FOR AGENDA

EBS/86/183

CONFIDENTIAL

August 8, 1986

To: Members of the Executive Board

From: The Secretary

Subject: Tanzania - Request for Stand-By Arrangement

Attached for consideration by the Executive Directors is a paper on a request from Tanzania for a stand-by arrangement equivalent to SDR 64.2 million which has been scheduled for Executive Board discussion on Thursday, August 28, 1986. Draft decisions appear on page 41.

Mr. Bhatia (ext. 6959) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

Att: (1)

CONFIDENTIAL

INTERNATIONAL MONETARY FUND

TANZANIA

Request for Stand-By Arrangement

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

(In consultation with the Legal Department and the Treasurer's Department)

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

August 8, 1986

Contents

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 Sept.-Nov.	1986/87 Dec.-Feb.	1987 March-May	1987 June-Aug.	1987 Sept.-Nov.	1987/88 Dec.-Feb.	1987/88 Mar.-May
				(In millions of SDRs)				
Purchases								
Stand-by arrangement	--	20.65	7.25	7.25	7.25	7.25	7.25	7.30
Ordinary resources	--	20.65	7.25	7.25	7.25	7.25	7.25	7.30
Borrowed resources	--	--	--	--	--	--	--	--
Repurchases	6.12	2.04	--	2.04	--	2.04	--	--
Credit tranches and enlarged access resources	6.12	2.04	--	2.04	--	2.04	--	--
Transactions under special facilities	--	--	--	--	--	--	--	--
Net purchases	6.12	18.61	7.25	5.21	7.25	5.21	7.25	7.30
Fund holdings of Tanzania's currency, subject to repurchase, at end of period	6.12	24.73	31.98	37.19	44.44	49.65	56.90	64.20
				(In percent of quota)				
Fund holdings of Tanzania's currency, subject to repurchase, at end of period	5.72	23.11	29.89	34.76	41.53	46.40	53.18	60.00
Under tranche policies	5.72	23.11	29.89	34.76	41.53	46.40	53.18	60.00
Special facilities	--	--	--	--	--	--	--	--

Source: 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 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 43.6 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 subect 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.

Table 2. Tanzania: Selected Economic and Financial Indicators, 1982-85, 1986/87

	1982	1983	1984	1985 Prel.	1986/87 Program
			(Changes in percent)		
GDP and prices					
Real GDP 1/	1.3	-0.4	2.5	2.5	3.5
Consumer prices	28.9	27.0	36.2	26.5	30.0
Government budget 2/					
Revenue, excluding grants	17.0	22.1	26.4	14.3	57.9
Total expenditure	-4.0	13.3	23.0	19.5	62.5
Money and credit					
Total credit	19.5	15.8	21.9	29.3 2/	12.0
Of which: government (net)	(25.3)	(17.5)	(21.9)	(25.0) 2/	(9.6)
Money plus quasi-money	20.4	13.2	22.4	21.5 2/	10.7
Velocity (GDP relative to M_2)	2.76	2.67	2.54	2.90 2/	3.46
Interest rates (12-month saving deposits)	7.50	7.50	7.50	10.00	15.00 3/
External sector (on the basis of U.S. dollars)					
Exports, f.o.b.	-26.6	-8.3	-2.6	-11.3	13.0 4/
Imports, c.i.f.	-5.8	-25.2	2.5	7.2	12.8 4/
Nominal effective exchange rate 5/	-4.2	-15.6	-19.2	-2.2	-46.5
Real effective exchange rate 5/	20.6	2.2	4.0	8.7	-12.7
			(In percent of GDP) 1/		
Overall government budget deficit (cash basis) at current exchange rate	-13.9	-9.1	-7.8	-8.5 6/	-11.1
Balance of payments current account deficit	-9.9	-7.4	-8.9	-9.0	-21.6
			(In percent of merchandise exports)		
External current account deficit					
Excluding grants	155.8	115.0	122.1	157.3	163.4
Including grants	133.2	92.7	96.0	123.7	110.9
Scheduled external debt service 7/					
Including IMF	19.4	35.3	66.4	55.7	66.0
Excluding IMF	17.3	30.2	62.1	53.3	63.9
Actual external debt service 7/					
Including IMF	14.7	22.0	24.0	23.9	...
			(In millions of U.S. dollars)		
External current account					
Balance excluding grants (deficit -)	-643.7	-435.7	-450.6	-514.6	-660.0
Overall balance (deficit -)	-93.6	-0.2	-158.7	-194.6	-430.0
Stock of payments arrears	387.9	452.5	438.5	638.0	670.0 8/
			(In weeks of imports)		
Gross official reserves	1.8	4.0	2.4	1.1	1.9

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

1/ Based on revised official GDP series and staff estimates for 1986/87.
2/ On a fiscal year basis, beginning on July 1 of each year, the monetary data for 1985/86 is on a fiscal year for comparability with the program period.
3/ Effective July 1, 1986.
4/ 1986/87 projections compared with 1985/86 estimates.
5/ Trade-weighted; changes in end-of-period indexes based on December 1978 = 100. Minus indicates depreciation.
6/ If the exchange rate and interest rate adjustments planned for 1986/87 had taken place in the 1985/86 budget, the overall deficit to GDP ratio would have been increased by about 7 percentage points.
7/ In percent of exports of goods and services, and private transfers.
8/ To increase to US$720 by end-June 1986 and to be reduced during the progam period by US$50 million.

They included selective increases in consumption and sales taxes, the elmination of food and agricultural input subsidies from the budget, the reorganization of some central government ministries, and the abolition of budgetary transfers to major agricultural parastatals. As a result, *the 1984/85 overall deficit was reduced to* T Sh *6.8 billion, about* 7.8 percent of GDP (Table 2).

The financial operations of the parastatals, which are predominant in agricultural marketing and other services resulted in persistent deficits which were financed by budgetary transfers and sizeable increases in bank credit. The combined operating deficits of the five major agricultural export marketing boards increased steadily to about T Sh 850 million by 1984/85 as the costs rose, the export prices declined, and the exchange rate was not adjusted adequately. The National Milling Corporation, which procures and markets domestic food crops, also recorded large deficits and relied heavily on budgetary subsidies and recourse to bank credit up to 1984. In mid-1984, the Government reintroduced cooperative unions and constrained the functions of marketing boards in an attempt to reduce the overall marketing costs. Simultaneously, efforts were to be launched to instil a greater degree of efficiency in the operations of the marketing organization. However, these efforts have failed to reduce the marketing costs, which, in fact, are estimated to have increased, and the marketing boards have experienced increasingly higher losses, which have been financed primarily by recourse to bank borrowing.

Domestic credit expansion averaged about 20 percent annually over the four years ended in December 1984, equivalent to 25 percent of the beginning stock of broad money, as the public sector's demand for credit was accommodated. Bank credit to the private sector, including parastatal enterprises, rose at modest rates, in part due to the decline in the level of imports and economic activity. Because of the persistent balance of payments deficits incurred in recent years (the sizable accumulation of external commercial payments arrears are included in the foreign liabilities of the banking system), the net foreign asset position of the banking system weakened precipitously from a net liabilities position of T Sh 3.0 billion in December 1981 to T Sh 7.1 billion as of end-December 1984. Over the four years, broad money increased at an annual average rate of about 21 percent.

During the period, the authorities generally followed a policy of low nominal interest rates. Thus, between 1982-84, the treasury bill rate (91-day maturity) was at 4.8 percent, the 12-month savings deposit rate at 7.5 percent, and the maximum lending rate at 13 percent, while the annual increase in consumer prices averaged 30 percent. In October 1985 deposit and lending rates were adjusted with the new treasury bill rate moving to 6.0 percent, the 12-month savings deposit rate to 10.0 percent, and the maximum bank lending rate to 14 percent--all rates still substantially negative in real terms.

Tanzania's external accounts progressively weakened in recent years. Underlying these developments were the above-mentioned inadequate pricing and expansionary financial policies, deterioration in the terms of trade, and an exchange rate policy that allowed a large real appreciation of the Tanzania shilling. In the face of a steady decline in export receipts, (18 percent in volume terms in the four years ending 1984), total imports were compressed even more sharply. As a result, the current account deficit declined from US$644 million in 1982 (9.9 percent of GDP) to an annual average of US$443 million in 1983-84 (equivalent to about 8 percent of GDP). Gross capital inflows remained relatively constant in nominal terms during the period, notwithstanding heavy recourse to credits for oil imports since 1983, but scheduled amortizations rose, thereby resulting in sharply lower net capital inflows. As a result, the overall balance of payments recorded large deficits, which, with the gross foreign reserves already having been exhausted, were mainly financed through an accumulation of arrears.

The Tanzania shilling has been pegged to a composite of the currencies of Tanzania's main trading partners since January 1979, when it was devalued by 10 percent and its peg to the SDR was discontinued. Subsequently, the shilling was devalued by 10 percent in foreign currency terms in March 1982, 20 percent in June 1983, and 26 percent in June 1984, to an exchange rate of T Sh 17 per U.S. dollar. However, despite these exchange rate adjustments, the real effective appreciation of the shilling between end-1978 and 1985 is estimated at about 112 percent (Chart 1) and a parallel exchange market has developed.

In 1984 Tanzania introduced an "own-exchange" import scheme in order to alleviate the domestic shortage of imported goods. The list of eligible commodities under the scheme was expanded in July 1984 to include building materials, textile goods, shoes, electrical appliances, tractors and spare parts, trucks, pickup vans, and buses. Also,in July 1984, an export retention scheme was introduced, whereby exporters were allowed to keep 10-15 percent of their foreign exchange proceeds and use them for the importation of inputs relating to their activities. Subsequently, the retention rates were increased to higher levels for some exporters. A tax rebate scheme (5-10 percent of value of exports), was in effect since 1981.

2. Developments in 1985/86

Tanzania's economic and financial situation continued to deteriorate in 1985 and through the first half of 1986; with external imbalances becoming more acute. Real GDP is estimated to have increased by 2.5 percent in 1985, primarily on account of a 3.5 percent increase in agriculture production attributed to improved weather conditions and to the easing of restriction on the marketing of food grains. However, the agricultural output growth was mostly in domestic food crops while the production of the principal export crops (coffee, cotton, tea and tobacco) either declined or stagnated. During 1985/86, inadequate price incentives (producer prices were increased by only 20 percent, implying a decline in real terms), shortages of essential inputs and transportation bottlenecks contributed to this decline. An acute shortage of fuel oil also affected the hauling of export crops to the ports and in turn reduced export earnings. This higher output of food crops and increased availability of imported commodities under the "own-exchange" import scheme contributed to a deceleration of the domestic inflation rate to 26 percent in 1985, compared with 36 percent in 1984.

Reflecting this continued decline in traditional agricultural exports, total export earning amounted to US$327 million in 1985, the lowest level in the past six years. The external current account deficit (excluding grants) rose by 16 percent to US$515 million (from the US$ 443 million annual average realized in 1983-84). Net capital receipts, including large unrecorded official transfers in the errors and omissions items of US$194 million in 1985, amounted to only US$ 320 million, as gross official inflows maintained their declining trends. As a result, the overall balance of payments registered a deficit of US$195 million, all of which was financed by a further build up of external payments arrears to an estimated US$638 million at end-1985 (including US$17 million to the Fund); among the accumulation of external payments arrears were payments for current transactions, oil payments, and debt service obligations, including to multilateral financial institutions. Reflecting this critical foreign exchange shortage and the increased utilization of own-exchange imports, the parallel market rate of the Tanzanian shilling is reported to have increased to T Sh 140 per U.S. dollar as of end-1985.

Tanzania's medium- and long-term external debt at end-1985 is estimated at US$3.2 billion and of commercial arrears at US$280 million. At the same time, the debt service ratio as a percentage of exports of goods, services, and private transfers has risen from 19 percent in 1982 to 56 percent in 1985, notwithstanding concessional terms of borrowing.

Preliminary estimates of the budgetary outturn for 1985/86 indicate that the overall budget deficit increased to about 8.5 percent of GDP. 1/ Total revenue is estimated to have increased by about

---

1/ This ratio underestimates the underlying structural deficit because of the substantial overvaluation of the currency (which reduces the external debt service and other external expenditure more than the loss of revenue from taxes on external trade), and the negative real interest rates. The staff estimates that if the average exchange rate expected in 1986/87 (see below) and the new interest rates on treasury securities announced for 1986/87 had been in effect during 1985/86, and assuming that nominal GDP would have also been 20 percent higher, the ratio of the overall budget deficit to GDP would have been about 7 percentage points higher in 1985/86.

14 percent, compared to the preliminary actual figures for 1984/85. Revenue from customs duties, and the sales tax on imports declined modestly, while income tax revenue rose by 33 percent, mainly because of an improvement in administration of the corporate income tax. The introduction of a payroll tax, increases in fees charged for services provided by the Government, and some increases in sales tax rates on local products also contributed to the increase in revenue.

Because a substantial amount of transactions are recorded in the closing days of the fiscal year, the preliminary expenditure estimates are much less reliable than the revenue estimates, in particular for 1985/86 because of the substantial devaluation in June 1986. Total expenditure (on a checks-issued basis) is presently estimated by the staff to have increased by 19 percent during 1985/86, with current expenditure increasing by 17 percent and development expenditure by 28 percent. However, compared with the original budget estimates, total expenditure and particularly recurrent outlays for defence and transfers were substantially higher.

Net external financing increased by T Sh 0.1 billion to T Sh 2.6 billion in 1985/86, while net nonbank financing declined from over T Sh 1.2 billion in 1984/85 to a more normal level of T Sh 0.5 billion in 1985/86, mainly because nonbank amortization payments increased sharply from their unusually low level in the previous year. Net bank financing rose from T Sh 3.1 billion in 1984/85 to T Sh 6.7 billion in 1985/86, equivalent to 11 and 20 percent, respectively, of the stock of broad money at the beginning of each period.

Based on preliminary data available for end-June 1986, total domestic credit rose by 29 percent (36 percent of the stock of money at the beginning of the period) primarily on account of the sharp increase in government borrowing during FY 1985/86. Non government bank borrowing also increased sharply (by 38 percent) mainly due to borrowing by the agricultural marketing boards, which accounted for over half of the credit expansion to the rest of the economy. Broad money is estimated to have increased by 22 percent in 1985/86, as some of the increase in credit was offset by the decline in net foreign assets (in the form of an increase in external arrears).

III. Adjustment Program for 1986/87

The program for 1986/87 is set within the medium-term context of the Government's recovery and rehabilitation program that envisages an average annual growth rate of 3.5 percent 1/ and the completion of the

---

1/ The attached Memorandum on Economic and Financial Policies refers to a growth rate of 4 percent based on the authorities' expectation of an import level of US$1,200 million. The program on the other hand assumes an import level of US$1,100 million (with oil prices assumed at about US$15 per barrel).

rehabilitation and recovery of the economy towards a sustainable growth and balance of payments within a period of 5-7 years. While the sustainability of economic growth and the balance payments is envisaged only after 5-7 years, full corrective policies will be in place within a maximum period of two years, with some of the elements of these policies being implemented up front.

The outlines of the Government's medium-term program were presented to the Consultative Group meeting in Paris on June 10-11 and its details will be finalized in the course of the discussions with the World Bank on a program loan (expected to be approved by the World Bank's Executive Board by end-October 1986) and with the Fund in the context of Tanzania's request for use of resources under the Fund's Structural Adjustment Facility. In the meantime, the program for the fiscal year 1986/87 has been devised with the medium-term balance of payments targets that envisage that by 1991 Tanzania would require minimal exceptional balance of payments support, in addition to rescheduling of the amortization and interest payments on loans contracted and used prior to mid-1986. However, at that time Tanzania would still have substantial obligations to repay in respect of its arrears accumulated up to 1986, will still need to reconstitute its external reserves up to a level of about two months of imports by 1991, and to make repurchases from the Fund in respect of purchases under the proposed stand-by arrangement.

For 1986/87, the program aims to constrain the external current account deficit to US$670 million (about 22 percent of GDP), with the resulting overall financing gap (after taking into account capital inflows out of existing commitments and normal additional inflows expected during the year) of about US$500 million. The authorities are seeking to cover the external gap through exceptional balance of payments assistance on concessional terms, debt rescheduling, World Bank assistance, and use of Fund resources. This overall financing gap takes into account a targeted increase of net official reserves of the banking system by US$20 million and a reduction, through cash payment, of the external payments arrears by US$50 million.

