labour inputs which combine in the production process enter in the resource bundle, underlying the nominal value of investment. But apart from this inescapable statistical index number problem in measuring investment, there is a different set of problems involved in

Table 4.6 GDP and investment shares in percentages at constant (1976-)prices

Sectors	GDP by sectors of origin			Investment by sectors of destination		
	1981-85	1986-88	1989-91	1981-85	1986-88	1989-91
Agriculture	41.6	44.4	45.9	10.7	3.9	2.9
Mining and quarrying	0.8	0.5	0.6	0.8	0.3	0.2
Manufacturing	9.1	7.7	7.9	24.2	25.4	28.4
Electricity and water	1.8	2.1	1.7	8.6	17.3	012.1
Construction	3.0	3.6	3.0	9.3	9.8	10.5
Trade, hotels & rest. etc.	11.0	11.4	11.8	2.6	1.2	1.3
Transport and comm.	6.5	5.8	5.6	23.0	35.2	38.4
Finance, insurance etc.	11.6	12.4	11.8	5.3	1.9	1.5
Public administration	14.6	12.1	11.7	15.5	5.0	4.7
Total	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

Source: National Accounts of Tanzania 1976-1991, DSM 1992. Own estimates.

measuring the return on investment. The IOCR indicates the total productivity of investment, when investment goods combine with labour in the process of production to produce a regular incremental flow of output per annum, per unit of investment. Since this incremental annual flow of output is the contribution of both investment goods and of labour, the rate of return on investment needs to separate the contribution of labour from that of capital. This involves controversial issues in the economic theory of distribution. However, for the present purpose, by taking the wage rate as exogenously given, a statistical measure can be obtained easily. From the incremental output (per unit of investment in the IOCR) must be deducted the payment to labour as wage cost to arrive at the calculation of the rate of return or profit on investment. It follows that business profit is not simply a measure of productive efficiency, but also of the social pattern of the distribution of income. Therefore, these social aspects of the distributive process must also be considered in calculating business profit.

4.5 The distributional aspect of the process of economic growth with liberalisation in the manufacturing sector

The distributional considerations implied in calculating the rate of profit on investment may be highlighted by means of a statistical identity. The additional profit generated per unit of investment, which defines the rate of profit or return on investment must satisfy the identity,

$$ r = \frac{\Delta \Pi}{I} = \frac{\Delta \Pi}{\Delta Y} \cdot \frac{\Delta Y}{I} = \left(\frac{\Delta \Pi}{\Delta Y} \right) \cdot (IOCR) $$

where, $\Delta \pi$ = profit (and $\Delta \pi$ = incremental profit)
Y = value added (VA) or output
I = investment

It may be noted that on the extreme right hand side of (4.13), the IOCR measures the total productivity of investment as emphasised earlier (see section 4.4), while the other bracketed term $(\Delta \pi / \Delta Y)$ is the marginal share of profit in output, a distributional parameter.

The use of this distributional parameter is highly problematic in general for the Tanzanian economy, especially because there is a very large, probably dominant, proportion of self-employment in agriculture and, in large segments of informal industry and services, which makes the separation between profit and wage meaningless for income from self-employment. However, this distributional parameter can be more meaningfully estimated and applied in the case of formal or organised manufacturing industry. Using (4.13) and, without making allowance either for depreciation or for corporate tax, table 4.7 calculates the pre-tax gross (before depreciation) rate of return on investment in manufacturing industry for the decade 1980 to 1990 at factor cost and (1976-)constant prices. Two features of the calculations presented in table 4.7 stand out as striking. First, the marginal

profit share in value added — the distributional factor — is extremely heavily biased in favour of profits and, against wage, by almost all international standards. (Gross profit share seldom exceeds 1/3 in industrialised countries and, typically lies below 1/2 in the manufacturing sector in most developing countries). Second, despite the extremely high marginal share of profits in manufacturing value added, the pre-tax, gross rate of return on investment is exceptionally low, again by international standards, exceeding 5% in real terms only in 1980, 1987 and 1988. It is also noticeable that after a recovery of the rate of return on manufacturing investment in 1987-88, there was a fall in 1989-90, with the rate of return becoming negative again in 1990. If this tendency persists, it can be taken to mean industrial stagnation, or even decline.

As a matter of accounting arithmetic, the rate of return on investment may be low, either because the real wage rate is "too high" or, because labour productivity is "too low". More precisely, it is the real wage in relation to labour productivity — the economist's concept underlying "unit wage cost" — which determines both the labour cost per unit of output as well as profitability. On the basis of available data for Tanzania, table 4.8 computes the real wage per worker in manufacturing industries with 10 or more employees. It can be seen that the real wage rate shows a continuous decline throughout the period 1980 to 1990 — a massive decline of nearly 80% during the decade, while manufacturing employment increased by a meagre 10 to 11% during the decade (cf. also table 4.9). It is also worth noticing that there is no perceptible reversal of the trend, either in terms of declining real wage or in terms of the sluggish growth of manufacturing employment, since economic liberalisation began.

Table 4.7 Gross pre-tax real rate of return on investment in manufacturing firms with 10 or more employees

Year	Total productivity of investment (IOCR), $\Delta Y/I$	Marginal profit share $\Delta \Pi/\Delta Y\%$	Rate of return on investment, $\Delta \pi / I \%$
1980	- 0.088	- 175.0	15.4
1981	- 0.130	85.5	- 11.1
1982	- 0.135	105.1	- 14.2
1983	- 0.057	55.7	- 3.2
1984	- 0.060	140.8	- 8.4
1985	- 0.028	41.7	- 1.2
1986	- 0.018	77.3	- 1.4
1987	0.027	430.0	11.6
1988	0.065	130.0	8.5
1989	0.035	93.8	3.3
1990	0.026	- 11.1	- 0.3

Source of data for $\Delta \Pi/\Delta Y$, Hali Ya Uchami/Economic Survey, several issues, using 3 years moving averages. IOCR for manufacturing industry is derived from table 4.1 which gives ICOR = (1/IOCR). The return on investment for 1989 and 1990 may be somewhat underestimated, because the GFCF figures for the manufacturing sector in those two years may be overestimated according to information obtained form the Bureau of Statistics.

The problem of the manufacturing sector is investigated further by computing the average productivity of labour, i.e. value added per worker in manufacturing industries. It

Table 4.8 Real wages in manufacturing firms with 10 or more employees

Year	Aver. wage TShs/worker	National cons. (at current prices). price index (1977=100)* wage	Average real (TShs /worker at 1977 prices)	% change of average real wages
1980	10372	156.73	6618	
1981	10059	196.93	5108	- 22.8%
1982	10654	253.90	4196	- 17.9
1983	12084	322.63	3746	- 10.7
1984	15212	439.20	3464	- 7.5
1985	18521	585.38	3164	- 8.7
1986	18095	775.23	2334	- 26.2
1987	20255	1007.40	2011	- 13.8
1988	24770	1321.50	1874	- 6.8
1989	26487	1663.20	1593	- 15.0
1990	29517	1990.80	1483	- 6.9
% change from aver. 1981-84 to aver. 1987-90		393.4%	- 57.9%	
% change of average real wage 1980-1990:			- 77.6%	

* Cost of living index of goods and services consumed by urban dwellers, Tanzania Mainland.
Source: Hali Ya Uchumi/ The Economic Survey, several issues.

Table 4.9 Employment and productivity in manufacturing firms with 10 or more employees

Year	Employment		Value added at factor cost at 1976-prices		Productivity of labour (value added per worker)	
	No. of workers	% change	Mill. TShs	% change	TShs/worker	% change
1980	102317		1972		19273	
1981	108366	5.9	1770	- 10.2	16334	- 15.2
1982	101320	- 6.5	1693	- 4.4	16709	2.3
1983	104231	2.9	1564	- 7.6	15005	- 10.2
1984	98983	- 5.0	1425	- 8.9	14396	- 4.1
1985	94789	- 4.2	1546	8.5	16310	13.3
1986	110144	16.2	1493	- 3.4	13555	- 16.9
1987	111580	1.3	1556	4.2	13945	2.9
1988	114163	2.3	1666	7.1	14593	4.6
1989	115567	1.2	1794	7.7	15523	6.4
1990	117560	1.2	1749	- 2.5	14878	- 4.2
% change of aver.1980-84 to aver. 1987-90	11.1%		0.4%		- 9.8%	

Sources: The Economic Survey/ Hali Ya Uchami, several issues and Bureau of Statistics/ Planning Commission: National Accounts of Tanzania 1976-1991, DSM 1992.

is worth emphasising that the limitations of available data do not permit productivity and real wage to be computed on exactly the same comparable basis (so that, the idea of labour cost per unit of output cannot be applied readily). Thus, real wage is derived by deflating with the national consumer price index at 1977-prices, while the productivity of labour is computed at factor cost at 1976 prices. Never

theless, the two tables 4.8 and 4.9 together are particularly revealing.

Table 4.9 suggests a more or less stagnating to slightly declining labour productivity in manufacturing — a trend which might be somewhat less marked since 1987. (But this is tentative, and too much significance should not be attached to it).

Thus, with or without the import support programme sustaining liberalisation, the overall picture of the manufacturing sector in Tanzania is dismal, from the point of view of both labour and capital. Real wages fell dramatically, while employment increased very little during the decade of the 1980s. Labour productivity also stagnated or fell slightly during the same period. With more or less stagnant productivity and sharp decline in real wages, the rate of return on investment improved somewhat, from negative real rates until 1985 to modest positive rates, which seem unsteady and with a tendency to decline towards the end of the decade. But even the modest gains in profit has been brought about by a further squeeze on the real wage rate and not by productivity gains. Since the real wage rate is probably already close to the subsistence level, this process cannot continue much further. In short, if the present strategy of general import support and economic liberalisation is to succeed in the manufacturing sector in Tanzania, it must focus on labour productivity rather than on real wages as the strategie variable. This must be the route to improving the "climate for investment" through higher profitability. And it is precisely on this future course of labour productivity that much of the future success of "structural adjustment" in the manufacturing sector would depend critically.

