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EBD/90/31
Correction 1

CONFIDENTIAL

February 5, 1990

To: Members of the Executive Board

From: The Secretary

Subject: Tanzania - Structural Adjustment Facility - Medium-Term
Economic and Financial Policy Framework, 1989/90-1991/92

The following correction has been made in EBD/90/31 (1/24/90):

Page 5, para. No. 17, line 2: for "T SH 43.7 billion"
read "T SH 30.2 billion"

A corrected page is attached.

Att: (1)

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Department Heads

and its administration with the aim of increasing revenue. These measures, in addition to the significant positive impact of the devaluation on revenue generation, were expected to result in a revenue-GDP ratio of 21.5 percent, as compared to 17 percent in 1987/88. Thus, projected revenue incorporated the effect of the first phase of the reform of the customs tariffs and sales taxes introduced in the context of the IRTAC program with the World Bank, while in the area of income taxation, marginal income tax rates were reduced while the minimum taxable income was raised. In addition, a number of fees and charges were increased to improve cost recovery. Tax administration was strengthened by recruiting more employees, providing more equipment and facilities, and by increasing penalties for noncompliance.

16. With regard to public expenditures, the Government continued its policy of giving high priority to rehabilitation projects in its public investment program and concentrated its recurrent expenditure on maintenance of buildings, equipment and plant, and improvements in social services delivery and in civil servants' salary and wages. The Government, in collaboration with the World Bank, prepared a Public Expenditure Review which will serve as a blueprint for structural expenditure changes during the 1989-92 period. In fact, as discussed below, some measures (such as an initial increase on civil service salaries) were already incorporated into the 1989/90 budget.

17. The provisional fiscal outturn for 1988/89 shows an overall deficit of T Sh 30.2 billion or 8.3 percent of GDP, below the 10.4 percent of GDP projected in the program. Revenue was at about the level projected in the program while recurrent as well as development expenditures were lower than expected. However, because of a larger-than-envisaged float and lower-than-projected external loan disbursements, the Government increased its indebtedness with the banking system by T Sh 5.4 billion (after adjusting to include checks in the process of clearing), compared with the benchmark under the program which called for zero net bank credit.

18. Monetary and credit policies during 1988/89 were intended to support the balance of payments and inflation targets of the program, while enhancing financial intermediation by making interest rates positive in real terms. In addition, the authorities intended to complete the preparation of an action program by mid-1989 aimed at improving the efficiency and competitiveness of the financial system. However, there have been some delays in this area.

19. Due to the existing deficiencies in agricultural marketing and in the financial system, the authorities encountered serious difficulties in the implementation of credit policies, failing to meet the program's benchmarks and targets. Thus in 1988/89, net domestic assets of the banking system rose by T Sh 46.7 billion (74 percent of the initial money stock) instead of the T Sh 27.4 billions (44 percent of the initial money stock) targeted in the program. This rapid credit growth resulted from the increase in credit to the Government, from the

excessive credit expansion to marketing boards, in particular the National Milling Corporation (NMC), and an increase in net unclassified assets. Broad money increased by 38 percent, compared to the program's target of 10 percent.

20. In early December 1988 interest rates were raised by up to 5 percentage points on term and savings deposits (to 29 and 26 percent, respectively) and by up to 2 percentage points on some loans (to 31 percent) as well as on most government borrowing. As of end-June 1989, the interest rate on 12-month term deposits was 1 percentage point above the rate of inflation, in compliance with the SAF program.

21. Substantial progress was attained in the restructuring of marketing of domestic foodstuffs, which has been liberalized de facto. Marketing restrictions were largely removed by allowing primary societies to sell maize to the NMC, or directly to private traders at a negotiated price, and not exclusively to cooperative unions as was the case before. In turn, the NMC was relieved of its obligation to purchase all the maize offered by the cooperative unions, while cooperative unions were instructed to buy from primary societies the procurement levels of maize they thought they could sell. The panterritorial price system (i.e., identical minimum producer prices for maize from all regions) did not apply in practice in 1988/89. This was done through the Strategic Grain Reserve (SGR) procuring at the floor price in the remote producing areas of the country, while private traders and the NMC, as a commercial operator, procured in closer-in areas and at higher prices. Additional price flexibility was introduced by allowing cooperative unions/primary societies, which are bound to buy at official producer prices, to negotiate their margin in their sale prices, thereby taking differential transport costs into consideration.

22. Notwithstanding the introduction of these new marketing rules, the NMC incurred substantial operating losses in its sales of maize and other grains in 1988/89 by selling at prices considerably below costs. In addition, due to operating and institutional deficiencies and transportation and processing bottlenecks, NMC accumulated large stocks, mainly of paddy, which resulted in credit requirements much in excess of program projections. Meanwhile, the NMC's procurement for the SGR as an agent of the Government proceeded on schedule.

23. With regard to the marketing of traditional export crops, the Government intended to deconfine the crops at the cooperative union level, with marketing boards operating as nonmonopolistic agents of cooperatives, and as government instruments for quality control and market intelligence. Complexities in design led to delays in the implementation of the action programs for restructuring in export marketing for traditional crops during 1988/89, aimed at improving benefits to producers.

24. During 1988/89 manufacturing activity increased reflecting both an increased availability of foreign exchange and improved resource