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IMF Concludes Article IV Consultation with Tanzania

The IMF Executive Board on December 3, 1997 concluded the 1997 Article IV consultation[1] with Tanzania.

Background

Over the last decade Tanzania liberalized external trade and payments, domestic prices, and agricultural marketing, but large segments of the economy continued to be dominated by public sector monopolies. Moreover, macroeconomic stability proved elusive. Inflation returned to over 30 percent in 1993/94, and remained above 20 percent in 1995/96, reflecting persistent weaknesses in budgetary management and the impediments to monetary policy posed by the insolvent condition of large state-owned banks and the losses of other parastatals.

In the first half of 1996, the government began to address the fiscal imbalances and structural impediments that had hampered financial management. A crucial step was the effective implementation of a cash management system to keep fiscal expenditures within the limits defined by revenue collections. Later in the year, a three-year program that was supported under the Enhanced Structural Adjustment Facility (ESAF), covering the years 1996/97-1998/99, was adopted. Looking ahead, the program aims to raise the growth rate to at least 6 percent, by raising savings through sound macroeconomic policies, accelerating structural reforms, improving the regulatory framework, and channeling resources to social sector development.

Policy implementation in the first year of the program was good with respect to financial

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[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. In this PIN, the main features of the Board's discussion are described.

performance, and there also was progress in a number of structural areas; however, key parastatal reforms fell substantially behind schedule.

Strong fiscal adjustment was central to the favorable economic performance in 1996/97. The government's recurrent savings moved from a deficit of 0.8 percent of GDP to a surplus of 1.3 percent of GDP, bringing the cumulative fiscal adjustment since 1994/95 to almost 4 percent of GDP. The government was therefore able to reduce its domestic debt in an amount equivalent to 1 percent of GDP. External and domestic arrears amounting to 1.2 percent of GDP were also cleared, although some new domestic arrears were incurred. Government revenue rose to 13.9 percent of GDP in 1996/97, despite the impact on customs revenues of unexpectedly low imports. The boost in revenues reflected a strong performance by the recently established Tanzania Revenue Authority. The wage bill was kept in check, and a large number of civil servants was retrenched. Rigorous application of the cash management system kept cash outlays for goods, services, and transfers within tight limits. Although efforts were made to safeguard outlays for the priority sectors of health, education, and law and order, development expenditures were compressed below budget during 1996/97.

Implementation of monetary policy during 1996/97 was complicated by rapid but irregular growth in official net foreign assets. Demand for credit was inhibited by uncertainties such as the developing drought, and banks were cautious in their lending operations, particularly for crop marketing. The tight fiscal and monetary stance made it possible for the level of gross official international reserves to increase to US$460 million at the end of June 1997 (2.6 months of import cover). The exchange rate continued to be determined in the market, subject to influence by Bank of Tanzania intervention. During 1996/97, the Tanzania shilling appreciated in real effective terms by 14 percent relative to consumer prices. Nevertheless, export growth remained strong (about 18 percent in real terms).

During 1996/97 structural reform measures in the areas of fiscal management, civil service reform, and statistics were carried out. The most prominent reform was the restructuring of the government-owned National Bank of Commerce (NBC) as a prelude to privatization. After broadly participatory political consultation, the NBC was split in September 1997 into the National Microfinance Bank and a single full-service bank, the NBC (1997) Ltd. Fifty parastatal entities were removed from government control. Other key reforms included the passage of an act to liberalize insurance, substantial liberalization of petroleum product imports, and passage of new investment and mining legislations.

The drought resulting from the failure of the short rains late in 1996 was exacerbated by erratic long rains in the first half of 1997, severely affecting production of the main export crop, coffee, as well as many food crops. Economic growth thus is estimated to have been less than 4 percent in 1996/97. The drought has also affected inflation, which averaged 17 percent in 1996/97, somewhat higher than the target, but half the level of 1994/95. However, nonfood inflation has come down more sharply as the end-period annual rate fell to around 10 percent in recent months.

Tanzania's balance of payments situation, while still fragile, continued to improve in 1996/97, led by a further large increase in export volume and a continuing rapid increase in tourism receipts. Imports of goods remained stagnant, owing to the relatively slow growth of the economy and the impact on import costs of strengthened customs administration. The current account deficit (excluding grants) narrowed to 12.4 percent of GDP, one-half the ratio of two years earlier. With respect to external debt, the Paris Club agreed on January 21, 1997 to provide a flow rescheduling on Naples terms (amounting to US$1.7 billion over 1996/97-1998/99) involving a 67 percent reduction in net present value terms.

Tanzania's real GDP growth is projected to rise to 4.7 percent in 1997/98, and average inflation to decline to 13 percent, with the expectation of a quick recovery from drought in the second half of the fiscal year. The macroeconomic program for 1997/98 targets a recurrent budget surplus of 1.1 percent of GDP, and a rise in gross official international reserves to the equivalent of 2.9 months of imports. The program is cast within a medium-term framework that also envisages an acceleration of the privatization program, among other structural reforms.