5. Public finance and the consequences of import support and counterpart revenue on the internal and external economic balance

5.1 Government budget deficit and external balance

The equality between expenditure and income, common to all national income accounting, was introduced earlier in the context of an open economy (see section 4.2). This accounting equality between expenditure and income in an open economy also links the internal and external sector of the economy (see equation 4.1), i.e.

$$I - S = M - E = A$$

to show the ex post or statistically realized identity between domestic savings imbalance on the left hand side matching external trade imbalance on the right hand side. Further decomposing investment and savings by the government and the private (including all corporate) sector, the internal savings imbalance on the left hand side of (4.1) takes the form,

$$(I_g - S_g) + (I_p - S_p) = (M - E) = A \quad (5.1)$$

Thus, the government excess spending measured by $(I_g - S_g)$ equals the trade deficit, if the assumption is made that private expenditure and income are balanced, i.e.

$$(I_g - S_g) = (M - E), \quad \text{if } I_p = S_p \quad (5.2)$$

Pursuing this line of reasoning further, equation (5.2) may be more explicitly related to the budgetary operations of the government. Writing G = total government expenditure as consisting of recurrent expenditure, C_g (government consumption) and development expenditure or investment, I_g, we have,

$$G = C_g + I_g.$$

If R is the recurrent government revenue from tax and non-tax sources, then government savings S_g, by definition, becomes $S_g = R - C_g$
and hence,

$$(I_g - S_g) = (G - C_g) - (R - C_g) = G - R$$

which may be substituted in equation (5.1) to obtain,

$$(G - R) + (I_p - S_p) = (M - E) = A \quad (5.3)$$

Disagreement about the underlying macroeconomic causal mechanism for interpreting the identity resulting from (5.1) to (5.3) is wide among economists. Often referred to as the "twin deficit" problem — the budget and the trade deficit — the underlying mechanism depends on the macroeconomic structure. A very common interpretation of this mechanism, which assumes special relevance in the present context because it is stated explicitly by the Report of the Presidential Commission of Enquiry into Public Revenues, Taxation and Expenditure (URT 1991, esp. pp. 73-74) runs in the following manner: higher deficit spending by the government financed by borrowing from the banking system results in expansion of money supply. "By pumping more money into the economy the government creates inflationary pressure ("too much money chasing too few goods") and pressures on the balance of payments, as excess demand spills over into demand for imports" (ibid.: 74). Thus, in this argument, an explicit, direct connection is made between the government budget deficit (i.e. the first bracketed deficit on the left hand side of equation (5.2)) and an expansion in the monetary base of the economy which in turn leads to inflation and trade deficit. This is also broadly the thinking of the multilateral Bretton Woods institutions.

This conventional argument, with strong emphasis on the role of the supply of "base money", as the fundamental causal mechanism, is essentially "monetarist" in nature. It visualizes the expenditure behaviours in the economy, both in the government and in the private sector, as following directly from an independent and exogenous supply of monetary aggregates. Thus, the government's decision to run a deficit leads to a potential increase in money supply through the creation of high-powered money i.e. due to the "monetization" of government deficit by the Bank of Tanzania (BOT) in some form. However, this line of reasoning tends to overlook the issue, as to whether this increase in potential money supply through deficit spending by the government would be actually utilised by the private sector and lead to a corresponding increase in actual spending by the private sector. Obversely, the lowering of the ceiling to potential money supply may not lead to a corresponding reduction in the credit advanced by commercial banks. This problem is especially relevant in the monetary system of Tanzania.

The lack of separation of authority among the government and the BOT and the commercial banks makes the money supply including credit from the commercial banks largely endogenous, i.e. it responds accommodatively to the expenditure decisions by the government, including the parastatals. This basically tends to make the credit advanced by commercial banks to the parastatals (and the government) largely demand-determined, probably subject to government approval. Thus, a demarcation of legal authority bet-

ween the Central Bank and the commercial banks which, in turn, underlies the distinction between the "high-powered" monetary base and the monetary aggregate, linked together by the "credit multiplier" of the fractional reserve system, cannot be taken for granted in the case of the present Tanzanian monetary system. The behaviour of the monetary aggregate would not necessarily bear any systematic relation with the monetary base, so that a contraction of the latter does not necessarily imply a contraction of the former (see chapter 3, table 3.4). This would also mean that the "transmission mechanism" from government budget deficit monetised by the BOT to total money supply and, form total money supply to aggregate expenditure (through a constant "velocity of circulation" of money) may fail to operate in the Tanzanian context. While excess aggregate expenditure may spill over to trade and payments deficit — which is one way of interpreting equation (5.1) — it may not be valid to assume that aggregate expenditure is guided by potential money supply which, in turn, is influenced strongly by the government budget deficit.

Table 5.1 shows the revenues and expenditures of the Central Government for the period 1981/82 to 91/92, (with the 1991/92 figure as provisionally estimated). It may be noted in table 5.1 that there is significant difference in later years between expenditure committed by the government (e.g. measured by promises or cheques issued) and expenditure realized in cash payments. The difference between the two, considered as the item of expenditure float, remains unreconciled from 1986/87 onwards in the Tanzanian central bank statistics. It seems theoretically more satisfactory to include expenditure float, and measure budget deficit on the basis of committed expenditures, rather than realized payments.

When the government budget deficit, with or without "expenditure float" is compared with deficit on trade plus services account in table 5.2, both are seen to increase over time (except 1985). Interestingly, the government budget deficit tended to be higher than the trade plus service account deficit in some earlier years of 1983 and 1984 implying from equation (5.1) that the non-government or private sector was then a net saver. Thus, the deficit of the government, (Ig - Sg) was partly compensated by the surplus of the private sector (Sp - Ip) in equation (5.1). However, this feature is no longer observable in the later years when, both the government and the private sector became net dissevers so that, in terms of equation (5.1), the deficit on trade and service account becomes considerably larger than the government budget deficit. In particular, with the increasing quantitative importance of import support counterpart revenue over time as a support to government revenue (see table 5.5 below), the budget deficit of the government tended to be somewhat more controlled. Despite this, the large trade plus service deficit implies from equation (5.1) that the private sector (including the parastatals) was involved on an increasing scale in excess spending over income.

Table 5.2 suggests an interesting pattern. The increasing availability of IS counterpart revenue as budgetary support (see also table 5.5) reduced the extent of government budget deficit by providing extra revenue. But this extra government revenue, which is also expected to be a transfer of domestic purchasing power from the private sector through counterpart fund payments, did not seem to have dampened significantly expenditure by the private sector, in so far as table 5.2 also indicates a sharp rise over time in excess spending (deficit) by the private sector. This also

Table 5.1 Central government finances (TShs. billion)

Year	81/82	82/83	83/84	84/85	85/86	86/87	87/88	88/89	89/90	90/91	91/92[a]
Total expenditure, G of which	17.4	19	20.4	28.5	31.7	40.7	65.5	94.9	123.8	183.9	232.4
Recurrent expenditure, Cg	12.9	14.6	15.9	21.5	23.9	34.5	56.2	81.8	111.8	162.3	194.3
Development expenditure, Ig	4.5	4.4	4.5	7.0	7.8	6.2	9.3	13.1	12.0	21.6	38.1
Recurrent revenue from sources tax and non-tax, R	9.4	12.6	13.5	18.6	22.0	29.3	47.5	70.4	97.9	137.1	176.6
Deficit on cash payment (without sign) |R-G|	8.0	6.4	6.9	9.9	9.7	11.4	18.0	24.5	25.9	46.8	55.8
Deficit on committed expenditure, (includes expendure float), without sign	8.0	6.4	6.9	9.9	9.7	18.5	27.8	35.7	43.0	70.1	n.a
Government savings, (R-Cg)=Sg (on cash basis)	- 3.5	- 2	- 2.4	- 2.9	- 1.9	- 5.2	- 8.7	- 11.4	- 13.9	- 25.2	- 17.7

a) Estimates
b) Total expenditure on cash (without expenditure float)
c) Underestimated in so far as government consumption is on cash payment basis, and, not on committed expenditure.
Sources: Bank of Tanzania, Economic and Operations Report, 1991 supplemented by the Economic Survey, and Budget Speeches (various issues) and Planning Commission/Min. of Finance: Tanzania, Public Expenditure Data, August 1992 (Draft), Dar es Salaam.

Table 5.2 The pattern of government and private deficit implied in external deficit (TShs billion)

Year	1983	1984	1985	1986	1987	1988	1989	1990
Trade plus service deficit1)	- 5.1	- 7.9	- 12.9	- 26.1	- 66.1	- 99.0	- 146.1	- 218.1
Government budget deficit by committed expenditure (i.e. with float)2)	- 6.9	- 9.9	- 9.7	- 18.5	- 27.8	- 35.7	- 43.0	- 70.1
Private deficit3)	+ 1.8	+ 2.0	- 3.2	- 7.6	- 38.3	- 63.3	- 103.1	- 148.1

Sources:
1) Bank of Tanzania, Economic and Operations Report, various issues.
2) Table 5.1.
3) Computed as residual with the aid of equation (5.1). Includes the corporate sector, also with parastatals.
    (+ = surplus, - = deficit)

tends to strengthen our hypothesis, substantiated in chapter 3 and mentioned at the beginning of this section, that usual instruments of restrictive monetary policies in Tanzania might have affected more significantly the credit ceiling (i.e. the potential maximum credit advancable) but not equally significantly the credit actually advanced to the non-government sector.

