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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 86/140

10:00 a.m., August 28, 1986

R. D. Erb, Acting Chairman

Executive Directors	Alternate Executive Directors
	Mawakani Samba
	E. L. Walker, Temporary
	G. Ercel, Temporary
	T. Alhaimus
H. Fujino	M. Sugita
G. Grosche	
Huang F.	
J. E. Ismael	
	J. R. N. Almeida, Temporary
T. P. Lankester	
	H. Fugmann
M. Massé	
E. I. M. Mtei	A. Abdallah
	J. Abramovich
	J. E. Suraisry
	J. E. Rodríguez, Temporary
	S. de Forges
	J. de Beaufort Wijnholds
	A. V. Romuáldez
G. Salehkhou	
A. K. Sengupta	
S. Zecchini	

J. W. Lang, Jr., Acting Secretary
B. J. Owen, Assistant

Also Present

R. Mariki, Economic Minister, Embassy of Tanzania. IBRD: D. Greene, Eastern Africa Regional Office. African Department: R. J. Bhatia, Deputy Director; A. Basu, G. Devaux, L. D. Dicks-Mireaux, A. Tahari. Central Banking Department: D. R. Khatkhate. Exchange and Trade Relations Department: W. A. Beveridge, Deputy Director; S. J. Anjaria. External Relations Department: A. M. Abushadi. Fiscal Affairs Department: A. A. Tait, Deputy Director; E. S. Kreis, W. R. Mahler, Jr. IMF Institute: J. B. Kimaro, J. S. C. Mhando, Participants. Legal Department: H. Elizalde. Research Department: R. Pownall. Treasurer's Department: T. Leddy, Deputy Treasurer; D. Berthet. Western Hemisphere Department: M. Caiola, J. Ferrân. Bureau of Computing Services: W. J. Walker. Advisors to Executive Directors: S. M. Hassan, G. D. Hodgson, A. Vasudevan. Assistants to Executive Directors: A. Bertuch-Samuels, V. Govindarajan, G. K. Hodges, Z. b. Ismail, S. King, J. Orleans-Lindsay, R. Msadek, W. K. Parmena, G. Schurr.

1. TANZANIA - STAND-BY ARRANGEMENT AND EXCHANGE SYSTEM

The Executive Directors considered a request from Tanzania for a stand-by arrangement in an amount equivalent to SDR 64.2 million for a period of 18 months (EBS/86/183, 8/8/86; Cor. 1, 8/14/86; and Cor. 2, 8/25/86).

Mr. Richard Mariki, Economic Minister of the Embassy of Tanzania, was also present.

Mr. Mtei made the following statement:

> The Tanzanian authorities wish to express their appreciation to the Fund staff for the good cooperation they established with Tanzanian officials in working out the comprehensive adjustment program. They hope that this spirit of cooperation will be continued during the implementation of the requested stand-by program. The authorities have also expressed their gratitude to the international community for its generous response and for the timely assistance which was extended to enable Tanzania to clear its arrears with the Fund, thus paving the way for the stand-by arrangement. The Government has expressed the hope that the approval of this stand-by arrangement will herald an acceleration of concessional bilateral and multilateral resources which are badly needed for the implementation of the program. Such an acceleration is vital if the severity of the stringent measures being implemented since June is to be alleviated.
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> The authorities, since the last election, have placed the highest priority on reviving the economy on a sustainable basis. They had to address, with resolve, the situation in which they found themselves under which most economic indicators were showing a serious and persistent economic deterioration with a per capita GDP which had been falling rapidly since the start of this decade. In addition, the rate of inflation has persisted at high levels, averaging an annual rate of 29 percent in the last five years, while shortages of a wide range of essential goods had become rampant in the face of a chronic shortage of foreign exchange. As a result, many transactions had been driven to parallel markets, causing considerable distortions. Despite these adverse developments the general situation was not totally negative. For example, since attaining independence in 1961, schools, medical facilities, and clean water have been extensively provided throughout Tanzania, and the country now has one of the highest rates of adult literacy among low-income countries. This provides a solid foundation upon which rural development can be built.
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> The stand-by program has been carefully formulated and assessed by the authorities in collaboration with the staff. Contrary to what others might say, the authorities have not

pursued gradualism for its own sake but have used the period since the election to mobilize mass support for the tough adjustment program now being implemented. This was essential in order to ensure lasting success and also to preserve the fragile sociopolitical fabric.

The recovery program was submitted to a Consultative Group meeting which endorsed it and pledged financial support for the program's first year in Paris on June 10 and 11, 1986. However, some detailed aspects of sectoral policies are now being finalized with the World Bank and they are expected to culminate in the next two to three months in a World Bank sectoral loan estimated at about $100 million. The sectoral loan will rehabilitate the agricultural, transportation, and industrial sectors, and reduce bottlenecks which have persisted in those areas. In this connection, the Government intends to work out a three-year structural program to include, in addition to rehabilitation, an intensified process of policy change to enhance productivity on a broader spectrum along the lines of the recovery program. They intend to submit this in the form of a policy framework paper to support a contemplated application for the use of Fund resources under the structural adjustment facility in the near future.