Executive Board Assessment

Executive Directors commended the Tanzanian authorities for their continued strong implementation of appropriate macroeconomic policies during 1996/97, as well as for the better-than-expected fiscal and external sector performance, especially during a period of drought. At the same time, Directors noted that Tanzania's economy remains vulnerable to external shocks. That highlighted the importance of structural reforms to complement sound financial policies to strengthen Tanzania's prospects for rapid and broad-based growth and rising living standards. Directors underscored the importance of continuing to press ahead with such reforms under the second annual ESAF-supported program.

Directors commended the Tanzanian authorities for maintaining a strong budgetary policy aimed at achieving high budgetary savings, and recognized the critical role of the cash management system in ensuring fiscal restraint. However, noting past shortfalls in development and social spending, Directors called for increased funding for such expenditures. They also stressed the need to monitor effectively expenditure commitments and to eliminate domestic arrears. They urged the authorities to maintain strict control over the government wage bill, while continuing to rationalize the civil service to be able to offer more adequate remuneration. Noting that the revenue ratio was still low, Directors endorsed the tax reform strategy, and called for adherence to the timetable for the introduction of the value-added tax and the plans to simplify further the tax and tariff structures. They welcomed planned cuts in customs duties, and noted that these should be accompanied by improvements in tax administration and compliance and strict limitations on duty exemptions. Directors welcomed the strong revenue measures taken in the 1997/98 budget. They urged the authorities to be vigilant in the implementation of fiscal policy and to be prepared to take further action, if necessary, to meet the fiscal targets.

Directors welcomed the prudent monetary policy that had complemented fiscal restraint in achieving lower rates of inflation, and urged the authorities to aim at further strong declines in inflation in the coming year. Directors also stressed the importance of monitoring a variety of indicators of monetary conditions, such as real interest rates and the exchange rate, in conducting monetary policy.

A key element for growth was a more efficient financial system. In that regard, Directors welcomed the fact that the NBC had been restructured as a prelude to privatization, though some expressed concern that the new structure did not go as far as it might have in enhancing competition in the banking system. Directors urged the authorities to adhere strictly to the fast-track schedule for the privatization of the new NBC subsidiaries, which they regarded as being crucial for achieving greater efficiency in financial intermediation. They stressed the importance of close supervision to ensure their development into efficient and readily marketable banks, as well as, more generally, strict banking regulation and supervision.

Regretting that privatization had not moved ahead as fast as programmed over the last year, Directors urged the authorities to accelerate privatization. They welcomed the expansion of its scope to cover the large utilities and other core parastatals. A further prerequisite for strong and sustained private sector growth was an environment of transparency in the public sector, and a good regulatory framework for business. In that regard, Directors welcomed the enactment of the new Investment Act, but the importance of strict administration and avoidance of special treatment was noted.

Given the fragility of Tanzania's balance of payments and the continuing importance of external assistance to Tanzania, Directors noted that a sustained commitment to strong macroeconomic policies and structural reforms would improve the prospects for obtaining the necessary financial support from the creditor and donor community. Directors stressed the need for Tanzania to avoid nonconcessional official borrowing, to meet in a timely manner its debt service obligations, and to negotiate promptly the remaining bilateral agreements with Paris Club and other bilateral creditors.

Press Information Notices (PINs) are a new series of IMF press notices (see Press Release 97/21). PINs are issued, at the request of a member country, following the conclusion of the Article IV consultation for countries seeking to make known the views of the IMF to the public. This action is intended to strengthen IMF surveillance over the economic policies of member countries by increasing the transparency of the IMF's assessment of these policies.

Tanzania: Selected Economic Indicators

	1994/95	1995/96	1996/97	Proj. 1997/98
		Percentage change		
Domestic economy				
Change in real GDP	2.6	4.1	3.9	4.7
Change in consumer prices (period average)	34.0	25.7	17.1	13.0
		In millions of U.S. dollars 1/		
External economy				
Exports, f.o.b.	592.9	695.9	793.6	844.9
Imports, f.o.b.	1,509.7	1,370.3	1,387.8	1,671.8
Current account balance	-547.0	-340.6	-152.1	-362.9
(In percent of GDP)	-11.0	-6.0	-2.2	-4.9
Capital account	324.2	171.3	171.4	326.7
Gross official reserves	255.1	240.1	460.5	591.7
(In months of imports)	1.6	1.4	2.6	2.9
Debt service (including to the IMF) 2/	43.3	37.0	27.0	19.5
Change in real effective exchange rate (in percent) 3/	-3.8	22.2	14.2	n.a.
		In percent of GDP		
Financial variables				
General government balance	-3.9	-2.2	2.3	0.5
Government current savings	-2.7	-0.8	1.3	1.1
Change in broad money (in percent)	36.4	16.1	18.2	10.4
Interest rate (in percent) 4/	38.6	14.4	8.4	n.a.

Sources:Tanzanian authorities; and IMF staff estimates.
1/ Unless otherwise noted.
2/ In percent of exports of goods and nonfactor services.
3/ (+) - appreciation.
4/ Treasury bill rate, end of period.