5.2 The government deficit, import support counterpart revenue and pattern of tax collection

It will be noticed from the last row of table 5.1 that, throughout the decade of the 1980s, the government has been a net dis-saver, even on the more conservative estimate of cash realized rather than committed expenditure. Table 5.3 constructed from table 5.1 emphasizes the same point in terms of the government budget deficit. The deficit (without expenditure float) viewed as a share of government realized expenditure has been about 25% on average since 1986, which is lower than the average of the first half of the 1980s.

However, measured as percentage of government committed expenditure (i.e. with expenditure float) the deficit has remained fairly steady at about 1/3 throughout the 1980s. Statistically speaking, no clear break in trend is visible, since large-scale IS and counterpart revenue financing began from around 1986/87. Thus, the budget deficit continued to account for approximately 1/3 of committed government

expenditure each year, both before and after the IS scheme. (Note the two measures of deficit with and without expenditure float are reconciled up to 1985/86 in table 5.3).

Analytically speaking, in the light of our income-expenditure balance equation (5.3), the critical issue is not the absolute size of the government expenditure, but the size of the budget deficit. As seen from both tables 5.1 and 5.2, the absolute magnitude of the budget deficit has been increasing steadily in nominal terms throughout the decade. However, some preliminary estimates given in table 5.4 on the basis of revised time-series at 1976 prices, suggest that the inflationary effect (including devaluation) has so strongly eroded the value of the domestic currency that in real terms (at 1976 prices) the size of the budget deficit may not have changed significantly (especially when the two extreme years 1981/82 and 1990/91) are excluded. However, this may to some extent involve macroeconomic circular reasoning, in so far as higher budget deficit, by fuelling aggregate demand, may itself be an important cause of inflationary price rise.

Therefore, the operational issue largely boils down as to whether the particular methods of financing the budget deficit has had a strong influence on determining the size of the deficit. Available statistics on the import support counterpart revenue suggest unambiguously the growing importance of this source. Table 5.5 provides summary statistics, where a definite break in trend can be seen from 1986/87, as IS counterpart revenue began to accrue to the govern-

Table 5.3 Behaviour of budget deficit in relation to total government expenditure (in percent)

Year	81/82	82/83	83/84	84/85	85/86	86/87	87/88	88/89	89/90	90/91	91/92
Deficit as percent of total expenditure (without expenditure float)	46	34	34	35	31	28	27	26	21	25	24
Same measured (with expenditure float)	46	34	34	35	31	39	37	34	31	34	n.a.

Sources: As table 5.1

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Table 5.4 Estimated real value of government budget deficit (in 1976 prices). TSh. billion

Year	81/82	82/83	83/84	84/85	85/86	86/87	87/88	88/89	89/90	90/91
Real (1976 budget-prices). Deficit, D	4.1	2.5	1.8	2.2	2.3	3.1	2.5	2.5	2.2	5.4
Real deficit as prop. (%) of current price deficit	51.3	39.1	26.1	22.2	23.7	16.8	9.0	7.0	4.9	7.7

Sources: As table 5.1.

ment in a major way. With 1986/87 as the water-shed, the counterpart revenue as a proportion of the budget deficit rose from an (unweighed period) average of 12.3% during 1981/82 to 1985/86 to 57.1% during 1986/87 to 1990/91. This dramatic increase in the average ratio of counterpart revenue to budget deficit was naturally associated with an even sharper increase in the marginal ratio for the period 1981-91 i.e. increments in the budget deficit in each succeeding year was increasingly (except 1990/91) being financed by simultaneous increment in counterpart revenue.

Although the increasing quantitative importance of counterpart revenue in the financing of average and marginal government budget deficit need not necessarily have any causal significance (i.e. availability of larger counterpart revenue may not have "caused" larger deficit in any way), there is circumstantial evidence to suggest that counterpart revenue might have become increasingly a "soft option", substituting for the resource mobilisation efforts by the government in some ways (see also section 4.3 on the role of resource mobilisation in the growth process of Tanzania during the 1980s). The regression results based on data in Table 5.5 between annual incremental budget deficit (ΔD) and annual incremental counterpart revenue (ΔCR) (incremental values are taken to eliminate rising linear time trend in both variables that might otherwise lead to spurious correlation) suggest an association which is sufficiently strong so that, a causal connection between the two variables cannot be ruled out.

$$\Delta D = 0.5281 + 1.3738(\Delta CR) \quad R^2 = 0.77$$

Or, with explicitly the time trend and absolute levels of the variables, we obtain the following regression of government expenditure (G) against counterpart revenue, significant at 0.5% level:

$$G = 632,605 + 2.56 \ (CR) - 315.9 \ (year), \quad R^2_{adj} = 0.74, \ DW=1.84$$
$$(5.01) \quad (-2.65)$$

More telling "circumstantial evidence" regarding the slackening of resource mobilisation efforts comes probably from an analysis of the pattern of resource mobilization by the government. It is to be noted from the last column of table 5.6 that (like in many other developing countries) the general administrative weakness of the tax collection machinery is evidenced by the relatively small and declining contribution made by direct taxes in total tax revenue. The government relies increasingly on indirect taxes as the administratively easier option of tax collection. More interestingly, direct tax collection in total tax revenue seems to show (the data is not entirely reconciled from various sources in Tanzania on this point, but the overall trend is qualitatively valid) a decline from around 1987/88, around the same time (1986/87, with one year lag) that IS counterpart revenue assumed great quantitative significance in government budgetary support. At the same time, table 5.6 also shows that the pattern of direct tax collection relies heavily on the corporate sector and does not depend so much on personal income. Moreover, within the corporate sector, the share of parastatals has been increasing steadily since 1986/87.

The overall pattern of tax collection in Tanzania seems to be moving towards an administrative "soft option". Tax collection from the parastatals is easier to administer; and it is administratively easy to tax indirectly some mass con-

Table 5.5 Import support counterpart revenue (CR) in relation to government budget deficit (D) (Billion TShs at current prices in percent)

Year	81/82	82/83	83/84	84/85	85/86	86/87	87/88	88/89	89/90	90/91
Budget defict D (including expenditure float)TShs bill.	8.0	6.4	6.9	9.9	9.7	18.5	27.8	35.7	43.0	70.1
Import support counterpart revenue, CR. TShs. bill.	1.0	0.8	0.6	1.2	1.5	8.0	12.9	20.9	31.1	45.6
Average (%) ratio of counterpart revenue to budget deficit, CR/D	12.5	12.5	8.7	12.1	15.5	43.2	46.4	58.5	72.3	65.0
Marginal ratio (%) of counterpart Revenue to Budget Deficit, $\Delta(CR)/\Delta D$	n.a	12.5	- 40	20	- 150	73.9	52.7	101.3	139.7	53.5

Sources:Previous tables 5.1 to 5.3 and Bank of Tanzania, March 1993.

Table 5.6 Resource mobilization pattern: Corporate tax collection as percent of direct tax and total tax revenue. Percentages

Year	Parastatal share in direct tax	Private companie s share in direct tax	Total corporate tax in total taxes	Other direct tax in total taxes	Direct tax as percent of total tax revenue
1981/82	37.5%	25.0%	62.5%	37.5%	33.5%
1982/83	44.7	15.8	60.5	39.5	35.0
1983/84	36.6	16.5	53.1	46.9	33.6
1984/85	35.6	22.2	57.8	42.2	29.8
1985/86	43.6	19.6	63.2	36.8	27.8
1986/87	29.6	27.0	56.6	43.4	32.9
1987/88	41.8	22.3	64.1	35.9	24.9
1988/89	44.8	21.9	66.7	33.3	22.7
1989/90	45.2	24.2	69.4	30.6	23.9
1990/91	50.6	29.5	80.1	19.9	23.9

Sources: Report of the Presidential Commission of Enquiry into Public Revenues, Taxation and Expenditure, Dar es Salaam, December 1991 pp. 83, 128 and 129 (some data reconciliation between different parts of the report on the basis of Indirect Taxation Reform Study, February, 1991 and Tanzania Economic Trends, July, 1992).

sumption items (e.g. beer and other alcohols, tobacco and a few other consumption items yield together nearly 35% of indirect taxes) without strengthening the machinery for tax collection.

Therefore available evidence does not suggest that the tax net is spreading to new bases, since the ERP began. Its disturbing macroeconomic implications have already been discussed (see section 4.3). We only need to add here that the pattern of sectoral growth brought about by the IS programme increased particularly direct tax collection from the manufacturing sector (where many parastatals operate) as the economic performance of this sector improved somewhat. Nevertheless, the other main sectors contributing to economic growth like agriculture, trade, transport and construction remain largely outside the tax net. Thus, the basic macroeconomic problem with sustaining the current pattern of economic growth in Tanzania, pointed out in our earlier macroanalysis, is reinforced. The main vulnerability of the growth process lies in the weak base for domestic resource mobilization, of which the system of public finance is a most important component. Without considerable strengthening of this aspect of the growth process simultaneously, a more liberalized foreign exchange regime could leave the economy trapped inextricably in foreign aid and debt.

