

EBS/86/183
Correction 2

CONFIDENTIAL

August 25, 1986

To: Members of the Executive Board
From: The Secretary
Subject: Tanzania - Request for Stand-By Arrangement

The following corrections have been made in EBS/86/183 (8/8/86):

Page 2, Table 1: revised

Page 3, 1st full para., line 4: for "SDR 43.6 million" read "SDR 43.5 million"

Page 70, under "Gross domestic product," line 3:

for "(constant 1966 prices)" read "(constant 1976 prices)"

Corrected pages are attached.

Att: (3)

I. Introduction

Protracted, and at times difficult, negotiations have been held between the Tanzanian authorities and the Fund staff during most of the 1980s after the last stand-by arrangement, approved by the Fund on September 15, 1980, became inoperative with only the initial purchase having been made. The most recent round of discussions on a possible stand-by arrangement started in late 1984, and intermittent discussions were held subsequently. In early 1986, following the election of the new President and the formation of the new Cabinet, the authorities invited the staff to hold discussions with a view to designing a comprehensive package of economic reforms and policy measures that could lead to economic recovery and to a sustainable balance of payments position in the medium term. At the same time, the authorities also began to prepare their own program of medium-term recovery and rehabilitation.

The staff representatives for the discussions since April 1986 were Messrs. R.J. Bhatia (AFR-head), A. Abdi (AFR), W. Mahler (FAD), and R. Pownall (ETR). Mr. Robin Kibuka (FAD) participated in the April mission, Mr. Peter Wickham (RES) in the end-June mission. Mr. Mtei, the Executive Director for Tanzania, participated in most of the policy discussions during this period.

In the attached letter from the Minister of Finance, dated August 8, 1986 (Annex III), the Government of Tanzania requests a stand-by arrangement, in support of the economic adjustment and recovery program, for a period of 18 months, from September 1986, in an amount equivalent to SDR 64.2 million. ^{1/} This represents an annual access of 40 percent and is equivalent to 60 percent of Tanzania's quota of SDR 107 million. The economic and financial policies which Tanzania proposes to pursue in support of this arrangement are detailed in Annex III. Tanzania has not used Fund resources over the past five years, and Fund holdings of Tanzanian shillings subject to repurchase amount to SDR 6.12 million, equivalent to 5.72 percent of quota, as of end-July 1986. Accordingly, the full amount of the purchases under the stand-by would be from ordinary resources and if the full amount under the proposed stand-by arrangement is purchased, the Fund's holdings of Tanzanian currency subject to repurchase at the end of the arrangement would amount to SDR 64.2 million, equivalent to 60 percent of quota (Table 1).

Since March 1985, Tanzania has had difficulties in meeting its payment obligations to the Fund in a timely manner. These difficulties coincided with inadequate adjustment policies in the face of a rapid deterioration in the country's economic and financial situation, and in particular, in the balance of payments position. However, Tanzania's

^{1/} The Government began implementing the underlying financial program from June 19, 1986.

Table 1. Tanzania: Schedule of Proposed Purchases and Repurchases,
September 1986-March 1988

	Position at July 31, 1986	1986/87		1987			1987/88	
		Sept.- Nov.	Dec.- Feb.	March- May	June- Aug.	Sept.- Nov.	Dec.- Feb.	Mar.- May
(In millions of SDRs)								
Purchases								
Stand-by arrangement	--	20.70	7.25	7.25	7.25	7.25	7.25	7.25
Ordinary resources	--	20.70	7.25	7.25	7.25	7.25	7.25	7.25
Borrowed resources	--	--	--	--	--	--	--	--
Repurchases	6.12	2.04	--	2.04	--	2.04	--	--
Credit tranches and en- larged access resources	6.12	2.04	--	2.04	--	2.04	--	--
Transactions under special facilities	--	--	--	--	--	--	--	--
Net purchases	6.12	18.66	7.25	5.21	7.25	5.21	7.25	7.25
Fund holdings of Tanzania's currency, subject to re- purchase, at end of period	6.12	24.78	32.03	37.24	44.49	49.70	56.95	64.20
(In percent of quota)								
Fund holdings of Tanzania's currency, subject to re- purchase, at end of period	5.72	23.16	29.93	34.80	41.58	46.45	53.22	60.00
Under tranche policies	5.72	23.16	29.93	34.80	41.58	46.45	53.22	60.00
Special facilities	--	--	--	--	--	--	--	--

Source: IMF, Treasurer's Department and staff estimates.