Other objectives of the 1986/87 adjustment program are to induce a growth rate of 3.5 percent of GDP through policies directed to increase agricultural and other production on a sustainable basis, and to increase domestic savings and investment principally for rehabilitation and maintenance of existing capital and for completion of ongoing projects which are essential for economic recovery. In line with this objective, domestic investment is envisaged to increase to about 23 percent of GDP in 1986/87 (from about 16 percent in 1985/86). The program also aims to limit the rate of inflation to 30 percent through restrictive financial policies which are programmed to contain both private and public consumption. As shown in Table 3, public consumption would rise only modestly through 1987, while private consumption is

Table 3. Tanzania: Gross Domestic Product and Expenditure, 1984-87

	1984 Act.	1985 Prel.	1986 Est.	1987 Proj.
	(In millions of Tanzania shillings)			
GDP at market prices	75,658	100,423	131,531	174,701
Consumption	71,579	97,473	127,585	166,242
Private	62,355	85,467	109,302	139,862
Government	9,224	12,006	18,282	26,380
Investment	10,982	13,196	25,385	47,841
Private, including increases in stock	4,754	6,232	13,416	18,813
Government	6,228	6,964	11,970	29,028
Export-import	-6,903	-10,246	-21,478	-39,382
Export	6,322	7,961	14,222	34,118
Import	13,225	18,207	35,700	73,500
	(As a percent of GDP)			
Consumption	94.6	97.1	97.0	95.2
Private	82.4	85.1	83.1	80.1
Government	12.2	12.0	13.9	15.1
Investment	14.5	13.1	19.3	27.6
Private	6.3	6.2	10.2	10.8
Government	8.2	6.9	9.1	16.6
Export-import	-9.1	-10.2	-16.3	-22.5
Export	8.4	7.9	10.8	19.5
Import	17.5	18.1	27.1	42.0
	(Annual percentage change)			
Real GDP	2.5	2.5	3.0	3.8
GDP at current market prices	14.7	32.7	31.0	32.8

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

estimated to decline to about 80 percent of GDP (from 85 percent in 1985).

The program for 1986/87, which is summarized in Annex 1, envisages a comprehensive set of measures to realize the stated targets. A pivotal role is assigned to providing the economy with appropriate price signals in the form of the exchange rate, and interest rates, combined with an enhanced price liberalization within the economy and a somewhat less restricted trade and exchange policy. In particular, the initial large depreciation of the T Shilling, and the proposed monthly flexibility in the conduct of the exchange rate policy have permitted the authorities to provide substantial real increase in producer prices which, combined with the hoped for increase in the imports of necessary inputs, spare parts, and incentive goods, should evoke greater production and export responses from the economy. These policies are being accompanied by a restrained fiscal and credit policy, including a 5 percentage point reduction in the overall fiscal deficit as a proportion of GDP (when the 1985/86 budget outturn is recast at the exchange rate expected to prevail in 1986/87), a 50 percent immediate increase in the general structure of interest rates, and only a 12 percent increase in total bank credit (equivalent to 16 percent of broad money outstanding at the beginning of the period). Also, the authorities will implement reforms to improve efficiency of the agricultural, industrial, and transport sectors during the course of the program period, within the framework of a program credit from the World Bank.

Given the critical nature of the resource constraint, the program places a greater emphasis on the monitoring of developments, with two reviews of the program scheduled, before end-February 1987 and end-July 1987. In addition, the follow-up on various performance criteria and indicative targets will permit the authorities a continuous monitoring of developments and any needed modification in policy implementation.

The following sections elaborate on various program targets and policy instruments proposed under the program.

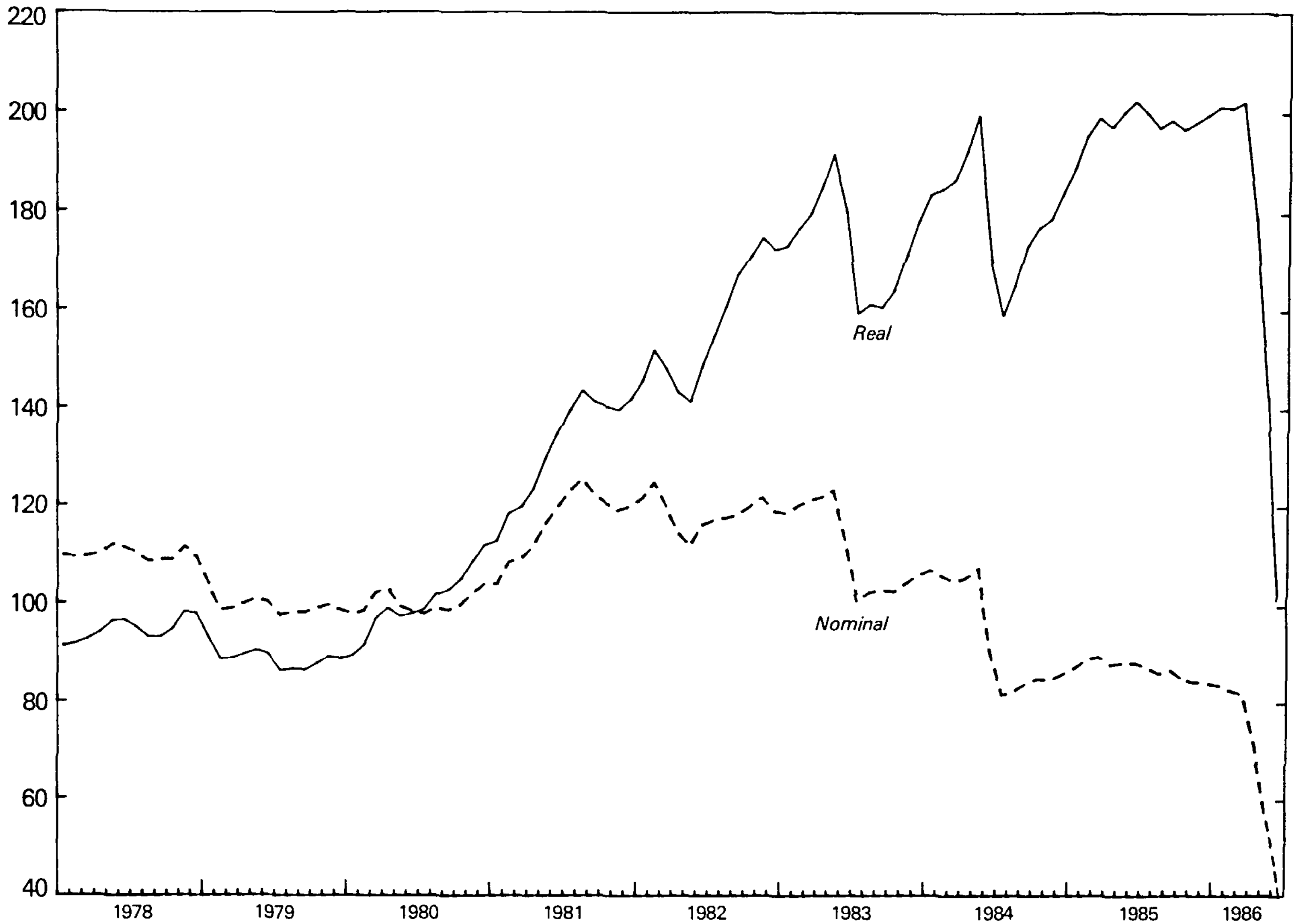
1. Exchange rate and trade policies

The adjustment program identifies the misalignment of the exchange rate as having been the principal factor underlying the decline in domestic production and the deterioration in the balance of payments. The Tanzanian authorities now recognize the need to move to an equilibrium exchange rate within a relatively short period in order to meet the objective of balance of payments sustainability by the early 1990s. It is their intention to establish an equilibrium exchange rate by no later than mid-1988. In line with this intention, the authorities began to adjust the exchange rate from about mid-April after preliminary discussions had taken place with the staff on a broad set of policies that could achieve the external target. By early June the exchange rate had been moved gradually from T Sh 17 = US$1 to T Sh 25 = US$1 and on

CHART

TANZANIA

NOMINAL AND REAL EFFECTIVE EXCHANGE RATES



Sources: IMF Information Notice System; and staff estimates.

June 19, concurrent with the presentation of the budget, the Tanzanian shilling was further depreciated to T Sh 40 = US$1. This latter exchange rate represents a depreciation of 57.5 percent in U.S. dollar terms (135 percent in terms of local currency) compared with the exchange rate prevailing in mid-April, and more than offsets the real effective appreciation of the shilling that has taken place since 1978 (Chart 1). It should be noted, however, that the real effective exchange rate index is based on the official consumer price index, which has been influenced by widespread price controls and subsidies, and the extent of the real appreciation could be higher than that indicated by the index.

Prior to undertaking this major first step, the Tanzanian authorities were made aware that such action would not fully correct for the substantial degree of over-valuation of the Tanzania shilling and could only be sustained by a continuation of trade and exchange controls, and that additional exchange rate action will be needed over the course of the program period to align it more closely to the equilibrium rate. Accordingly, exchange rate policy will be guided initially by the need to effect further real effective depreciations of the shilling. The real effective exchange rate of the shilling is to be adjusted by 1 percent each month against the basket of currencies to which it is pegged. Thus, nominal depreciation would equal the monthly percentage difference in the inflation rate in Tanzania and the weighted average inflation rate in the countries comprising the currency basket to which the shilling is pegged, plus an additional 1 percent. The rate of inflation in Tanzania will be measured by the change in the National Consumer Price Index (NCPI) and the change in the average weighted inflation rate in countries comprising the currency basket as indicated by consumer price indices as reported in IFS. 1/

While the programmed 1 percent per month real effective depreciation should be viewed as building on the depreciation of June 19, it may not be sufficient to ensure adequately rapid progress toward the attainment of the equilibrium rate. In this regard, the program provides for reviews of exchange rate policy to be undertaken with the Fund before end-February 1987 and end-July 1987, with a view to determining if additional depreciation may be needed and/or the monthly rate of depreciation to be accelerated to ensure a smoother attainment of the equilibrium rate. During the February review, attention will be focused on certain key elements in the balance of payments, including the satisfaction of the indicative net external assets target, the proportion of the demand for import licenses satisfied, and the inflow

1/ The NCPI is available on a quarterly basis only. In practice, therefore, monthly adjustments in the exchange rate will be based on the difference between the latest available quarterly NCPI data and the consumer price indices of the basket countries for the relevant month with compensating adjustments when the actual NCPI data become available. The performance criterion on exchange rate policy relates to end-quarter figures with a lag of one quarter.

of external assistance as compared to the present expectations. In this review, the staff will also consider the gap between the official and parallel market exchange rates as an important indicator of the extent of the overvaluation of the official exchange rate. The response of exports to the increases in producer prices and the progress made in further liberalizing the export retention scheme, as well as the import payments system, will also be taken into account. During the remainder of 1986, Tanzania will need to effect repurchases (SDR 3.3 million) to the Fund, make some cash reduction in payments arrears, and liquidate certain outstanding short-term deposit liabilities of the Bank of Tanzania. Given these needed reductions in external liabilities and the tight foreign exchange constraint, it is unlikely that there will be any increase in gross foreign reserves during this period.

In February 1986 the export earnings retention scheme was liberalized further, and the list of permissible imports under the "own exchange" scheme was expanded. Exporters of nontraditional exports became entitled to retain 50 percent of their foreign exchange earnings. For those exporters involved in a production activity this foreign exchange must be used to purchase imports essential to their production activities. For export traders, 50 percent of their retained foreign exchange must be used for imports of raw materials and spare parts, while the remaining 50 percent may be used to import goods on the enlarged "own exchange" scheme list for sale in the local market. In addition, the free transferability of retained earnings among export producers and from export traders to export producers through the normal banking channels and at prevailing official rates is now permitted. As progress is made toward the attainment of the equilibrium exchange rate, the authorities plan to terminate the scheme, thus implying a maximum life span of two years for the scheme. In the meantime, the authorities intend to review the scheme by August 1986 with a view to improving its working and facilitating access to foreign exchange by broadening the scope for transferability of retained export earnings.

The export tax rebate scheme, in existence since July 1981, under which exporters could claim rebates varying from 5-20 percent of the f.o.b. value of exports, depending on the commodity, and which gave rise to a multiple currency practice, was terminated in July 1986.

2. Agricultural sector policies

After the exchange rate policy, the provision of adequate incentives to producers constitutes the second most important area of the Government's adjustment efforts. In order to reverse the decline in agricultural output and exports, the Government has undertaken to implement, during the program period and over the medium term, policies aimed at providing adequate price incentives, accompanied by improvements in crop marketing and efficient supply and distribution of inputs. The authorities have adopted a medium-term policy to aim at producer prices that equal the higher of at least 60 percent of export prices, or provide a 5 percent annual increase in real terms. In recent years, the overvaluation of the Tanzania shilling and increasing domestic marketing costs have prevented the authorities from providing appropriate prices to producers. The recent exchange rate action provided the opportunity to give producers the needed incentives, and, effective July 1, 1986, producer prices were increased by 80 percent for coffee, 60 percent for cocoa and cardamom, 55 percent for tea and cashewnuts, and 30 percent for cotton and tobacco.

In deciding on the level of producer prices for the current crop season, the authorities have taken three principal considerations into account: the need to provide adequate incentives to producers in line with the above-mentioned medium-term policy, the need to avoid incurrence of operating losses by the marketing boards, and the need to integrate incomes policy with the restrained stance of the adjustment program.

As noted above, the agricultural marketing boards have been incurring large financial losses. Under the program, therefore, a part of the relief to be provided by the exchange rate action had to be absorbed by the need to eliminate these operating losses of the marketing boards. Simultaneously, to avoid the experience of the past two crop seasons, limits on bank credit to these boards are being established under the program (see below) and the authorities intend to examine the marketing situation in detail (including the institutional structure) in conjunction with their negotiations on a program loan from the World Bank and the SAF with the Fund. In the meantime, and on the basis of the announced producer prices, the overall financial operations of the marketing boards should be either in surplus or in an approximate balance, with the possible exception of the Cotton Marketing Board which is estimated to record a T Sh 450 million loss in 1986/87. On the other hand, the Coffee Marketing Board is projected to generate a surplus of about T Sh 1.5 billion (Table 4), as a result of the higher average export prices estimated to be realized in 1986/87.

The projected surplus of the Coffee Marketing Board could have been used to provide an additional price increase to the producers. However, the overall demand-management considerations, apart from the presumably temporary nature of the higher export prices being realized, precluded such a step. The announced 80 percent increase in nominal prices would add about T Sh 1.8 billion to coffee producers, thus raising the total additional income in the hands of coffee farmers by over 83 percent in nominal terms, as against an estimated increase of about 32 percent in nominal GDP. A higher producer income could have generated further demand pressures, and probably put an even greater squeeze on the urban wage earners. Instead, the authorities have decided that this surplus would be invested in government securities, held currently in bank portfolios, to establish a stabilization Fund for the farmers.

For most export crops, the proposed producer prices would reverse the decline in real producer prices since 1974/75. With the main exception of cotton and tobacco, for the current crop season, farmers

Table 4. Tanzania: Financial Operations of Major Agricultural Marketing Boards

(In Tanzania shillings per kg, unless otherwise indicated)

	Coffee		Tea		Cashewnuts		Cotton	
	1985/86	1986/87	1985/86	1986/87	1985/86	1986/87	1985/86	1986/87
Total receipts	65.0	149.6	33.3	74.6	17.0	41.4	3.4	13.8
Sales price (T Sh/kg)	60.1	142.6	32.3	73.6	17.0	41.4	3.4	13.8
Other income	4.9	7.0	1.0	1.0	--	--	--	--
Total costs	62.7	123.5	44.8	72.6	25.3	33.3	17.4	25.4
Producer price	39.0	70.2	23.5	36.4	11.6	18.0	12.4	16.1
Co-op union costs	5.6	10.1	...	...	3.2	5.2	1.8	3.4
Other operating costs	18.1	43.2	21.3	36.2	10.5	10.1	3.2	5.9
Operating profit/loss	2.3	26.1	-11.5	2.6	-8.3	8.1	-14.0	-11.6
Quantity purchased ('000 tons)	55	56	5.2 1/	6.2 1/	25	35	40	40
Total profits/losses (T Sh million)	127	1,462	-60	16	-208	280	-560	-464
Memorandum items:								
Farmers' receipts	2,145	3,931	586	1,085	290	630	496	644
Percent change	...	83.3	...	85.2	...	117.0	...	30.0

Source: Data provided by the Tanzanian authorities.

1/ Made tea equivalent to one fifth of green-leaf tea.

are being provided real increases in prices ranging between 20 and 42 percent, the highest annual increase ever provided to farmers in Tanzania. These increases should stimulate production and reduce the incentive to market through unofficial channels. As shown in Table 4, in 1986/87, farmers' income from the main export crops would increase by 83-117 percent compared to 1985/86 (except for cotton farmers with a rise of only 30 percent), thus signaling a significant shift in incomes to farmers.

As regards domestic food products, the producer prices are no longer established as maximum prices. Instead, for maize (the main food crop), the National Milling Corporation (NMC), which previously had monopsony as the sole buyer, now stands ready to buy the produce in support of the guaranteed minimum producer prices. Trading in maize has been liberalized partially by allowing private trading up to a designated amount.

The Tanzanian authorities are expected to agree with the World Bank, in the context of its program credit, on measures to improve the efficiency of crop procurement, internal grain distribution, and the supply and distribution of essential inputs and, under the program with the Fund, to implement those measures no later than end-1986. Most agricultural inputs can now be imported only by designated parastatals (e.g. Tanzania Fertilizer Company and Tanseed) which retail at limited outlets, with the result that the input delivery system has not been extensive or efficient. The authorities recognize that an appropriate modification of the current institutional structure would be crucial for the recovery of the agricultural sector.

