FOR AGENDA

SM/84/249

CONTAINS CONFIDENTIAL
INFORMATION

November 6, 1984

To: Members of the Executive Board

From: The Secretary

Subject: Tanzania - Staff Report for the 1984 Article IV Consultation

Attached for consideration by the Executive Directors is the staff report for the 1984 Article IV consultation with Tanzania. A draft decision appears on page 24.

This subject will be brought to the agenda for discussion on a date to be announced.

If Executive Directors have technical or factual questions relating to this paper prior to the Board discussion, they should contact Mr. R. J. Bhatia (ext. (7)3253) or Mr. Basu (ext. (5)6511).

Att: (1)

Other Distribution:
Department Heads

CONTAINS CONFIDENTIAL INFORMATION

INTERNATIONAL MONETARY FUND

TANZANIA

Staff Report for the 1984 Article IV Consultation

Prepared by the Staff Representatives for the 1984 Consultation with Tanzania

(In consultation with the Exchange and Trade Relations, Fiscal Affairs, Legal, and Treasurer's Departments)

Approved by J.B. Zulu and W.A. Beveridge

November 5, 1984

I. Introduction

The 1984 Article IV consultation discussions with Tanzania were held in Dar es Salaam during the period August 27-September 10, 1984. The mission met with the Minister of Finance, Mr. C.D. Msuya; the Minister of Planning and Economic Affairs, Mr. K.A. Malima; the Minister in the President's Office, Mr. A.H. Jamal; and the Governor of the Bank of Tanzania, Mr. C.M. Nyirabu, as well as with other senior officials of ministries and agencies concerned with economic and financial matters. The staff representatives were Messrs. R.J. Bhatia (head-AFR), A. Basu (AFR), E. Kreis (FAD), A. Abdi (AFR), M. Bell (AFR), G. Begashaw (ETR), and Miss M. Simpson (secretary-AFR). The Alternate Executive Director for Tanzania, Mr. E. Mtei, attended the policy discussions.

Tanzania continues to avail itself of the transitional arrangements of Article XIV, Section 2. Selected economic and financial indicators and basic data are shown in Attachment I and summaries of Tanzania's relations with the Fund and the World Bank Group are contained in Attachments II and III. The Fund and the Bank staff have cooperated fully, both in the diagnosis of the situation and in the identification of appropriate adjustment policies. In particular, the Fund staff has shared its macroeconomic analysis with the Bank staff, just as the latter have cooperated with the Fund staff on agricultural policies and rehabilitation of state enterprises.

II. Recent Economic Developments

Since the mid-1970s the economic and financial situation of Tanzania has deteriorated rapidly. Admittedly, during this period Tanzania experienced recurrent droughts, sharp increases in petroleum and other import prices, substantial decreases in export prices, the heavy costs of the Uganda war, and the disruptions in trade, transport, and communications facilities caused by the break-up of the East African Community. While these adverse events contributed to the deterioration, domestic policy adjustments were not far-reaching enough, and in many respects further added to the weakening of the economy, leading to the emergence of an economic and financial crisis that has worsened markedly over the past three years.

Based on preliminary official national accounts data, 1/ real gross domestic product (GDP) declined in each of the past three years, 1981-83, with the overall decrease amounting to about 5 percent (Table 1). The output of most agricultural crops has fallen or remained stagnant, and the export volumes of almost all cash crops decreased over the past three years. In the industrial sector capacity utilization has dropped to exceptionally low levels. With these disappointing trends in the productive sectors, the services sector was the only sector which registered positive growth rates and became increasingly large as a proportion of real GDP. In 1983, however, when the real GDP declined by about 1 percent, even the services sector registered, for the first time in a number of years, a small decline.

The domestic inflation rate, as measured by the official national consumer price index (CPI), accelerated from an average annual rate of 12 percent in 1977-79 to 28 percent in 1980-83. The Government has relied on extensive price controls and on substantial subsidies for foodstuffs to moderate domestic price increases. Nevertheless, as unit costs of domestic production and of imports have risen, administered prices have generally been adjusted upward to at least partially cover the cost increases. This largely explains the rising trend in the official CPI, despite the prevalence of price controls. As cost-based adjustments were markedly inadequate in the case of selected foodstuffs, budgetary subsidies have been substantial. Moreover, the effectiveness of official price controls has varied from region to region. This is particularly true in the case of foodstuffs, since the officially marketed volumes have accounted for a very small proportion of total production. As a result, the open market prices of foodstuffs have exceeded official prices, but their movements are not reflected completely in the national CPI. The increases in the GDP price deflator have been even lower than those in the CPI, as the external terms of trade worsened, and the Government has kept producer prices low and, until recently in July 1984, permitted no increases in wages; thus the average annual increase in the GDP deflator amounted to only about 10 percent during the three years 1981-83, with the increase in 1983 being only 8 percent.

Over the past decade Tanzania's parastatal sector grew rapidly, with public enterprises assuming an increasing role in agricultural marketing and processing, foreign trade, industry, and finance. The operations of the parastatal sector have resulted in persistent deficits. In particular, the major export crop authorities have incurred large deficits over the past three years, because both producer prices and operating costs increased at a time when average export prices fell sharply and the exchange rate was not adjusted adequately. In the case of the cereal

---

1/ These accounts are estimated from partial information and, therefore, should be interpreted with caution.

Table 1. Tanzania: Gross Domestic Product and Agricultural Production Trends, 1973-83

	1973-79 Average	1980 Revised	1981 Revised	1982 Revised	1983 Prel.	1984 Proj.	
		(Annual changes in percent)					
Real gross domestic product (at factor cost)		3.1	-2.6	-1.9	-0.7	0.6	
Agriculture		4.7	-8.0	-5.9	-0.9	1.4	
Manufacturing and mining		-15.8	-16.9	-26.0	-4.0	-5.0	
Other		6.2	3.7	4.0	-0.3	0.7	
		(Percentage share in GDP at factor cost)					
Gross domestic product	100.0	100.0	100.0	100.0	100.0	100.0	
Agriculture	39.4	37.9	35.8	34.4	34.3	34.6	
Manufacturing and mining	10.7	9.4	8.0	6.0	5.8	5.5	
Other	49.9	52.7	56.2	59.6	59.9	59.9	
Volume of officially marketed output	Peak production	1980/81	1981/82	1982/83	1983/84		1983/84 Production as percent of peak production
Export crops		(In thousands of tons)					
Coffee	66.6 (1980/81)	66.6	54.8	53.8	49.5		74.3
Cotton	75.2 (1972/73)	57.2	44.6	42.9	47.0		62.5
Tea	18.5 (1977/78)	17.3	15.9	17.6	15.2		82.2
Cashew nuts	143.3 (1973/74)	64.0	43.2	32.2	47.0		32.8
Tobacco	19.1 (1976/77)	16.8	16.1	13.6	11.0		57.6
Sisal	230.0 (1964)	86.0	72.0	60.6	40.2		17.5
Pyrethrum	6.0 (1966/67	1.9	1.0	1.6	1.4		23.3
Food crops 2/							
Maize 3/	222.5 (1978/79)	104.5	85.4	86.0	70.9		31.9
Paddy and rice	43.7 (1977/78)	15.0	16.6	12.1	13.5		30.9
Wheat	56.7 (1971/72)	27.9	23.1	31.1	28.3		49.9
Cassava	63.2 (1978/79)	7.5	9.2	18.8	30.7		48.6

Source: Based on data provided by the Tanzanian authorities.
1/ Marketed production data relates to crop years.
2/ Officially marketed peak production of food crops from 1971.
3/ Purchases by the National Milling Corporation.

marketing and processing unit, the National Milling Corporation (NMC), financial problems arose, essentially because the final sales prices of cereals and related processed products (mainly maize flour) were not set at levels that covered the increasing costs of procurement, processing, distribution, and overheads. In industry, input shortages and the resulting low rates of capacity utilization have contributed to an escalation of unit costs, while officially determined ex-factory prices have lagged behind. Over the years, as the financial imbalances of the parastatal sector grew, they were financed by heavy recourse to domestic bank credit and budgetary subsidies. In the 1983/84 crop year the combined deficit of the export produce parastatals and the NMC is estimated at over T Sh 800 million. 1/

The central government overall fiscal deficit (excluding grants) has also increased very rapidly through 1981/82, when it reached T Sh 7.9 billion or 16.6 percent of GDP). This deficit declined somewhat to 13.9 percent of GDP in 1982/83, as capital expenditure was cut back and the recurrent deficit was maintained at the previous year's level. 2/ Over the past six years total revenues have grown at an average annual rate of 15 percent, with most of the revenue growth originating from sales and excise taxes. The latter was generated by steep increases in taxes on beer and cigarettes. As a result of the declining trends in average export prices and import volumes, the tight restraints on wages and salaries, 3/ and the slump in industrial production, the taxes on foreign trade and domestic incomes have contributed only marginally to revenue growth; the small revenue increases from these taxes are attributable mainly to improvements in tax collection procedures. Total expenditures recorded a large increase (51 percent) in 1978/79, and since then have grown at an average annual rate of about 11 percent. An important factor contributing to the sharp increase in expenditures in 1978/79 was the cost of the Uganda war, and thereafter it was mainly sizable government subsidies and transfers, especially to the parastatals, that led to further growth of expenditures. Although the growth of outlays for wages, materials, and development was tightly restrained, so that they declined markedly in real terms, the overall fiscal position continued to deteriorate throughout this period, except in 1982/83 when the recorded deficit declined sharply.