The 18-month stand-by program forms a crucial link with the medium-term recovery plan. The stand-by program provides a broad range of incentives necessary to revive the economy, which was progressively coming to a standstill. Thus, the new exchange rate policy, higher producer prices, price liberalization, and restrained fiscal and monetary stance, including higher interest rates, are expected to provide a strong stimulus to the economy so that during the remainder of the decade, Tanzania can restore an acceptable rate of economic growth and a sustainable balance of payments.

The Tanzanian authorities are aware that many of the present difficulties have been exacerbated by price distortions, particularly the overvalued exchange rate. They have, therefore, started implementing a comprehensive and flexible price policy revolving upon a flexible exchange rate. With effect from June 19, 1986 the Government announced a major change in the exchange rate of the Tanzanian shilling, placing the new rate at T Sh 40 to the U.S. dollar compared with T Sh 17 as of April. In addition, the Government committed itself to a sliding exchange rate policy that would continue the process of exchange rate depreciation. The monthly rate of depreciation is to be equal to the difference between the monthly movement in the National Consumer Price Index and the monthly movement in the weighted average of the currency basket to which the shilling is pegged plus an additional 1 percent depreciation. This formula, therefore, not only ensures that the real effective exchange rate does not appreciate but also that it continues to depreciate.

In practice, the Central Bank is applying the formula to adjust the rate weekly. As of Tuesday, August 26, the rate stood at T Sh 42.21 to the U.S. dollar. In December 1986 the exchange rate will constitute a major aspect of the review under the stand-by arrangement. In this respect it is worth noting that the parallel market rate has fallen sharply since the announcement of the adjustment measures from a level of about T Sh 150 per dollar to about T Sh 110 at present. The authorities believe that with improvements in the domestic supply situation, and also in foreign exchange availability and expectations, the rate in the parallel market will continue to come down substantially.

The rest of the price policy being implemented from the beginning of the 1986/87 fiscal year includes the adjustment of producer prices and general liberalization to provide incentives and eliminate distortions in resource allocation. The exchange rate depreciation created room for the Government to grant the highest ever annual producer price increases, reaching real levels of 20-42 percent for export crops. The Government has reiterated its intention to continue increasing real levels of producer prices throughout the recovery program. It is also the declared policy to liberalize all other prices, thus departing from the old practice of price controls with the exception of a small "negative list" of basic goods whose prices will, however, be periodically adjusted to reflect true costs. Already the Government has sharply reduced the number of items subject to price control and the few remaining items will be decontrolled in stages over the next two years. But even the prices of those items have been raised substantially in the meantime in order to reflect the postdevaluation costs.

In the financial sphere, the Government realizes that management will remain difficult during the recovery period until the end of this decade but it has resolved to reduce external and budgetary deficits to manageable levels. Thus, although economic growth in Tanzania is highly dependent on the availability of imports the level of imports will be allowed to expand only moderately during the period of the stand-by program. Thereafter, for the rest of the decade, the import level will be held constant in real terms through the interplay of exchange rate, import substitution, and demand restraint measures, while exports are to expand substantially from an estimated $398 million in 1986 to $622 million in 1990. Nevertheless, sizable balance of payments deficits will still persist and a financing gap of $227 million is projected for 1990.

In the field of fiscal policy, the program objective--as stated by the Government in the budget for 1986/87--is to reduce the budgetary deficit by more than 5 percent of GDP. Data estimates are still very preliminary as these are dependent on price changes that are just now taking shape following the sharp devaluation. The Government will therefore keep a constant watch on revenue and expenditure developments during the fiscal year. Total revenues are estimated to increase by 58 percent at current prices, due both to the impact of the prices on the tax system, the more so since a number of specific taxes were converted to ad valorem rates, and due also to other discretionary measures introduced with respect to import duties and sales taxes. On the expenditure side the Government will not only continue to restrict the growth in current expenditure but will phase itself progressively out of the provision of some services. With respect to wages, while the Government has exercised considerable restraint, it has found it necessary to grant a moderate salary increase mainly to low-income employees to partly offset the recent cost increases. For higher income employees, the reduction in income tax rates provided some relief. The devaluation has led to an improvement in the financial position of agricultural marketing boards for 1986/87 and obviated the need for budgetary transfers to these enterprises. In addition, in subsequent years the rehabilitation of these as well as other public enterprises that is being undertaken in collaboration with the World Bank should have a salutary effect on the budget. To underscore the authorities' commitment to holding down the budgetary deficit, development expenditure has been virtually limited to rehabilitation and ongoing projects. With regard to overall expenditure, the Government will ensure strict control to avoid expenditure overruns. To this effect, the Ministry of Finance is to ascertain, before authorizing any expenditure, that total commitments do not exceed the allocation for each department.