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arrears to the Fund, which increased to a peak level of SDR 22.9 million as of July 23, 1986, were fully settled effective July 31, 1986 with the assistance of a bridge loan from a commercial bank and by contributions from bilateral donors. Tanzania has also acquired sufficient SDRs to settle all Fund obligations falling due through end September 1986, and is expected to meet on time forthcoming obligations of SDR 3.3 million through the end of 1986. The proposed program, in the staff's view, is an initial step toward generating economic recovery and external adjustment. The medium-term balance of payments scenario for 1986-91, within which the proposed program has been formulated, foresees a progressive reduction of the overall deficit in the balance of payments, and also, after accounting for repurchase obligations to the Fund and a modest buildup of external reserves, a progressive decline in the size of financing gaps. Given that Tanzania intends to remain committed to a sustained adjustment effort, it is expected that Tanzania will be able to mobilize adequate amounts of assistance from foreign donors to cover the prospective financing gaps in the coming years and to meet its financial obligations to the Fund.

The stand-by arrangement provides for a purchase of SDR 20.7 million (the balance of the first credit tranche) to be made when the arrangement takes effect. Other purchases under the stand-by arrangement (SDR 43.5 million) will be phased into six equal tranches of SDR 7.25 million each. The second tranche will be available after November 15, 1986 and the subsequent purchases at quarterly intervals. The second purchase would be subject to the observance of the end-September 1986 performance criteria; the February 1987 purchase would be subject to the observance of the December 1986 performance criteria and the satisfactory completion of the review of developments under the program to be concluded before end-February, at which time the performance criteria for end-March and end-June 1987 would also be set. The performance criteria for the period July 1987 to February 1988 will be established within the context of the second review of the program no later than end-July 1987, to coincide with the preparation of the budget for fiscal year 1987/88.

The Fund and Bank staff have had extensive discussions and have collaborated closely in the efforts to arrive at a consistent diagnosis of Tanzania's economic problems and in the identification of appropriate adjustment policies. On several occasions Bank staff have participated in the discussions between the Fund staff and the Tanzanian authorities, and they have assisted in the preparation of the sectoral policies and the assessment of the investment program and the country's minimum import requirement for rehabilitation and recovery. The Bank staff has also held discussions with the authorities in the context of a proposed program loan in support of Tanzania's economic adjustment and recovery efforts. The program loan is aimed at the rehabilitation of the agricultural, industrial, and transportation sectors. Subject to agreement on the required policy reforms in these sectors, the program loan is expected to be submitted to the Bank's Board in October 1986. As the authorities have expressed interest in the Fund's structural

adjustment facility (SAF), and as the policy framework paper has to be prepared in conjunction with the Bank staff, a request for a SAF is expected to be made at the time of the finalization of the Bank's program loan.

Summaries of Tanzania's relations with the Fund and the Bank are presented in Annexes IV and V, respectively.

II. Recent Economic Developments

1. Developments through 1984/85

Tanzania's economic and financial situation has deteriorated since the late-1970s ^{1/}. While adverse external developments were a contributing factor, the deterioration was principally attributable to inadequate domestic policies, and manifested itself in low production, high inflation, depletion of official reserves, large external debt, and a buildup of external payments arrears (Table 2). Real gross domestic product (GDP) increased by only about 2 percent over the four years ended 1984. Agricultural output, which accounts for about 46 percent of GDP, increased only modestly, while manufacturing output declined sharply. The volume of marketed food crops and traditional agricultural exports generally declined and was significantly below the peak levels realized in the 1970s. Both export and domestic food crops were adversely affected by erosion of price incentives, as officially set producer prices for export crops declined in real terms by 30-50 percent over the decade to 1985/86, shortages of essential inputs, transportation difficulties, and inefficient and costly marketing arrangements. Price distortions and shortages of imported inputs also contributed to a sharp decline in industrial output, and constrained the growth of the services sector. The domestic inflation rate, as measured by the official national consumer price index (NCPI), accelerated sharply to an annual average of about 30 percent in 1980-84, from about 12 percent in 1976-79.