To finance its growing fiscal deficits, the Government has had to rely increasingly on domestic bank credit. The Government's annual recourse to domestic bank borrowing increased sharply from T Sh 0.5 billion in 1977/78 (18.4 percent of the deficit) to an average of T Sh 2.9 billion

1/ Comprehensive and up-to-date data relating to the financial accounts of the parastatals do not exist, making it difficult to get an overall financial picture of the public sector.

2/ There is an urgent need to improve the recording and compiling of public finance data on a regular basis to facilitate the derivation of a comprehensive overall picture of government finance operations.

3/ An additional factor was that, when salary increases were granted, tax brackets were adjusted downward.

during 1978/79-1980/81 (46.4 percent of the deficits); subsequently, it continued to rise further and reached T Sh 5.1 billion in 1983/84 (almost 75 percent of the deficit and 23 percent of the beginning stock of money).

While the rate of overall domestic credit expansion has decelerated steadily since 1978 (from 64.5 percent to 16 percent by 1983), most of the credit expansion has been used by the Government and the major parastatals; bank credit to the private sector (other than the parastatals) has shown little or no growth. Reflecting the persistent deficits in the balance of payments, the banking system's net foreign assets declined markedly from about T Sh 1.0 billion at the end of 1978 to a negative T Sh 5.1 billion by the end of 1983. 1/ With the banking system's foreign position weakening and the noted deceleration in overall credit expansion, broad money has grown at increasingly slower rates since 1979, its growth rate having declined steadily from 35 percent in 1979 to 13 percent in 1983. During this period the domestic inflation rate has accelerated, and there has been a marked increase in velocity. At the same time, the interest rates have remained low and consistently negative in real terms. The last major change in the interest rate structure was made effective in July 1982, when the lending rates were increased from a range of 7.5 to 12.0 percent to one of 8.0 to 12.5 percent, while most deposit rates were raised by between 1 and 2 percentage points to between 3.15 percent and 10.25 percent. A few minor adjustments to specific rates have been made subsequently.

Tanzania's deficit in foreign trade and the external current account increased by about threefold in 1978, and thereafter their substantial magnitudes led to a dramatic deterioration in the overall balance of payments (BOP) position, accompanied by increasingly more severe import and exchange controls. During 1978-82, as current account deficits averaged about US$592 million annually, despite a rising trend in net inflows of official grants and capital, the overall BOP deficits averaged about US$138 million and resulted in an almost complete exhaustion of gross official reserves and the accumulation of large payments arrears. Beginning in 1983, a steep rise in external debt-service payments added to the already existing deteriorating trend of declining exports, and compelled the authorities to further curtail the nominal level of imports by over 25 percent to only US$786 million, implying an almost 40 percent reduction in real imports from that of 1980. As a result of such a reduction, the current account deficit was contained to $387 million (compared to $606 million in 1982). Apparently, a substantial amount of external arrears was accumulated. 2/ In 1983, for the first time in many years, net capital

---

1/ The data on foreign assets and liabilities are subject to considerable errors, reflecting the uncertain quality of the data on external payments arrears, external debt, and even the deposits of the domestic banking system with its correspondents abroad.

2/ The data on the balance of payments are also subject to substantial errors in respect of debt service and arrears accumulation. This must be particularly so since 1983, when the increasingly severe foreign exchange crisis has compelled the authorities to resort to ad hoc management of the foreign exchange budget, or seek suppliers and other short-term credits.

inflows declined by nearly $100 million, reflecting both the reluctance of donor countries and institutions to provide support to Tanzania on the basis of the latter's inappropriate policies, and the increasing burden of debt service. On the other hand, reflecting the successful conclusion of a credit to import oil, the net inflow of suppliers' credits increased markedly.

Trends in the export trade have been particularly disappointing. Export earnings remained stagnant around an average level of about US$500 million during 1978-81, and thereafter recorded a markedly declining trend, reaching US$348 million in 1983; the decline in exports between 1981 and 1983 was spread across all major products, with large decreases in the export volumes of coffee, tobacco, sisal, and cashew nuts.

The reduction in imports has been achieved primarily through increasing restrictions on trade and payments. Such restrictions have included the substitution of specific for open general licensing and a reduction in import licenses and foreign exchange allocations. In addition, the authorities have increasingly confined foreign trade in specific goods to specialized public enterprises. Moreover, certain current transactions have been suspended; these principally include tourist allowances (except for religious pilgrimages to Mecca), remittances by residents to their dependents abroad, and dividend payments to nonresident companies.

The exchange rate of the Tanzanian shilling in terms of the U.S. dollar (the intervention currency) was broadly maintained during the 1970s between T Sh 7.2 and T Sh 8.4. Subsequently, after devaluations on March 8, 1982 and on June 6, 1983, the exchange rate moved to T Sh 12.3 per US$1. However, despite those devaluations, in real terms the (import-weighted) effective exchange rate had appreciated in local currency terms by more than 90 percent over the period 1979-83. On June 14, 1984 there was a 36 percent devaluation (in local currency terms) of the rate to T Sh 17 per US$1. Assuming the CPI to have increased by about 15 percent during the first half of 1984, this latest devaluation would still leave the effective exchange rate appreciated by about 60 percent in real terms. Since July 1981 Tanzania has maintained a tax rebate scheme under which Tanzanian exporters may claim rebates varying from 5 to 20 percent of the f.o.b. value of exports, depending on the commodities involved. This practice, which involves payments features, has given rise to a multiple currency practice. Moreover, the authorities are maintaining a foreign exchange retention scheme under which selected enterprises are permitted to retain a part (5-20 percent) of their foreign earnings as a cover for their normal purchases of imported inputs.

Although there is a considerable information gap about the level and composition of external arrears, these are estimated to be in the order of US$500 million (over one year's export receipts), and include payments for imports and other current transactions, suppliers' credits, and long-term debt service payments. Tanzania's outstanding medium- and long-term foreign debt is preliminarily estimated to be close to US$2.8 billion as of end-1983. 1/ Since 1978 the rising trend in net borrowing from official sources was accompanied by sizable supplementary recourse to foreign suppliers' credits. With the rapid build-up of the foreign debt, the related actual debt service payments, including obligations to the Fund, have risen from 18 percent in 1980 to 26 percent of exports of goods and services in 1983. As arrears were accumulated on external debt service payments, the underlying debt service ratio was higher. As presently scheduled, the debt service ratio is estimated at 61 percent for 1984.

With the adoption of the budget for 1984/85 (July/June) the Government announced several major policy decisions regarding the agricultural sector, parastatals, subsidies, and government finance operations. These policy decisions 2/ included, inter alia, the abolition of subsidies for maize flour, pesticides, and fertilizers; substantial increases in agricultural producers' prices (46-55 percent); the elimination of deficits in the operations of the crop authorities and parastatals; the introduction of school fees; the reduction of budgetary subsidies for local governments; and selective tax increases. Concurrently, as mentioned above, the Tanzanian shilling was devalued. The Article IV consultation discussions focused on making a diagnosis of the difficult problems facing Tanzania and on assessing the extent to which the newly announced policies are likely to contribute to an eventual resolution of those difficult problems.

While the authorities and the staff worked in close cooperation to make the consultations as comprehensive as possible, serious weaknesses in the existing economic and financial data base were evident and mutually recognized. The fire that destroyed the Bank of Tanzania headquarters in May this year compounded the already existing deficiencies in data relating to foreign assets and liabilities, external arrears, foreign debt and related service payments, and domestic banking aggregates.

The mission did not attempt a detailed analysis of the medium-term prospects, given the lack of adequate data and the absence of firm intentions of the authorities with respect to medium-term policies. In addition, it appeared to the mission that, in the absence of further corrective policies, the outcome in the medium-term would approximate the trend of the more recent years, including large external imbalances and further accumulation of payments arrears.

1/ The external debt data are highly conjectural. The Tanzanian authorities have engaged a foreign bank to conduct a census of the country's external medium- and long-term debt and have requested Fund assistance to determine the extent of the short-term debt and external arrears. The conclusions of these surveys should become available before the year-end.

2/ The details of these as well as the underlying reasoning, are reported in section III below.

III. Report on the Discussions

1. A general diagnosis

The Tanzanian authorities now recognize that, apart from external and exogenous factors, domestic policies have also contributed toward the negative performance of the economy over the past several years. They have, accordingly, sought to reorient their policies, beginning with the 1984/85 fiscal year (July-June). This reorientation of policy is based on the diagnosis that in the past incentives to agricultural producers had been inadequate, various parastatal authorities had become increasingly inefficient and loss-making bodies, budgetary deficits had escalated, and the exchange rate had been seriously out of line. The Tanzanian representatives stated that the Government had made significant policy changes in these areas, and hoped that, as a result, the past unfavorable trend in production, prices, and the balance of payments would be reversed.