5.3 Government expenditure pattern and counterpart revenue

It was already suggested in the last section 5.2 that "circumstantial evidence" points to the role of counterpart revenue as a "soft option" for the government. It might have, on the one hand, stimulated to some extent the level of budgetary expenditure and, on the other, reduced the immediate need to strengthen the efforts at tax collection. However, apart from influencing the level of government expenditure, counterpart revenue might also have exerted some influence on the pattern of government expenditure. Heavy reliance on counterpart funds as a source of government revenue might lead to greater "accountability" to the donors, which

in turn might, to some extent, modify the expenditure pattern of the government in favour of the donors' preference. This "political sociology of public finance" is somewhat speculative, but may not be altogether groundless in the Tanzanian context.

Table 5.7 presents a broad view of the changing pattern of government expenditure. The almost steady decline in the share of defence expenditure from the beginning of the 1980s was undoubtedly largely governed by extraneous factors. However, there is also a strong negative statistical association (significant at a 0.5% level) between the share of defence in total government expenditure (Gd/G) and counterpart revenue as a proportion of total government revenue, particularly when lagged by one year, (CR_{t-1}/R_{t-1}):

$$\ln. (G_d/G) = 0.15 - 0.24 \cdot \ln. (CR_{t-1}/R_{t-1}), \quad R^2_{adj} = 0.87, DW = 1.59$$

Experimenting econometrically in different ways, we also found significant (at 1% significance level) positive association between expenditure on social services and other purposes and the proportion of counterpart revenue in total revenue. As already mentioned, such statistical association does not mean much about causation, except providing some empirical basis for speculation. However, while it is tempting, it may also be particulary misleading in the present context to speculate too much!

On the other hand, it should be noted that the share of education and health in total expenditure was still lower in 1991/92 - 1992/93 than in the crisis years 1980/81 - 1985/86. A former study of Norwegian CIS to Tanzania concluded that, "Today, the quality of services within education and health in Tanzania has reached a stage where all former investments within these sectors and the significant progress that was achieved, threaten to get lost." (Skarstein et al. 1988b:82). In our view, this is now coming true.

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Table 5.7 Pattern of government expenditure in percentages

Period average	Adm. or general services	Econ. infra. or economic services	Social infra. or education & health	Defence	Public Debt	Rest.
70/71 to 79/80	16.9	37.8	19.5	12.2	7.3	6.3
80/81 to 85/86	21.1	26.7	15.6	12.8	17.7	6.1
86/87 to 90/91	27.2	17.9	10.6	9.8	28.4	6.1
91/92 to 92/93*	25.9	20.8	13.3	7.8	27.7	4.5

* estimated and anticipated
Source: Economic Research Bureau, Tanzania Economic Trends, Vol. 5, No. 1 & No. 2.

Finally, it should be noted that administrative services and public debt servicing have increased their share of total government expenditure. Particularly notable is the increase of public debt servicing from an average of about 7% in the 1970s, to about 28%, or nearly 1/3 of total government expenditure in 1986/87 - 1992/93. This is mainly servicing of debt to the IMF and the World Bank, which is debt that can neither be rescheduled nor relieved. Most of the debt to the World Bank represents government guarantees of onlending to projects which in quite many cases have been running at large losses or failed altogether, such as the cashew-nut processing factories, the pyrethrum factories, the Morogoro Tannery and the Southern Papermill.

6. Problems and deficiencies of Tanzanian economic statistics

Tanzania has comparatively well-functioning institutions for the collection and processing of economic statistics. The official national accounts are compiled in accordance with the UN System of National Accounts. The staff members with the Bureau of Statistics (BOS) carrying the responsibility for this work, are competent professionals. However, there are serious problems of coverage, data collection methods and data presentation which give rise to deficiencies in the statistics. Some of these problems have been aggravated by the economic liberalisation programme. In the following we will discuss some deficiencies which affect data used in this report.

6.1 The agricultural sector

Agriculture accounts for approximately 60% of Tanzania's official GDP. A major weakness of the official agricultural value added (VA) statistics is lack of primary data on probably as much as 40% of production, comprising food crops such as barely and other cereals, sweet potatoes, yam, cocoyam, potatoes, cooking bananas, some other starches, dry peas, lentils and other pulses, shelled groundnuts, vegetables and fruits. These crops are not registered by the Ministry of Agriculture (KILIMO). The Bureau of Statistics (BOS) therefore estimates their volumes from benchmark figures in the 1976/77 Household Budget Survey (HBS) extrapolated by rural population growth. Price data for these crops are based on observations in local markets.

Moreover, there are inconsistencies in recorded data, especially on food production, as reported from various sources. There are two sets of series which originate from KILIMO. One set is compiled by the Crop Monitoring and Early Warning Bureau within the Food Security Unit (FSU). The other set is compiled by the Statistics and Farm Management Unit (SFMU) under the Planning and Marketing Division. The two units carry out the production estimates quite independently of each other.

The SFMU production estimates are derived from the Current Agricultural Sample Survey (CASS) which involves measurement of crop areas and yields in a stratified sample of villages. The survey is not geographically representative, as it is conducted in only two or three regions each year. The SFMU activities have been limited by inadequate funds as well as skilled manpower, and the results of their surveys have usually been two years behind.

The FSU, on the other hand, estimates production by using a methodology known as the Crop Soil Water Specific Balance Model developed by FAO. This methodology uses

weather parameters, mainly amount of rainfall in an area, to modify the crop yield per hectare provided by KILIMO extension officers. The FSU has a country-wide network of reporters who provide weekly reports on the amount of rainfall, crop stage and condition. On this basis, they produce production forecasts, covering the whole of Tanzania.

Table 6.1 SFMU and FSU production estimates for maize and rice 1985786 – 1990/91 (crop seasons) '000 tonnes.

Year	Maize		Rice	
	SFMU	FSU	SFMU	FSU
1985/86	2671	2211	272	356
1986/87	2244	2359	332	419
1987/88	2423	2339	509	400
1988/89	2528	3128	499	467
1989/90	2227	2445	468	481
1990/91	2332	2331	264	406

Source: MDB: Summary Review of Agricultural Marketing, DSM Sept. 1992, pp. 13-14.

Table 6.1 shows SFMU's and FSU's production estimates for the two major food crops maize and rice in the period 1985/86 to 1990/91 (crop seasons). It appears from the table that there have been large and erratic divergences between the two estimates. For example for maize, Tanzania's major food crop, FSU's estimate for 1985/86 was 17% lower than that of the SFMU, while for 1988/89, it was 24% higher. For rice, FSU's estimate for 1987/88 was 21% lower than that of the SFMU. On the other hand, FSU's estimate for 1990/91, was as much as 54% higher than the SFMU estimate. It goes without saying that such differences indicate a week reliability of VA (GDP contribution) estimates for agriculture, Tanzania's by far largest economic sector.

In 1992, the Marketing Development Bureau (MDB) made the following comment on the two sets of estimates:

"It is not MDB duty to judge which set of estimates is more accurate and reliable than the other. However, it is considered that it would be more reasonable if one of the two units formulated and streamlined their methods of data collection and rationalised the activities in order to avoid duplication of work and minimise costs. It should be pointed out that FSU figures are mere forecasts which attempt to provide the probable food situation during the coming twelve months (...). The SFMU figures are issued too late for planning purposes, but they are of historical value" (MDB, June 1992:2-3).

Information on marketing of agricultural crops is compiled and published by the MDB. Until recently, the MDB collected all marketing information on food crops from the National Milling Corporation (NMC) and the cooperatives, and all information on export crops from the cooperatives, the respective crop authorities, and KILIMO.

Especially for food crops, this information is no longer adequate. A large number of private traders have taken over a rapidly increasing share of food crop purchases in recent years. Most of these traders are not registered, and so far the MDB is not in a position to collect information from them. As a consequence, the quality of data on marketed production of foodcrops may be expected to deteriorate in the years ahead. The rapidly declining role of the NMC and the cooperative unions in food crop marketing is indicated in table 6.2. It appears that these institutions' purchases of total crops declined by almost 70% from 1987/88 to 1991/92.

Table 6.2 **Purchases of food crops by NMC and cooperative unions.** '000 tonnes

Year	Maize	Rice	Total food crops*
1987/88	229	43	365
1988/89	154	58	341
1989/90	149	34	254
1990/91	57	23	100
1991/92	99	9	110
% change 1987/88- 1991/92	- 56.8%	- 79.1%	- 69.9%

* In addition to maize and rice: wheat, cassava, millet/sorghum and beans.
Source: MDB: Summary Review of Agricultural Marketing, DSM Sept. 1992, p. 22.

The Bureau of Statistics (BOS) has until recently estimated the GDP of subsistence agriculture on the basis the difference between value of total production and marketed production estimates. The dramatically reduced quality of data on volumes of marketed production has made this exercise meaningless, and the BOS has stopped publishing estimates of subsistence production.

The MDB makes its own assessments of the production data from SFMU and FSU and presents its own estimates on that basis. Although the MDB may be critical to specific annual figures provided by FSU (cf. e.g. MDB, Sept. 1992: 15), they seem in general to adhere to the FSU production forecast data. In addition the MDB collects and publishes data on agricultural producer prices.

For the purpose of estimation the VA of agriculture, the BOS uses the production estimates, based on production forecast data from the FSU, and producer price data provided by the MDB. In order to calculate VA (contribution to GDP), they use data on recurrent costs of production obtained from farm case studies (cf. BOS 1985). These costs of intermediate consumption are assumed to be a constant share of 10% of gross production value of 40 agricultural and 15 livestock products (BOS 1985:4). It is self-evident that such an assumption may involve considerable errors. In its adjusted estimates of VA in Tanzanian agriculture, the World Bank found that the official series at current prices were about 5 to 10% higher than the adjusted ones. One main reason for this is the low estimate of intermediate consumption, averaging 10% of gross output value in the official series (World Bank 1991, Vol. 2:58-59).