3. Fiscal policies

To achieve its basic objectives, the program calls for a substantial reduction in the underlying budgetary deficit as the primary instrument to restrain demand and improve domestic savings. Thus "hidden" subsidies to the budget, for example, in the form of an overvalued exchange rate and negative real interest rate on treasury borrowing, would be gradually eliminated in the course of the first two years of the recovery program and the aim would be to generate savings in the public sector to finance a significant part of investments in the economy. The taxation system would be modified to improve its elasticity. For 1986/87 (July-June), the authorities have taken measures toward achieving those objectives and to reduce the reliance on domestic bank financing. With foreign grants treated as a financing item, while the apparent ratio of overall deficit to GDP is estimated to increase from 8.5 percent in 1985/86 to 11.1 percent in 1986/87, however, if the exchange and interest rate adjustments are included in the 1985/86 budget, the overall deficit in 1986/87 would have been reduced by about 5 percentage points. 1/ At the same time, the current

---

1/ The overall deficit to GDP ratio would have been 16.3 percent of GDP in 1985/86. This calculation assumes nominal GDP in 1985/86 would have been 10 percent higher than our present estimates and that nominal GDP in 1986/87 would have increased by 22 percent.

account deficit is projected to be reduced by nearly one third to about T Sh 2.0 billion (1.4 percent of projected GDP, compared to 2.6 percent in 1985/86).

Total revenue is projected to increase by 58 percent in 1986/87, or by 4.4 percentage points to 22.4 percent of GDP, while total expenditure is projected to increase by 62 percent (or by 6 percentage points to 32.6 percent of GDP), with current expenditure increasing by 47 percent and development expenditure and net lending increasing by 119 percent. The main factor contributing to the sharp increases in revenue and expenditure are the price changes resulting from the large devaluation in local currency terms.

The budget for the program year 1986/87 seeks to improve the elasticity of the revenue system, while reducing the disincentive effects of the extremely high marginal income tax rates. Additional revenue measures were also taken to contain the fiscal deficit, including adjustments on import duties and sales taxes. Accordingly, revenues from customs duties and sales tax on imports are expected to increase by over 200 percent as a result of the devaluation and a conservative estimate of a 13 percent increase in the dollar value of imports. In addition, customs revenue is expected to increase by T Sh 255 million as a result of an increase in the rate of duty on many items from 20 percent to 25 percent. In an effort to enhance the price elasticity of the tax system, almost all of the remaining specific local sales tax rates were converted to ad valorem rates. This shift to ad valorem rates combined with the commitment to fully pass on increased costs, particularly those resulting from the devaluation, is expected to result in about a 56 percent increase in revenue from the local sales tax. These higher costs of imported inputs and the conversion of the specific rates to ad valorem rates on beer, liquors, soft drinks, and cigarettes alone are estimated to yield over T Sh 2.0 billion in additional revenue.

The specific rates on regular and premium gasoline and on liquified petroleum gas were converted to ad valorem rates at roughly the old equivalent ad valorem rates, while the specific rates on jet fuel, diesel oil, industrial diesel oil and fuel oil were increased (in each case raising the ad valorem equivalent rate). The specific rate of tax on kerosene, which accounts for 13 percent of petroleum product consumption, was left unchanged. The additional revenue from petroleum is estimated to be about T Sh 600 million. The sales taxes on most other products are already on an ad valorem basis, and it is expected that the price increases announced on July 25, which take account of increased costs, particularly for imported inputs, will yield close to another T Sh 1.0 billion in additional revenue.

While the revenue from goods and services taxes is expected to increase sharply in 1986/87, revenue from income taxes is expected to increase by less than 10 percent, because of a number of measures which will reduce revenue from this source: (1) the range of personal income tax brackets was reduced from 25-95 percent to 20-75 percent; (2) the minimum monthly taxable income level was raised; (3) the first T Sh 20,000 of interest income from banks was made exempt from income tax; (4) the amount of deduction permitted for housing allowances was increased; and (5) the 20 percent investment deduction for capital expenditure by companies in the industrial sector was extended to the agricultural sector. In addition, there were increases in airport service charges and the introduction of toll charges on certain road and ferries.

As explained in some detail in the footnotes to Table 5, the 1986/87 budget presentation was prepared without taking full account of the programmed exchange rate adjustments, while estimates under the program reflect the impact of the exchange rate policy. Thus, the level of current expenditure, is about T Sh 510 million higher than the budget estimates. The program estimates also assume that development expenditure will be T Sh 1.0 billion less than the estimate included in the budget. This is considered a conservative estimate of the likely shortfall and assumes a considerable improvement in the implementation of development projects, as actual development expenditure normally falls substantially short of the budget estimate.

The Government has taken measures to reduce its share of certain types of expenditure. With effect from January 1987, parents will be required to make larger payments to cover part of the expenses of secondary education, technical colleges, and other schools and training institutions. In most cases, the Government will also abolish pre service allowances to students in schools and training colleges or institutions. The current practice of providing free transport to most senior employees, which has resulted in increasing costs of maintaining and running government vehicles, is being limited. Instead, the Government will give soft loans to civil servants to buy the needed transport vehicles from the Government and will provide allowances for running the vehicles for government business, but maintenance costs will be the responsibility of the owners of the vehicles. The Government is also abolishing all subsidies to parastatals and has abolished the export bonus scheme effective July 1986. Employment levels in all sectors of the civil service, except for teachers and medical personnel, are being frozen.

The budget provides for a 20.3 percent increase in the total wage bill in order to partially compensate employees for increases in their cost of living. The authorities regard this as a modest adjustment, in light of the fact that there has been no general wage increase over the past two years, during which time the cost of living has increased by nearly 70 percent. Teachers have been granted an allowance equal to 25 percent of their gross salaries, while other civil servants have been

Table 5. Tanzania: Central Government Operations, 1983/84-1986/87

	1983/84 Prov.	1984/85 Prov.	1985/86 Revised Estimates	1986/87 Budget 1/	1986/87 Program Estimates
	(In millions of Tanzania shillings)				
Total revenue	14,426	18,228	20,840	33,416	32,899
Tax revenue	13,711	17,228	19,687	31,989	31,843
Customs duty	959	1,531	1,435	4,935	4,935
Sales tax (imports)	1,492	1,276	1,258	3,943	3,943
Sales tax (local)	6,418	8,878	9,409	14,533 2/	14,711 3/
Income tax	4,083	4,678	6,235	7,105	6,781 4/
Other taxes	759	865	1,350	1,473	1,473
Nontax revenue	715	1,000	1,153	1,427	1,227 5/
Safety margin					-171 6/
Total expenditure	29,886	25,699	30,700	50,389	49,899
Current expenditure	16,174	20,376	23,900	34,530	35,040
Development expenditure and net lending	4,712	5,323	6,800	15,859	14,859 7/
Overall deficit (checks-issued basis)	-6,460	-7,471	-9,860	-16,973	-17,000
Adjustment to cash and other items (net)	-3	628	--	--	--
Overall deficit (checks-cashed basis)	-6,463	-6,843	-9,860	-16,973	-17,000
External grants and loans (net)	1,464	2,500	2,600	13,473	13,800
Domestic financing	4,999	4,343	7,260	3,500	3,200
Bank financing (net)	4,492	3,112	6,740	2,500	2,500
Nonbank financing (net)	507	1,231	520	1,000	700
	(In percent of GDP)				
Total revenue	20.4	20.7	18.0	21.8	21.4
Total expenditure	29.5	29.2	26.5	32.9	32.6
Current expenditure	22.8	23.1	20.7	22.6	22.9
Development expenditure	6.9	6.0	5.9	10.4	9.7
Overall cash deficit	9.1	7.8	8.5	11.1	11.1
Bank financing	6.3	3.5	5.8	1.6	1.6

Source: The Tanzanian authorities; and staff estimates.

1/ The 1986/87 budget presentation was complicated by the fact that the decision to move the exchange rate in line with the negotiations with the Fund (an average rate of T Sh 49.55 = US$1) was not taken until shortly before presentation of the budget. Thus, the current expenditure figures contained in the budget were based on an exchange rate of T Sh 17 = US$1, or a rate of T Sh 25 = US$1 in the case of amortization and foreign interest payments.

2/ The figure presented in the budget for revenue from local sales tax was T Sh 14,533 million, but this figure contained an overestimation of T Sh 913 million so that the figure in the budget should have been T Sh 13,620 million.

3/ The program estimate of sales tax local excludes the above T Sh 913 million from the budget figure. However, it also estimates that price changes on price-controlled products subject to local sales tax will add T Sh 1,127 million above what was assumed in the budget estimates. Actually the estimated additional revenue is T Sh 1,298 million, but T Sh 171 million is dept as a safety margin (see footnote 6).

4/ The program estimate assumes that revenue from PAYE income tax will be T Sh 324 million less than the optimistic figure included in the budget, which expects a sharp increase due to enhanced enforcement during the year.

5/ The program estimate excludes T Sh 200 million included in the budget as a contribution from Zanzibar, but which has not actually been paid in the past.

6/ The program changes in the revenue estimates plus the program changes in the expenditure estimates leave a balance of T Sh 171 million, which is kept as a safety margin, rather than being used to increase expenditure or reduce the deficit below T Sh 17,000 million.

7/ The program estimates assume that development expenditure will be T Sh 1,000 million less than the estimate included in the budget.

granted increases ranging from 30 percent at the lowest end of the salary scale to 2.5 percent at the upper end of the salary scale. However, because of the differential impact of the reductions in income tax rates, which will have a relatively higher benefit for those in the upper end of the salary scale, the increase in net after tax income will range from 30 percent at the minimum wage to a little over 14 percent at the upper end of the salary scale.

The priority in development expenditure is given to projects already under implementation and on rehabilitation of existing structures, with the emphasis placed on the agricultural, manufacturing, and economic services sectors. New projects are limited to those considered essential to the effort to rehabilitate the economy. The Government proposes to review its investment program for 1986/87 with the World Bank in an effort to ensure that it is consistent with the rehabilitation and recovery priorities.

The Government is committed to enhancing the control over expenditure. Since February 1986 the Ministry of Finance has sought to bring expenditure under control by at least temporarily dishonoring checks issued in excess of monthly allocations. In order to ensure the success of the program of expenditure restraint, to avoid past problems of expenditure overruns and to avoid the need to dishonor government checks in the new fiscal year, starting in July, the Ministry of Finance is enforcing the maintenance of ledgers on a commitment basis and of records of checks issued. Moreover, spending departments are required to report these data more fully and promptly. Financial officers from the Ministry of Finance will be empowered to make sure that total commitments do not exceed allocation limits for each department and this process will be enforced by withholding from any delinquent reporting departments part of the subsequent monthly release of allocations.

Also under the program, to closely monitor revenue and expenditure developments, indicative quarterly targets have been established for revenue, recurrent expenditure, and development expenditure. In addition, quarterly ceilings of overall budget deficit have been set as performance criteria (Table 6).

The quarterly quantitative performance ceilings on the overall deficit, as well as the indicative targets for current expenditure and total expenditure are based on cash revenue data and checks issued expenditure data, because cash expenditure (i.e., checks cashed) data are only available with a substantial lag. Because these data are not affected by the check float at the end of the fiscal year, the seasonal pattern used to set targets and ceilings differs from that used to set the bank credit ceilings. The normal check float at the end of the fiscal year is over T Sh 1.0 billion, or equal to over 40 percent of the maximum permissible increase in bank credit to Government of T Sh 2.5 billion during 1986/87. Since the normal check float is such a large percentage of the total annual bank credit increase envisaged for 1986/87, the ceiling on the increase in bank credit in the first quarter

Table 6. Tanzania: Cumulative Revenue, Expenditure, Overall Deficit and Bank Credit Targets and Ceilings

(In millions of Tanzania shillings)

	July-Sept. 1986	July-Dec. 1986	July 1986-March 1987	July 1986-June 1987
Revenue	6,600	14,800	23,050	32,899
Total expenditure (excluding amortization)	9,247	20,075	30,954	49,899
Recurrent	6,870	14,575	21,954	35,040
Development	2,377	5,500	9,000	14,859
Overall deficit	2,647	5,275	7,904	17,000
Net bank credit to Government	1,600	1,800	... 1/	2,500

Source:

1/ This ceiling will be established during the February 1987 review.

is set at 64 percent of the ceiling for the entire fiscal year, while the ceiling on the overall deficit for the quarter is equal to only 16 percent of the deficit envisaged for the year, with about 20 percent of the total revenue and 19 percent of total expenditure expected to occur during that quarter.

4. Monetary and credit policies

Monetary and credit policies will be restrained, through a lower rate of credit expansion and higher interest rates, in order to limit the impact on prices and to support the balance of payments objectives. Accordingly, the net domestic credit expansion of the banking system will not increase by more than 12 percent for the period July 1, 1986, to June 30 1987; compared with a 29.3 percent increase in 1985/86. This lower credit expansion will be obtained by a targeted reduction of government borrowing from the domestic banking system to a maximum of T Sh 2.5 billion (compared with an estimated increase of T Sh 6.7 billion in 1985/86). In addition to the planned reduction of government borrowing, bank credit to the specified seven agricultural marketing boards would be contained during the program period. The gross indebtedness of these specified boards to the banking system is programmed to increase by not more than 10 percent or 0.6 billion in 1986/87, in view of the actions taken in respect of the exchange rate and producer prices. Thus within the reduced overall credit expansion there would be adequate room for the expansion of credit (21 percent) to the rest of the economy, including the private sector and the rest of the parastatals. In the event the budget receives external assistance in excess of what is assumed presently, the permissible level of bank credit to Government will be reduced correspondingly, and the full amount of such credit released would become available to the private sector. Given the projected improvement in the net foreign assets of the banking system by US$20 million, the allowed expansion in credit would result in an 11 percent growth of broad money (Table 7). This targeted monetary expansion is substantially lower than the preceeding year's monetary growth of 21.5 percent, and is significantly below the estimated 32 percent increase in nominal GDP. As a result, the velocity of circulation is projected to increase from 2.9 to 3.4, primarily due to chanelling of more transactions through the official market, which should reduce the need for holding large currency balances.

In order to monitor credit policy closely under the program, quarterly ceilings have been established as performance criteria for the net domestic credit of the banking system; for the net domestic borrowing by the Government, and for bank credit to the following seven specified marketing boards (coffee, cotton, cashew, tea tobacco and sisal, and the National Milling Corporation). As shown in Table 7, the cumulative increase in the net domestic credit of the banking system, which is estimated at T Sh 52,212 million as of end-June 1986, will not exceed T Sh 4,600 million during June-September 1986, and T Sh 6,309 million during June-December 1986. The subceiling on net domestic borrowing by the Government from the banking system, which is

Table 7. Tanzania: Monetary Survey, 1981-87

(In millions of Tanzania shillings)

	1982	1983	1984	1985		1986			1987	
	Dec.	Dec.	Dec.	June	Dec.	June Est.	Sept.	Dec.	March	June
Foreign assets (net) 1/	-4,187.2	-5,367.2	-7,099.2	-7,611.9	-11,356.0	-14,755.5	-14,751.1	-14,513.5	-14,089.3	-13,555.5
Medium-term foreign liabilities	--	--	--	--	--	--	-528.0	-1,500.0	-2,398.5	-3,600.0
Domestic credit	26,234.0	30,377.9	37,024.4	40,392.2	49,299.8	52,212.0	56,812.0	58,512.0	58,872.0	58,477.0
Claims on Government (net)	17,763.2	20,880.2	25,432.4	27,028.2	32,559.3	33,772.0	35,372.0	35,572.0	35,772.0	36,272.0
Claims on public entities and private sector	8,470.8	9,497.7	11,592.0	13,364.0	16,740.5	18,440.2	21,440.0	22,940.0	23,100.0	22,205.0
Of which: crop marketing boards	(5,914.2)	(6,673.2)	(5,023.0)	(6,782.3)	(6,145.0)	(6,145.0)	(7,645.0)	(8,695.0)	(7,496.0)	(6,770.0)
Money and quasi-money	21,787.0	24,664.4	30,197.8	32,885.4	38,501.8	39,969.3	44,044.1	45,051.7	45,061.9	44,233.1
Currency and demand deposits	15,406.6	16,190.3	20,780.3	22,594.7	24,999.6	25,768.2				
Time and saving deposits	6,380.4	8,474.1	9,417.5	10,290.7	13,502.2	14,201.1				
Other items (net)	259.8	346.0	-272.6	-105.1	849.0	849.0	849.0	849.0	849.0	849.0
Valuation account	...	...	...	...	-1,405.6	-3,360.6	-3,360.2	-3,402.6	-3,526.6	-3,760.6

Sources: Data provided by the Tanzanian authorities; and staff estimates.
1/ Includes external payment arrears.

estimated at T Sh 33,772 million as of end-June 1986, will not increase by more than T Sh 1,600 million by end-September 1986, T Sh 1,800 million by end-December 1986, and T Sh 2,500 million by end-June 1987, over the actual end-June 1986 level. However, the relevant performance criterion for March 1987 will be established in the context of the end-February 1987 review. These quarterly ceilings on net credit to Government will be reduced if the external inflow through the budget exceeds the Tanzania shilling equivalent of US$36 million (T Sh 1,534 million) by end-September 1986, US$108 million (T Sh 4,911 million) by end-December 1986, and US$270 million (T Sh 13,697 million) by end-June 1987.

Also credit to the specified seven marketing boards which is estimated at T Sh 6,145 million as of end-June 1986, will not increase by more than T Sh 1,500 million between end-June and end-September 1986, and by more than T Sh 2,550 million between end-June and end-December 1986. The relevant performance criteria for March and June 1987 will be established in the course of the end-February 1987 review. It may be noted that the permitted gross increase in credit to these marketing boards contrasts with a reduction in similar credit last year. This is explained by the substantially increased producer prices, as well as the program's requirement that the boards pay cash for all purchases.