2. Problems and policies affecting domestic production

The Tanzanian authorities stated that, apart from the periodic occurrence of drought, the poor performance of agricultural output over the past five years was also attributable to a combination of four equally important factors. The agricultural sector has suffered increasingly from shortages of necessary inputs (such as fertilizers, pesticides, insecticides and improved seeds), reduced and minimal budgetary allocations for the agricultural sector, increasingly reduced producer prices in real terms, and virtual nonavailability of incentive goods in the rural markets. The shortages of inputs were attributed, by the Tanzanian representatives, to the balance of payments difficulties obliging the authorities to curtail imports. The reduction in the recurrent and investment outlays in the agricultural sector was dictated by the relatively greater emphasis on the development of industry and by the growing budgetary deficits; this has resulted in a deterioration in extension services and almost total absence of supporting applied-research facilities.

The past adjustments in agricultural producers' prices have been kept relatively low out of concern to avoid excessive increases in the cost of living, but still the rate of inflation had accelerated and rapidly eroded the increases accorded in producer prices. Real incentives to producers have therefore been insufficient. The Tanzanian representatives said that more sizable adjustments in producers' prices had not been possible, given the rising operating costs and losses incurred by most of the crop marketing authorities. This problem had been relatively more severe for export crops than for food crops, because the evolution of export prices in the second half of the 1970s constrained the price increases that could be granted (Table 2). Finally, the incentives for agricultural production have been weak, because the rural sector has had virtually no access to incentive goods, as domestic production had suffered due to the inability to procure abroad necessary raw materials and spare parts.

Table 2. Tanzania: Real Producer Prices of Selected Food and Export Crops, 1974/75-1984/85

(In Tanzanian shillings/kg, in constant 1982/83 prices)

	1974/75	1981/82	1982/83	1983/84	1984/85 1/	1981/82-1984/85
	Actual				Projected	Percentage change
Food crops						
Maize	2.04	1.99	1.75	1.76	2.31	16.0
Paddy	2.65	3.05	3.00	3.20	3.47	13.8
Wheat	3.14	2.92	2.50	2.40	2.60	-11.0
Cassava (grade 1)	1.47	0.93	0.90	0.96	1.15	23.7
Sorghum/millet	2.24	1.33	1.60	1.60	1.73	30.0
Export crops						
Cashew nuts	4.28	6.63	5.00	5.61	5.66	-14.6
Cotton (AR)	6.12	4.90	4.70	4.81	4.85	-1.0
Coffee (Arabica)	15.71	19.75	15.09	16.92	19.23	-2.6
Tea	3.02	1.99	2.00	2.24	2.36	18.5
Tobacco (flue)	23.85	16.70	18.00	14.42 2/	14.55 2/	-12.9
Tobacco (fire)	10.40	10.21	11.50	9.21	9.30	-8.9

Source: Based on data provided by the Tanzanian authorities.

1/ Assumes a 35 percent increase in value of consumer price index during 1984/85 crop season.

2/ Estimated total price for tobacco, based on actual advances.

The Tanzanian representatives stated that, as a first step, under the 1983/84 and 1984/85 budgets, the Government had increased the budgetary allocations for recurrent and capital expenditures in the agricultural sector; the larger allocations would be used to strengthen extension services, alleviate transportation bottlenecks, and implement a number of rehabilitation projects for the major agricultural cash crops. They indicated that this was being supported by according the highest priority to providing the agricultural sector with increased foreign exchange allocations to cover, as far as possible, its minimum needs of inputs, equipment, and spare parts.

The Government has also expressed a clear determination to follow a policy of concurrently reducing the operating deficits of the state-owned crop authorities and increasing the real levels of agricultural producer prices. In line with this approach, in July 1984 the Government announced the elimination of all existing subsidies on inputs, and increased agricultural producers' prices by as much as 46-55 percent for various crops. The Tanzanian representatives stated that, after taking into account the increased costs to producers due to the abolition of input subsidies, this implied that in real terms the net increases would average about 5 percent, or about the same size as accorded last year. They indicated that this latest price increase is in conformity with their objective of ultimately raising real producer prices by about 30-35 percent. The latest announced structure of producer prices still appeared to favor food crops in comparison to export crops, at least insofar as returns to labor are concerned. The mission noted that, from the point of view of the balance of payments, the presently high levels of cereal imports and the depressed conditions of production in the export crop sector were essentially matters of equal concern. Under the circumstances, given that labor is the dominant factor constraint to agricultural production, the higher comparative return in the production of competing food products could constrain export production. The Tanzanian representatives, while agreeing with this observation, felt that the present structure could be reviewed in the next round of price increases.

The mission also inquired whether, in view of the decline in agricultural production marketed through official channels, the recently announced increases in producer prices could be regarded as adequate. The Tanzanian representatives remarked that the provision of necessary inputs and incentive goods was also crucial and that until that could be assured, further increases in producer prices would not evoke any significant production response; nor would the proportion of marketed output rise.

As regards the operations of the major crop parastatals, the mission inquired about the timetable for the introduction of the intended reforms and the expected net savings from such reforms. The Tanzanian representatives stated that the precise scope of the reforms and the timetable for their execution was yet to be worked out with the individual ministries concerned. The main element in these reforms was the re-establishment of cooperative unions, which will take over the existing functions of the parastatals between the purchase of the crop from the producer and its delivery to the parastatals. The Tanzanian representatives stated that, taking into account the estimated cost-savings from such reforms, the new (devalued) exchange rate (T Sh 17 = US$1), and the newly announced producer prices, the parastatal authorities concerned with agricultural products should register an approximate financial equilibrium in their operations in the current year. The mission noted that the majority of the reform measures were unlikely to be implemented before the end of the year. Moreover, even if the cooperative unions were able to become operative as scheduled (so far only two have been established), their operating costs would need to be taken into account in estimating the net cost reductions that are likely to be achieved throughout the stage between crop procurement and final sales (to domestic or foreign markets). Thus, the objective of financial equilibrium for these authorities was unlikely to be realized in the current year. 1/ The mission also noted that some of the cost-reductions taken into account in the Tanzanian calculations resulted from the Government taking over some of the loan obligations of the parastatals and that for the public sector as a whole these could have only an accounting significance.

In discussing the problems facing agro-processing and other industrial enterprises in the public sector, two specific issues were raised: the role of official price controls and the need for a broad structural reform of the public enterprises.

The Tanzanian representatives indicated that the coverage of various commodities subject to official price controls had been reduced over the past five years. They agreed that to some extent these reductions had occurred because some of the commodities, especially imported items, were no longer available in the domestic market. Nevertheless, they indicated that official price controls were in most cases applied in a flexible manner. In setting and periodically revising the prices of various commodities, due consideration was given to covering the normal unit costs of production and to allowing reasonable profit margins at the factory, wholesale, and retail levels. In this context, since budgetary price subsidies for cereals have been substantial in recent years, the mission inquired about the authorities' intention, as announced with the 1984/85 budget, to liberalize retail prices of maize flour. It was ascertained that the most recent increase in the retail price of maize flour was based first on an averaging of domestic unit production costs and, relatively lower, unit import costs, and secondly, on covering a part of the NMC's maize flour operating losses by a transfer of its profits from operations in wheat flour and rice sales. In the circumstances, the mission suggested that a more correct pricing policy would be to set the retail prices of cereals at a level that reflects the domestic unit production costs, particularly as the imported cost was

---

1/ On the basis of data provided to the mission, these authorities are likely to register, in the aggregate, about the same level of losses as in the previous year.

administratively determined by the exchange rate fixed by the authorities. The Tanzanian representatives indicated that already the recent increase in the price had been substantial and that a further change in pricing policy, as suggested by the mission, could be considered along with the next budget.

The country's industrial enterprises have been crippled by scarcities of inputs and foreign exchange and by a serious deterioration of capital equipment. Concurrently, their financial position has also steadily weakened. The Government plans to implement, on a case-by-case basis, comprehensive rehabilitation programs in the major industrial enterprises; their main aims would be to improve financial management, and to rehabilitate (and not expand) the existing productive capacity. Interministerial study groups have been set up to formulate appropriate reform proposals. In the meantime, the Government is focusing on alleviating the problems of mainly those productive enterprises which have the potential of generating net earnings or savings in terms of foreign exchange; these enterprises are being accorded the benefit of a foreign exchange retention scheme and/or priority foreign exchange allocations to enable them to meet their minimum input requirements.

3. Demand management policies

The Tanzanian representatives stated that, while the emphasis of the new policies was supply-oriented, the Government also wished to support those policies with appropriate demand management. In that vein the 1984/85 budget included various revenue-raising and expenditure-restraint measures with a view to containing the overall deficit. They noted that for the past several years recurrent expenditures had continued to expand in excess of recurrent revenues, which, together with ongoing development outlays, had increased the overall deficit. As foreign resource availability declined, bank borrowing by the Government increased, with consequent adverse effects on domestic prices and economic development. Accordingly, the 1984/85 budget aims at cutting down on unnecessary expenditures, consolidating the existing basic services and expanding outlays for the productive sectors.