Monetary and credit policies are to be tightened and, accordingly, the rate of growth in domestic credit and money supply during fiscal year 1986/87 will be held below half of the growth rates prevailing last year. The expansion in total domestic credit in 1986/87 is projected at 12 percent while the growth in broad money should be limited to 11 percent against a background of a nominal GDP growth rate of 32 percent estimated for 1986/87. The brunt of this slowdown falls on credit to the Government while a reasonable credit expansion is permitted to productive enterprises. At the same time the Government has undertaken to raise interest rates to real positive levels. As a first step, all interest rates were increased substantially effective July 1, 1986. Despite the restraint in fiscal and monetary policy, the rate of inflation is expected to remain high at 30 percent in 1986/87 owing to the effect of devaluation.

In conclusion, the authorities are fully aware that the success of this program will depend not only on the efforts of Tanzania itself but also on the support of the international community in various ways, including debt relief and exceptional financing commensurate with the projected financing gaps. In particular, as emphasized by the staff, the recovery program in Tanzania's context relies heavily on the level of imports; the authorities also realize that even by 1991 their achievement will only have taken them one step further toward self-reliance. Nevertheless, Tanzania is endowed with an assortment of natural resources which can support a diversified economy. The Government recognizes that with good management these resources can be harnessed to support rapid economic growth.

Mr. Lankester said that he welcomed the fact that the Board was finally able to discuss a Fund-supported adjustment program for Tanzania. The shortcomings of the policies followed over the previous few years had been all too evident, with growing external arrears, high inflation, and a low level of capacity utilization. Therefore, it was encouraging that the authorities had recognized the need--as quoted from the summing up of the Board's discussion of the previous Article IV consultation with Tanzania (EBM/86/48, 3/20/86)--for a "comprehensive adjustment program that could lead to both a sustainable external position and economic recovery."

The proposed adjustment program represented a significant step toward the broad package of measures that had been advocated by the Board during its discussion of the previous Article IV consultation with Tanzania, Mr. Lankester continued. The fact that a number of measures had already been put partly or wholly in place was also clear evidence of an important shift in the authorities' thinking. However, the progress that was envisaged for certain key areas could only be described as modest in pace, as evidenced by program projections that indicated that even by 1991, Tanzania would still require some exceptional balance of payments support. The Board was being asked to endorse a program that left no room for slippages in policy if the support of donors and the financial community in general was to be maintained and if the country was to avoid running into financial difficulties later. The Tanzanian private sector had to be convinced of the authorities' serious intentions if it was to be persuaded to respond with additional exports and production and, in particular, if the parallel economy was to be integrated once again into the official economy. However, the degree and pace of adjustment envisaged in the program was, in his view, so modest that he would have difficulty supporting a waiver in future if the program went off track for other than technical reasons.

There were several reasons for his concern about the pace and durability of the adjustment program, Mr. Lankester went on. On the central question of the exchange rate, he acknowledged that significant depreciation had recently occurred, reversing the real appreciation that had taken place since 1978. However, it was more than likely that the official price index strongly understated the true rate of inflation since 1978. Furthermore, although the parallel market rate had fallen encouragingly since the news of Tanzania's agreement with the Fund, it was still more than 150 percent higher than the current official rate. The continuing real depreciation of 1 percent a month in the official rate, which was envisaged under the program, therefore, appeared rather modest when compared with the magnitude of the external imbalance that Tanzania faced. He welcomed the fact that the authorities had agreed to examine the appropriateness of the exchange rate at the time of the first review of the program.

The continuation of a not fully competitive exchange rate during the initial stages of the program had several implications, Mr. Lankester considered. It presumably was the explanation for the need to maintain the distortionary foreign exchange and export retention scheme. He was heartened that the authorities planned to terminate those schemes within two years as progress was made toward a fully competitive exchange rate. Nevertheless, he hoped that those schemes could be dismantled more quickly.

He was concerned that the continuing overvaluation of the exchange rate should not undermine an essential part of the recovery program--namely, the aim of ensuring that agricultural producers were given adequate price incentives, Mr. Lankester commented. The recent increases in producer prices were welcome, and the medium-term objective of increasing producer prices to at least 60 percent of export prices was another step in the right direction. However, for prices that were below that level, the authorities had committed themselves to increasing real prices only by 5 percent a year. Hence, if the parallel market exchange rate remained well above the official rate, considerable incentive would remain for unofficial exports by the private sector, which would deny the authorities much needed foreign exchange. Any thoughts the staff might have on that subject would be welcome, as would be more detail in future staff reports on the relationship between producer prices in Tanzania and neighboring countries as well as on world markets.

As for the domestic financial policies proposed in the program, the adjustment measures to be undertaken in the program were also rather modest, Mr. Lankester remarked. However, it was encouraging to note that the authorities recognized the need to tackle the longstanding problem of substantially negative real interest rates. Also, whereas the recent increases in rates were in the right direction, the objective of achieving positive real rates only by the middle of 1988 was disappointing.

The program included targets for total bank credit and for credit to the Government and to the seven selected marketing boards, Mr. Lankester continued. However, the program did not appear to place any controls on the demand for credit of a large number of the other parastatal enterprises. He would be interested in hearing any comments the staff might have on the potential risk that those unconstrained public enterprises would absorb an excessive amount of the increase in commercial credit allowed under the program.