The data on investment (fixed capital formation — FCF) in agriculture contains two major components. These are, firstly, reported investments of parastatal and private agricultural estates, i.e. the commercial enterprises within agriculture, such as dairy farms, sisal- and tea plantations etc. And secondly, the BOS makes an estimate of own account construction of rural households. This is done on the basis of cost data from the Household Budget Survey of 1976/77, using the estimate of total own-account construction in that year as a benchmark. The growth rate of own-account construction (at constant prices) is then assumed to be equal to rate of growth of rural population. There is no other estimate of investment in private agricultural holdings. This means that smallholder own account, on-farm investments in e.g. land improvements, storage construction and development of trees such as coffee, cloves, tea, cashewnuts, coconuts, avocadoes, mangoes etc., and more recently, cocoa and cardamon, are practically left out. But most probably, such investments are of relatively great importance for agricultural growth.

The estimates of increase in livestock, which is categorised as increase in stocks, comprise cattle, sheep and goats. These estimates have been made by assuming an annual growth rate of 3.6% for cattle, 5.7% for sheep and 4.1% for goats, based on data available in the 1971/72 Agricultural Census, the HBS 1976/77 and the 1978 Census of Livestock (BOS 1985:25).

Since the economic liberalisation began, officially recorded total gross investments (GFCF) in agriculture declined dramatically, from an average of TShs. 726 mill. at constant (1976-) prices per year in 1983-85, to only 262 mill. per year in 1988-90, i.e. a decline by 64% (cf. Nat. Acc. of Tanzania 1976-1991). This decline of reported agricultural investments was probably mainly due to the lower investments in parastatal agricultural estates as a consequence of the reform measures. Thus, the sharply reduced investments in agriculture in recent years are probably more in appearance than in reality. This also means that our estimates of ICOR for agriculture in 1986-90 may be too low, while, conversely, the productivity of investments may have been somewhat overestimated. On the other hand it should be kept in mind that investments in agriculture are not significant in explaining short-term fluctuations in production. Weather conditions seem to play a far more important role.

6.2 Manufacturing industries
The BOS's estimates of manufacturing value added (VA) are based on figures in the Survey of Industrial Production (SIP), the latest of which is for 1988. The SIPs cover all industrial establishments in Mainland Tanzania with 10 or more employees. Between the SIPs, mainly data for parastatal firms are collected, through questionnaires sent by mail to all parastatals and a small sample of private firms. The VA of the whole manufacturing sector is estimated from this data.

Here it may be noted that the BOS's published statistics on VA in parastatal manufacturing (Analysis of Accounts of Parastatal Enterprises 1981-1990, DSM 1992) and the manufacturing sector as a whole (Nat. Acc. of Tanzania 1976-1991, DSM 1992) show serious inconsistencies. For example, for the years 1983-1985, VA in manufacturing parastatals is reported to account for an average of 55% of total manufacturing VA. For 1988, this share drops to a mere 4%, but for 1990, parastatal manufacturing VA is reported to be 1.7 times higher than VA in the manufacturing sector as a whole! Similar inconsistencies, although of less magnitude, also appear for fixed capital formation. Such aberrations indicate that one or both data sets may contain serious errors.

The BOS's Industrial Census of 1978, also recorded the VA of industrial firms with 5 to 9 employees. Estimates of output for firms with less than five employees are derived from the 1976 input/output study. On the basis of the 1978 Industrial Census data and the 1976 input/output study, the BOS has for all years since 1978 assumed that VA of manufacturing firms with less than 10 employees is about 1/3 of VA in manufacturing firms with 10 or more employees. In other words, VA of the whole manufacturing sector is arrived at by multiplying VA in firms with 10 or more employees by a constant escalation factor of 1.336.

BOS's use of the 1976 I/O study and the Industrial Census of 1978 involves three problems. First, one of these studies did not cover and the other covered inadequately a large group of small establishments with less than 5 employees which may have been growing quite rapidly particularly in the post-liberalisation years after 1986. Second, to the extent that small-scale industries may have grown faster than the industrial sector as a whole due to the economic liberalisation in recent years, this circumstance along with the constant escalation factor leads to an underestimate of the manufacturing sector's contribution to the GDP. And third, the figures for firms with 5 to 9 employees in BOS's Industrial Census of 1978 are grossly inconsistent with the figures in SIDO's Small Scale Industry Census carried out independently of BOS in 1977/78 (cf. Havnevik et al. 1985: 97-99). There is no reason to claim that the BOS census was of lower quality than that of SIDO. However, as pointed out in an earlier study, a cooperation between the two institutions in making one single Industrial Census in 1978, would most probably have meant higher quality of data at a lower cost (cf. Havnevik et al. 1985:116).

To summarise, if anything, it seems that manufacturing VA may have been underestimated in recent years. Inasmuch as that is the case, our estimates of market shares are too low, our estimates of ICORs are too high, and accordingly the productivity of investment may have been underestimated.

The BOS assumes the domestic production of capital goods, except buildings and other construction works, to be negligible, so that almost all requirements of machinery and other capital equipment are met through imports. For this reason, BOS estimates fixed capital formation in the manufacturing sector as imports of industrial capital goods corrected for domestic transport and trade margins (totalling 25%) plus the value of domestic industrial construction works. The method involves two sources of errors. First, there is the possibility of false identification of imported goods, which may lead either to over- or under-estimates of the imports of industrial capital goods. (The World Bank (1991, vol. 2:56) suggests that these figures have been underestimated.) And second, the data on domestic construction activity are not adequate because of bad coverage (cf. Bagachwa 1993). In any event, in March 1993 we were informed by the Industry Division of the BOS that industrial investments for 1990 and 1991 may have been overestimated. A consequence of that would be that we have overestimated the ICOR and, conversely, underestimated the productivity of manufacturing investment for those years in this report.

6.3 Domestic trade etc.

For national accounts purposes, the trade sector has been divided into four subsectors comprising the parastatal trading enterprises, the non-parastatal trading enterprises covered by the Employment and Earnings Surveys, the remaining small trading enterprises and restaurants and hotels.

Data on receipts and expenditures of all parastatal trading and hotel/restaurant enterprises are obtained from them directly, and their VA is estimated as the aggregate of employee compensation and gross operating profits. The 1976 input/output table contains information on gross output and VA originating in private trade, hotels and restaurants. The estimate of gross domestic product at factor cost for 1976 has been projected to later years on the basis of gross output in agriculture, forestry, manufacturing and some other activities (BOS 1985:15). It goes without saying that such an estimation method may involve considerable errors.

In addition comes the problem of a presumably rapid growth of unlicensed and unregistered "informal sector" trading activities in recent year, an issue we will return to in section 6.8.

Our table 4.6, shows that the share of trade, hotels and restaurants etc. in total GDP remained almost constant from 1981-85 to 1989-91, whereas this sector's share of total investment declined by 50% from the former to the latter period. The reason for this probably statistical mirage may be the sharp decline in cooperative union and parastatal trading activities (ranging from Regional Trading Companies to the crop authorities), along with the decline in parastatal hotel and restaurant activity. During our field work we got a clear impression that especially private trading, and to some extent also private hotel & restaurant activities have expanded considerably in recent years. Much of these activities are unregistered "informal sector" businesses which are not covered by the BOS.

Our conclusion, based on impressionistic evidence during the field work, is that the sector Trade, hotels & restaurants etc. has increased its share in GDP as well as in total investments in recent years, quite in contrast to the official data published by the BOS. Also the World Bank (1991, Vol. 2:55) holds that this sector is underestimated in the official national accounts. Inasmuch as this is true, another conclusion would be that Trade and Transport are probably the two most rapidly expanding sectors during the economic liberalisation process presently taking place in Tanzania. (See also section 6.8 on the informal sector.)

6.4 Transport and communications

Again the main problem is the reporting of private sector activities. In order to arrive at VA estimates for these activities, the BOS uses the data for the transport sector in the 1976 Input-Output table as a benchmark. This data is projected to later years on the basis of petrol/diesel consumption and the cost of living index in respect of transport services consumed by urban dwellers in Tanzania Mainland (BOS 1985:17).

Apparently, there has been a considerable increase in transport activity since liberalisation began. Table 4.6, also shows a dramatic increase of Transport in total investment. However, this increase is not associated with any corresponding increase in the sector's share in GDP, which may indicate that the growth of VA in the transport sector has been underestimated since 1986. On the other hand, use of a fixed input/output coefficient in the transport sector based on the 1976 I/O table, should have overestimated VA in the sector when oil prices increased during 1980-86.

6.5 Consumption and domestic savings

Government consumption equals total recurrent government expenditure. For some years, estimates of private consumption have been attempted by combining information from the Household Budget Survey, the Survey of Employment and Earnings (the latest of which is from 1984), and the Population census. However, as a general rule, private consumption in the national accounts has been derived as a mere residual from the formula:

$$Cp = Y + (M-E) - Ip - G, \text{ where}$$

Cp = private consumption
Y = gross domestic product
M = imports
E = Exports
Ip = private investments (private GFCF)
G = total government expenditure.

Also, total domestic savings are derived as a residual from the formula:

$$S = I + (E-M), \text{ where}$$
S = total domestic savings, and
I = total investments (GFCF)

The accuracy of the estimates of private consumption and domestic savings as mere residuals, therefore depends on the accuracy of the other estimates from which they are derived. Moreover, the procedure of residual derivation deprives one of the possibility of checking the accuracy of other estimates. Some of these estimates are discussed below.