In 1984/85 the overall fiscal deficit as budgeted would increase by nearly 3 percentage points to 15.5 percent of GDP (Table 3). Additional revenue measures, yielding about T Sh 0.8 billion in new revenue (6 percent of total revenue) include increases in various fees (including fees for secondary education) in sales and excise tax, and airport service charges. The growth rate in total expenditure is being limited to about 21 percent, which is mainly accounted for by a 59 percent increase in development outlays and the 30 percent average increase granted in salaries. Taking into account the domestic nonbank borrowing and external loans and grants, the required bank borrowing would amount to T Sh 4.8 billion, or 19 percent of total expenditure and money supply. The Tanzanian representatives stated that these estimates made only a partial allowance for the effects of the devaluation.

Table 3. Tanzania: Summary of Central Government Operations, 1980/81-1984/85

	1980/81	1981/82	1982/83	1983/84	1984/85 2/	
	Actual	Prov. actual	Prov.	Prel. 1/	Budget est.	Staff estimate Incl. deval.
	(In millions of Tanzania shillings)					
Total revenue	8,742	10,101	11,819	13,995	14,809	15,160
Tax revenue	8,139	9,078	11,252	13,407	13,144	14,164
Nontax revenue	603	1,023	567	588	1,665	996
Total expenditure and net lending 3/	14,370	19,182	18,442	20,886	25,250	23,444
Recurrent expenditure 3/	9,656	13,980	14,062	16,174	17,668	17,283
Development expenditure	4,688	5,196	4,359	4,733	7,532	6,111
Net lending	26	6	21	-21	50	50
Overall deficit (checks-issued basis) 4/	-5,628	-9,081	-6,623	-6,891	-10,441	-8,284
Adjustment to cash and other items (net) 5/	-612	1,213	-412	154	--	--
Overall deficit (checks-cashed basis) 4/	-6,240	-7,868	-7,035	-7,045	-10,441	-8,284
Foreign grants	1,870	1,656	1,593	1,234	3,540	2,032
Net foreign financing	832	1,204	970	230	1,424	513
Gross borrowing	907	1,287	1,151	661	2,200	1,289
Repayment	-75	-83	-181	-431	-776	-776
Domestic nonbank financing (net)	620	780	469	507	725	683
Domestic bank borrowing (net)	2,918	4,228	4,003	5,074	4,752	5,056
Memorandum item:						
Bank financing plus adjustment items	2,306	5,441	3,591	4,920	4,752	5,056
Overall cash deficit as percentage of total expenditure	42.4	41.0	38.1	33.7	41.4	35.3
	(As percent of GDP)					
Total revenue	20.1	21.3	23.4	24.4	22.0	22.5
Total expenditure	33.1	40.4	36.5	36.4	37.5	34.8
Recurrent expenditures	22.3	29.5	27.9	28.1	26.3	25.7
Development outlays	10.8	10.9	8.6	8.3	11.2	9.1
Overall cash deficit	14.3	16.6	13.9	12.3	15.5	12.3

Sources: Ministry of Finance; and staff estimates.

1/ These figures are very preliminary, especially recurrent expenditures.
2/ These estimates include: the original budget, supplementary expenditure bills, new tax measures, and adjustments for the devaluation announced in early July 1984.
3/ Includes extrabudgetary expenditures since 1979/80. Expenditure and net lending on checks issued basis.
4/ Before grants.
5/ Increase in checks-cashed deficit (-). Comprises adjustments from checks-issued to checks-cashed expenditure, expenditure minus revenue of the Production Funds, along with unrecorded items.

The mission attempted to re-estimate the budgetary provisions to reflect, first, an adjustment in development spending based on past realization rates and financing patterns, and, second, the net effect of the devaluation using certain restrictive assumptions. The restrictive assumptions made were that only expenditures directly financed by foreign assistance and external debt service payments would increase as a result of the devaluation. It was assumed that the Government would permit no increases in other allocations to offset the increased cost effects of the devaluation. With these adjustments, the overall budget deficit would increase by much less than the official estimate, and would remain unchanged as a ratio to GDP (12.3 percent). The net impact of the devaluation was estimated to be negative, because the overall expenditure increase was much larger than the possible gain in revenues from foreign trade taxes; the latter account for only a small proportion of total revenues and are mainly specific in nature. The Tanzanian representatives remarked that they were yet to assess fully the impact of the devaluation, but that the allowed increases in allocations would be minimal; in any case, no further increase in salaries was to be granted during the current fiscal year.

The mission noted that, notwithstanding the significant revenue effort, the absolute level of the overall budget deficit in 1984/85 would be higher than that realized in 1983/84. Even as a proportion of GDP, given the restrictive assumptions regarding supplementary expenditures in the wake of the devaluation, the deficit is at best likely to remain unchanged when account is taken of the devaluation. The mission inquired whether, in view of the existing financial disequilibria, this was an appropriate stance of the demand management policies. The Tanzanian representatives replied that the increases in tax revenues were of necessity neutralized by the announced increase in wages, which was inevitable, given that no general wage increase was given over the past three years and the substantial increase in the maize price announced with the budget. In a more medium-term context, they suggested that a sustainable reduction in the budget deficit could only come from an expansion of the domestic economy which would increase the tax base. On the expenditure side also, there was considerable inelasticity as allocations were already kept to a minimum and as the debt servicing was assuming increasing proportions of total expenditure. Thus, they expected that if the new stance of their policies could generate the necessary growth response, the deficit ratio should decline perceptibly in the medium term. In the more immediate period, they see little scope to reduce the deficit through discretionary revenue raising or expenditure-cutting measures.

As regards monetary policy, the officially announced targets for expansion of total domestic bank credit and of broad money are about 19 percent and 21 percent, respectively, as compared with increases of 21 percent and 15 percent, respectively, in 1983/84. These targets were viewed as quite restrained when taken in conjunction with the current rate of inflation (about 30 percent). However, the mission inquired whether an adequate margin of credit would remain for the private sector after account is taken of the credit need of the budget and the financial needs of the public enterprises which, as mentioned earlier, could experience operating losses as against the officially assumed equilibrium in their finances. The Tanzanian representatives remarked that they were yet to assess the impact of the devaluation and to examine the financial operations of the state enterprises. If, after this assessment and in the context of an overall financial program, the presently targeted credit limits were found to be inadequate, they could be revised. The Tanzanian authorities were also reviewing their position with regard to the domestic interest rate policy. The mission noted that these rates were in the range of 3.2-7.5 percent for deposits and 8-13.5 percent for lending operations, and therefore substantially negative in real terms. The Tanzanian representatives recognized that there was a case for both raising and rationalizing the structure of interest rates, even though they did not feel that such an action could have a significantly visible positive impact on resource allocation and the savings performance of the economy.

On the general subject of financial statistics, the mission discussed the main problems facing the authorities. Since the fire that destroyed the Bank of Tanzania building in May, the authorities have encountered serious difficulties in reconstructing and preparing the usual monetary statistics for recent months, because many records were destroyed, in some cases irretrievably. In addition, there are unresolved conceptual issues regarding the treatment and classification of various transactions. Finally, there is a long-standing problem of relatively long delays in the reporting systems within various banking and nonfinancial institutions. The problems are particularly serious in the key areas of external debt and arrears, foreign assets and liabilities, and domestic credit, and the authorities have requested Fund technical assistance in an attempt to improve the quality and timeliness of the monetary data.

4. External sector problems and policies

The Tanzanian representatives stated that the balance of payments position remained critical. The substantial (almost one-third) reduction in imports in 1983 had exhausted the stocks of imported goods and shortages of essential inputs and spare parts had forced the economy to come to a virtual halt. For 1984 also, without the benefit of drawing on the stocks, the level of imports would not exceed the (reduced) level realized in 1983, and even this level implied a substantial (about $155 million) additional external assistance and/or a further increase in external payments arrears (Table 4). The Tanzanian representatives noted that since the last year the debt-service payments had assumed significant importance in the balance of payments, and that the ratio of such payments to exports of goods and services is projected to rise further to 66 percent in 1985. In the circumstances, the Tanzanian representatives said, the authorities were making concerted efforts to seek external assistance to underpin their new policies designed to revive the economy.