The measures the authorities had taken to reform public finances were welcome, Mr. Lankester noted. Those measures included the effort to improve the elasticity of the tax system in the face of the fall in tax receipts as a share of GDP in recent years. It was also encouraging that the authorities were re-examining their expenditure priorities in order to shift resources away from current spending toward development projects. The advice of the World Bank would, of course, be helpful in that regard, and he was glad to see that the Government planned to review its investment program in conjunction with the World Bank. Perhaps the World Bank representative could indicate how much progress had been made in that respect as well as in its discussions with Tanzania more generally. The Bank and the Fund were to be congratulated for their close collaboration in the previous months in putting together their respective programs with Tanzania.

Despite the measures that had already been taken, the fiscal position would need further strengthening, Mr. Lankester went on. The overall fiscal deficit in 1986 was expected to be more than 11 percent of GDP, a significant improvement compared with 1985 when the underlying deficit had been more than 16 percent of GDP. However, there was no room for short-term slippages and sizable further reductions in the deficit would be required in years to come.

The program was to be warmly welcomed in that it reflected the Tanzanian authorities' recognition of the need to adopt more appropriate policies in the face of the large imbalances and disappointing growth in the economy that had arisen in recent years, Mr. Lankester concluded. The authorities had instituted a wide range of policy reforms that represented an important first step on the adjustment path. Nevertheless, relative slow progress was envisaged under the program in a number of key respects. In supporting the program, his authorities placed great emphasis on the policy reviews that would be undertaken during the stand-by arrangement. He hoped that there would be no slippages in the program and that faster progress would be made in some areas than currently envisaged.

Mr. Mawakani made the following statement:

> It was apparent from the Board's discussion concluding the previous Article IV consultations with Tanzania early this year that the authorities were determined to take strong measures to address, in a long-term perspective, the financial and structural difficulties that had characterized the economy for almost a decade. That this determination had led to the request for the stand-by arrangement before the Board today is a welcome development. I am pleased to note that the Tanzanian authorities in the design of their adjustment program have paid due consideration to the policy recommendations that the staff and the Board have made on a number of occasions, especially in the recent past.
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> I welcome the authorities' courageous shift in policy toward a new and firmer path that could lead to a meaningful and lasting improvement in Tanzania's economic and financial position, as well

as the comprehensive package of policies. I am happy to support the Government's request for a stand-by arrangement for its economic adjustment and recovery program.

I endorse the thrust of the measures under the program, aimed at providing appropriate incentives to the economy through large shifts in relative prices. The major emphasis that is being given to the role of the exchange rate and the bold steps already initiated in this area, including the adoption of a flexible exchange rate policy, show clearly that the authorities are determined to stay on the right track toward meeting their objective of balance of payments sustainability by the early 1990s. To that end, I would encourage the authorities to reduce the extensive restrictions on imports and exchange transactions as the beneficial effects of their flexible exchange rate policy emerge. In this regard, I note that the authorities have given assurances that they will keep an open mind on the nature of further exchange rate ajdustment, in the context of establishing an equilibrium rate not later than mid-1988.

As for the additional measures of support for the external sector, I welcome the policies aimed at reversing the decline in agricultural output and exports. It is worth noting that in the context of the medium-term policy of providing and maintaining adequate incentives to farmers, the authorities have significantly increased producer prices for the main export commodities. This is an encouraging development. Efforts undertaken with the assistance of the World Bank to rehabilitate the agricultural marketing and transportation system, including measures for improving the supply and distribution of inputs, are steps in the right direction for ensuring the efficient performance of the enterprises dealing with agricultural products.

In the fiscal sector, the authorities' objective of achieving a further reduction in the budget deficit in order to lessen the Government's absorption of domestic and foreign resources should go a long way in helping to generate the necessary savings for more efficient investments in the economy. The recent revenue-increasing measures and the Government's efforts to restrain expenditure should lead to a decline of government borrowing from the banking system so that more credit can be directed to the private sector. The close monitoring of both expenditure and revenue developments envisaged under the program seems appropriate.

I am encouraged to note that the World Bank has closely collaborated with the staff in identifying areas of both immediate policy concern and those of concern for the medium term. It is recognized that demand management policies alone will not be sufficient to ensure the economy's attainment of sustainable growth over the medium term. It is therefore all the more assuring to note that, with the help of the World Bank, policies are being considered for implementation under a sectoral structural adjustment program giving appropriate priority to the public investment program. These policies could form the basis of the policy framework for an arrangement under the structural adjustment facility.

Finally, given the exceptionally difficult economic and financial situation of Tanzania, there is very little room for slippage; the more so as the medium-term projections indicate that even with favorable assumptions and full implementation of appropriate policies, a viable balance of payments would not be attainable until the early 1990s. This underscores the importance for the authorities to sustain their adjustment efforts. As mentioned by Mr. Mtei in his opening statement, support from the international community would be critical for the success of Tanzania's bold adjustment efforts.