As mentioned earlier, the Coffee Marketing Board is expected to make operating profits, and, as an indicative target, is expected to invest T Sh 1.0 billion in government securities presently held by the banking system. The program envisages that this investment will be neutralized by providing for a corresponding reduction in ceilings on the total bank credit, as well as net credit to Government. Should this materialize, monetary expansion will be correspondingly lower.

The objective of interest rate policy is to attain a positive interest rate structure within a minimum period of two years, i.e., by mid-1988. As a first step, all deposit and lending rates were adjusted effective July 1, 1986 with the rate on one year saving deposits increased to 15 percent (from 10 percent) and for fixed deposits, of more than 24-month maturity, to 16-19 percent. Lending rates were adjusted to a range of 13-21 percent from 11-15 percent, with consumer loans attracting the higher rate and agricultural, cooperatives and small scale industries obtaining the more preferential lending rates. Interest rates on treasury bills were increased from 6.0 to 9.5 percent for 91-day maturities, and 13 percent for 2-year maturities. In addition the authorities have undertaken to adjust all interest rates, except the treaasury bill rate, quarterly, beginning during the third quarter of 1986, and to reach no less than 75 percent of the average inflation rate of the last twelve-month period for which price data is available, by no later than end-June 1987.

5. Domestic pricing and other structural reforms

The number of products under price controls has been significantly reduced from about 400 products types, when such controls were introduced in 1973, to about 47 commodity types which were controlled by the National Price Commission as of mid-1986. Under the program, the authorities will continue this process of decontrol. For this purpose, the authorities have identified a "negative list" of 12 categories of commodities which are considered basic necessities and whose prices will continue to be administratively determined. 1/ All other commodities would be decontrolled over a three-year period, with one third already specified to be decontrolled in the first year of the program. 2/ For the commodities to be decontrolled over the next two years, as well as those to remain under price control, frequent price adjustments will be made to ensure that the increased costs of production including the impact of the exchange rate adjustments will be passed through to the consumers and to avoid putting excessive pressures on the financial viability of the enterprises concerned. Consistent with this policy the controlled prices of a number of commodities were increased effective July 25, 1986, and additional prices will be decontrolled during July/August 1986.

As a further indication of the Government's commitment to its declared intention of appropriate pricing of all commodities, retail prices of petroleum products were adjusted effective June 20, 1986 by about 50 percent for kerosene, diesel oil and liquified petroleum gas, by 55 percent for gasoline, and by 68 percent for jet fuel, so as to reflect the impact of the exchange rate depreciation, the changes in world market prices 3/ and the new ad valorem rates of taxation. The authorities have continued the cross subsidies on kerosene and diesel oil which will be financed by the surplus generated by other petroleum products. Also in the case of maize and maize flour the authorities have decontrolled prices and have eliminated direct budgetary subsidies.

The authorities regard the structural policies as an integral part of their medium-term adjustment and recovery program. As noted above, the Government intends to continue its efforts to improve the marketing of agricultural products and the efficiency of the parastatals, and will implement cost saving measures in their operations. Also, in collaboration with the World Bank the needed reforms in internal grain marketing and deconfinement of inputs supply and distribution will be introduced. The authorities also view improvements in the present low

---

1/ The negative list comprises cement, cooking oils, farm implements, corrugated iron sheets, fertilizer, milk, petroleum products, safety matches, soap, sugar, and tires.

2/ Products decontrolled as of July 1986 are aluminum containers, cotton wool, blended polyester, electric bulbs and tubes, mosquito coils, knitted polyester, plastic containers, torches, louver frames, steel products, vacuum flasks, and wire products.

3/ Assuming oil prices at about US$15 per barrel.

capacity utilization in the industrial sector and a selectively more efficient functioning of the transport system as essential components of the recovery program. The existing shortages of essential inputs and spare parts needs to be addressed but also policy changes are required to lead to efficient operations in both sectors. Accordingly, a rehabilitation and reform program will be implemented to improve the operational efficiency of selected viable enterprises which are essential for the recovery of domestic production and exports in the context of the World Bank program loan.

6. Program targets and financing for 1986-87

The immediate objective of the adjustment program is to reverse the deteriorating economic performance, especially in the external accounts, that has taken place over the past 5-6 years and allow a sufficient level of imports to underpin this recovery. In the first year of the program (which coincides with the Tanzanian fiscal year) exports are projected to attain about US$410 million. Official and private transfer receipts plus medium- and long-term capital inflows, mainly from existing contracts, and normal import support from major donors should provide an additional US$743 million. Abstracting from import requirements, other total foreign exchange commitments are estimated to amount to US$560 million, including about US$237 million in service payments (mainly interest), US$180 million in amortization of medium- and long-term loans, some US$30 million in respect of IMF repurchases (including the elimination of US$25 million overdue obligations), and a cash reduction in commercial and other payments arrears of some US$25 million (Table 8). In the absence of additional financing, total net foreign exchange availability would thus amount to about US$593 million. With the economic recovery program in place it is expected that additional financing of about US$500 million would be available, with resources under the stand-by arrangement and the Structural Adjustment Facility providing US$75 million and the World Bank's multi-sector rehabilitation credit a minimum of US$100 million. At the consultative group meeting held in Paris on June 10 and 11, 1986, donors pledged about US$130 million in addition to their normal aid commitments. In pledging additional assistance, however, the donor community made it clear that such assistance was based on the assumption that a stand-by arrangement with the Fund would remain operative. Tanzania has already made an approach to the Paris Club and other official creditors for debt relief on current maturities in respect of medium- and long-term debt and existing payments arrears in respect of all obligations. The projected debt relief, combined with the above mentioned external assistance, would allow the import bill to attain about US$1,100 million, a level not far short of the US$1,200 million established by the government in its economic recovery program, and representing an increase in real terms of some 15 percent over the 1985 outcome.

In addition to the exceptional financing granted by the donor community, and the debt relief on current maturities that Tanzania is seeking from the Paris Club and its other official creditors, Tanzania

Table 8. Tanzania: Balance of Payments, 1982-85, 1986/87

(In millions of U.S. dollars)

	1982	1983	1984	1985	1986/87 Program
Trade account	-681.6	-440.0	-470.5	-572.7	-690.0
Exports, f.o.b.	413.0	378.8	368.9	327.3	410.0
Imports, c.i.f.	-1,094.6	-818.8	-839.4	-900.0	-1,100.0
Oil	(-251.8)	(-229.9)	(-227.4)	(-229.8)	(-196.2) 1/
Own exchange	(...)	(...)	(-40.0)	(-120.0)	(-135.0)
Other	(-842.8)	(-589.0)	(-571.9)	(-550.2)	(-768.7)
Services (net)	12.4	-14.6	-43.2	-71.9	-112.4
Receipts	117.3	108.1	107.4	103.0	125.0
Payments	-104.9	-122.7	-150.6	-174.9	-237.4
Interest 2/	(-54.1)	(-55.8)	(-89.3)	(-90.8)	(-144.9)
Other	(-50.8)	(-66.9)	(-61.3)	(-84.1)	(-92.5)
Private transfers (net)	25.4	18.9	63.0	130.0	132.5
Inflows	41.5	38.9	80.9	150.0	155.5
Outflows	-16.1	-20.0	-17.9	-20.0	-23.0
Current account	-643.8	-435.7	--450.6	-514.6	-669.9
Government transfers (net)	93.7	84.4	96.5	106.5	215.2
Inflows	95.6	88.7	100.0	110.0	219.2
Outflows	-1.9	-4.3	-3.5	-3.5	-4.0
MLT loans (net)	240.5	149.9	-74.1	-18.5	-19.2
Inflows	285.6	252.7	182.8	200.0	160.0
Outflows	-45.1	-102.8	-256.9	-218.5	-179.2
Suppliers' credits (net)	57.6	101.8	109.8	-32.0	-48.5
SDR allocation	--	--	--	--	--
Import support	91.7	60.6	49.1	70.0	83.5
Errors and omissions 3/	50.1	20.0	110.6	194.0	—
Overall balance	-110.2	-19.0	-158.7	-194.6	-438.9
Financing	110.2	19.0	158.7	194.6	-69.0
IMF 4/	(-11.5)	(-29.9)	(-27.5)	(-14.2)	(-29.0)
Reserves (- increase)	(28.8)	(-15.1)	(3.1)	(10.0)	(-15.0)
Arrears	(92.9)	(64.0)	(183.1)	(198.8)	(-25.0)
Financing gap	--	--	--	--	507.9 5/

Source: Data provided by the Tanzanian Authorities and staff estimates.

1/ If oil prices turn out to be lower than the assumed US$15 per barrel, the oil import bill will be lower and the nonoil imports will be higher.
2/ Includes interest on gap financing and on commercial arrears outstanding.
3/ Prior to 1986 includes a portion of official transfers.
4/ Includes elimination of overdue obligations in 1986.
5/ The gap would be financed by purchases from the Fund, a World Bank program loan, exceptional BOP assistance by donor countries and rescheduling of debt outstanding to official creditors.

is also seeking from official creditors a rescheduling of all external payments arrears that have arisen since the late 1970s. On the basis of the banking records, which may underestimate the level of arrears, external payments arrears were estimated at US$637 million (including US$17 million to the Fund) as of end December 1985. Arrears recorded by the National Bank of Commerce (NBC) relate to import payments and other current payments as well as to external debt service payments by parastatals which are effected through NBC, and amounted to US$490 million at end December 1985, of which arrears in respect of commercial transactions and service payments recorded by NBC were about US$310 million. Arrears recorded by the Bank of Tanzania relate to external debt obligations of the Central Government and are based on checks issued by the Government but not externalized; such arrears stood at US$147 million at end-1985.

Tanzania's request for a rescheduling from official creditors is expected to cover arrears on all obligations. As regards the nonguaranteed commercial arrears and arrears to multilateral institutions, a means needs to be found of ensuring their orderly settlement. The program assumes that a combination of rescheduling and cash payments in regard to these arrears will be devised to ensure their orderly elimination. In 1986 only small cash payments will be possible given the tight foreign exchange constrTabn. As a performance criterion, the program specifies that Tanzania would reduce its existing arrears by cash payments by US$50 million between July 1, 1986 and June 30, 1987, of which the arrears reduction would amount to at least US$25 million before end-September 1986, and US$30 million before end-December 1986. In addition, as a performance criterion, no new arrears would be accumulated during the program period except against debt service obligations under Tanzania's request to official creditors, until the Paris Club meets to consider such a request.

In view of this constraint and the evident difficulties that Tanzania has encountered in servicing its external debt obligations, the program establishes strict limits on the contracting of new nonconcessional loans of a maturity of up to and including 15 years. This limit is zero for all government and government (or central bank) guaranteed debt, as well as other public debt, except that producing enterprises in the public sector may contract such loans aggregating no more than US$50 million. Normal short-term import credits are also allowed under the program.

7. Performance criteria and review clauses

The stand-by arrangement includes the following performance criteria, and the quantitative ceilings are specified in Table 9:

(i) Ceilings on the net domestic credit of the banking system; through end-December 1986;

(ii) Subceilings on net bank credit to Government; through June 30, 1987, with March 1987 as an indicative target.

Table 9. Tanzania: Quantitative Ceilings and Performance Criteria, 1986/87

	June 1986 Est. 1/	July-Sept. 1986	July-Dec. 1986	July 86-Mar. 87	July 86-June 87
		1986 Performance criteria			
	(In millions of U.S. dollars)				
Cumulative reduction of external arrears (end of period) (including IMF)	720	25	30	40	50
New external payments arrears (gross)	--	--	--	--	--
Increase in public and publicly guaranteed short-term external debt 2/	...	--	--	--	--
Government's contracting and guaranteeing of nonconcessional loans of 1-15 years maturity	...	50	50	50	50
	(In millions of Tanzania shillings)				
Change in total bank credit 3/	52,212	4,600	6,309	...	...
Increase in net central government domestic bank borrowing 3/	33,772	1,600	1,800	...	2,500
Bank credit to specified marketing boards	6,145	1,500	2,550	...	...
Indicative total central government expenditure targets	...	9,247	20,075	30,954	49,899
Indicative central government recurrent expenditure targets	...	6,870	14,575	21,954	35,040
Overall central government deficit	...	2,647	5,275	7,904	17,000

1/ Data represent the estimated stocks outstanding at the end of June 1986.
2/ Excludes bridging finance and import-related credits.
3/ Excludes non-negotiable securities issued to cover devaluation losses on nongovernment external payments arrears.

(iii) Subceilings on banking system credit to seven specified marketing boards (coffee, cotton, tobacco, tea, sisal, cashew nut and the NMC boards);

(iv) The agreed policy in respect of the exchange rate adjustments;

(v) Limits on the quarterly overall budget deficit;

(vi) Reduction in commercial payments arrears through cash payments; and an injunction against the accumulation of any new external payment arrears, except that debt service for which Tanzania has requested a rescheduling from its official creditors, which will not be subject to this performance criterion until the Paris Club meets.

(vii) Limits on new govenment or government-guaranteed borrowing on commercial terms with maturity of more than 1 and up to 15 years;

(viii) A prohibition on such borrowing of up to and including one year maturity, except for import credits;

(ix) The standard performance criteria with respect to the trade and payments restrictions;

(x) A review to be completed by end-February 1987, which would include reaching understandings on exchange rate policy and establishing performance criteria for March and June 1987;

(xi) A review to be completed before end-July 1987, to reach understandings on the 1987/88 budget, on exchange rate policy, and to establish performance criteria for the rest of the program period.

IV. Medium-Term Outlook

The outlook for the external sector remains extremely difficult and success in achieving external viability over the next 5-7 years will depend on the continued and vigorous implementation of policy reforms as well as on support from the international community, including further exceptional financing and debt relief. Real imports will need to increase considerably in the early years of the adjustment effort to support rehabilitation of the infrastructure which is essential tosustaining the expected improvement in production and exports stemming from the policy reforms.

Total exports are expected to improve considerably from the depressed levels of 1985 to attain about US$442 million in 1987, and increasing thereafter to about US$674 million by 1991 (Tables 10 and 11). For some traditional crops (coffee, tea, cashew nuts) an increase in the volume of exports is expected as a result of the significant increases in producer prices announced with the budget on June 19. Some of this increase will result from the direct effect on production, but it is also anticipated that some exports that were taking place outside of official channels will be redirected as a result of the recent depreciation of the exchange rate and improved incentives. Additional real increases in producer prices will be effected in 1987 and 1988 as per the Government's declared intentions. In addition, the projected reorganization of the agricultural marketing institutions and arrangements, along with the provision of larger incentive goods in the

Table 10. Tanzania: Balance of Payments, 1985-91

(In millions of U.S. dollars)

	1985 Prel.	1986 Est.	1987	1988	1989 Projections	1990	1991
Trade account	-572.7	-651.7	-707.6	-703.2	-621.4	-611.2	-608.6
Exports, f.o.b.	372.3	398.3	442.4	516.8	654.2	621.8	673.7
Imports, c.i.f.	-900.0	-1,080.0	-1,150.0	-1,220.0	-1,185.6	-1,233.0	-1,282.3
Oil	(-229.8)	(-189.5)	(-203.0)	(-217.4)	(-232.9)	(-249.5)	(-267.3)
Own exchange	(-120.0)	(-130.0)	(-140.0)	(-60.0)	(--)	(--)	(--)
Other	(-550.2)	(-730.5)	(-807.0)	(-942.6)	(-952.7)	(-983.5)	(-1,015.1)
Services, net	-71.9	-115.1	-109.1	-114.0	-118.7	-122.6	-128.2
Receipts	103.0	110.0	140.0	156.0	165.5	175.6	186.3
Payments	-174.9	-225.1	-249.1	-270.0	-284.1	-298.3	-314.5
Interest 1/	(-90.8)	(-135.1)	(-154.1)	(-169.3)	(-177.2)	(-184.8)	(-194.1)
Other	(-84.1)	(-90.0)	(-95.0)	(-100.8)	(-106.9)	(-113.5)	(-120.4)
Private transfers, net	130.0	130.0	135.0	140.0	145.0	150.0	155.0
Inflows	150.0	152.0	159.6	166.0	171.0	176.0	181.0
Outflows	-20.0	-22.0	-24.0	-26.0	-26.0	-26.0	-26.0
Current account	-514.6	-666.8	-681.7	-677.2	-595.1	-583.8	-581.8
Government transfers, net	106.5	223.0	234.4	246.8	259.3	272.4	286.2
Inflows	110.0	227.0	238.4	250.3	262.8	275.9	289.7
Outflows	-3.5	-4.0	-4.0	-3.5	-3.5	-3.5	-3.5
MLT loans, net	-18.5	-17.7	-20.8	8.7	5.1	45.2	63.3
Inflows	200.0	165.0	155.0	162.8	170.9	179.4	188.4
Outflows	-218.5	-182.7	-175.8	-171.4	-165.8	-134.2	-125.1
Suppliers' credits, net	-32.0	-55.4	-41.7	8.4	23.0	46.6	46.6
SDR allocation	--	--	--	--	--	--	--
Import support	70.0	83.0	84.0	87.0	91.0	95.0	98.0
Errors and omissions 2/	194.0	--	--	--	--	--	--
Overall balance	-194.6	-433.9	-425.8	-343.7	-216.7	-124.6	-87.7
Financing	194.6	-25.5	-75.0	-85.0	-90.0	-102.0	-114.0
IMF 3/	-14.2	-26.5	-5.0	--	--	-12.0	-24.0
Reserves (- increase)	10.0	-5.0	-30.0	-35.0	-40.0	-40.0	-40.0
Arrears (increase +)	198.8	57.0	-40.0	-50.0	-50.0	-50.0	-50.0
Financing gap		-408.4	-500.8	-428.7	-306.7	-226.6	-201.7

Sources: Data provided by the Tanzanian authorities; and staff estimates and projections.