Table 4. Tanzania: Summary Balance of Payments, 1980-85

(In millions of U.S. dollars)

	1980	1981	1982	1983	1984 Proj.
Trade balance	-724.7	-628.9	-670.1	-438.9	-434.2
Exports, f.o.b.	495.1	529.7	399.7	347.6	383.8
Imports, c.i.f.	1,219.9	1,158.6	1,069.8	786.5	818.0
Services (net) 1/	19.0	70.0	38.9	34.5	4.0
Private transfers (net)	21.8	24.4	25.4	17.3	38.0
Current account	-684.0	-534.5	-605.8	-387.1	-392.2
Government transfers (net)	106.9	154.4	93.9	101.1	101.7
Medium- and long-term capital 2/	166.2	187.7	243.5	144.6	48.3
Government (net)	130.0	167.3	231.3	139.6	63.9
Nonfinancial public (net)	35.6	19.0	10.8	3.7	-10.7
Private (net)	0.6	1.4	1.4	1.3	-5.0
Suppliers' credit (net) 2/	60.5	100.7	35.6	119.8	36.9
Of which: oil credit, net	--	--	--	75.9	19.9
Other capital movements, and errors and omissions	36.8	-9.7	29.9	-40.1	--
SDR allocations	7.0	6.0	--	--	--
Exceptional financing 3/	110.1	111.9	91.7	61.4	50.2
Overall balance	-196.4	16.5	-111.3	-0.4	-155.2
Monetary movements	196.4	-16.5	111.3	0.4	155.2
Arrears (increase +)	147.3	-7.1	105.3	45.2	...
Other reserve movements	49.1	-9.4	6.0	-44.8	...
Of which: Fund purchase, net	9.4	-14.1	-11.5	-26.8	-27.5
Memorandum item:					
Arrears outstanding (end of period)	303.3	296.2	401.5	446.7	...
Debt service ratio (as percent of exports of goods and services					
Excluding Fund	10.3	13.8	12.6	18.9	54.5
Including Fund	17.6	19.3	16.3	26.3	65.6
Index of import prices	100.0	110.2	117.4	110.8	115.2
Index of export prices	100.0	103.8	93.4	93.2	99.2
Terms of trade	100.0	94.2	79.6	84.1	86.1
T Sh/US$1 (average)	8.2	8.3	9.3	11.1	15.0
T Sh/US$1 (end of period)	8.2	8.3	9.6	12.5	17.0

Source: Data provided by the Tanzanian authorities; and Fund staff estimates.

1/ Interest payments on external debt for the period 1980-83 are actuals while those for 1984 are scheduled payments.

2/ Actual amortization payments during 1980-83 are used to obtain net inflows, while for 1984 scheduled amortization payments are included. However, the financing of the overall balance of payments reflects the accumulation of arrears on debt service. Disaggregate data are not available to reflect this discrepancy in the capital account.

3/ These include external assistance obtained in the form of import support (balance of payments support) not related to any specific project.

Given the tight foreign exchange situation, the mission inquired about the extent to which the authorities were relying on regular foreign exchange budgeting procedures to ration the available foreign exchange among alternative priority uses. For 1984 the preliminary estimates of the annual oil bill and scheduled debt service payments suggest that only marginal amounts of the cash receipts of foreign exchange are likely to be available for direct allocation to other uses. The Tanzanian representatives explained that foreign exchange receipts and foreign lines of credit were monitored on a weekly basis, and that, after the immediate payment obligations were provided for, decisions were taken to allocate the remaining resources to various urgently needed priority imports. Apart from this, the essential foreign exchange needs of export-oriented entities are met by permitting them to benefit from the existing foreign exchange retention scheme.

Although useful under the present circumstances, the foreign exchange retention scheme, when regarded as more than a device to allocate foreign exchange, appeared to be deficient in two important respects. First, the share of foreign exchange earnings that could be retained differed among the various entities covered by the scheme. Second, it was believed that at any one time a part of the foreign currency balances of various entities was likely to be idle. The mission noted that both the balance of payments difficulties, as well as the need to maintain the retention scheme, were symptomatic of inadequate policies, including an over-valued exchange rate. In that respect, the mission welcomed the recent depreciation of the Tanzanian shilling as a step in the right direction, but noted that the real effective exchange rate still remained substantially appreciated.

The Tanzanian representatives stated that, unlike in the past, the authorities were now flexible in their attitude toward the exchange rate as an instrument of adjustment policy. They themselves indicated two broad objectives with which exchange rate policy would have to be consistent. The first was to provide adequate real increases in agricultural producers' prices, and the second was to insure that the crop parastatals are able to eliminate their deficits. An added consideration was that exchange rate adjustments by themselves would not have a strong effect on production; such action would have to be supported by adequate supplies of inputs and incentive goods, efforts to alleviate transportation bottlenecks, and improvements in supporting extension services. All these considerations had led the authorities to announce, and to limit the extent of, the recent devaluation.

The mission commented that, while this approach to the determination of the exchange rate had the merit of quantifying the extent of the exchange rate adjustment, at best it was a micro-approach. In the mission's view such an approach to the exchange rate question needs to be supplemented by a more broad-based macroeconomic analysis, taking into account both the perceived degree of noncompetitiveness of the economy and the need to move to a sustainable position of internal and external balance over the medium term. In this context the newly announced exchange rate was still seriously overvalued. But, even apart from this consideration and on the basis of the authorities' own criteria, the present rate would appear to be inadequate. The mission advanced this conclusion on the basis of the data provided by the authorities, which indicated that, after making a realistic assessment of the operating costs of all the marketing entities (both cooperative unions and crop authorities), these would still sustain financial losses at the present exchange rate. Also, as mentioned earlier, the mission's view was that the present level and structure of producer prices needs to be raised and revised, which would have further cost implications for the parastatals. As regards supportive actions, the staff took the position that it would be important to clearly formulate and quantify the rural sector's need for budgetary resources and foreign exchange allocations, setting out the related projects and uses in order of priority. This was inevitably necessary, since the authorities would continue to have to work within a framework of financial constraints.

The Tanzanian representatives rightly foresee that the success of any major economic rehabilitation effort would depend crucially on both domestic adjustment policies and supporting inflows of external assistance. They were hoping that, on the basis of the policies already announced, the international community would respond with additional quick disbursement aid. In their view, were such aid forthcoming and the economy begin to revive, the new orientation of adjustment policies would become politically and socially more acceptable, which then could be further reinforced. Given the extremely tight liquidity position in terms of foreign exchange and the prospective large burden of external debt-service payments, the Tanzanian representatives rightly feel that any immediate adjustment effort would require more concessional balance-of-payments support rather than tied project aid.

The mission did not discuss with the authorities a specific medium-term scenario in the balance of payments, given the extreme uncertainty as to the existing stock of external debt and the extent of payments arrears. However, it did point out to the authorities that, on the basis of present policies, and assuming that minimum import needs of the economy must be satisfied, the external imbalances would be large. Even with a more reinforced policy package, the Tanzanian economy would require a large additional inflow, around $250-300 million per year, over a medium-term period to bring about a sustainable turnaround in the economy.

IV. Staff Appraisal

Economic performance of the Tanzanian economy in 1983 further confirmed the overall deteriorating trend visible during the previous few years. Apart from the services sector, production declined in almost all the other sectors and capacity utilization in several areas fell below 30 percent. The rate of inflation remained very high, as did the overall budget deficit and the related bank financing. Although, of necessity, as exports declined imports were cut by over 20 percent, and the country accumulated external payments arrears which now exceed the present annual value of total exports. In the meantime, notwithstanding the fact that most of the country's external debt (around $2.8 billion) was incurred on concessional terms, total debt service increased markedly in 1983 to 34 percent of exports of goods and services. The likely outcome in 1984 is expected to repeat the developments registered in 1983. In the meantime, the situation in relation to the scheduled debt service would worsen and reach about 61 percent of projected exports of goods and services.

These continued deteriorating trends can only partially be explained by external factors, including adverse weather conditions, and must be attributed also to the inadequate domestic policies which have been expansionary, and the maintenance of an increasingly overvalued exchange rate accompanied by declining (and inadequate) producer prices in real terms. Notwithstanding some corrective policy actions, including a modest real increase in producer prices, announced in mid-1983, the economy failed to respond and the balance of payments difficulties worsened. The proximate reason for the disappointing performance was the severe shortage of necessary inputs and of the necessary consumer goods in the rural sector, but, in the staff's judgment, the ultimate cause continues to lie still in the inadequacy of production incentives, and policies and institutional framework that have failed to divert into the official channels even the current production potential under the existing supply restrictions.

The authorities now appear to have reached the same conclusion and have proclaimed a significant policy reorientation in the context of the 1984/85 budget (July-June). This reorientation is based on a diagnosis of the present malaise that puts emphasis on reviving agricultural production by providing encouragement primarily in the form of the provision of adequate producer prices and incentive goods, while improving the efficiency of the parastatal agricultural authorities, including the parastatal concerned with the marketing of maize. Accordingly, last July, substantial increases in producers prices were announced, and the Tanzanian shilling was depreciated by over 36 percent, in local currency terms. In the fiscal area substantial new revenue measures, including the imposition of school fees, were announced with a view to containing the budget deficit. Increases were also announced in the domestic sales price of maize grain and maize flour with a view to eliminating the losses of the National Milling Corporation. In addition, the authorities are in the process of quantifying various reforms of the parastatals, the broad lines of which were traced in the budget speech. The authorities expect that these policies, supported by appropriate external assistance, would produce the needed revival of the economy; indeed in their view external assistance is almost a prerequisite for continuing with the new direction of policies.