Mr. Wijnholds made the following statement:

I am very pleased that we finally can discuss a new stand-by arrangement for Tanzania. Since the last stand-by arrangement became inoperative almost six years ago, the situation in Tanzania has worsened dramatically. The value of production of officially marketed major foodcrops, including those for exports, last year constituted only half of that realized at the end of the 1970s, the production of manufactures registered substantial declines in all years since 1980, and the share of manufactures in GDP has more than halved since then. Exports also have undergone considerable declines in the 1980s; as a result, imports had to be compressed and debt service payments as a percentage of exports shot up to over 50 percent in 1985 compared with only some 12 percent in 1981. External arrears, including to the Fund, accumulated. No doubt external factors contributed greatly to the general economic decline. But, as the authorities rightly stress in paragraph 2 of their Memorandum of Understanding, "a country's economic problems, however caused, are primarily its responsibility." I welcome the fact, therefore, that the Tanzanian authorities are now embarking upon a course of economic adjustment.

The program before us today, however, can only be seen as a first step in the process of what appears to be a rather gradual implementation of an adjustment program. The exchange rate has been devalued, and the appreciation of past years seems to have been reversed. Moreover, and this is a very welcome step, the authorities are committed to further devaluations of the shilling. Nevertheless, the black market rate is still considerably higher than the official one, and an equilibrium rate is foreseen as attainable only in 1988, two years from now. I should add, however, that the flexible attitude the Fund is showing on exchange rates in the difficult Tanzanian case should serve to illustrate that the Fund does not have a standard approach to these matters. Considerable flexibility is also being shown with respect to interest rates, which will be adjusted quite slowly, and will only be positive in mid-1988. The process of liberalizing prices and the exchange system has also begun, but its completion is foreseen only at some time in the future.

Therefore, the gradual pace of adjustment foreseen carries obvious risks. To begin with, the results can be expected to be gradual also, and for some time to come, the country will remain vulnerable to adverse exogenous developments. One wonders, moreover, in view of the deep-rooted problems, whether a more determined adjustment effort would not have been warranted. In any case, close monitoring seems of the essence, and I would like to stress the importance of the coming reviews to see if further measures are needed.

Turning now to specific areas of policy making, I would first of all draw attention to producer prices. The increase last July, mentioned on page 15 of the staff report, was a very welcome step. However, it comes after two years during which no increases in producer prices were granted, even though the inflation rate was about 30 percent annually. Moreover, the price increases in general do not fully reflect the devaluation of the currency, and as a consequence, domestic producer prices generally decreased in terms of world market prices. I wonder therefore whether the authorities should not pursue a more flexible pricing policy.

As regards fiscal policy, there is no denying that significant progress has been made in the area of tax reforms and revenue-raising measures. Nevertheless, I fully agree with the staff that the overall deficit, which will amount to 11 percent of GDP in 1986, is still too high. In this respect, it is worrisome that the Government still has to rely on domestic bank financing, although to a much lesser extent than in the past. I would strongly urge the authorities to find ways to decrease the deficit further and to limit the deficit to an amount that can be financed from available external sources. In this respect I have some doubts about the lowering of income taxes. I note, moreover, that development expenditure, as a share of GDP, is to double between 1985/86 and 1986/87. I should like to add that measures to increase the efficiency of the public sector, including the parastatals, are of the utmost importance in order to improve the fiscal situation and the overall functioning of the economy.

On monetary policy, a major issue is, of course, the level of real interest rates. The progress to be made here seems to be on the gradual side, as I have indicated earlier, and it would seem desirable for the authorities to raise interest rates more quickly. I concur with the credit targets that have been set and fully agree with the staff that close monitoring in this area is essential to ensure that these targets are not compromised.

Concerning structural reforms, I note that the authorities are in the process of eliminating price controls. Indeed, the progress that has been made is already considerable as the list of products for which controls were in effect has declined from about 400 items to 47 by the middle of this year, and a further decline to 12 products in a three-year period is foreseen. But here again, if the authorities intend to abolish almost all controls, and in the meantime have committed themselves to adjust the prices fully to cost increases, could matters not be speeded up?

Further, it seems to me very important that the World Bank continue to be involved in structural reform. Much still needs to be done with respect to parastatals. Moreover, improvements in infrastructure and transportation are essential complements to the increase in producer prices and a greater role of market forces in price determination. Therefore, in this vein I am looking forward to a paper on a structural adjustment facility arrangement for Tanzania.

In conclusion, this program seems to be a modest first step toward adjusting the economy. But, as is evident from the Board's discussions of the past years, negotiations with the Tanzanian authorities have been difficult and protracted. The important thing is that after a period of serious mismanagement of the economy, the authorities are now in a process of reversing past policies. Like Mr. Lankester, we attach importance to the reviews under the program, and I would express the hope that in those reviews it will be possible to strengthen further some of the policies embarked upon. On that basis, I can support the proposed decision.

Mr. Fugmann made the following statement:

As other speakers before me, I greatly welcome Tanzania's request for a stand-by arrangement--a request which we support. The proposed arrangement is a result of long and often difficult negotiations between the Tanzanian authorities and the staff. It is high time that an agreement was reached between these two parties on 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. Apart from this stand-by arrangement, Tanzania will require further financing from the Fund and the World Bank. A Bank program loan in support of Tanzania's economic adjustment and recovery efforts is expected to be submitted to the Bank's Executive Board in October. Tanzania's request for an arrangement under the structural adjustment facility is expected to be made at the time of the finalization of the Bank's program.