The financial operations of the Central Government and the rest of the public sector have recorded large deficits. The Central Government's overall deficit in fiscal years 1981/82-1983/84 (July-June) averaged about T Sh 7.1 billion, equivalent to 11.4 percent of GDP, and reflected both a lower rate of growth of revenues (mainly a result of an overvalued exchange rate and price controls) and a rapid growth in current expenditure, primarily for subsidies and transfers. These deficits were financed to a large extent by domestic bank credit, which averaged about two thirds of the overall deficit and about one fourth of the money stock at the beginning of each fiscal year during the three-year period. In order to reduce the deficit, a number of fiscal measures were introduced with the presentation of the 1984/85 budget.

^{1/} Recent economic developments in Tanzania were described in detail in the last staff report on the Article IV consultations (SM/86/23) which was discussed by the Executive Board on March 20, 1986.

Tanzania: Relations with the World Bank Group

Relations

1. Tanzania joined the World Bank in 1962. Beginning with an IDA credit for education in 1963, 62 IDA credits and 19 Bank loans, two of these on third window terms, amounting to US\$1,224.50 million have so far been approved for Tanzania. Total disbursements amounted to US\$955.41 million as of June 30, 1986. In addition, Tanzania has been a beneficiary of 11 loans totalling US\$244.8 million, which were extended to institutions of the former East African Community. IFC investments in Tanzania total US\$11.1 million. Overall, Bank Group lending in Tanzania has been channelled primarily to agriculture, transport and communications, industry, and education and manpower development and on three occasions non-project assistance has been provided in support of government efforts to deal with its balance of payments difficulties. Total IDA lending over the period 1987-91 is currently projected at US\$385 million and Special Facility resources of US\$70.0 million in FY87 on a commitment basis.

Economic Assessment

2. Despite small increases in GDP in the past two years, per capita incomes have been declining since 1980. Production of the main export crops has been falling in volume terms, capacity utilization in industry is at a low level, and the physical infrastructure of the country has deteriorated. The acute shortage of foreign exchange has contributed to bottlenecks in transportation and other services, and the level of imports is insufficient for the proper functioning of the economy. At the same time external arrears are mounting, and the major portion of the country's medium- and long-term debt remains unserviced.

3. The prospects for ameliorating this situation, however, are good. In recent months the process of reform has gathered momentum, and the Government has begun adopting macroeconomic and sector policies that, if maintained and further developed, should lay the basis for sustained growth and a more viable balance of payments. Together with the Fund, the Bank has been working with the Government on a comprehensive program of adjustment and recovery measures. These include an agreement on exchange rate policy, increases in official agricultural producer prices, fiscal and monetary restraint, and an agenda of sector policy reform of which the first steps are now being made. As these reforms are adopted and are supported by increased aid flows, the Bank expects a strong recovery of exports and a GDP growth level of 4-5 percent annually over the medium-term.

TANZANIA - Basic Data

Area and population

Area	945,100 square kilometers
Population : Total (1985)	21.8 million
Growth rate	3.3 percent

1981 1982 1983 1984 1985

(In millions of Tanzanian shillings)

Gross domestic product

At factor cost					
(constant 1976 prices)	24,163	24,475	24,368	24,972	25,596
Agriculture	10,854	11,140	11,259	11,546	11,950
Manufacturing and Mining	1,997	1,675	1,532	1,356	1,153
Other	11,312	11,660	11,577	12,070	12,493

Gross domestic product at
current market prices

50,839 60,508 65,976 75,658 100,423

National consumer price index
(1970 = 100)

NCPI (Annual charge) 25.6 28.9 27.0 36.2 26.5

1981/82 1982/83 1983/84 1984/85 1985/86

(In millions of Tanzania shillings)

Central government budget

Total revenue	10,101	11,819	14,426	18,228	20,840
Tax revenue	9,078	11,252	13,711	17,228	19,687
Nontax revenue	1,023	567	715	1,000	1,153
Total expenditure and net lending	19,182	18,442	20,886	25,699	30,700
Recurrent expenditure	13,980	14,062	16,174	20,376	23,900
Development expenditure	5,196	4,359	4,733	5,308	6,785
Net lending	6	21	-21	15	15
Overall deficit (checks- issued basis) 1/	-9,081	-6,623	-6,460	-7,471	-9,860
Adjustment to cash and other items (net)	1,213	-412	-3	628	--
Overall deficit (checks- cash basis) 1/	-7,868	-7,035	-6,463	-6,843	-9,860
Grants	1,656	1,593	1,234	1,892	1,685
Net foreign borrowing	1,204	970	230	608	915
Domestic nonbank financing	780	469	507	1,231	520
Domestic bank financing	4,228	4,003	4,492	3,112	6,740