6.6 Fixed capital formation

In the government sector, gross fixed capital formation (GFCF) is the difference between total government expenditure and recurrent expenditure, i.e. development expenditure. For the parastatal sector, estimates of GFCF is based on data in the Analysis of Accounts of Parastatal Enterprises, the latest edition of which was published in October 1992. For the economy as a whole, gross fixed capital formation is estimated by escalating imports of equipment and machinery by a trade and transport margin of 25%. The official estimates do not include domestically produced machinery and equipment.. In practice, only buildings and other construction works are accounted for as domestic production of capital goods, measured by their gross output value. This may involve an underestimation of GFCF.
Private investment is estimated as a residual, that is, the difference between total GFCF and GFCF in the government sector and parastatals.

After the abolishment of District and Town Councils in 1972 there was no proper registration of private construction activity. The Household Budget Survey of 1976/77 provided data on volume and costs of residential buildings. Using this data as a benchmark, the BOS has estimated aggregate GFCF in private buildings/construction by marking-up the 1976 figure by the increase in cement production. An index of construction costs has until recently been derived from information obtained from MECCO in Dar es Salaam.

As we noted in section 6.2, there are several possible sources of error in the measurement of GFCF, viz. errors in classification and measurement of value of imports of investment goods and errors in measurement of gross output value in domestic construction activity. The World Bank (1991, Vol. 2:55-56) indicates that gross value of private construction activity as well as imports of capital goods are underreported. This would imply underestimates of GFCF with the consequence that the productivity of investment calculated in chapter 4 of this report may be overestimated.
As already noted, there is no registration of rural own account housing construction. This item is assumed to grow at the same rate as population. Neither is there any registration of changes of quality of rural housing, although casual impression suggests that it has changed significantly in the last 20 to 30 years, with a wider use of burnt bricks, cement blocks and roofings made from corrugated iron sheets.

In section 6.8 we will see that informal sector construction activity has apparently expanded quite rapidly in recent years, which, along with the other factors we have noted, may imply that the actual rate of growth of GFCF in the economy as a

whole has been considerably underestimated. As already noted, this would imply that we have overestimated productivity of investment in chapter 4.

6.7 Tanzania's transactions with the rest of the world

Tanzania's official balance of payments statistics, as presented by the BOT, are shown in table 6.3 for the years 1984-1991. We will discuss some major problems of these statistics which have a bearing on our report.

A first problem is that the Customs Department has not compiled foreign trade statistics comprehensively since 1988. As a consequence, the BOT has in recent years proxied balance of payment statistics by the value of ILs issued for imports and export revenue data from various sources. With regard to the registration of imports, this problem was eliminated when preshipment inspection (PSI) companies in 1992 were assigned a more comprehensive role in reviewing imports and preparing tax assessment notices.

Another major problem is that "own funds" imports, i.e. imports financed by illegally earned forex revenues from smuggling, capital flight, overinvoicing of regular imports, underinvoicing of regular exports, theft of forex etc. are included in the officially recorded imports in table 6.3, whereas the revenues financing these imports, including export revenues, are recorded as private transfer inflows (cf. BOT 1987:11). This should imply an underestimate of exports and correspondingly an overestimate of the trade deficit and the

private transfer inflows.

The BOT estimates own funds imports from the value of ILs issues. From table 6.4 it can be seen that ILs for own funds imports accounted for an average of 31% of the total value of ILs issued in the period 1989-92. On the other hand, the table shows that actual imports were considerably lower in every year than the value of ILs issued. The difference between ILs issued and LCs opened within the OGL facility can explain somewhat less than half of this discrepancy in 1991 and 1992 (cf. table 2.2). The remaining part of the discrepancy may partly be explained by the fact that not all ILs for commodity import support (CIS) are covered by LCs. However, there remains also the possibility that actual own funds imports are somewhat lower than the value of ILs issued for such imports. Bagachwa (1993) assumes that the share of own funds imports in total imports equals the share of own funds ILs in the total value of ILs. On that assumption, we arrive at the estimates for own funds imports in table 6.5, calculated from figures in table 6.4.

The figures in table 6.5 are most probably too low, because we may reasonably assume that the ratio of actual imports to the value of ILs is typically lower for other categories, i.e. the OGL, the free resources and CIS, than for the own funds. However, in the following analysis of the implications of own funds imports for the balance of payments we will use this conservative estimate.

A major problem is to estimate the share of own funds imports which are financed by (illegal) export earnings (and not by illegal and /or legal transfers/remittances). Mbelle and

Table 6.3 Tanzania's official balance of payments 1984-1991 in US $ mill.

	1984	1985	1986	1987	1988	1989	1990[1]	1991[2]
Balance of trade	- 474.40	- 670.60	- 681.20	- 796.80	- 812.18	- 814.90	- 955.70	- 1001.30
Exports (fob)	399.60	328.60	366.30	353.20	380.20	415.10	407.80	408.00
Imports (cif)	- 874.00	- 999.20	- 1047.50	- 1150.00	- 1192.38	- 1230.00	-1363.50	- 1409.30
Balance of services[3]	- 43.20	- 68.10	- 85.10	- 99.10	- 196.05	- 204.59	-162.75	- 152.70
Service receipts[4]	107.40	108.10	110.00	108.60	119.75	122.69	141.10	149.90
Interest payments	- 89.30	- 97.30	- 112.80	- 99.40	- 187.80	- 206.40	-210.10	- 192.10
Other service payments[5]	- 61.30	- 78.90	- 82.30	- 108.30	- 128.00	- 120.88	-93.75	- 110.50
Net transfers	159.50	366.70	473.00	583.00	621.30	652.20	693.50	867.50
Transfer inflows to govt.	100.00	134.40	227.00	272.00	392.70	480.00	539.30	n.a
Transfer inflows to priv. and parast.	80.90	259.90	274.00	338.00	250.30	202.00	184.20	n.a
Total transfer inflows	180.90	394.30	501.00	610.00	643.00	682.00	723.50	975.10
Total transfer outflows	- 21.40	- 27.60	- 28.00	- 27.00	- 21.70	- 29.80	-30.00	- 107.60
Current acc. balance	- 358.10	- 372.00	- 293.30	- 312.90	- 386.93	- 367.29	-424.95	- 286.50
Net medium and long-term loans	- 74.10	- 18.50	- 21.00	- 7.00	39.60	32.30	137.20	} 30.50
Net suppliers' credits	109.80	- 32.00	- 55.40	5.00	- 4.80	- 1.30	-0.55	
Imp. Supp. & net exc. fin.	49.10	60.00	83.00	42.70	100.70	130.00	20.34	
Errors & commissions	114.60	- 32.10	- 96.90	- 8.90	- 6.47	- 42.26	-8.80	- 13.40
Overall balance[6]	- 158.70	- 394.60	- 383.60	- 281.10	- 257.90	- 248.55	-276.76	- 269.40

1) Preliminary estimates.
2) Provisional.
3) Factor and non-factor services.
4) Mainly forex revenues from tourism.
5) Payments for management contracts, dividends to foreign-owned companies, fees to foreign consultants etc.
6) Financed by use of reserves, borrowing from IMF, rescheduling of debt and/or accumulation of payments arrears. (Cf. e.g. BOT 1992:88).
Source: BOT: Economic and Operations Report for 1990 and 1991, and Tanzanian Economic Trends, Vol. 5, Nos 1-2, July 1992.

Table 6.4 Import licences (ILs) issued by lines ("windows") of financing. US $ mill.

Financing "window"	1986	1987	1988	1989	1990	1991	1992
Open general licence (OGL)	0.00	0.00	49.70	167.50	309.97	465.38	482.80
Free resources	333.84	483.36	335.05	358.40	383.25	349.16	433.18
(Net) loans/ grants/credits	199.28	287.82	547.88	399.32	405.59	314.43	362.85
Import support (CIS)	104.80	122.59	167.73	203.63	156.85	63.30	64.07
Suppliers credits	153.88	64.34	68.18	30.00	12.98	8.39	17.07
Export retention	0.70	2.88	8.12	19.29	19.25	4.83	8.40
Own funds	475.56	541.68	638.59	484.31	448.46	493.58	539.16
Barter trade	11.39	13.63	10.06	5.42	2.90	4.83	9.06
Exchange bureaus	0.00	0.00	0.00	0.00	0.00	0.00	38.76
Total value of ILs	1,279.45	1,516.30	1,825.31	1,667.88	1,739.25	1,703.90	1,955.35
Actual off. merch. imports	1048	1150	1192	1230	1364	1409	1520*
Act. off. merch. imports as % of total ILs	81.9%	75.8%	65.3%	73.8%	78.4%	82.7%	77.7%

* Provisional, cf. Minister for Finance: Budget Speech for the Financial year 1992/93, DSM 1992, p. 69.
Source: BOT, Directorate of Import Licensing, March 1992; and BOT: Economic and Operations Report, several issues (figures for off. imports).

Karamagi (1991) assume that about 90% of own funded imports are financed by foreign exchange earnings from illegal exports. Through a compilation of data from studies of smuggling of particular items and of underinvoicing of regular exports, Bagachwa (1993) arrives at the figures presented in table 6.6.

Table 6.6 shows that estimated smuggling and overinvoicing of regular exports in the period 1988-1991, exceeded the value of own funds imports, leaving a considerable amount for net capital flight. On this basis we assume that the whole of estimated own funds imports in table 6.5 are financed by illegal exports and overinvoicing of regular exports. It is worth noting that on this assumption, illegal exports in the period 1986-1991 were about of the same magnitude as regular exports (compare tables 6.5 and 6.3).