The program under the proposed stand-by arrangement as well as the phasing of purchases, appears to be well designed. It identifies and addresses the main problems facing the Tanzanian economy, envisaging sustainability of economic growth and the balance of payments only after 5-7 years which, to my mind, is a realistic outlook. The program envisages full corrective policies to be in place within two years with some of these policies either having been already implemented or currently being implemented.

Previous attempts by Tanzania and the Fund to reach agreement on a program were to no avail primarily because of different views about an appropriate exchange rate policy. The Tanzanian authorities have parted with their view that "in the context of the Tanzanian economy, the exchange rate was not the determining, nor even a relevant, policy instrument to bring about the needed economic and financial sustainability." The program takes into account the view held by the staff and underlined by the Executive Board--with respect to "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."

I welcome these developments and it is my understanding that the exchange rate actions already implemented by the authorities and the proposed 1 percent monthly depreciation of the real effective exchange rate constitute only the first--albeit important--steps on the path to full correction of the exchange rate. I note the authorities' resistance to exchange rate adjustment as a major policy instrument as well as their caution in its use and skepticism about its effectiveness. Like the staff, however, I am encouraged by the assurances provided by the authorities to the Managing Director on this issue. Adjustment of the exchange rate is an integral element of this program, and hence, it is of vital importance that this adjustment be carried out to the full extent envisaged in the arrangement. The reviews in February and July 1987 ought to be meaningful exercises to be conducted with a view to bringing the exchange rate into closer alignment with the equilibrium rate. At these reviews, no preconceptions should be held about the proper level of the exchange rate or the degree of its flexibility.

In addition to exchange and trade policies, the program addresses pricing, fiscal, monetary, and credit policies, as well as public enterprises and parastatal reform. It is of the utmost importance that improvements are made in all these areas, and performance criteria have been linked to most or all of them. It may be debatable whether the corrective measures go far enough. It is to be hoped, though, that if carried out as envisaged, the policy actions will bring about a transformation of economic and financial conditions in Tanzania. In this respect, I wish to underline the importance of the domestic pricing policies and the transformation of the structure of interest rates.

The Tanzanian authorities do not have an easy task ahead of them. However, it would not have been easy either to continue on the course that brought economic and financial deterioration and denied the Tanzanian people the benefits of sound economic management and policies. A full implementation of the measures agreed upon in the current program will also be necessary if the authorities are to establish their credibility vis-à-vis both the domestic sector and the international financial community, including Tanzania's donors and creditors. For this, the authorities will also have to exercise perseverance and endurance. The Nordic countries warmly welcome the change of attitude of the Tanzanian authorities and wish them well in the period ahead.

Mr. Grosche made the following statement:

Like others, I welcome this opportunity to discuss a program which could mark the beginning of a new era in Tanzania's economic development. The actions and reforms envisaged under this program constitute a clear shift in policies away from previous piecemeal attempts to a more comprehensive approach to the country's deep-seated financial and structural problems.

I also welcome Tanzania's close collaboration with the World Bank, which has a central role to play in assisting Tanzania in its medium-term structural adjustment efforts. As far as the Fund's role is concerned, I would have preferred a somewhat more ambitious pace of adjustment, given the magnitude of the existing imbalances. This caveat applies in particular to exchange and interest rate policies.

However, I found the various measures already taken--in particular those relating to agricultural producer prices--quite promising. The structural reforms under way, combined with tight monetary policies and fiscal restraint, should go quite some way toward attaining acceptable economic growth and a sustainable balance of payments, provided external assistance is forthcoming as envisaged. In this respect I am heartened by the response of donors to Tanzania's needs. The financial assistance pledged by donors and the expected debt relief from official creditors should provide the necessary financial base to allow imports to recover as necessary without increasing the country's debt burden.

In sum, I can join previous speakers in lending my support to the requested stand-by arrangement and the proposed decisions. Since I am in broad agreement with the staff appraisal, let me just comment briefly on a few aspects of the program before us.

First, I find it wholly appropriate that the program is focusing on rebuilding an efficient agricultural sector as the backbone of Tanzania's economy. Tanzania's natural resources are indeed plentiful and offer a great potential for the future if properly exploited. The staff's medium-term export projections indicate that remunerative producer prices, a reorganization of the marketing system, and the realignment of the exchange rate should all have a positive impact on agricultural production and exports. However, while exports are expected to recover to their 1981 levels, or even beyond, production for most crops in 1991 may still fall considerably short of previous peak levels. Perhaps the staff could provide an explanation why they do not expect a more pronounced increase despite the improved incentives to producers and the planned reorganization of the marketing and transportation systems.

