

DOCUMENT OF INTERNATIONAL MONETARY FUND
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**IMMEDIATE
ATTENTION**

EBS/86/183
Supplement 2

CONFIDENTIAL

October 14, 1986

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

It is not proposed to bring the attached supplement to the agenda of the Executive Board for discussion unless an Executive Director so requests by the close of business on Monday, October 20, 1986. In the absence of such a request, the draft decision that appears on page 2 will be deemed approved by the Executive Board and it will be so recorded in the minutes of the next meeting thereafter.

Mr. Bhatia (ext. 6959) or Mr. Abdi (ext. 6517) is available to answer technical or factual questions relating to this paper.

Att: (1)

INTERNATIONAL MONETARY FUND

TANZANIA

Request for Stand-By Arrangement
Supplementary Information

Prepared by the African Department and
the Exchange and Trade Relations Department

In consultation with the Treasurer's and
Legal Departments

Approved by A. D. Ouattara and W. A. Beveridge

October 10, 1986

In the phasing of purchases under the stand-by arrangement for Tanzania (EBS/86/183, Supplement 1), the first purchase of SDR 20.7 million fell short of the normal entitlement of a member country to make a purchase that would not increase the Fund's net outstanding holdings of its currency under the credit tranches (excluding supplementary purchases of less than 12.5 percent of quota) beyond 25 percent of quota. To allow for this minimum normal entitlement, the first purchase to which Tanzania would be entitled under the stand-by arrangement should have been SDR 26.75 million (equivalent to the first credit tranche). Tanzania has in fact purchased the full amount of SDR 26.75 million in accordance with its entitlement under the stand-by arrangement. To accommodate this change within the total amount approved under the current stand-by arrangement, (SDR 64.2 million), in the attached letter dated October 1, 1986 the Tanzanian authorities have requested a modification of the phasing of the remaining purchases under the arrangement as follows:

	<u>Old phasing</u>	<u>New phasing</u>
Initial purchase (Sept.-Nov. 1986)	20.70	26.75
December 1986-February 1987	7.25	6.24
March 1987-May 1987	7.25	6.24
June 1987-August 1987	7.25	6.24
September 1987-November 1987	7.25	6.24
December 1987-February 1988	7.25	6.24
March 1988-May 1989	7.25	6.25

To reflect these changes, the stand-by arrangement for Tanzania needs to be amended and pages 1, 2, and 3 of EBS/86/186, Correction 2 (8/25/86) have been corrected (see attachments). The staff has been in touch with the Tanzanian authorities and they indicated their agreement with the proposed amendment.

Accordingly, the following draft decision is proposed for adoption by the Executive Board.

Paragraph 2 and the introductory part of Paragraph 4 of the stand-by arrangement for Tanzania (EBS/86/183, Supplement 1) is hereby amended to read, respectively, as follows:

"2. (a) Purchases under this stand-by arrangement shall not, without the consent of the Fund, exceed the equivalent of:

SDR 26.75 million until November 15, 1986

SDR 32.99 million until February 15, 1987

SDR 39.23 million until May 15, 1987

SDR 45.47 million until August 15, 1987

SDR 51.71 million until November 15, 1987

SDR 57.95 million until February 15, 1988.

(b) None of the limits in (a) above shall apply to a purchase under this stand-by arrangement that would not increase the Fund's holdings of Tanzania's currency in the credit tranches beyond 25 percent of quota, or increase the Fund's holdings of that currency resulting from purchases of supplementary financing beyond 12.5 percent of quota."

"4. Tanzania will not make purchases under this stand-by arrangement that would increase the Fund's holdings of Tanzania's currency in the credit tranches beyond 25 percent of quota or increase the Fund's holdings of that currency resulting from purchases of supplementary financing beyond 12.5 percent of quota:"

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 5.33 million, equivalent to 4.98 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
<u>(In millions of SDRs)</u>								
Purchases								
Stand-by arrangement	--	26.75	6.24	6.24	6.24	6.24	6.24	6.25
Ordinary resources	--	26.75	6.24	6.24	6.24	6.24	6.24	6.25
Borrowed resources	--	--	--	--	--	--	--	--
Repurchases	5.33	1.26	--	2.04	--	2.03	--	--
Credit tranches and en- larged access resources	5.33	1.26	--	2.04	--	2.03	--	--
Transactions under special facilities	--	--	--	--	--	--	--	--
Net purchases	5.33	25.49	6.24	4.20	6.24	4.21	6.24	6.25
Fund holdings of Tanzania's currency, subject to re- purchase, at end of period	5.33	30.82	37.06	41.26	47.50	51.71	57.95	64.20
<u>(In percent of quota)</u>								
Fund holdings of Tanzania's currency, subject to re- purchase, at end of period	4.98	28.80	34.64	38.56	44.39	48.33	54.16	60.00
Under tranche policies	4.98	28.80	34.64	38.56	44.39	48.33	54.16	60.00
Special facilities	--	--	--	--	--	--	--	--

Sources: IMF, Treasurer's Department; and staff estimates.

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 26.75 million (equivalent to the first credit tranche) to be made when the arrangement takes effect. Other purchases under the stand-by arrangement (SDR 37.45 million) will be phased into five equal tranches of SDR 6.24 million each and a last purchase of SDR 6.25 million. 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.

October 1, 1986

Mr. Jacques de Larosière
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Mr. de Larosière:

Having purchased the full amount available to Tanzania in the first credit tranche (SDR 26.75 million) instead of the initially envisaged amount of SDR 20.7 million under the stand-by arrangement (EBS/86/183), we hereby request a modification of the phasing of the remaining purchases under the arrangement as follows:

	<u>Old phasing</u>	<u>New phasing</u>
Initial purchase (Sept.-Nov. 1986)	20.70	26.75
December 1986-February 1987	7.25	6.24
March 1987-May 1987	7.25	6.24
June 1987-August 1987	7.25	6.24
September 1987-November 1987	7.25	6.24
December 1987-February 1988	7.25	6.24
March 1988-May 1989	7.25	6.25

Yours sincerely,

/s/

Charles M. Nyirabu
Governor
Bank of Tanzania