By adding estimated own funds imports (table 6.5) to the value of official exports and subtracting them from transfer inflows to private and parastatals (table 6.3), we arrive at the adjusted current accounts in table 6.7. The figures in table 6.7 show that the adjusted trade deficits are between 40 and 50% smaller than the official ones (compare with table 6.3). Most probably, the real trade deficit is even smaller, because our assumptions on own funds imports are quite conservative. This implies, among other things, that we have most probably overestimated net capital inflow and underestimated the share of domestic savings in fixed capital formation in section 4.3. In other words, the picture of domestic resource mobilisation may not be as dismal as we have implied form the analysis of official statistics.

Moreover, the figures for government transfer outflows plus net private and parastatal outflows in table 6.7 may indicate a considerable amount of capital flight from Tanzania which is not "compensated" by own funds imports. The magnitude of capital flight may seem to be in the order of 100 to 200 mill. US $ per year in recent years. However, this phenomenon may also, at least partly, be explained by a possible underreporting of foreign grants inflows to the private and parastatal sectors.

Such a partial explanation is suggested by the fact that Tanzania's official balance of payments statistics cannot easily be reconciled with the World Bank's debt data and OECD's data on foreign grants. Table 6.8 shows total transfer inflows to Tanzania according to BOT. Here it must be recalled that official Tanzanian statistics on transfer inflows comprise own funds imports. In table 6.8 we therefore compare official Tanzanian (BOT) statistics of gross transfer inflows (table 6.3) adjusted for the estimated export financed own funds imports (table 6.5), with OECD's ODA-statistics on inflows of grants net of technical cooperation grants.

Table 6.5 Estimates of own fund imports, 1986-1992. US $ mill.

Year	1986	1987	1988	1989	1990	1991	1992
Own funds imp. US $ mill.	399	411	417	358	352	408	419
Estimated share in total merch. imp.	38.1%	35.7%	35.0%	29.1%	25.8%	29.0%	27.6%

Source: See table 6.4.

Table 6.6 Estimates of illegal exports and underinvoicing of regular exports. Mill US$

Year	1988	1989	1990	1991	Total 1988-91
Mill. US $	384	397	407	434	1622
As % of estimated own funds imports *	92.1%	110.9%	115.6%	106.4%	105.7%

* Cf. table 6.5.
Source: Bagachwa 1993.

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Table 6.7 Current accounts of Tanzania adjusted for own fund imports. Mill US$

	1986	1987	1988	1989	1990	1991
Balance of trade	- 282.20	- 385.80	- 395.18	- 456.90	- 603.70	- 593.30
Exports (fob)	765.30	764.2	797.20	773.10	759.80	816.00
Imports (cif)	- 1047.50	- 1150.00	- 1192.38	- 1230.00	- 1363.50	- 1409.30
Balance of services	- 85.10	- 99.10	- 196.05	- 204.59	- 162.75	- 152.70
Net transfers	74.00	172.00	204.30	294.20	341.50	459.50
Total transfer inflows1)	227.00	272.00	392.70	480.00	539.30	567.10
Total transfer outflows2)	- 153.00	- 100.00	- 188.40	- 185.80	- 197.80	- 107.60
Current acc. balance	- 293.30	- 312.90	- 386.93	- 367.29	- 424.95	- 286.50

1) For the years 1986-1990, equal to transfer inflows to the government, which we assume are correctly recorded.
2) Transfer outflows from government plus net inflows to private and parastatals, which are negative.

Table 6.8 Transfer inflows adjusted for own funds compared to OECD statistics on grants disbursements. US $ mill.

	1986	1987	1988	1989	1990
(1) Off. reported (BOT) gross transfer inflows net of estimated own funds	102.0	199.0	226.0	324.0	371.5
(2) Total foreign grants disbursements net of technical coop. grants, acc. to OECD	483.4	481.1	599.3	533.6	688.6
(3) = (1) - (2)	- 381.4	- 282.1	- 373.3	- 209.6	- 317.1

Sources: cf. tables 1.1, 6.3; and 6.5.

OECD's statistics on annual grant disbursements are based on specific information from all DAC member countries and reconciled with the donors' own foreign aid statistics. There are, therefore, strong reasons to assume that the OECD figures are fairly accurate. Moreover, as we have already emphasised, our estimates of own funds imports, based on BOT's data on ILs for own funds imports, are quite conservative, i.e. most probably in the lower range. Against this background, the persistent negative difference, i.e. item (3), in table 6.8 indicates that Tanzanian official statistics underreport quite considerably the inflows of foreign grants.

One reason for this may be that large amounts of grants circumvent the government budget or any other official registration by being channelled directly to specific projects or to NGOs. To the extent that this is the case, the responsibility for underreporting of grants to Tanzania also rests with the donors. Another partial reason for the discrepancies in table 6.8 may be the fact that the BOT apparently includes all import support, also IS grants under the item in the Capital Account denoted "Import support & net exceptional financing". As a consequence, IS is, firstly, made unidentifiable by being mixed up with another item, and, secondly, the grant component of IS is apparently and quite wrongly included in the Capital Account instead of under the item Transfers in the Current Account.

Yet another problem with Tanzania's official balance of payments statistics is that the figures on net medium- and long-term capital flows (table 6.3) do not confirm the debt flow figures reported in the World Bank's World Debt Tables, cf. table 6.9.

The figures in table 6.9 indicate a considerable difference between the BOT's and the World Bank's data on net debt inflow. For medium- and long-term net inflows (which the World Bank merge to long-term), BOT's annual figures turn out to be between 100 and 200 mill. US $ lower than the World Bank figures (row (4) in table 6.9). The discrepancy does not even disappear if we include import support, (which apparently comprises a considerable component of grants, cf. preceding analysis) and exceptional financing (which seems to be mainly short-term) in BOT's figures for net capital inflow (cf. row (5) in table 6.9). Still, annual net capital inflows to Tanzania in 1985-1990 according to BOT's data are on average close to US $ 100 mill. lower than the World Bank's figures.

One explanation of the above discrepancies could be that BOT's data are on net capital inflow, including direct and portfolio investments, while the World Bank data cover debt flows only. However, according to the IMF statistics which are based on reporting from the BOT, net direct and portfolio investments in Tanzania have been negligible during the period in question (cf. IMF: International Fin. Stat. Dec. 1992: 677).

Hence, the conclusion remains that either the World Bank debt statistics on Tanzania are wrong, or the Bot has underreported considerably net capital inflows. This is all the more surprising, since the World Bank's data is primarily based on official reports from Tanzania to the World Bank's Debtor Reporting System (DRS).

In order to make Tanzania's official balance of payments statistics a helpful instrument of monitoring and planning for the Tanzanian authorities as well as for the donors, the following should in our view be the minimum requirements:

* All foreign grants, with a distinction between IS grants and

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other grants, should be explicitly specified under Transfers.

* Financing of own funds imports should either be explicitly specified under Transfers, or — in our view better — be specified under exports as "own funds exports".

* The Capital Account should specify net multilateral, bilateral and private loan inflows, respectively. In addition, loans for IS should be specified.

6.8 The second economy in Tanzania

In our discussion of own funds imports and other issues in the preceding sections, we have implicitly dealt with aspects of the second economy in Tanzania, i.e. broadly speaking all economic activities which are neither adequately covered by official statistics nor captured e.g. by the tax authorities. Bagachwa (1993) distinguishes between three categories of the second economy, viz. informal, parallel and black market activities. Informal sector units are largely unregistered. They are unrecorded in official statistics, have little or no access to organised markets, to credit institutions and many public services. But the activities as such are not illegal. Parallel market activities involve illegal production and trade of goods and services that are legal in themselves and therefore have an alterative legal market. In most cases, the principal objective of such activities is to reap scarcity rents, as for example in the parallel forex market. Black market activities produce and/or distribute goods and services that are illegal and strictly forbidden by government statutes, such as smuggling, over- and underinvoicing, unlicensed deals in e.g. arms and narcotics, thefts, bribes, etc. (Bagachwa 1993). Many activities may of course involve components of more than one of these categories. For example, own funds imports, which are now legal, are most probably to a large extent financed by illegal activities.

There can be little doubt that the second economy, and maybe in particular its parallel market component has expanded enormously since the early 1980s. A survey carried out in 1990, revealed that in Dar es Salaam, the number of informal sector enterprises was at least three times the level of the mid-1980s. And a country-wide survey of Tanzania Mainland in 1991 showed that the informal sector employed about 2.37 mill. people, or 22% of the total estimated labour force of 10.9 mill. (Planning Commission/Min. of Labour 1992:1-5). One major reason for this rapid growth seems to be the dramatic erosion and compression of formal sector real wages and salaries and the consequent economic hardships for large sections of the population which we discussed in section 4.3 (cf. Bagachwa 1993). This explanation is supported by the findings in the 1990/91 Labour Force Survey, that almost half of the informal sector activity is a secondary activity to formal wage employment or agricultural work in terms of time spent (Planning Commission/Min. of Labour 1992:1-5).

In recent years, both individual researchers and the Tanzanian authorities have attempted to assess the size of the second economy, and in particular the informal sector (cf. e.g. Maliyamkono & Bagachwa 1990; Planning Commission/Min. of Labour & Youth Dev. 1992; and Bagachwa 1993). Some of the important results from a comprehensive study based on survey data for 1991 are shown in table 6.10.

The figures in table 6.10 show that estimated informal sector employment in 1991 was almost four times larger than in the formal sector. On the other hand, value added (VA) in the informal sector was only 32% of formal sector GDP. This implies an extremely low average productivity of labour in the informal sector, which can, however, partly be explained by the large extent of part-time work in this sector.