My second point concerns fiscal policy. The staff tells us on the one hand that the overall deficit will increase from 8.5 percent of GDP in FY 1985/86 to 11 percent of GDP in FY 1986/87. On the other hand, we are told that taking into account interest and exchange rate adjustments, the underlying deficit will be reduced by some 5 percentage points. I agree that the conditions under which the 1986/87 budget is to be implemented differ substantially from those prevailing last year. Ceteris paribus the depreciation and the interest rate adjustment will result in expenditure increases. But I am not fully convinced of the underlying assumptions on nominal GDP described in footnote 1 of page 17 of the staff report. Nonetheless, I agree with the staff that an overall deficit of 11 percent of GDP is worrisome and that therefore the authorities should monitor fiscal developments closely, using any excess revenue for a further reduction of the deficit. In this connection, I welcome the enhanced expenditure controls to be enforced by the Ministry of Finance and the establishment of indicative quarterly revenue and expenditure targets. I also welcome the provision that any external assistance to the budget in excess of that presently assumed will be made available to the private sector.

Turning to monetary policy, I have no problems with the program's targets, which provide for both a sufficiently restrained overall money supply and adequate room for the expansion of credit to the private sector. This policy should contribute importantly to a significant reduction in the rate of inflation.

The recent increase in interest rates is certainly a commendable step in the right direction. I am somewhat concerned, however, about the slow pace at which positive rates in real terms will be achieved. Given the central importance of appropriate price signals for an efficient allocation of resources, I would urge the authorities to strive for an earlier attainment of positive real interest rates.

The same applies to the exchange rate. The staff has provided us with a useful and extensive account of the discussions of this sensitive subject, and I have very little to add to its assessment. I do appreciate the authorities' concern, and I very much welcome the change of mind that has already expressed itself in their decision to depreciate the shilling by almost 60 percent this June. I am aware that this decision was not an easy one, and I commend the authorities for the courage they displayed in taking it. I still feel, however, that when it comes to exchange rate adjustment a gradual approach tends to have quite substantial negative repercussions, particularly because it keeps a permanent pressure on prices, thus eroding the positive effects of the devaluation and maintaining a climate of inflationary expectations. I can therefore only support the staff in urging the authorities to keep an open mind on this issue and take whatever steps may be needed at the time of the end-1986 review of the program.

Finally, I join previous speakers in hoping that the authorities will make speedy progress in the formulation of a medium-term policy framework that could be supported by resources from the structural adjustment facility.

Mrs. Walker made the following statement:

Last March when the Board discussed Tanzania's economy in the context of the 1985 Article IV consultation, we were not optimistic about the prospects for the adoption by Tanzania of a comprehensive macroeconomic and structural adjustment program that would begin to tackle the serious and long-standing imbalances in the economy. Only a few months later, however, the Tanzanian authorities decided to adopt a medium-term recovery program supported by Fund and World Bank resources. The shift in the attitude of the authorities toward tackling their difficult economic problems in the context of a Fund-supported adjustment program is a positive development, and the steps they have taken thus far to demonstrate their resolve toward adjustment are commendable.

The World Bank's involvement in Tanzania's adjustment efforts has been valuable and we are encouraged by the close collaboration between the Bank and the Fund in this case. Financial support from bilateral donors and commercial banks also has been a critical element in this package--particularly in settling Tanzania's arrears to the Fund--and will also be necessary for the program's objectives to be realized.

The measures the authorities have adopted thus far in the context of the June budget announcement constitute a sign of the authorities' willingness to take adjustment measures that can help ensure the successful completion of the program and the achievement of its medium-term objectives. The medium-term outlook, however, remains difficult, with the balance of payments showing large, though declining, financing gaps for the period through 1991. The expectation that debt relief will be sufficient to close the gap by the end of the period presupposes actions by creditors that may not materialize. Furthermore, the staff stressed that this outcome is crucially dependent on the strengthened implementation of the adjustment program. As others have said, this may signal the need for increasing the speed of adjustment in certain key policy areas--including exchange rates, interest rates, and reform of the parastatals.

We welcome the authorities' decision to use the exchange rate as an economic policy instrument as exemplified in the recent devaluation of the shilling and in the authorities' commitment to follow an active exchange rate policy in the future. Exchange rate adjustment, in conjunction with an increase in agricultural producer prices, should increase the profitability of exports, allow imports to be valued at prices approaching their true opportunity costs, and bring about a new and more realistic structure of relative prices in the economy. It is important, however, that the authorities remain open to adjustment of the exchange rate beyond the 1 percent real depreciation a month to ensure the attainment of the targets in the program and the medium-term objectives.

In this light, the inclusion of exchange rate policy in the first review is critical, and we would urge discussion in this review of a targeted real effective exchange rate by a specific date before June 1988. Furthermore, if changes in the exchange rate beyond what is currently planned are warranted before this review takes place, we would urge the authorities to make the changes.

Improvements in the allocation of foreign exchange to reflect economic priorities and a strengthening of the monitoring of foreign exchange inflows and outflows are needed. Steps have been taken in this direction. The goal, however, is to remove the restrictions on allocation of foreign exchange and allow a more realistic exchange rate to play its full role. Therefore, as the results of exchange rate adjustments emerge, import and foreign exchange controls should be removed.

Along with exchange rate action, the substantial increases in producer prices should help promote exports by stimulating production and reducing incentives for marketing through unofficial channels. The liberalization of price controls that has begun should increase production and distribution incentives, and we urge the authorities to continue with this reform. Over the medium term the Government's price policy should be designed to more effectively reflect international prices through a correctly valued exchange rate and realistic relative price structure.