1/ Includes interest on gap financing and on commercial arrears outstanding.

2/ Prior to 1986 includes a portion of official transfers.

3/ Includes elimination of overdue obligations in 1986.

Table 11. Tanzania: Export Projections, 1985-91

(Value in millions of U.S. dollars; volume in thousands of metric tons; 1/ unit value in U.S.dollars per kg)

	1985	1986	1987	1988	1989	1990	1991
Coffee							
Value	121.44	180.77	172.64	182.91	193.40	210.38	228.85
Volume	46.00	52.40	60.26	65.68	68.97	72.42	76.04
Unit value	2.64	3.45	2.86	2.78	2.80	2.91	3.01
Cotton							
Value	40.32	32.94	34.99	38.21	40.20	42.30	44.50
Volume	32.00	32.00	33.92	36.97	38.82	40.76	42.80
Unit value	1.26	1.03	1.03	1.03	1.04	1.04	1.04
Sisal							
Value	8.25	8.06	9.45	10.49	11.22	12.01	12.85
Volume	25.00	25.00	28.75	31.34	32.90	34.55	36.28
Unit value	0.33	0.32	0.33	0.33	0.34	0.35	0.35
Tea							
Value	16.20	20.39	24.88	28.78	32.06	35.71	39.79
Volume	12.00	14.00	16.10	17.55	18.43	19.35	20.32
Unit value	1.35	1.46	1.55	1.64	1.74	1.85	1.96
Tobacco							
Value	14.70	11.48	13.05	14.07	14.60	15.15	15.73
Volume	10.00	9.00	10.35	11.28	11.85	12.44	13.06
Unit value	1.47	1.28	1.26	1.25	1.23	1.22	1.20
Cashewnuts							
Value	16.00	18.70	22.37	25.35	27.69	30.23	33.01
Volume	20.00	22.00	25.30	27.58	28.96	30.40	31.92
Unit value	0.80	0.85	0.88	0.92	0.96	0.99	1.03
Subtotal	216.91	272.35	277.38	299.81	319.17	345.79	374.74
Petroleum products	24.48	25.46	30.00	33.00	35.00	38.00	43.00
Minerals	25.32	30.00	35.00	49.00	55.00	58.00	61.00
Manufactured goods	37.55	45.50	75.00	90.00	95.00	110.00	120.00
Other	23.00	25.00	25.00	45.00	60.00	70.00	75.00
Subtotal	110.35	125.96	165.00	217.00	245.00	276.00	299.00
Grand total	327.26	398.31	442.38	516.81	564.17	621.79	673.74

Source: Data provided by the Tanzanian authorities, and staff projections.

1/ Peak production in thousands of metric tons, for each commodity were: coffee 67.0 in 1980/81; cotton 75.2 in 1972/73; sisal 230.0 in 1964; tea 18.5 in 1977/78; tobacco 18.1 in 1976/77; and cashewnuts 143.3 in 1973/74.

rural sector, should have a salutory effect on production and exports. The cumulative effect of these measures is expected to revitalize t.aditional exports, with the sharpest increase in volumes taking place by 1988 on the completion of major rehabilitation of the infrastructure. For most traditional exports, by 1991 volumes will be at least as high as the levels reached in 1981, but would still continue to be below peak production levels reached in earlier years, except in the cases of coffee and tea (Table 11). Coffee, the single most important export, is projected to increase by 14 percent in volume between 1985 and 1986 to 52,400 metric tons and by a further 15 percent in 1987 to 60,260 metric tons. The projected rate of increase is somewhat slower thereafter rising to 76,000 metric tons by 1991. The volumes of other traditional exports are expected to respond in a similar manner to give total traditional export receipts of about US$375 million by 1991 compared with US$217 million in 1985.

As regards nontraditional exports, a major improvement is expected in response to the changed policy environment. In 1985 the value of nontraditional exports had fallen to only about 50 percent of the level attained in 1981. Particular scope would appear to exist for the revitalization of mineral exports and manufactured products. Output response in this sector will of course be dependent upon the provision of capital and spare parts to enable rehabilitation of productive capacity, and upon a judicious selection of potentially viable enterprises that should be rehabilitated. With the provision of these imports the Tanzanian authorities are optimistic that manufactured exports will respond markedly, increasing by four-fold between 1985 and 1991 to about US$120 million. Mineral exports and other exports are also expected to respond favorably resulting in nontraditional export earnings of about US$300 million by 1991 compared with about US$110 million in 1985.

Revitalization of the Tanzanian economy depends crucially on the provision of an adequate level of imports. In drawing up their medium-term recovery program the Tanzanian authorities had estimated that imports amounting to about US$1,200 million would be needed in fiscal year 1986/87, representing an increase of about 26 percent in nominal terms and 20 percent in real imports over 1985. The authorities' import program consisted of two broad categories: investment/rehabilitation and recurrent imports. Investment and rehabilitation requirements relate to continuing development projects and specific rehabilitation programs aimed at remedying the main bottlenecks in manufacturing and agriculture. The largest share of resources is targeted toward infrastructure which has been identified as the most important sector for rehabilitation. Recurrent requirements were derived from an analysis of the productive inputs required for priority areas (energy, manufacturing and agriculture), to relieve bottlenecks in transportation and to provide essential social services. Recurrent requirements also include commodities entering under the "own exchange scheme." After the initial rehabilitation needs of the program have been met, which is expected to be by 1988, under the authorities' projections, imports are to be held constant in real terms through 1991 by the combination of the move to the equilibrium exchange rate, continued restrain of demand, and the anticipated increase in domestic production. The move to the equilibrium exchange rate combined with the liberalization of pricing and domestic trade policies will also strengthen incentives for significant import substitution, increase efficiency in the use of imports and decrease dependence on imported inputs. It is envisaged that imports entering Tanzania under the "own exchange scheme" will increase in both 1986 and 1987, reflecting the increase in retained export receipts and the enlargement of the list of eligible imports. However, as progress is made toward attainment of the equilibrium exchange rate and the export retention scheme is phased out, this source of imports is expected to diminish.

Tanzania's heavy dependence on imports means that despite the improvement in exports a considerable deficit on trade account remains in prospect for the foreseeable future, although there will be a gradual improvement to 1991 (Table 10). In addition, debt service obligations will continue to impose a considerable burden on foreign exchange resources, even though much of the existing stock of debt (medium- and long-term debt and short-term), estimated at about US$3.2 billion at end 1985, was contracted on concessional terms. Debt service payments before any debt relief in 1986 are estimated to amount to 66 percent of exports of goods, services and private transfers and to decline to 36 percent by 1991 primarily on account of the improvement in exports and other inflows (Table 12). Interest payments will increase sharply between 1986 and 1988; in addition to interest on existing commitments this reflects projected new borrowing over that period and interest on that part of the financing gap not covered by exceptional concessional assistance. Despite continuing normal external assistance inflows which are estimated to keep pace with inflation, and some projected improvement in private transfers, the current account deficit, like the trade balance, will improve only slowly from US$667 million in 1986 to US$582 million in 1991.

The overall balance is projected to show a more marked improvement as normal capital inflows and aid donor import support will more than offset amortization of existing debt (it is assumed that all new medium- and long-term borrowing to 1991 is on concessional terms with no principal repayments until after 1991). However, there will be a continuing need to rebuild foreign reserves and to reduce commercial arrears through cash payments which will result in large, though declining, financing gaps throughout the period. These gaps will need to be closed by the provision of exceptional financing and debt relief on current maturities, although it is expected that debt relief alone should be sufficient to close the gap by the end of the period. It should be stressed that this outcome depends crucially on the strengthened implementation of the adjustment program and is also sensitive to the assumptions built into the projections.

Table 12. Tanzania: Medium- and Long-Term Debt as of end-1985 and Scheduled Debt Service Payments, 1986-91

(In millions of U.S. dollars)

	Medium- and long-term external debt by creditor 1/ End-1985	Debt service obligations 1986	1987	1988	1989	1990	1991
A. Multilateral organizations	1,061.9	80.04	82.78	82.00	79.85	70.78	64.21
Principal		50.14	53.78	54.60	54.31	47.27	42.80
Interest		29.90	29.00	27.40	25.54	23.51	21.41
B. Use of Fund credit	52.6	17.00	7.60	4.00	4.00	16.00	28.00
Repurchases		14.20	4.40	--	--	12.00	24.00
Charges		2.80	3.20	4.00	4.00	4.00	4.00
C. Suppliers' credits	300.1	50.92	34.03	27.27	22.42	18.20	16.28
Principal		37.70	23.30	19.12	16.49	14.06	13.27
Interest		13.22	10.73	8.15	5.93	4.14	3.01
D. Bilateral loans	1,260.0	179.70	159.86	153.70	132.38	85.58	84.27
Principal 2/		143.90	126.42	126.34	111.18	68.51	69.12
Interest		35.80	33.44	27.36	21.20	17.07	15.15
E. Financial institutions	520.9	65.63	54.29	45.04	37.14	28.98	21.91
Principal		44.07	37.28	32.06	27.39	21.77	16.61
Interest		21.56	17.01	12.98	9.75	7.21	5.30
F. Total debt	3,203.5	393.29	338.56	312.01	275.79	219.54	214.67
Principal		290.01	245.18	232.12	209.37	163.61	165.80
Interest		103.28	93.38	79.89	66.42	55.93	48.87
G. Total debt, excluding use of Fund credit	3,150.9	376.29	330.96	308.01	271.79	203.54	186.67
Principal		275.81	240.78	232.12	209.37	151.61	141.80
Interest		100.48	90.18	75.89	62.42	51.93	44.87
Memorandum items:							
Interest on new commitments and gap financing		31.7	60.9	89.4	110.9	128.9	145.3
Debt service as a percentage of exports of goods, services, and private transfers 3/		66.6	53.9	49.4	44.2	36.7	35.5

Source: World Bank; debt reporting system.

1/ Includes principal and interest on arrears.
2/ Repayments of oil credits to Algeria, Iran, and Libya included in suppliers' credits in balance of payments table.
3/ Includes Fund obligations and debt service on gap financing.

V. Staff Appraisal and Recommendations

In concluding the 1985 Article IV consultation discussions, the Executive Board had urged Tanzania to adopt a comprehensive adjustment program that went considerably further than the partial measures the authorities had been adopting until then within the context of their earlier Structural Adjustment Program and the 1984/85 budget. The Tanzanian authorities have also recognized that the content and intensity of the corrective measures adopted so far was not enough, and that there was a need to intensify and complement these measures. Accordingly, they have now proposed a program for Fund support under a stand-by arrangement that envisages corrective policy actions on several fronts, including the exchange rate, interest rates, producer prices, and fiscal management.

Over the past several years, Tanzania has been engaged in intermittent negotiations with the Fund to conclude a stand-by arrangement. These negotiations foundered on every occasion on the issue of an appropriate exchange rate (and the consequential needed changes in other prices), the Tanzanian side insisting that in the context of the Tanzanian economy, the exchange rate was not the determining, or even a relevant, policy instrument to bring about the needed economic and financial sustainability. Such sustainability in their opinion, was more a function of the injection of external capital inflows to buy the needed spare parts and inputs to rehabilitate the economy and to produce self-generating export growth and foreign exchange. The staff, on the other hand, had emphasized the primordial importance of correct price signals, including the exchange rate, in the economy which, at the same time, would also ensure an efficient use of potential external capital inflows in support of the Tanzanian effort to rehabilitate the economy. This point of view of the staff was underlined by the Executive Board in the course of the last Article IV consultation discussions when it urged Tanzania to begin its adjustment effort which should include the correction of "most, if not all, the real appreciation of the Tanzanian shilling" since 1978. In addition, in concluding discussions on the 1985 Article IV consultation with Tanzania, the Executive Board had stressed the importance of, inter alia, adequate increases in real producer prices, liberalization of domestic price controls and marketing arrangements, improving the efficiency of the parastatals, adequately restrictive fiscal and domestic credit policies, and sizable adjustment in interest rates.

The program as described above tries to fully take into account these recommendations of the Directors. Beginning in April, when broad understandings were reached between the staff and the Tanzanian authorities on the main elements of the program, the authorities began to depreciate the Tanzanian shilling and on June 19, 1986 the currency had been depreciated by 57.5 percent against the U.S. dollar (and by a larger percentage against the Tanzanian trade basket) to T Sh 40 = US$1. In addition, the authorities propose to depreciate the effective exchange rate monthly by 1 percent in real terms to bring it in closer realignment with the equilibrium rate. A major review of the exchange rate is also envisaged toward the end of 1986 (in the context of the review of the program to be completed before end-February 1987) to determine whether a larger and/or faster rate of depreciation would be needed to ensure the attainment of the targets both within the program year and within the medium-term period. While it is difficult to determine what that equilibrium rate could be, the staff has emphasized that the rate must be such as to discourage the flow of foreign exchange into unofficial channels, and provide the needed competitive edge to Tanzania's present and potential exports. It should also help reduce considerably the present reliance on import and exchange controls to manage the balance of payments, and enable a significant reconstruction of the external reserve position. In the staff's view, the exchange rate actions already implemented by the authorities, and the proposed small monthly depreciation of the real effective exchange rate, are first steps. In those decisions, the authorities have signaled an end to their resistance to use the exchange rate adjustment as a major policy instrument. Naturally, they are rather cautious about its use and probably still skeptical of its effectiveness. The staff hopes that the experience with this policy instrument in the coming months will convince them that a rapid move toward an equilibrium exchange rate would enhance the chances of realizing their longer-term objectives of rehabilitation and recovery of the economy, as well as of a sustainable balance of payments position. In this connection, the staff would urge that the authorities keep an open mind on this issue at the time of the end-1986 review of the program and not be unalterably attached to any preconceived level of the exchange rate, or the degree of its flexibility. The staff is encouraged by the assurances provided by the Tanzanian authorities to the Managing Director on this issue.

The present program weaves a substantial number of policy actions in other areas in a way which promises that at long last the Tanzanian economy should begin to move forward and repair the damage suffered by its infrastructure, production, and exports, over the last several years. Producer prices for the main agricultural export crops have been increased by between 30-80 percent, agricultural marketing and transportation systems are to be reorganized, domestic pricing controls are being dismantled (with one-quarter of the broad categories of controlled commodities having been liberalized in July 1986 and substantial price increases allowed for the remainder) with a view to retaining eventually only a small number of essential categories of goods under price control. The 1986/87 budget envisages that the underlying budgetary deficit would be reduced by some 5-6 percentage points of GDP, the interest rate structure has been revised upward with a view to achieving positive rates within a two-year period, and credit expansion is being limited to keep the expansion of money supply to around 11 percent during the fiscal year 1986/87. Simultaneously, import and exchange controls have been made less restrictive through a modification of the export retention scheme and an expansion of the list of commodities that can be imported with the importers' own foreign exchange. Within this macro-framework of policies, the authorities are in active consultation with the World Bank to formulate and implement sectoral structural policies to improve the marketing and transportation systems, increase the operational efficiency of parastatals and private sector enterprises, and establish appropriate priorities in the Public Investment Programs as well as in the minimum import requirements. Furthermore, the authorities propose to develop a medium-term macroframework of policies in the course of discussions, expected to be initiated next November, on the use of resources under the Structural Adjustment Facility (SAF). Concurrent with the implementation of the 1986/87 budget, Tanzania abolished the export tax rebate scheme that gave rise to a multiple currency practice, but Tanzania continues to maintain restrictions on payments and transfers for current international transactions, including the accumulation of payments arrears, which are inconsistent with the provisions of Article VIII of the Fund's Articles of Agreement. However, the staff believes that the adoption of the adjustment policies described above provides a reasonable basis to assume that the authorities could eliminate these restrictions in the near future, and, in the circumstances, the staff would recommend their approval.

The staff believes that the policy mix chosen by the authorities is appropriate in the circumstances, and the various objectives and targets established for 1986/87 are achievable. However, given the large imbalances existing in the economy, and the uncertainties surrounding the estimated effects of various policy measures, the program would need to be continuously monitored and adapted to ensure that the program's objectives are not compromised. In particular, given the implied large negative effects on the overall budgetary outcome of the exchange rate depreciation, the authorities should remain vigilant regarding budgetary expenditure and revenues, enforcing vigorously the reporting and monitoring system and being prepared to adopt additional measures to ensure that the overall deficit remains within the stated target. In the staff's opinion, the targeted budget deficit of 11.1 percent of GDP is too high, and future efforts at adjustment will be compromised if this target were allowed to be exceeded in the current year, and if the future deficits are not reduced more rapidly. The program provides quarterly indicative targets for revenue and expenditure with the view to ensuring that the feasibility of the overall deficit target, which is a performance criterion under the program, is constantly assured and that if revenues turn out to be higher than assumed, the excess revenue would go towards reducing the deficit further.