The staff shares the authorities' diagnosis of the situation and considers that they have put the emphasis of corrective actions in appropriate areas--areas which had been highlighted in the previous year's consultation discussions. In the circumstances the staff has assessed these policies in the light of the existing and prospective imbalances and how far these policies would redress those imbalances within a medium-term period. The general conclusion drawn from this assessment is that the announced policies are in the right direction in that they would prevent a further deterioration. However, given the severity of the present situation, the authorities should move further in the directions indicated by the recent policy orientation. Accordingly, the staff would encourage the authorities to formulate and implement more comprehensive and stronger measures in a number of specific areas of economic and financial management to bring about a fundamental improvement in the economic and financial situation. It will also be important to ensure that the policy package by itself has a strong potential of initiating adjustment and recovery, so that whatever external support were to become available would be counted upon only to speed up the rehabilitation process.

In Tanzania the twin objectives of economic recovery and external adjustment could be achieved simultaneously and most effeciently by reversing the past declining trends in agricultural production. In the staff's view, the role of the level and structure of producer prices is critical. The authorities have declared that, as a long-term aim, they would raise the real level of producer prices by about 30 percent, and in pursuit of this aim they have granted a 5 percent real increase in the current year. Given the serious erosion of real producer prices in the past and the current rate of inflation, the pace of adjustment of prices needs to be much faster than that granted by the authorities. Furthermore, the present structure of producer prices appears to provide higher per-labor-unit returns in food production than in export products and needs to be revised so as to be at least neutral in terms of rates of return as between food and export products. Thus, as a minimum, the producer prices of export crops should be increased appropriately and, more desirably, accompanied by further (smaller) increases in the producer prices for food products. The staff believes that while the role of inputs and incentive goods in reviving agricultural production should not be minimized, a further increase in producer prices by itself would evoke higher production and marketing, given the impressive range of crops, the wide diversity of climatic conditions, and the substantial gaps that exist between present and past peak levels of output.

In their framework of intended adjustment policies, the authorities have rightly emphasized the need to eliminate the presently large imbalances in the parastatal sector, and have proposed various reform measures. They believe that, as a result, the overall financial operations of these enterprises in the agricultural sector should be in balance in the current crop year. In the staff's view this implies that the intended reform measures would be in place early this year and that the assumed economies from such measures would not be offset by the necessary costs implied in the creation of alternative bodies, such as cooperative unions. However, the reform measures would have to be worked out with reference to specific enterprises and a determined timetable, and, in the process, one should account for the fact that there would be some costs for alternative bodies. Thus the authorities may have underestimated the required degree of the exchange rate adjustment even for the limited purpose of assuring the financial equilibrium of parastatals, even at the existing set of producer prices. To the extent that, as mentioned above, these prices also need to be raised upward, and the parastatals must generate some operating surpluses to rehabilitate and add to their capital equipment, the exchange rate needs to be adjusted to a much larger extent.

In the recent past the authorities have moved gradually toward a flexible pricing policy, as they have reduced the number of commodities subject to official controls and permitted price increases to reflect increased costs. In the current year even the price of maize, a sensitive food item, was raised following the announced increase in the producer price. The staff would encourage the authorities to make even bolder moves in the direction of liberalization of prices, for various reasons. Firstly, given that the supply of many of the controlled commodities is practically nonexistent, price controls are ineffective. Secondly, even though adjustments in prices are permitted periodically, they tend to be too small and too late, leading to financial losses for enterprises. Finally, price controls generate an uncertainty for productive units which could not be conducive to investor confidence. The authorities should also give serious consideration to the existing marketing mechanism and how far it is appropriate in the light of the needed incentives to production.

To achieve adjustment and economic recovery, fiscal policies would have to be both restrained and adequately supportive of the rehabilitation needs of such key sectors as agriculture and transport. To achieve a significant reduction in the size of the budget deficit relative to GDP it would also be necessary to improve revenue performance, especially through the liberalization of controlled prices. In view of this, demand management policies would have to be supplemented by emphasizing the role of supply-oriented policies, including the exchange rate and the liberalization of controlled prices, in an appropriate adjustment policy package. As regards the 1984/85 budget, the effects of the substantive revenue-raising measures would be more than absorbed by the increases in outlays entailed by the 30 percent increase in wages granted with the budget. Further, once the effects of the devaluation are taken into account, the overall deficit for the year may turn out to be higher than budgeted, even though the authorities were to avoid further wage increases and to adhere to the decision to eliminate subsidies for parastatals.

In recent years domestic credit policy has been primarily geared to covering the sizable financing needs of the Government and the parastatal sector. This policy has contributed to pressures on both the external accounts and the domestic price level. For 1984/85 the envisaged rate of credit expansion does not appear to be unduly expansionary. However, given the credit requirements of the public sector (including parastatals), this target may imply that the credit needs of the private sector may not be adequately met, and, therefore, the credit target may be exceeded. In the period ahead the staff feels that the goal of economic recovery would be best served by insuring that productive activities are allocated adequate credit and by holding the overall expansion of credit within prudent limits to avoid excess demand pressures. Undoubtedly a move in this direction would be greatly facilitated if determined efforts were made to reduce the imbalances in the public sector. Furthermore, given the existing tight financial constraints, the authorities are right in foreseeing the need to adjust domestic interest rates. As these rates are markedly negative in real terms, it would be important to raise them (both loan and deposit rates) and to eventually eliminate the presently negative element in real rates, so as to encourage financial savings and improve resource allocation.

Over the past two years, the balance of payments position has weakened in three respects. Exports have shown a declining trend. The debt service burden has risen very sharply and substantial external arrears have been accumulated. Finally, with the growing foreign exchange scarcity, imports recorded a very substantial drop, causing acute shortages of inputs and bottlenecks in production. What is more disquieting is that, even with a reinforced adjustment policy, the balance of payments would register sizable deficits which would have to be covered by exceptional external assistance. The staff feels strongly that, in these circumstances, a fundamental improvement in the external accounts requires, inter alia, a more sizable depreciation of the exchange rate than was recently made, and thereafter the continuation of a flexible policy aimed at further adjustments in the real exchange rate, taking into account the domestic rate of inflation and the balance of payments developments. The The size of the exchange rate adjustment should fully reflect the need to substantially strengthen agricultural producer price incentives, to restore equilibrium in the parastatals, and the seriousness of the existing balance of payments crisis. The staff also feels that continued reliance on tight import and exchange controls would be a serious impediment to economic recovery, and hence the authorities should consider some liberalization of import controls by expanding the list of commodities covered by the open general licensing system. Furthermore, it would be advisable to modify the existing foreign exchange retention scheme for selected exporters, to allow all exporters to retain a uniform proportion of their foreign exchange earnings and to allow a more liberal use of such retained amounts.

Tanzania maintains restrictions on payments and transfers for current international transactions, including the accumulation of payments arrears, and a multiple currency practice, all of which are inconsistent with the provisions of Article VIII of the Fund's Articles of Agreement. However, the staff believes that, given the immediate potential of the economy, the adoption of comprehensive adjustment policies, including, inter alia, an appropriately flexible exchange rate policy, would permit the elimination of these practices. Accordingly, in the meantime, the staff does not recommend their approval.

V. Proposed Decision

The following draft decision is proposed for adoption by the Executive Board:

1. The Fund takes this decision relating to Tanzania's exchange measures subject to Article VIII, Section 2 and 3, and in concluding the 1984 Article XIV consultation with Tanzania, in the light of the 1984 Article IV consultation with Tanzania conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. The Fund notes that Tanzania maintains restrictions on payments and transfers for current international transactions and a multiple currency practice as described in SM/ / . The Fund urges Tanzania to adopt a more rigorous set of adjustment policies that would permit the elimination of these restrictions.

Tanzania: Selected Economic and Financial Indicators, 1980-84

	1980	1981	1982	1983	1984 Est.
			(Changes in percent)		
GDP and prices					
Real GDP	3.1	-2.6	-1.9	-0.7	0.6
Consumer prices	30.2	25.6	28.9	27.0	35.0
Government budget 1/					
Revenue, excluding grants	13.4	15.5	17.0	18.4	8.3
Total expenditure	-3.0	33.5	-4.0	13.3	12.2
Deficit before grants 2/	-2.9	26.1	-10.6	0.1	17.6
Money and credit					
Total credit	25.4	23.9	19.5	15.8	18.6
Of which: government (net)	(39.0)	(28.3)	(25.3)	(17.5)	(21.3)
Money plus quasi-money	23.4	27.1	20.4	13.1	12.0
External sector (on the basis of U.S. dollars)					
Exports, f.o.b.	-3.7	7.0	-24.5	-13.0	10.4
Imports, c.i.f.	12.2	-5.0	-7.7	-26.5	4.0
Export volume	-11.9	3.2	-11.2	-12.8	3.8
Import volume	-11.9	13.8	-13.4	-22.1	--
Terms of trade	-14.1	-5.8	-15.5	5.7	2.4
Nominal effective exchange rate 3/	1.0	12.7	-4.2	-15.6	...
Real effective exchange rate 3/	23.7	26.7	20.6	2.2	...
			(In percent of GDP)		
Overall government budget deficit 1/	-14.4	-16.6	-13.9	-12.3	-12.3
Balance of payments current account deficit	-13.7	-9.7	-11.5	-8.2	-9.5
			(In percent of merchandise exports)		
External current account deficit					
Excluding grants	138.2	100.9	151.6	111.4	102.2
Including grants	116.6	71.7	128.1	82.3	75.7
External debt service 4/					
Including IMF	10.3	13.8	12.6	18.9	54.5
Excluding IMF	12.6	19.3	16.3	26.3	61.5
			(In millions of U.S. dollars)		
Overall balance (deficit -)	-196.4	16.0	-111.3	-0.4	-155.2
Stock of payments arrears	303.3	296.2	401.5	446.7	...
			(In weeks of imports)		
Gross official reserves	4.3	2.3	1.9	4.1	...