Some sub-sectors within the informal sector appear to be considerably larger than the corresponding formal sub-sectors. In particular, informal trade/restaurants/hotels has 26 times higher employment and 1.3 times higher value added than in the formal sector. But also informal manufacturing and construction are larger than in the formal sector, especi-

Table 6.9 Net capital inflows according to Bank of Tanzania compared with net debt inflows according to the World Bank. Mill. US $[1]

	1984	1985	1986	1987	1988	1989	1990
(1) Net medium & LT[2] capital inflow acc. to BOT	- 74.1	- 18.5	- 21.0	- 7.0	39.6	32.3	137.2
(2) Net med. & LT capital inflow plus IS and net exc. fin. acc. to BOT	- 25.0	41.5	62.0	35.7	140.3	162.3	157.5
(3) Net LT debt inflow acc. to WB[3]	204	124	197	171	232	176	246
(4) = (1) - (3)	- 278.1	- 142.5	- 218.0	- 178.0	- 192.4	- 143.7	- 108.8
(5) = (2) - (3)	- 229.0	- 82.5	- 135.0	- 135.3	- 91.7	- 13.7	- 88.5

1) Net debt inflow is loan disbursements less principal repayments. All figures exclude IMF purchases /repurchases, since these items are included in the settlement of the overall balance of payments.
2) LT - long-term
3) WB - World Bank. The World Bank makes no distinction between medium and long-term loans which are all categorized as long-term, juxtaposed to short-term loans with an original maturity of one year or less.
Sources: Table 6.3; and World Bank: World Debt Tables 1991-92, Vol. 2, Washington DC 1992, pp.390-91.

ally with regard to employment which is about 4.5 and 4.8 times higher, respectively.

Hence, provided that the informal sector figures in table 6.10 are fairly correct, their inclusion into Tanzania's national accounts statistics involves adjustments both of the estimated size of GDP and of the structure of the economy in 1991. The GDP of the entire economy, including the informal sector, turns out to be 32% higher than the official figures. Most probably, this also implies that actual private consumption is considerably higher than the official estimate. Agriculture accounts for 50% of GDP (at current prices) compared to about 60 % in official statistics. The share of manufacturing in GDP is 6.7%, compared to 3.6% in official statistics. Construction accounts for 3.3%, against 2.5% in the official statistics. And, maybe most notably, trade/hotels/restaurants accounts for 24.8% of GDP, compared to 14.5% in the official statistics. On the other hand, the share of Transport and communications in total GDP is only 7%, compared to 8.2% in official statistics. This means that the strongly increasing share of Transport and communications in total investment, reaching more than 38% at constant (1976-) prices in 1989-91, has not resulted in any corresponding rise of this sector's share in GDP, even when the informal economy is included.

Although the informal sector is characterised by extremely low productivity, it does involve a considerable loss for Tanzanian authorities in terms of resource mobilisation, especially tax collection. Moreover, economic infrastructure services for the informal sector cannot be planned and carried out in a satisfactory manner unless most of the activities within the sector become formal. This points to a paradox. On the one hand, the informal sector in Tanzania is assuming the character of a parasite which uses the infrastructural services without contributing to government revenue. On the other hand, it must also be emphasised that the same sector is essential for providing employment and livelihood to a significant section of the economically disadvantaged population.

6.9 Some concluding remarks

Since the mid-1980s, EUROSTAT of the European Community (EC) and Statistics Sweden, financed by SIDA, have granted technical assistance to the Bureau of Statistics with the objective of improving its overall capacity. The assistance from the EC has focused primarily on the improvement of the national accounts, while the Swedish assistance has paid more attention to the enhancement of computer operations and dissemination capabilities.

The main emphasis of the EUROSTAT project has been improvements and refinements of methodology using existing data sources. More than half a dozen of consultancies have been carried out, but their results have not been incorporated, so far, into Tanzania's national accounts. The World Bank in 1991 noted that the EUROSTAT projects, "are quite ambitious given the available resources" (World Bank 1991, Vol. 2: 67). As we have shown above, essential parts of Tanzanian national accounts have a low reliability, and much of the economic activity going on is not captured by official statistics. In our view, the inadequacy of Tanzanian national accounts data imposes a strong limitation on the EUROSTAT project, and it is questionable whether this project has attacked the most urgent aspects of the problem of national accounting in Tanzania.

In order to make the best possible use of scarce professional and financial resources, any improvement of Tanzania's national accounts statistics should be selective, targeting on defined objectives. To illustrate with specific examples, it would be important to (a) determine and monitor the capacity of agriculture to supply urban areas with food grains (marketed production); (b) identify and broaden the tax base by recording relevant informal sector transactions; (c) collect reliable information for a viable and selective industrial policy; and, (d) make the balance of payments statistics more transparent in order to show how foreign aid affects the Tanzanian economy.

Table 6.10 Employment and value added in the informal sector compared to the formal sector in Tanzania, 1991

	Employment '000			Value added at current prices TShs. bill.		
	Formal sector	Inf. sector	Inf. sector as % of formal	Formal sector	Inf. sector	Inf. sector as % of formal
Agriculture and fishing	108.1	236.4	218.7	358.7	20.4	5.7
Mining and quarrying	5.4	21.7	401.9	7.0	1.2	17.1
Manufacturing	117.6	526.2	447.5	20.7	29.8	144.0
Construction	34.4	163.4	475.0	14.4	10.9	75.7
Trade/rest./hotels	46.7	1213.7	2599.0	83.3	104.7	125.7
Transport/communication	61.3	78.1	127.4	47.0	6.1	13.0
Commodity and pers. services and other	234.6	129.8	54.9	42.4	10.3	24.3
Total	608.1	2369.3	389.6	573.5	183.4	32.0

Note: Employment in the formal sector, except manufacturing, is for 1984, which is the latest year for which we could obtain employment data with break-down on sectors. Manufacturing employment in the formal sector is for enterprises with 10 or more employees in 1990 (cf. Economic Survey 1992).

Sources: Planning Commission/Ministry of Labour and Youth Dev.: Tanzania — The Informal Sector 1991, DSM 1992, pp. 1-6 and 1-14; and Bureau of Statistics/Planning Commission: Statistical Abstract 1990, DSM 1992, p. 45 (employment formal sector).

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This list of references contains publications referred to in the present report, as well as some relevant publications used in the preparation for this study. In the list of references the following acronyms are used:

BOS	Bureau of Statistics
BOT	Bank of Tanzania
DSM	Dar es Salaam
ERB	Economic Research Bureau (at the University of DSM)
GOT	Government of Tanzania
IMF	International Monetary Fund
MDB	Marketing Development Bureau
OECD	Organization for Economic Cooperation an Development
SIDA	Swedish International Development Authority
SPA	Special Program of Assistance to Africa
TAC	Tanzania Audit Corporation
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
URT	United Republic of Tanzania

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04.03:   NORAD, Dar es Salaam. Mr. Jens Claussen, Country Economist.

06.03:   Bank of Tanzania. Mr. Komari, Director of Import Licencing; Mr. Mohando, Manager, import data analysis; Mr. Msami, Foreign Exchange Manager; Mr. Vilato, Director of Exchange Management.

06.03:   Bureau of Statistics. Dr. Komba, Director of National Accounts.

09.03:   Planning Commission. Dr Buberwa, Director, Human Resources Department; Mr. Rweyemamu, Ag. Director Macroeconomic Division.

10.03:   International Monetary Fund, DSM Office. Dr. E. Taha, Resident Representative.

12.03:   National Bank of Commerce. Mr. M. L. Naluyaga, Chief Manager, Derectorate of International Banking.

15.03:   NORAD, Dar es Salaam. Mr. Arild Eik, Embassador and Resident Representative, Mr. Jens Claussen, Country Economist.

16.03:   SIDA, Dar es Salaam. Mr. Bo Westmann, Resident Representative; Mr. Erik Korsgren, Country Economist.

17.03:   Ministry of Industries and Trade. Mr. Ngemera, Director of Industries. Mr. Mshana, Director of Planning.

17.03:   SGS, Dar es Salaam. Mr. J. Rijken, Managing Director; Mr. A. Kessi, Liaison Officer.

18.03:   Bank of Tanzania. Mr. Chacha, Department of Import Licencing; Ms. Machanga, Research Department.

19.03:   Bureau of Statistics. Mr. Komba, Director of National Accounts.

19.03:   NORAD, Dar es Salaam, Debriefing meeting. Present in addition to evaluation team: Jens Claussen, NORAD; Erik Korsgren, SIDA; Darius Mans, World Bank; John Horgan, EC Delegation; Angel Carro, EC Delegation; J. Biswaro, JICA; O. Rothschild, CIDA; Hans Heinsbroek, Netherlands Embassy; E. Taha, IMF Res. Rep.; Mark Wuyats (member of SIDA-financed team), Howard White (member of SIDA-financed team); Paul D. Morris, USAID; Ammon Mbelle, Ass. Professor,

Department of Economies, University of Dar es Salaam.

19.03:   Ministry of Finance. Mr. Odinga.

22.03:   National Bank of Commerce. Mr. Matawalo, Chief Advising Manager for Domestic Banking; Mr. Msoma, Commercial Finance Manager.

23.03:   Metal Engineering Industries Development Association (MEIDA). Mr. A.S. Mohando, Ass. Accountant; Mr. R.B. Kanegene.

26.03:   Tanzania Industrial Services and Consultancy Company. Mr. Kamuzora, Derector General.

26.03:   Bureau of Statistics, Industrial Section. Mr. S. Mbaruko.

EVALUATION REPORTS

Country Studies and Norwegian Aid Reviews

(Most studies are available in English and Norwegian)