The present program has been designed to provide the economy with the necessary plan to rehabilitate and recover, toward attaining an acceptable growth rate and sustainable balance of payments within a period of about 5-7 years, while at the same time providing the necessary assurances to the donor community that the Tanzanian adjustment efforts merit additional financial support. The overall credit program allows for a 20 percent increase in credit to the nongovernment sector in the expectation that production in this sector would grow. The potential availability of credit to the private sector is even higher as the program provides that the T.Sh 2.5 billion of bank credit presently earmarked for Government could be channelled to the private sector were the Government to receive (as it is expected to) external assistance in amounts larger than inscribed in the fiscal part of the program. In this respect, therefore, the response of the donors community in terms of both the rapidity and amount of additional assistance would be crucial to the revival of the private sector. The encouraging response evoked during the Consultative Group meeting last month, when additional external support came forth to assure the realization of Tanzania's minimum import requirements during 1986/87, augurs well for the adjustment program. It is now up to the Tanzanian authorities to implement rigorously the proposed adjustment policies. Given the generous response of the donor community, the staff believes that the program's immediate objectives are attainable with the proposed policies, provided that the authorities would, as indeed they have indicated, be prepared to monitor the program in its details and to adapt their policies accordingly. The long-term objectives of the program are also realistic, given that even by the 1990s the projected export volumes would about match their historical highs and that the Tanzanian economy has a varied production base. In this context, the role of the private sector would be pivotal and the authorities would need to give appropriate price signals by moving the exchange rate to its equilibrium level, and interest rates to position levels in real terms as quickly as possible. The agricultural sector must also be assured of a continuous increase in real producer prices in keeping with the declared objective of the Government within its medium-term program of recovery.

The 1986/87 program, based on an import level of US$1,100 million, envisages a "financing gap" of US$500 million. Given the results of the Consultative Group meeting, and the anticipated program credit of US$100 million from the World Bank, the staff believes that the gap is entirely financeable with the projected purchases under the proposed stand-by arrangement and the possible debt relief that may be expected from Tanzania's official creditors (the Government has already approached the Paris Club in this respect and the Tanzanian request is expected to be considered in September). To the extent that even further assistance may be forthcoming, the staff would urge that Tanzania use a part of it to retire its arrears more rapidly than envisaged and to reconstruct its external reserves. In the circumstances, the following draft decisions are proposed for adoption by the Executive Board.

VI. Proposed Decisions

I. Request for Stand-By Arrangement

1. The Government of Tanzania has requested a stand-by arrangement for a period of 18 months from September --, 1986 to March --, 1988, in an amount equivalent to SDR 64.2 million.

2. The Fund approves the stand-by arrangement set forth in EBS/86/183.

II. Exchange System

3. Tanzania maintains the restrictive measures described in SM/86/23 in accordance with Article XIV, Section 2, except that the exchange restrictions evidenced by external payments arrears as described in EBS/86/183, are subject to approval under Article VIII, Sections 2(a) and 3. The Fund notes the recent abolition of the multiple currency practice as described in EBS/86/183 and notes the authorities' intention to eliminate the remaining restrictions subject to Article VIII. The Fund grants approval of these restrictions until the next Article IV consultation or the completion of the first review under the stand-by arrangement for Tanzania set forth in EBS/86/183 whichever is earlier.

Tanzania - Summary of Proposed Financial Program, 1986/87

Elements of the program	Status and phase of implementation
I. Exchange and trade policies	
a. Initial depreciation of the exchange rate by 135 percent (in local currency term) or 58 percent in U.S. dollar terms, with the objective of reaching an equilibrium rate by mid-1988 (i.e. in two years)	Depreciation of 50 percent alreadey affected between April 11 and May 23. The remaining depreciation (to T Sh 40 = US$1) will be effective by June 19, 1986.
b. Further monthly depreciation of the rate by the equivalent of the price differential between Tanzania and the partner countries, comprising the currency basket, plus one percent additional depreciation per month.	To begin after June 1986 and is estimated to bring the rate to about T Sh 60 = US$1 by June 1987.
c. Exchange rate policy to be reviewed in December 1986 and June 1987 with the view to bringing the rate in closer alignment with the equilibrium rate.	Specific criteria guiding the review agreed in the Policy Memorandum.
d. Abolition of the present multiple-currency practice implied in the expert bonus scheme.	The scheme was abolished in June 1986.
e. Liberalization of the export-earnings retention scheme, including its transferability. Retention rates increased from 5-15 percent to 50 percent of exports for non-traditional goods.	Already being Implemented
f. Substantial expansion of the list of commodities that can be imported with "own" foreign exchange or with retained exchange.	Implemented.

with "own" foreign exchange or with retained exchange.

II. Pricing policies

a. Excluding 12 categories of products, domestic price controls of the remaining 36 categories will be eliminated over a three-year period, of which one third in the first year of the program.

The "negative list", as well as the commodities to be decontrolled in the first year, already identified and provided to the staff. Prices of other controlled commodities will be increased to allow full pass through of the devaluation.

b. As a medium-term objective producer prices for export commodities to be increased to a level equal to 60 percent of export price or to provide a minimum real increase of 5 percent per annum. For 1986/87 price increases of between 30-80 percent for various commodities.

The agreed increases for 1986/87 range from 30 percent for cotton and tobacco, to 55 percent for tea and cashewnuts, 60 percent for cocoa and cardamom, and 80 percent for coffee, announced on June 19, 1986.

c. The excess windfall profits of the Coffee Marketing Board will be will be neutralized through investment in government securities already in the portfolio held by banks.

Quarterly indicative targets specified in the program, and the ceilings on net credit to the Government will be adjusted automatically.

d. Petroleum products will be so priced as to involve no consumer subsidies. The present specific tax rates to be converted into ad valorem rates on various products. The full cost of the devaluation will be passed on to consumers.

Price increases ranging between 50 and 68 percent announced on June 19, in conformity with this policy, the rates on LPG and premium and regular gasoline converted into ad valorem rates.

III. Fiscal policies

a. Overall budget deficit for 1986/87 to be limited to T Sh 17 billion (11.6 percent of estimated GDP).

Announced with the budget on June 19.

b. Various new revenue measures to yield about T Sh 2.5 billion (probably more) including taxes on petroleum products, and conversion of some specific duties to ad valorem basis, to be implemented.	Announced with the budget on June 19.
c. Domestic bank financing to be limited to T Sh 2.5 billion, or less if net external assistance through the budget exceed the equivalent of US$270 million (presently estimated at T Sh 13.8 billion).	The budget announcement corresponds to this limit.
d. Quarterly ceilings on overall deficit and on bank financing, as well as indicative targets on quarterly revenue and expenditure.	Overall deficit is a per- performance criterion.

IV. Monetary and Credit Policies

a. Limit net domestic credit expansion in 1986/87 (July/June) to 12 percent; with quarterly ceilings.	Performance criterion.
b. Quarterly ceiling on net bank credit to the Government.	Performance criterion.
c. Limit quarterly credit expansion to seven specified Marketing Boards (coffee, cotton, sisal, cashewnut, tea, tobacco and the NMC Boards).	Performance criterion.
d. Broad money increase to be limited to 11 percent.	
e. (i) The structure of interest rates will be made positive within two years (by mid-1988); (ii) Interest rates paid on 12-month savings deposits will be increased to at least 50 percent of the inflation rate of the preceding year by June 1986, and to at least 75 percent of the inflation rate by June 1987.	Initial adjustment announced on July 1, 1986, with further adjustments to be made through the program period.
f. Interest rates will be the subject of a review with a view to smoothing the increase from 50 to 75 percent of the prevailing inflation in December 1986.	Review to be concluded before end-February 1987.

V. External indebtedness

a. Request for comprehensive rescheduling of 1986/87 maturities and arrears on medium- and long-term debt service obligations from the Paris Club and other official creditors to be made.	Request to schedule made to Paris Club.
b. Government or the Bank of Tanzania will not contract or guarantee any nonconcessional borrowing of maturity of more than one year and up to and including 15 years. Similar borrowing by production enterprises in the public sector to be limited to US$50 million.	Performance criteria.
c. Cash reduction of existing external payments arrears by US$50 million between July 1, 1986 to June 30, 1987. Also there will be no accumulation of any new arrears during the program period.	Performance criteria.

VI. Public Enterprises and Parastatal Reform

a. Improvements on marketing of agricultural products and efficiency of the parastatals to be implemented in collaboration with the World Bank. These reforms will cover internal grain transport, agricultural input supply and procurement.	Implementation not to be delayed beyond end-1986. The World Bank program credit is expected to be approved in late October.
b. Government to identify selected enterprises which are crucial to the recovery of exports and production and to present a comprehensive reform package to improve their operations and so that their minimum import requirements would be met.	To be presented before end-September 1986, in consultation with the World Bank.

C. Monitoring of the Program

I. Performance criteria

i. Adjustment of the exchange

rate.

ii. Reduction in external arrears.

iii. Avoidance of accumulation of new arrears.

iv. Limits on external nonconcessional borrowing of up to and including 15 years.

v. *Overall budget deficit.*

vi. Ceilings on total bank credit.

vii. Ceilings on net credit to Government.

viii. Ceilings on credit to specified marketing boards.

ix. Understandings on trade and payment restrictions.

II. Indicative targets

i. Investments in government security by the Coffee Marketing Board

ii. Recurrent government expenditure.

iii. Total government expenditure

iv. Net foreign assets of the banking system.

III. Review under the program

i. Before end-February 1987	To reach understanding on the exchange rate policy and establish performance criteria for March and June 1987.
ii. Before end-July 1987	To reach understandings on the 1987/88 budget on the exchange rate policy, and to establish performance criteria for the rest of the program period.

Tanzania: Stand-By Arrangement

Attached hereto is a letter, with annexed memorandum, dated July --, 1986 from the Minister of Finance, Economic Affairs and Planning of Tanzania, requesting a stand-by arrangement and setting forth (a) the objectives and policies that the authorities of Tanzania intend to pursue for the period of the stand-by arrangement; and (b) understandings of Tanzania with the Fund regarding reviews that will be made of progress in realizing the objectives of the program and the policies and measures that the authorities of Tanzania will pursue for the remaining period of this stand-by arrangement.

To support these objectives and policies, the International Monetary Fund grants this stand-by arrangement in accordance with the following provisions:

1. For the period from September--, 1986 to March --, 1988, Tanzania will have the right to make purchases from the Fund in an amount equivalent to SDR 64.2 million subject to paragraphs 2, 3, 4, 5, and 6 without further review by the Fund.

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

SDR 20.70 million until November 15, 1986
SDR 27.95 million until February 15, 1987
SDR 35.20 million until May 15, 1987
SDR 42.45 million until August 15, 1987
SDR 49.70 million until November 15, 1987
SDR 56.95 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.

3. Purchases under this stand-by arrangement shall be made from ordinary resources only.

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:

(a) during any period in which the data at the end of the preceding period indicate that:

(i) the adjustment of the exchange rate as described in paragraph 8 of the annexed memorandum, or

(ii) the ceiling on net domestic credit to the Government of the banking system as described in paragraph 23 of the annexed memorandum, or

(iii) the limit on the net domestic assets of the banking system described in paragraph 24 of the annexed memorandum, or

(iv) the limit on total bank credit to the specified seven parastatals as described in paragraph 15 of the annexed memorandum, or

(v) the cumulative reduction in external payments arrears through cash payments, and the limit on accumulating new external payments arrears as described in paragraph 12 of the annexed memorandum, or

(vi) the limit on new external borrowing contracted or guaranteed by the Government in the maturity ranges of 1 to 15 years, excluding concessional loans, and of maturity of 0 to 1 year, excluding normal import trade credits as described in paragraph 13 of the annexed memorandum, or

(vii) the ceilings on the overall budget deficit as described in paragraph 22 of the annexed memorandum,

is not observed; or

(b) after February 14, 1987, and July 14, 1987, respectively, until the reviews described in paragraph 4 of the attached letter have been completed and suitable performance criteria have been established, or after such performance criteria have been established while they are not being observed; or

(c) during the entire period of the stand-by arrangement, if Tanzania

(i) imposes or intensifies restrictions on payments and transfers for current international transactions, or

(ii) introduces multiple currency practices, or

(iii) concludes bilateral payments agreements which are inconsistent with Article VIII, or

(iv) imposes or intensifies import restrictions for balance of payments reasons.

When Tanzania is prevented from purchasing under this stand-by arrangement because of this paragraph 4, purchases will be resumed only after consultations have taken place between the Fund and Tanzania and understandings have been reached regarding the circumstances in which such purchases can be resumed.

5. Tanzania will not make purchases under this stand-by arrangement during any period of the arrangement in which the member has an overdue financial obligation to the Fund or is failing to meet a repurchase expectation pursuant to the guidelines on corrective action in respect of a noncomplying purchase.

6. Tanzania's right to engage in the transactions covered by this stand-by arrangement can be suspended only with respect to requests received by the Fund after (a) a formal ineligibility, or (b) a decision of the Executive Board to suspend transactions, either generally or in order to consider a proposal made by an Executive Director or the Managing Director, formally to suppress or to limit the eligibility of Tanzania. When notice of a decision of formal ineligibility or of a decision to consider a proposal is given pursuant to this paragraph 6, purchases under this arrangement will be resumed only after consultation has taken place between the Fund and Tanzania and understandings have been reached regarding the circumstances in which such purchases can be resumed.

7. Purchases under this stand-by arrangement shall be made in the currencies of other members selected in accordance with the policies and procedures of the Fund, and may be made in SDRs if, on the request of Tanzania, the Fund agrees to provide them at the time of the purchase.

8. Tanzania shall pay a charge for this arrangement in accordance with the decisions of the Fund.

(9) (a) Tanzania shall repurchase the outstanding amount of its currency that results from a purchase under this arrangement in accordance with the provisions of the Articles of Agreement and decisions of the Fund, including those relating to repurchases as Tanzania's balance of payments and reserve position improves.

(b) Any reductions in Tanzania's currency held by the Fund shall reduce the amounts subject to repurchase under (a) above in accordance with the principles applied by the Fund for this purpose at the time of the reduction.

10. During the period of the stand-by arrangement, Tanzania shall remain in close consultation with the Fund. These consultations may include correspondence and visits of officials of the Fund to Tanzania or of representatives of Tanzania to the Fund. Tanzania shall provide the Fund, through reports at intervals or dates requested by the Fund, with such information as the Fund requests in connection with the progress of Tanzania in achieving the objectives and policies set forth in the attached letter and annexed memorandum.

11. In accordance with paragraph 6 of the attached letter, Tanzania will consult the Fund on the adoption of any measures that may be appropriate at the initiative of the Government, or whenever the Managing Director requests consultation because any of the criteria in paragraph 4 above have not been observed or because he considers that consultation on the program is desirable. In addition, after the period of the stand-by arrangement and while Tanzania has outstanding purchases in the upper credit tranches, the Government will consult with the Fund from time to time, at the initiative of the Government or at the request of the Managing Director, concerning Tanzania's balance of payments policies.

August 8, 1986

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

Dear Mr. de Larosière:

1. Annexed hereto is a Memorandum of Understanding on Economic and Financial Policies describing the economic program that the Government of Tanzania intends to pursue in the 18-month period ending March 30, 1988 and the quantitative targets it expects to achieve in the remainder of 1986. The primary objective of the Government is to lay the basis for a rehabilitation and sustainable recovery of the economy within the context of achieving viability of balance of payments. To this end, the Government has adopted policies aimed at improving the competitiveness of the economy by devaluing the Tanzanian shilling, containing the public sector deficit, and ensuring an adequate level of producer incentives. The Tanzanian Government is requesting from its major creditors that these policies are adequately supported by the restructuring of external debt and external payments arrears, and the arranging of new financing on concessional terms.

2. In support of this program, the Government of Tanzania requests herewith a stand-by arrangement for 18 months from the International Monetary Fund in an amount equivalent to SDR 64.2 million.

3. The Government of Tanzania has initiated discussions with the international financial community to secure a restructuring of its external debt and external payments arrears and to obtain new external financing. Already, as a result of the Consultative Group meeting held in Paris on June 10-11 under the aegis of the World Bank, a significant amount of additional balance of payments support on concessional terms has been pledged in support of our program. We are confident that the Paris Club and the official creditors will also be equally sympathetic to our request for debt and arrears rescheduling. This, combined with the expected program loans from the World Bank and the use of Fund resources, would make the program fully financable.

4. For purposes of monitoring the program the attached memorandum envisages various performance criteria, which will govern purchases from the Fund under the requested stand-by arrangement, and some indicative targets that would guide discussions with the Managing Director of the Fund. The performance criteria relate to the monthly adjustment of the exchange rate (paragraph 8 of the attached Memorandum), the completion of the two reviews with the Fund before end-February 1987, and end-July 1987, the reduction in the existing stock of external payments arrears and the avoidance of accumulation of new arrears during the program (paragraph 12), limits on new external debt with an initial maturity of more than one year and up to and including 15 years (paragraph 13), the ceilings on the overall government deficit

(paragraph 22), and limits on external debt of up to one year (excluding bridge finance and normal import credits), the ceilings on net bank credit to Government (paragraph 23), ceilings on total bank credit (paragraph 24), ceilings on total bank credit to specified parastatals (paragraph 15), and understandings regarding multiple currency practices, restrictions on payments and transfers for current international transactions, import restrictions, and new bilateral payments agreements (paragraph 11). In addition, the Memorandum specifies indicative targets in respect of net external assets, investments in government securities by the Coffee Marketing Board and government total and recurrent expenditures.