Sources: Based on data provided by the Tanzanian authorities; and staff estimates.

1/ On a fiscal year basis, beginning on July 1 of each year.
2/ Cash basis.
3/ Import-weighted; quarterly averages based on December 1978. Minus is depreciation.
4/ As a percent of exports of goods and services. The figures for 1980-83 are actuals, while those for 1984 are scheduled.

TANZANIA - Basic Data

Area and population

Area	945,100 square kilometers
Population: Total (1983)	19.7 million
Growth rate	3.4 percent

	1980	1981	1982	1983	1984 Est.
	(In millions of Tanzanian shillings)				
Gross domestic product					
At factor cost (constant 1966 prices)	12,035	11,719	11,494	11,412	11,480
Agriculture	4,560	4,197	3,950	3,914	3,970
Manufacturing and mining	1,128	937	693	665	632
Other	6,347	6,585	6,851	6,833	6,878
Gross domestic product at current market prices	40,827	45,949	48,910	52,524	62,245
National consumer price index (1970 = 100)	369.5	464.2	598.6	760.4	1,026.5

	1980/81	1981/82	1982/83	1983/84	1984/85
	(In millions of Tanzania shillings)				
Central government budget					
Total revenue	8,742	10,101	11,819	13,995	15,160
Tax revenue	8,139	9,078	12,252	13,407	14,164
Nontax revenue	603	1,023	567	588	996
Total expenditure and net lending	14,370	19,182	18,442	20,886	23,444
Recurrent expenditure	9,656	13,980	14,062	16,174	17,283
Development expenditure	4,688	5,196	4,359	4,733	6,111
Net lending	26	6	21	-21	50
Overall deficit (checks-issued basis) 1/	-5,628	-9,081	-6,623	-6,891	-8,284
Adjustment to cash and other items (net)	-612	1,213	-412	-154	--
Overall deficit (checks-cashed basis) 1/	-6,240	-7,868	-7,035	-7,045	-8,284
Grants	1,870	1,656	1,593	1,234	2,032
Net foreign borrowing	832	1,204	970	230	513
Domestic nonbank financing	620	780	469	507	683
Domestic bank financing	2,918	4,228	4,003	5,074	5,056

	1980	1981	1982	1983	1984 Est.
Money and credit	(In millions of Tanzania shillings)				
Domestic credit	17,720	21,957	26,234	30,378	36,028
Of which: government	(11,051)	(14,176)	(17,763)	(20,880)	(25,325)
Money plus quasi-money	14,210	18,062	21,753	24,612	27,565

1/ Before grants.

TANZANIA - Basic Data (concluded)

Balance of payments	(In millions of U.S. dollars)				
Trade balance	-725	-629	-670	-439	-434
Exports, f.o.b.	(495)	(530)	(400)	(348)	(384)
Imports, c.i.f.	(-1,220)	(-1,159)	(-1,070)	(-787)	(-818)
Services (net)	19	70	39	35	4
Private transfers (net)	22	24	25	17	38
Current account	-684	-535	-606	-387	-392
Government transfers	107	154	94	101	102
Medium- and long-term borrowing	166	188	243	145	48
Central Government	(130)	(167)	(231)	(140)	(64)
Other	(36)	(21)	(12)	(5)	(-16)
Suppliers' credits (net)	61	101	36	120	37
Other capital movements and errors and omissions	37	-10	30	-40	--
SDR allocation	7	6	--	--	--
Exceptional financing	110	112	92	61	50
Overall balance	-196	16	-111	--	-155
Monetary movements	196	-17	90	-4	155
Arrears (decrease -)	147	-7	105	45	...
Net foreign assets (increase -)	49	-9	6	-45	...
Gross official foreign reserves					
(end of period)	99.8	50.6	38.2	62.1	...
In weeks of imports	4.3	2.3	1.9	4.1	...
External public debt					
Disbursed and outstanding (end of period) (including trade credit)	1,988	2,276	2,556	2,819	2,904
Debt service as percent of exports of goods and nonfactor services					
Excluding the Fund	10.3	13.8	12.6	18.9	54.5
Including the Fund	17.6	19.3	16.3	26.3	61.5
Exchange and trade indices					
Export volume (1980 = 100)	100.4	103.2	86.5	75.4	78.2
Import volume (1980 = 100)	100.8	86.2	74.7	58.0	58.2
Terms of trade (1980 = 100)	100.7	94.2	79.6	84.1	86.1
Nominal effective exchange rate (Dec. 1978 = 100)	90.6	102.1	97.8	82.5	68.6 (June)
Real effective exchange rate (Dec. 1978 = 100)	113.5	143.8	173.4	177.2	159.3 (June)

Tanzania - Fund Relations
(As of September 30, 1984)

I. Membership Status

(a) Date of membership	September 10, 1962
(b) Status	Article XIV

A. Financial Relations

II. General Department

(a) Quota	SDR 107.0 million
(b) Total Fund holdings of member's currency	SDR 139.27 million (130.15 percent of quota)
(c) Fund holdings of member's currency subject to repurchase	SDR 32.25 (30.14 percent of quota)
Credit tranches	SDR 6.50 million
Compensatory financing	SDR 11.50 million
Supplementary financing	SDR 14.25 million

III. Current Stand-By or Extended Arrangement and Special Facilities

(a) Current stand-by	None

(b) Previous arrangements
(i) Two-year stand-by arrangement in the amount of SDR 179.6 million approved in 1980: utilization SDR 25.00 million

IV. SDR Department

(a) Net cumulative allocation	SDR 31.37 million
(b) Holdings	0
Holdings as percent of allocation	-- percent

V. Administered Accounts

(a) Trust fund loans outstanding	SDR 37.91 million
(b) Subsidy account payments	SDR 1.8 million

Tanzania - Fund Relations (concluded)

VI. Overdue Obligations to the Fund (as of September 30)	SDR 7.6 million
(a) Repurchases	SDR 5.1 million
(b) Charges	SDR 0.8 million
(c) Trust Fund repayments	SDR 1.7 million

B. Nonfinancial Relations

VII. Exchange System: The Tanzanian shilling is pegged to a basket of currencies; the middle rate terms of the U.S. dollar, the intervention currency, was T Sh 17.4500 per U.S. dollar as of Sept. 10, 1984

VIII. Last Article IV Consultation

Last Article IV consultation was discussed by the Executive Board on July 11, 1983 (EBM/83/107) the following decision was adopted:

Decision Concluding 1983 Article XIV Consultation

1. The Fund takes this decision relating to Tanzania's exchange measures subject to Article VIII, Sections 2 and 3, and in concluding the 1983 Article XIV consultation with Tanzania, in the light of the 1983 Article IV consultation with Tanzania conductd under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. The Fund notes that Tanzania maintains restrictions on payments and transfers for current international transactions and multiple currency practices, as described in SM/83/125. The Fund urges Tanzania to pursue policies that would permit the elimination of these practices.

Tanzania is on the 12-month cycle for Article IV consultation.

IX. Technical assistance: Members of the CBD panel are serving respectively as advisor to the Governor of the Bank of Tanzania and advisor for bank supervision.

Relations with the World Bank Group and its Economic Assessment

1. Relations

Tanzania joined the Bank, the Association, and the International Finance Corporation in 1962. Beginning with an IDA credit for education in 1963, 58 IDA credits and 19 Bank loans, two of these on Third Window terms, amounting to US$1,116.5 million have so far been approved for Tanzania. Total disbursements amounted to US$750.9 million as of March 31, 1984. In addition, Tanzania has been a beneficiary of 10 loans totalling US$244.8 million, which were extended for the development of the common services and development bank operated regionally by Tanzania, Kenya, and Uganda through their association in the East African Community. IFC investments in Tanzania, totalling US$4.7 million, were made to the Kilombero Sugar Company in 1960 and 1964. Another IFC investment of US$1.7 million in soap manufacturing in Mbeya was approved in 1978 and an investment of US$1.5 million in metal product manufacturing was approved in 1979.

Bank Group lending in Tanzania has been centered on: (i) agriculture; (ii) transport and communications; (iii) industry; and (iv) education and manpower development. Since FY81 new Bank Group lending has been focussed primarily on the rehabilitation and use of existing productive facilities and the introduction of infrastructure and services (such as power generation and education facilities) of long-term use to the economy. Proposed lending during FY84-FY88, including industrial and infrastructural rehabilitation, is projected at US$217 million.