5. The satisfactory completion of these reviews, along with the observance of the relevant performance criteria, would govern purchases from the Fund under the proposed stand-by arrangement. The first review will focus, inter alia, on the exchange rate and interest rate policies, as well as establish performance criteria for March and June 1987. The second review will be devoted to reaching understandings on the budgetary policies for the fiscal year 1987/88, the exchange and interest policies, and the performance criteria for the rest of the program period. In addition, the Government will consult with the Managing Director no later than November 1986 on the policies set forth in the economic and financial memorandum, including the projected revision of the export policy in August 1986, as well as the results of the approaches to external donors and creditors and their implications for the balance of payments. It is also the Government's intention to use the occasion of that consultation to initiate negotiations with the Fund on a program under the Structural Adjustment Facility.

6. The Government of Tanzania believes that the policies set out in the attached Memorandum on Economic and Financial Policies are adequate to achieve the objectives of its program, but will take any further measures that may become appropriate for this purpose. The Tanzanian Government will consult with the Fund on the adoption of any measures that may be appropriate in accordance with the policies of the Fund on such consultations.

Yours sincerely,

C.D. Msuya
Minister of Finance, Economic
Affairs and Planning

Attachment

Memorandum on Economic and Financial Policies

I. Background Developments

1. Since 1978, following the second wave of oil price shock, global recession, the collapse of commodity prices, drought and the effects of the break-up of the East African Community, the economic and financial situation of Tanzania has deteriorated and the country is presently experiencing its worse economic crisis since independence in 1961. Production has declined steadily in all the major sectors, leading to a decline in per capita incomes and a deterioration in the country's social and physical infrastructure. The rate of inflation remains high, foreign exchange has become increasingly scarce, the country has accumulated substantial external payments arrears, food and basic consumer items are in great shortage, and the quality of essential services has declined sharply. The effects of large fiscal deficits, rapid monetary expansion, high rates of inflation, and a balance of payments deficits have accelerated since 1979.

2. External factors also contributed to the general economic decline. But, however caused, a country's economic problems are primarily its responsibility and the Government of Tanzania is determined to undertake the measures needed to reverse the decline in living standards and in the country's productive capacity. It is in this spirit that in June 1982, the Government adopted a three-year Structural Adjustment Program (SAP) to restructure future economic activity through better incentive systems, to rationalize production structures, and to improve planning and control mechanisms. These policies were further reinforced with the measures adopted with the 1984/85 budget

3. As a result of the above policies, initially the Government was successful in increasing the resources available to agriculture, raising producer incentives, and cutting expenditures. But chronic shortage of foreign exchange continued to exist, production continued to slacken and growth remained inadequate. With hindsight, it is recognized that the content and intensity of the corrective measures adopted were not enough, given the underlying imbalance in the economy. Thus, there is the need to intensify and complement the recovery measures undertaken under the SAP and with the 1984/85 budget. These measures, which have been developed in the context of a medium-term recovery program and have been initiated with the introduction of the 1986/87 budget are described below.

II. Medium-Term Recovery Program

4. The recovery program represents a continuation of the structural adjustment effort which will enable Tanzania to achieve sustained growth in real incomes, through increased output of food and export crops, rehabilitation of the physical infrastructure, increased capacity

utilization, and appropriate pricing, fiscal, monetary, and exchange and trade policies. The program envisages that the Tanzanian economy would gradually attain positive growth rates in per capita income, a sustainable external balance of payments position, and an acceptably low rate of inflation by the end of a medium-term period of 5-7 years. To these ends, the major emphasis will be to improve the efficiency of resource use by ensuring their allocation to the most productive sectors, and by providing those users with the necessary incentives to employ them in the most efficient manner. Accordingly, within the present socio-political framework chosen by the people of Tanzania, greater attention will be paid to establishing correct price signals in the economy, and greater weight will be placed on people's initiatives and cooperative efforts to increase the production and marketing of goods and services. Furthermore, such price signals would be accompanied by appropriate fiscal and monetary policies. Given the inevitable time lag between the establishment of policies and the resulting effects on production, and given the above-mentioned timeframe for growth and balance of payment adjustment, it will be important that most corrective policies are put into operation within a relatively short period--not to exceed 18 months to two years.

5. Within the medium-term established, the Government has identified these corrective policies as well as the timeframe for their implementation. In particular, it is proposed to provide adequate incentives to agricultural producers beginning with the launching of the adjustment program in mid-1986 and to maintain them throughout the program period; to continue with the decontrol of domestic prices, to immediately correct the appreciation in the real effective exchange rate which the Tanzanian shilling has undergone since 1978, and through active exchange policy, to aim at establishing an equilibrium exchange rate within a two-year period, and to make a significant upward adjustment in the interest rate structure immediately with a view to achieving positive real rates by mid 1988. These policies will be accompanied by suitable improvements in the marketing and other institutional arrangements and rehabilitation measures in key industries and enterprises.

6. The success of the above medium-term program would depend crucially on the provision of necessary inputs to rehabilitate the productive sectors and to sustain their recovery. While the proposed measures should increase the capabilities of the Tanzanian economy to generate additional domestic resources and foreign exchange, this process would inevitably be slow in the initial phase of the program and would therefore need to be supported by additional, exceptional, balance of payments assistance. It is expected that such requirements of exceptional assistance would be relatively high in the first three years of the program period, but should taper off by the end of the medium-term recovery period.

III. Program for Fiscal Year 1986/87 (July-June)

7. For 1986/87 the program will aim at generating a growth rate of 4 percent in real GDP, containing the rate of inflation to around 30 percent and limiting the external current account deficit to 21.6 percent of GDP. To achieve these targets, the following policies are proposed:

a. External sector policies

8. As stated earlier, the exchange rate policy is being accorded crucial importance in the recovery program. The Government intends to make considerable progress toward establishing an equilibrium exchange rate for the Tanzanian shilling in the critical period of the program. As a major step in this direction, the Tanzanian shilling has been *depreciated to US$1 = T Sh 40 as of June 19, 1986. This depreciation* has more than offset the measured real effective appreciation of the currency that has taken place since 1978, though still leaving a substantial degree of overvaluation and not obviating the need to continue with trade and exchange restrictions. It is the Government's intention to make regular monthly adjustments in the rate throughout the 1986/87 fiscal year. To this end, the value of the Tanzanian shilling will be adjusted every month against a currency basket to which it is linked, by the percentage change in relative prices, plus an additional one percent per month. The relevant relative price change will be the change in the NCPI (National Consumer Price Index) for the latest available month and the corresponding weighted average price change in the countries included in the basket.

9. The ultimate objective of the exchange rate policy is to establish an equilibrium rate by mid-1988. To ensure that sufficient progress is being made toward attaining this objective, a review of the exchange rate policy will be undertaken with the Fund at the time of the review of the stand-by arrangement to be concluded no later than end-February 1987. In conducting this review, particular attention will be given to developments in the balance of payments especially the movement in exports, buildup of BOP assistance in relation to the expectations under the program, the progress toward liberalization of imports (as evidenced by the relative value of licenses demanded and granted), the progress made in reducing (and rescheduling) arrears and the movement in official net foreign assets of the Bank of Tanzania, and developments in domestic costs. On the basis of this review, understandings will be reached with the Fund as to any modifications that might be needed, inter alia, in the conduct of exchange rate policy to realize the objective of attaining an equilibrium exchange rate within the above stated period. A further review of the exchange rate policy will also be undertaken with the Fund to be concluded no later than end-July 1987.

10. In July 1982, selected exporters were authorized to retain a 5-15 percent of the foreign exchange receipts and to use it for imports relating to their economic activity. In July 1985 these retention rates

were raised to higher levels on a case-by-case basis, and retained earnings could be used to finance imports listed as importable under the own exchange scheme, provided that the imported items were needed for the production of exports of goods or services. In February 1986, the retention scheme was liberalized further; exporters of nontraditional products became entitled to retain 50 percent of their foreign exchange earnings and the own exchange import list was expanded. For those exporters involved in a production activity, this retained foreign exchange must be used to purchase imports essential to their production activities. For export traders, 50 percent of their retained foreign exchange must be used for imports of raw materials and spare parts while the remaining 50 percent may be used to import goods on the new, considerably expanded, list of goods financed by own exchange for sale in the local market. Retained earnings may be transferred among export producers and from export traders to export producers. It is the Government's intention to further review the export policy by August 1986 with a view to improving its working and facilitating access to foreign exchange. Consultation on these modifications will be held with the Managing Director of the Fund no later than end-November 1986. As progress is made toward attaining external equilibrium, the Government's ultimate objective would be to abolish this scheme.

11. During the period covered by the stand-by arrangement the Government does not intend to: (i) modify existing or to introduce multiple currency practices; (ii) impose new or intensify existing restrictions on payments and transfers for current international transaction; (iii) impose new or intensify existing import restrictions for balance of payments purposes; (iv) conclude bilateral payments agreements with member countries of the Fund.

12. Tanzania's difficult foreign exchange position has resulted in a large accumulation of external payments arrears, including those regarding public and publicly-guaranteed debt service obligations. As of end-March 1986 total external payments arrears (public and private) are estimated to amount to US$700 million (including arrears to the Fund), of which US$380 million related to medium- and long-term debt and US$320 million to short-term debt obligations. It is the Government's intention to settle the bulk of these arrears, by seeking rescheduling arrangements with creditors in the framework of a general agreement on debt relief, and by some cash payments. The Government will effect cash reductions in these arrears in the amount of US$50 million between July 1, 1986 and June 30, 1987. These arrears would be reduced by cash payments of US$25 millions before end-September 1986, and by US$30 million before end-December 1986. Understandings on the schedule for further quarterly reductions during the balance of the program period would be reached at the time of the review of the program with the Fund before end-February 1987. In addition, the Government will not allow any accumulation of new arrears, excluding debt service payments subject to rescheduling, during the program period.

13. It is estimated that Tanzania's total foreign debt outstanding at end-1985 amounted to US$3.2 billion, including US$280 million of short-term debt. Although most of this debt has been on concessional terms, the external debt service ratio has risen from about 17 percent in 1980 to nearly 55 percent in 1985. This fact, plus the limited prospects for foreign exchange earnings in the near future necessitates a very cautious foreign borrowing policy in 1986 and 1987. The Government and the Bank of Tanzania will not contract or guarantee any external borrowing on nonconcessional terms with an initial maturity of more than one year and up to and including 15 years. This provision will also apply to public enterprises except public sector production enterprises who may contract such loans on their own creditworthiness (thus not requiring government or Bank of Tanzania guarantee) in amounts which aggregate to no more than US$50 million. In addition, except for normal import trade credits, the Government will not allow any increase in the outstanding amount of short-term credits of an original maturity of up to and including one year, over the end-June 1986 level. These limits will not apply to the restructuring of any loans or external payments arrears that may be agreed within the framework of the debt rescheduling arrangements.

b. Agricultural policies

14. The recent output stagnation and the decline in export earnings are primarily attributable to the poor performance of the agricultural sector (the mainstay of the Tanzanian economy), which in turn is attributable, inter alia, to a sharp decline in world commodity prices and real producer prices. Given the central role of agriculture in the recovery program, priority will be given to raising producer incentives, and the level of producer prices is an important component of the incentive package. As a medium-term policy, the Government intends to set producer prices at a level equivalent to 60-70 percent of F.O.B. prices, and to ensure an annual increase of at least 5 percent in real terms, whichever is higher. For 1986/87, as a first step toward meeting that objective, producer price of coffee has been raised by 80 percent,, of cocoa and cardamom by 60 percent, of tea and cashews by 55 percent, of tobacco and cotton by 30 percent, over those prevailing for the 1985/86 season. Regarding domestic food crops, the Government has already eliminated all budgetary subsidies and price controls on maize. Presently, the administered producer price for maize is the minimum guaranteed price by the National Milling Corporation (NMC). The NMC, in turn, will price its sale of maize and maize flour in such a way as to avoid any trading losses on these commodities. All other commodities traded by the NMC will also be priced in such a way as to avoid any subsidies. The purchasing boards and cooperative unions will pay cash to all producers for the procured crops.

15. On the basis of present estimates, the above price increases should result in an approximate balance in the accounts of all the parastatals, except that the Coffee marketing Board (CMB) will be left with an estimated operating profit of T Sh 2.0 billion, and the Cotton Marketing

Board is estimated to incur a loss of about T Sh 400 million. Given the presumably temporary nature of the present increase in the world market prices of coffee, the CMB will be required to keep these excess profits in a Stabilization Fund by investigating them in government securities presently held by the banking system. For purposes of monitoring the ceilings on net bank credit to government, as well as the overall credit any such sale of government securities by the banking system to the CMB will be netted out. As an indicative target, CMB will be expected to purchase (cumulatively) government securities of at least T Sh 500 million before end-March 1987, and T Sh 1.0 billion before end-June 1987 and T Sh 1.2 billion by end-September 1987. Should the CMB purchases of securities fall below these targets, the Government will consult with the Managing Director of the Fund on its causes and remedial measures. Taking account of the estimated surplus of the marketing boards and the proposed investments for purposes of the coffee stabilization fund, as a performance criterion the total of bank credit to the seven parastatals (coffee, cashew, cotton, sisal, tea, tobacco, NMC) will not increase by more than T Sh 1.50 billion between end-June and end-September 1986, and by more than T Sh 2.55 billion between end-June and end-December 1986. This credit is expected to decline in the subsequent two quarters and the relevant ceilings will be set in the course of the review to be completed before February 1987.

16. The Government intends to continue with its efforts to improve the marketing of agricultural products and the efficiency of the parastatals. The new institutional structure of the cooperatives and marketing boards will be consolidated. To this effect, the Government will, in collaboration with the World Bank, agree on the needed measures in the context of a program credit for economic rehabilitation no later than end-October 1986. These measures will concern internal grain transport, agricultural input supply, and procurement. The introduction of these measures will not be delayed beyond end-1986.

c. Fiscal policies

17. Over the past four fiscal years (1981/82-1984/85 the central government's budget deficit has averaged nearly 11 percent of GDP, and is estimated at about 8.5 percent of GDP for 1985/86. However, these figures underestimate substantially the underlying structural deficit, partly because of the overvaluation of the currency and partly because of the regime of low interest rates. Thus, as an example, at the average exchange rate expected to prevail in 1986/87 and the proposed changes in interest rates, the overall budget deficit for 1985/86 would rise from 8.5 percent to over 16 percent of GDP.

18. As a medium-term policy, it is proposed that the Central Government's financial operations be reflective of the real conditions prevailing in the economy, so as to better assess their economic and financial impact and to bring them into a consistent relationship with the medium-term objectives outlined above. It will be the Government's policy to reduce substantially the fiscal deficit, while improving the

quality and scope of the public sector's investment. To this end, emphasis will be placed on mobilizing and improving the elasticity of tax revenue and minimizing the disincentives that have emerged over the years. In particular, it is intended to reduce the very high marginal income tax rates and widen the in income tax base. It is also intended to review, with the assistance of the World Bank, the external tariff structure in line with the exchange rate and exchange system changes that are being implemented, and to initiate studies and undertake reforms in the nonfinancial public entities to improve their financial operation and minimize their reliance on the Central Government while ensuring that they pay taxes and dividends as appropriate to the budget. With regard to capital expenditure, an overall review of investment priorities will be undertaken with the World Bank so as to increase the efficiency of the public sector investment program. Finally, to enhance expenditure control and proper implementation of the budget, the Government has already instituted procedures to ensure the collection of timely data, its review and follow-up by the relevant departments in the Ministry of Finance and the Bank of Tanzania.

19. On June 19, 1986 the Government announced the budget for the fiscal year 1986/87, based on current understandings on the exchange policy as described in paragraph 8 above. These estimates, which took into account the impact of the devaluation, are being further corrected in the light of the more accurate assessment of the impact of the exchange rate action on individual votes and could add about T Sh 510 million to recurrent expenditure. Taking these adjustments into account, the budget envisages total expenditure (excluding debt amortization) of T Sh 49.9 billion, of which recurrent expenditure (excluding debt amortization) of T Sh 35.0 billion. Capital expenditure, on the other hand, is estimated to amount to T Sh 14.9 billion. Revenue, on the other hand, is estimated at T Sh 32.9 billion, including an estimated yield of T Sh 2.4 billion from the new tax measures described below. The overall budget deficit is, therefore, estimated at T Sh 17.0 billion, excluding debt amortization, or at T Sh 22.2 billion when amortization is included. This deficit is expected to be financed by the budgetary receipt of the local currency equivalent of US$360 million (T Sh 17.90 billion) of external grants and loans, T Sh 1.8 billion of domestic nonbank borrowing, and up to T Sh 2.5 billion of net bank credit to the Government. Included in this amount of external aid is the anticipated additional balance of payments support in an amount of US$140 million expected to be channeled through the budget. Any excess in the budgetary receipts above the local currency equivalent of US$ 360 million from external grants and loans would be offset by a corresponding reduction of net bank credit to the Government.