2. Economic assessment

The economy experienced another critical year. Although the economy grew by 1.5 percent in 1983, showing its first positive growth in two years, most of the increase in output was accounted for by the services sector, while output in productive sectors such as agriculture and industry continued to decline. Export revenues were kept up to the 1982 level, mainly due to an increase in the export prices of nearly all commodities, while export volumes of coffee, cotton, cloves, and tobacco fell. Aid flows also declined, and the Government was forced to cut back on imports by 10 percent in real terms over 1982. This resulted in continuing shortages of inputs for agriculture and an industrial capacity utilization rate of about 30 percent. Tanzania's debt burden has reached unmanageable proportions. The Government has recently completed a study of short-term debt with assistance from the United Kingdom. As of December 1983, Tanzania's arrears were $382 million on short-term debt and $60 million on medium- and long-term debt. Debt service on medium/long-term debt averages $175 million per annum over the next three years. The debt service ratio next year could reach 40 percent if there is no improvement in export earnings. The Government has decided to try to reschedule a substantial portion of the import arrears and the debt service falling due. Given that a large portion of the debt is owed to non-Paris Club members, non-DAC countries, and multilaterals, an appropriate rescheduling strategy has to be devised. A suitable debt relief package is, however, unlikely to materialize in the absence of agreement with the IMF, in which case such a package would likely be an integral part of an IMF program.

The recently announced economic policy reforms represent an intensification of a process that was initiated with the adoption of the Structural Adjustment Program (SAP) in July 1982. The most recent measures include a major exchange rate adjustment (35 percent), the second in two years, an increase in agricultural producer prices of between 40 to 60 percent (also for the second time in two years), the conversion of about $150 million equivalent of parastatal overdrafts into long-term loans, and an initiation of a program to improve the efficiency and productivity of agricultural parastatals. Also a serious attempt was made to make the National Milling Corporation (NMC), the parastatal responsible for grain marketing, financially viable through an increase in the consumer price for maize, a decontrol of the price of maize flour (sembe) and a reduction in both its functions and geographical coverage. Our preliminary analysis shows that these pricing changes are an attempt to allow agricultural parastatals as a group to break even, while resulting in an increase of 5 percent in real incomes of export crop producers. These measures together should reduce the need for budgetary transfers to the parastatals, which had amounted to nearly 11 percent of total recurrent expenditures in FY83. The measures also include politically sensitive actions, such as the removal of subsidies on fertilizer and insecticides and the introduction of fees for secondary schools to cover a part of the costs. The 1984/85 budget is thus a recognition of the need to reverse economic policies adopted in pursuit of deeply held political convictions. However, it is at the same time risky since, to a large extent, the success of the budget in meeting its financial targets will be dependent on availability of additional external assistance. Similarly, the supply response in agriculture to the improved incentives is likely to be weak in the absence of an increase in import capability that could finance incentive goods and agricultural inputs.

We welcome the recently adopted measures and, while we had hoped these measures would have been taken earlier, the important task now is to see them successfully <u>implemented</u> and followed through with <u>further action</u> in the future. The success of the measures taken so far will clearly depend upon Tanzania's willingness and flexibility to take further measures on the exchange rate and fiscal policies, and its ability to raise additional external assistance. However, continued progress in the following areas is required:

(a) progressive adjustments in agricultural producer prices in real terms to a level equal to that in 1980. This implies additional real price increases of between 10 percent to 15 percent;

(b) rationalization of the foreign exchange allocation system (e.g., implementation of recently announced foreign exchange retention schemes and separate foreign exchange account for agriculture similar to that under previous Export Rehabilitation Project);

(c) progressive reform of key parastatals with principal aim of reducing functions, thereby increasing efficiency and reducing operating costs, particularly in the agricultural sector (along the lines of the National Milling Corporation), with cooperatives and private sector assuming the main functions of marketing and input distribution; and

(d) preparation of a medium-term public expenditure program covering both recurrent and capital expenditures in the framework of realistic assumptions of resource availability.

Tanzania--Statistical Issues

The Ministries of Finance, Planning, Agriculture, and Industry and Commerce, and the two main financial institutions, the Bank of Tanzania and the National Bank of Commerce, are the principal sources of economic and financial statistics in Tanzania. In addition, for major agricultural commodities, the Marketing Development Bureau and the public enterprises specializing in marketing and/or processing are important sources of crop-based data on production, domestic and foreign trade, and cost-price relationships. By and large, the data cover only mainland Tanzania, with little or no coverage of Zanzibar. In general, the main weaknesses of the available data base are lags in availability (often two to three years), lack of consistency among data series, deficiencies in data classification, and aggregates estimated from a limited coverage of its components. For these reasons, a large part of the data requires adjustments and is in the form of "rough estimates" rather than actual recorded data. Finally, the information gap is particularly serious in a few key areas, including external debt and arrears, foreign assets and liabilities of the commercial banks, and foreign trade indices. There are the following specific problems with the data:

1. National accounts, prices, wages, and employment

Official national accounts data are available with a two-year lag. However, these data have a limited statistical foundation, because of the lack of agricultural output data, the "rough estimate" nature of sectoral value-added components, and the hypothetical valuations attached to the subsistence sector. These data could at best provide some indication of overall trends.

Tanzania publishes a Quarterly National Consumer Price Index (NCPI) which covers 20 urban centers; retail price indices for Dar es Salaam and some other urban centers are also published separately. The most recent NCPI data are up to the first quarter of 1984. The NCPI is of limited usefulness as a reliable indicator of price trends, mainly because it includes prices that are officially controlled or subsidized and does not reflect unofficial (free market) prices.

The employment and wages data available since 1980 are generally estimates. They are of limited coverage, and are not published in IFS.

2. Public sector finance

The available central government statistics include audited final accounts through the 1980/81 fiscal year, provisional actuals for 1981/82 and 1982/83, and preliminary estimates for 1983/84. Summaries of government finance operations that are derived from these data require substantial adjustments before they can be reconciled with banking data on net credit to the Government, and balance of payments data on external debt service, foreign aid inflows, and changes in payments arrears. For recent years only provisional financial accounts are available for major agricultural parastatals; final audited accounts are published with a considerable lag (of about two to three years). The treatment of accounting interrelationships between government finance data and the provisional accounts of the parastatals is weak, particularly with regard to budgetary outlays allocated for covering the parastatals' domestic debt service payments and other operating costs. The lack of comprehensive and current financial accounts for the nonfinancial public enterprises is a major deficiency in public sector statistics. The data published in IFS are not current, with data for 1979 being the latest available.

3. Monetary accounts

The monthly balance sheets of the Bank of Tanzania (BOT) and the National Bank of Commerce (NBC) are available through April 1984, although the reporting of these data for IFS has been infrequent. A fire destroyed the BOT headquarters in May 1984, and since then the preparation of monetary statistics has been disrupted by the loss of data and records. There are also a few long-standing problems with the recording of foreign assets and liabilities. The NBC's foreign asset holdings as shown by its records differ by a large margin from those reported by its correspondent banks. The data on outstanding external payments arrears at the BOT and NBC need to be organized and classified, to identify the nature of the original transactions and the domestic institutions to which they relate. New accounting procedures have been recently introduced at the NBC, and it is planned to respond positively to the authorities' request for Fund technical assistance to improve the quality and currentness of the monetary accounts.

4. Balance of payments and external debt

Reliable trade data on a customs basis are available up to end-1982. For 1983 preliminary export statistics are available and imports were partly estimated on the basis of licenses issued. Other balance of payments data were compiled with assistance of the Research and Foreign Exchange departments of the Bank of Tanzania. There are serious information gaps with regard to data on external debt service, external payments arrears, and, as noted above, foreign reserves. A complete inventory of the external debt and related service payments, broken down by creditor and domestic borrowing entities, is lacking, the authorities are presently working to fill this gap with the help of foreign technical assistance.

5. Coverage, currentness, and reporting of data in IFS

The table below shows the currentness and coverage of data published on the country page for Tanzania in the October 1984 issue of IFS. The data are primarily based on reports sent to the Bureau of Statistics by the Bank of Tanzania, which during the past year have been provided rather irregularly, and, as the table shows, the data are generally not current.

ATTACHMENT IV

		Latest Data in October 1984 IFS
Real Sector	- National Accounts	1982
	- Prices	Q4 1983
	- Production	n.a.
	- Employment	n.a.
	- Earnings	n.a.
Government Finance	- Deficit/Surplus	1979
	- Financing	1979
	- Debt	n.a.
Monetary Accounts	- Central Bank	March 1984
	- Deposit Money Banks	October 1983
	- Other Financial Institutions	December 1983
External Sector	- Merchandise Trade: Values	Q2 1983
	- Merchandise Trade: Prices	Q2 1983
	- Balance of Payments	Q2 1982
	- International Reserves	March 1984
	- Exchange Rates	July 1984