20. The new tax measures include increases in import duties from 20 to 25 percent (estimated revenue yield T Sh 225 million), conversion and changes in various specific duties on beer, spirits, soft drinks, and cigarettes to valorem basis (estimated additional revenue yield T Sh 1,475 million). Sales tax on some petroleum products has also been increased (to yield T Sh 618 million) by converting and changing the

present specific taxes on liquified petroleum gas and premium and regular petrol and by increasing the current specific rates for diesel, industrial diesel oil, fuel oil, and aviation fuel. Apart from raising the necessary additional receipts, another purpose of the announced tax measures is to improve the elasticity of the revenue system so that the budget benefits automatically from the improved growth performance of the economy as a result of the measures being implemented under the program. On the other hand, in order to provide better incentives to work and invest, the maximum and minimum rates of income tax are being reduced from 95 to 75 percent and from 25 to 20 percent respectively and the present system of granting investment deduction allowance of 20 percent to factory owners is extended to investments in the agricultural sector. Also the customs duty and sales tax on tractors is abolished.

21. On the expenditure side, recurrent expenditure (excluding amortization) is estimated to increase by 47 percent, while development expenditure will rise by 119 percent. A substantial part of the increase, especially to development expenditure, reflects the adjustments consequent upon the exchange rate depreciation and the accompanying price adjustments. The Government is undertaking active steps to reduce operational costs and to increase productivity and efficiency in public administration. Thus, effective January 1987, parents are being required to make larger contributions to cover part of the expenses of secondary education, technical colleges, and other schools and training institutions, and the present government procedure of giving preservice allowance to students in schools and training colleges or institutions (with some exceptions) will be abolished. Furthermore, in 1986/87 local governments will be expected to contribute an additional T Sh 1,000 million through their revenue collection measures towards meeting their operational costs. The current practice of providing free transport to employees, which has resulted in increasing yearly costs of maintaining and running government vehicles, is being limited. Instead, the Government will give soft loans to civil servants to buy the needed transport vehicles and will provide allowances for running those vehicles for government business. It is expected that this measure will greatly assist the Government in reducing its overall costs. Employment in all sectors of the civil service, except teachers and medical personnel, is being frozen, and all subsidies to parastatals are abolished. The existing export bonus scheme is also abolished, effective July 1986. As against these reductions in expenditure, the Government is compelled to provide for increases in wages and salaries to compensate its employees for the higher cost of living, especially taking into account the fact that there has been no general increase in wages over the past two years when the cost of living has increased by nearly 70 percent. Accordingly, teachers have been granted an allowance equal to 25 percent of their gross salaries, and other civil servants are granted increases ranging between 2.5 percent for salaries above T Sh 6,000 per month to 30 percent for minimum wage earners. As regards development expenditure, priority is given to projects already under implementation

and new products are limited to those considered essential in the context of the effort to rehabilitate the economy. High priority is given to directly productive sectors as well as the economic service sectors which are important for the success of directly productive sectors. The Government proposes to review its investment program for 1986/87 with the World bank with a view to limiting its investment expenditure and selecting projects consistent with available resources, including availability of imports under the minimum import requirement, and with the investment and rehabilitation priorities.

22. The above-mentioned budgetary targets, are based on the underlying expectation (on a cumulative basis) that for each quarter of the fiscal year total revenues, total expenditures (excluding amortization), with its subcategories of recurrent and development expenditure, as well as the overall deficit will develop as follows:

Table. Revenue, Expenditure, and Overall Deficit

(In millions of T Shillings)

	July - Sept. 86	July - Dec. 86	July 1986 March 1987	July 1986 June 1987
Revenue	6,600	14,800	23,500	32,899
Total expenditure (excluding amortization)	9,247	20,075	30,954	49,899
Recurrent	6,870	14,575	21,954	35,040
Development	2,377	5,500	9,000	14,859
Overall deficit	2,647	5,275	7,904	17,000

The (cumulative) quarterly ceilings on the overall deficit (as measured by the difference between revenue and total expenditure excluding amortization) for end-September, end-December 1986, and end-June 1987 are the performance criteria while that for March 1987 is an indicative target which will be set as a performance criterion in the context of the review of the program to be completed before end-February 1987. On the other hand, the quarterly cumulative targets in respect of recurrent expenditure and total government expenditure while not constituting performance criteria, will be indicative targets which if exceeded will lead the Government to consult with the Managing Director on any needed corrective measures. Beginning in February 1986 the

Government has increased its efforts to bring expenditure under control by shifting allocation from a quarterly to a monthly basis and has dishonored checks issued in excess of monthly allocations. To ensure the success of the program of expenditure restraint, to avoid past problems of expenditure overruns and to avoid the need to dishonor government checks, the Government will enforce the maintenance of commitment ledgers and cash books by each spending department, starting in July 1986 to be monitored by financial officers from the Ministry of Finance. These officers will review all commitments and will be empowered to ensure that total commitments do not exceed the allocation limits set for each department. To support this review process, each department will be required to submit monthly its commitments reports in addition to the present monthly Flash Report on checks issued. This process will be enforced by withholding from any delinquent reporting departments subsequent monthly release of allocations.

23. As stated earlier, the program envisages T Sh 2.5 billion of net bank credit for financing the 1986/87 budget, with the bulk of the remaining deficit being financed by external assistance. Taking into account the expected pattern of receipts and expenditures, the amount of outstanding net bank credit to Government, which is estimated at T Sh 32.56 billion as of end-December 1985, and projected at T Sh 33.77 billion as of end-June 1986, will not increase by more than T Sh 1.60 billion by end-September 1986, and by T Sh 1.80 billion by end-December1986, and T Sh 2.50 billion by end-June 1987 over the actual end-June 1986 level. The corresponding ceiling for end-March 1987 will be established in the context of the review of the program no later than end-February 1987. These ceilings are based on the estimated inflow of the local currency equivalent of US$270 million (T Sh 13.80 billion) in net external assistance accruing to the budget, of which US$36 million between July-September 1986, US$100 million between July-December 1986, US$201 million between July 1986-March 1987. The quarterly ceilings on net bank credit to the Government would be reduced by the full amount of any excess inflow of external assistance over that indicated above, as well as by the amount of the sale of government securities by the banking system to CMB pursuant to paragraph 15 above. As is the current practice, the Government will pay in full the domestic currency equivalent of the Central Government's external debt service on the original maturity basis to the Bank of Tanzania. To ensure that such payments relating to rescheduled amounts are fully frozen, a blocked account will be established in the Bank of Tanzania to be credited with those payments and will be reflected as medium-term external liabilities of the bank of Tanzania. To the extent that there are exchange losses in connection with these debt service payments, they will be liability of the Bank of Tanzania and will be so reflected in its accounts. As regards the local currency counterpart of the existing nongovernment arrears currently on deposit with the National Bank of Commerce (NBC), the Government will absorb the corresponding exchange losses. For that purpose the Government will issue non-interest bearing, non-negotiable securities, but these securities will not be counted as net credit to

Government for purposes of monitoring the above mentioned ceilings on such credit.

d. Monetary and credit policies

24. The Government will implement a monetary and credit policy which is consistent with strengthening the balance of payments and reducing the inflation rate, and which will meet the credit needs of the public and private sectors respectively. To attain these objectives, the maximum total credit expansion in the fiscal year 1986/87 will be limited to 12 percent, the expansion in broad money to 11 percent, compared to an expected increase of about 32 percent in nominal gross domestic product. Within the maximum limits, total domestic credit, which is estimated at T Sh 49.30 billion at end-December 1985 and projected at T Sh 52.22 billion and end-June 1986, will be constrained to limit the expansion to T Sh 4.60 billion between end-June 1986 and end-September 1986, and to T Sh 6.31 billion between end-June 1986 and end-December 1986. These ceilings will be automatically adjusted as a result of any adjustment in the ceiling on net credit to Government, pursuant to paragraph 15 above. The ceilings for end-March 1987 and end-June 1987 quarters will be established in the context of the review before end-February 1987. The noninterest bearing non-negotiable government securities issued to absorb the devaluation losses (paragraph 23) will not be counted for purposes of monitoring the ceilings on total credit or net credit to Government.

25. Although the Government of Tanzania has normally kept the interest rate structure under review, adjusting them most recently on October 1, 1985, the interest rates have remained negative in real terms. In keeping with the above stated intention to make the interest rate structure positive within two years, the interest rates paid on savings deposits of one year or more were raised on July 1, 1986 to a level that equals at least 50 percent of the inflation rate of the previous 12-month period for which the CPI data are available, and will be further raised by end-June 1987 to 75 percent of the average inflation rate for the latest 12-month period for which the price data would be available. Accordingly, effective July 1, 1986, the treasury bill (91 day maturity) rate was adjusted by 3.5 percentage points to 9.5 percent, the rate on 12-month savings deposits increased by 5 percentage points to 15 percent, the highest lending rates increased to 21 percent, and all other interest rates were adjusted correspondingly. In addition, the Government will adjust the interest rates (other than on treasury bills) quarterly, beginning during the third quarter of 1986, to smoothen the transition to positive rates as envisaged above.

e. Domestic price liberalization policy

26. There has been a significant reduction in the list of products under price controls and at present retail prices of 47 broad categories of commodities are controlled by the National Price Commission. It is

government policy to continue this process of reducing the list of products subject to price controls. Except for the identified 12 categories of commodities, all the remaining controlled commodities will be decontrolled over a period of three years, with one third of the categories (as per attached list) being decontrolled before end-July 1986. For the specific items where price controls will remain during this transitional period, frequent price adjustments will be made to ensure that relevant enterprises are able to avoid imbalances in their cost-price relations. In keeping with the Government's policy to pass on to consumers the costs of the depreciation of the exchange rate, the Government will be permitting appropriate increases in prices of all the affected commodities before end-July 1986.

f. Minimum import requirements and the reform of enterprises

27. In connection with the execution of the expanded import program, which is estimated at US$1.1 billion as a result of the external assistance indicated during the Consultative Group meeting, a rehabilitation and reform program to improve the operational efficiency of selected industries in return for higher allocations of imported inputs will be put in place. The Government will identify, in consultation with the World Bank, a selected number of economically viable enterprises, public as well as private, which are crucial to the recovery of domestic production and exports, and they will be required to present to the Government, before end-September 1986, comprehensive packages of measures to improve their efficiency in the use of imported inputs. Inasmuch as these enterprises present such a comprehensive package, their minimum imports requirements will be met under the adjustment and recovery program.

g. Financing gap and the reserve target

28. The above mentioned policies, including the target to effect imports amounting to US$1,100 million during 1986/87 in close conformity with the minimum import requirements of US$1,200 million, are projected to result in an overall balance of payments deficit of US$430 million. In addition, the Government would wish to improve the net reserves position of the Bank of Tanzania (before additional purchases from the Fund) by an amount of US$70 million. The financial gap for the fiscal year 1986/87 would, therefore, amount to US$500 million which is expected to be met by external assistance, including use of Fund resources, IBRD program loans, and debt rescheduling. Already, friendly donor countries have indicated their willingness to provide additional concessional balance of payments assistance amounting to about US$130 million during 1986/87, and the Government has received indications from creditor countries of their willingness to provide generous debt relief within the context of Paris Club rescheduling which the Government has requested. As mentioned above, the present program is based on an estimated import level of US$1,100 million, as against the projected minimum requirement of US$1,200 million. The Government is hopeful that additional external assistance would be forthcoming in

which case the Government will revise upwards its import target by a maximum of US$100 million to US$1,200 million, and any available balance of resources would be used to improve the external reserve position and to reduce external arrears. To underpin the projected balance of payments objective, as indicative targets the net external reserves of the Bank of Tanzania are targeted to increase by US$5 million between end-June and end-December 1986, by US$12 million between end-June 1986 and end-March 1987, and US$20 million between end-June 1986and end-June 1987.

ATTACHMENT I

A. List of Core Products for Price Control

1. Cooking fats and oils
2. Soap
3. Saftey matches
4. Galvanised corugated iron sheets
5. Cement
6. Farm implements
7. Tyres
8. Sugar
9. Fertilizer
10. Bags (sisal)
11. Milk
12. Petroleum products

B. Products for Price Decontrolling in 1986/87

1. Wire products
2. 100 percent polyester knitted
3. Blended polyester
4. Plastic containers
5. Torches
6. Vacuum flasks
7. Aluminium ware products
8. Steel products
9. Louvre frames
10. Cotton wool
11. Mosquito coils
12. Electric bulbs and tubes

Tanzania - Fund Relations
(As of July 31, 1986)

I. Membership status

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

A. Financial Relations

II. General Department (General Resources Account)

(a) Quota — SDR 107.00 million

	SDR million	Percent of quota
(b) Total Fund holdings of Tanzanian dollars:	113.12	105.72
(c) Fund holdings subject to repurchase and charges	6.12	5.72
Of which: credit tranche	(--)	(--)
supplementary financing facility	(6.12)	(5.72)
compensatory financing facility	(--)	(--)
(d) Reserve tranche position:	--	--

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

(a) Current stand-by arrangement: None

(b) Previous stand-by arrangements:

Arrangement	Duration	Amount	Utilization	Undrawn balance
			(In millions of SDRs)	
Stand-by	8/21/75-8/21/76	10.50	--	10.50
Stand-by	9/15/80-6/30/82	179.60	25.00	154.60

(c) Special facilities:

Compensatory financing facility — Approval was given on September 15, 1980 for a purchase equivalent to SDR 15.0 million.

IV. SDR Department

(a)	Net cumulative allocation	SDR 31.37 million
(b)	Holdings:	--

Tanzania - Fund Relations (concluded)

V. Administered Accounts

(a) Trust fund loans:

(i) Disbursed	SDR 41.04 million
(ii) Outstanding	SDR 33.43 million

(b) SFF Subsidy account:

(i) Payments by Fund	SDR 1.94 million

VI. Overdue Obligations to the Fund
(As of July 31, 1986) SDR -- million

B. Nonfinancial Relations

VII. Exchange System

The Tanzanian shilling is pegged to a basket of currencies; the middle rate in terms of the U.S. dollar, the intervention currency, was T Sh 40.000 per U.S. dollar as of June 20, 1986.

VIII. Last Article IV Consultation

The last Article IV consultation was concluded by the Executive Board on March 20, 1986 (EBM/86/--). The following decision was adopted:

1. The Fund takes this decision relating to Tanzania's exchange measures subject to Article VIII, Section 2 and 3, and in concluding the 1985 Article XIV consultation with Tanzania, in the light of the 1985 Article IV consultation with Tanzania conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. Tanzania continues to maintain restrictions on payments and transfers for current international transactions in accordance with Article XIV, Section 2. In addition, exchange restrictions evidenced by the external payments arrears, and a multiple currency practice as described in SM/86/--, are subject to approval under Article VIII, Sections 2(a) and 3. The Fund urges the authorities to adopt adjustment policies which will permit the elimination of these restrictions.

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

IX. Technical Assistance

Technical assistance missions from the Bureau of Statistics were undertaken to improve the compilation of monetary aggregates (September 2-18, 1985). A member of the CBD panel of experts is assigned to the Bank of Tanzania as short-term technical advisor on external debt management.

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 1966 prices)	24,163	24,475	24,368	24,972	25,596
Agricultrure	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-cashed 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

TANZANIA - Basic Data (continued)

	1981 Dec.	1982 Dec.	1983 Dec.	1984 Dec.	1985 Dec.
	(In millions of Tanzania Shillings, end of period)				
Money and credit					
Domestic credit	21,957	26,234	30,378	37,024	49,299
Of which: government	(14,176)	(17,763)	(20,880)	(25,432)	(32,599)
Money plus quasi-money	18,105	21,787	24,664	30,198	38,502

	1981	1982	1983	1984	1985 est.
Balance of payments	(In millions of U.S. dollars)				
Trade balance	-599	-682	-440	-471	-573
Exports, f.o.b.	(563)	(413)	(379)	(369)	(327)
Imports, c.i.f.	(-1,162)	(-1,095)	(-819)	(-840)	(-900)
Services (net)	51	13	-15	-43	-72
Private transfers (net)	22	25	19	63	130
Current account	-526	-644	-436	-451	-515
Government transfers	107	94	84	96	107
Medium- and long-term borrowing	180	240	150	-74	-19
Inflows	(230)	(285)	(253)	(183)	(200)
Outflows	(-50)	(-45)	(-103)	(-257)	(-219)
Suppliers' credits (net)	101	58	102	110	-32
SDR allocation	6	--	--	--	--
Import support	112	92	61	49	70
Other capital movement and errors and omissions	18	50	20	111	194
Overall balance	-2	-110	19	-159	-195
Financing	2	110	19	159	195
Arrears	22	93	64	183	199
Net foreign assets (increase -)	-20	17	-45	-24	-4
Gross official foreign reserves 1/					
In weeks of imports	2.3	1.8	4.0	2.4	1.1

TANZANIA - Basic Data (concluded)

	1981	1982	1983	1984	1985
External public debt					
Debt service obligation as percent of exports of goods and services					
Excluding the Fund	11.7	17.3	30.2	62.1	53.3
Including the Fund	16.7	19.4	35.3	66.4	55.7

Sources: Data provided by the Tanzanian authorities and staff estimates.

1/ Gross foreign assets held by the Monetary authorities and the National Bank of Commerce.