A more competitive and efficient marketing structure will be needed in order to increase exports further, as well as changes in the institutional structure for the collection, processing, and marketing of Tanzania's export crops. In this regard, we believe the coverage, in the context of the World Bank loan, of measures designed to improve the efficiency of the agricultural sector is helpful.

Policies designed to revive industrial production by channeling resources to subsectors and firms that can use the limited resources most efficiently should be encouraged. Further, improvements in the transport sector are critical for economic recovery, and attention should be devoted initially to improvements in the parts of the transportation network of greatest importance to the collection, processing, and shipping of export products.

The budgetary situation will be difficult, particularly in light of the large devaluation of the shilling. We agree with the staff that the targeted budget deficit is too high and therefore must be monitored carefully. The new procedures for monitoring expenditure should contribute to this process. Further, we welcome the limits on bank credit to the marketing boards that are included in the Fund program. We also believe the efforts to reduce government expenditure are essential, particularly relating to the civil service. In this regard, the 20.3 percent increase in the total wage bill seems on the high side, and we would appreciate staff comment on this. Further, we note that the budget presentation was prepared without taking full account of the programmed exchange rate adjustments, and therefore the staff's estimates are different from those of the authorities. Has this difference been reconciled? We would agree that if revenues turn out to be higher than assumed, the excess revenue should go toward reducing the deficit further. A review of the investment program will also be important to ensuring effective use of government resources.

We also welcome the elimination of subsidies to parastatals and the export bonus scheme. Reform of the parastatals, however, is missing in this program and should be tackled in the context of the structural adjustment facility.

The objective of obtaining a positive real interest rate structure is important to ensure a more efficient use of credit, but attainment after only two years seems to be too long a delay; we urge that interest rate policy be reconsidered in the context of the midyear review to determine if the time period for adjustment should be shortened.

The limits on credit available to the public sector appear adequate. Further, we support the channeling to the private sector of T Sh 2.5 billion of bank credit currently earmarked for the Government if external assistance is higher than expected. The role of the private sector is critical to the development of Tanzania's export base and should be facilitated through adequate interest and exchange rate pricing.

Tanzania's external arrears are quite substantial, and while some progress in their reduction is programmed, a substantial amount of arrears will remain in 1991. If further external assistance is forthcoming, it should go to paying off arrears, particularly to other multilateral development banks with whom Tanzania has not yet become current.

Finally, I note that a description of Tanzania's ability to repay the Fund is not included in this paper. We have asked for such a section in each request for use of Fund resources and are disappointed by their lack of inclusion thus far. Could the staff tell me whether a general policy on this matter has been developed?

In conclusion, we can support Tanzania's request for use of Fund resources and urge the authorities to find the courage and political will to continue their adjustment effort with vigor.

Mr. Massé made the following statement:

Discussions on Tanzania in recent years have taken on an increasingly somber tone. Poor economic management, as reflected in inappropriate financial, pricing, and exchange rate policies have resulted in rigidities throughout the economy and poor resource allocation. As a consequence, there has been a steady deterioration in economic performance since the mid-1970s and particularly since 1982. Real incomes, therefore, have declined steadily for much of the past decade.

It is in this light that I am very pleased to consider the proposed stand-by arrangement now before us. I find the amount of the program to be appropriate when measured against Tanzania's probable need for further Fund resources through the medium term. At this initial stage, there are a number of measures that are welcome, beginning with the devaluation of the exchange rate to T Sh 40 per U.S. dollar. The issue of devaluation has been a sticking point in negotiations with the staff for some time now and has been a source of considerable concern to the Board. We therefore welcome the fact that the authorities now appreciate the need to adjust the exchange rate regularly, with the eventual goal of reaching equilibrium in the foreign exchange market and thus eliminating the parallel market. Similarly, we are pleased by the comprehensive structural reforms that are being introduced, including increases in domestic producer prices, the reduction or elimination of a variety of consumer subsidies, and the reorganization of agricultural marketing and transportation systems. The efforts to eliminate the operating losses of agricultural marketing boards through real increases in producer prices are noteworthy, especially when seen as part of the effort to reduce and eventually abolish government subsidies to parastatals.

In terms of demand management policy, initial steps are being taken to increase interest rates and to tighten credit available to the public sector broadly defined. The underlying budgetary deficit is also to be reduced. We certainly welcome all these measures.

However, these can only be the first steps along a long road of adjustment. The magnitude of the imbalances within the Tanzanian economy and the long duration of poor economic management will require an equally lengthy and far-reaching program of adjustment. It is clear to us that the authorities will have to demonstrate a strong commitment to comprehensive adjustment measures for some time to come. It should also be noted that to a great extent, donor assistance, which is projected at exceptional levels under this program, will be conditioned by the policy response of the authorities.

We have a number of specific concerns, most of which are related to the pace of the proposed adjustment. Frankly, in some important respects, we find the adjustment path to be insufficiently ambitious. The gap between the new official exchange rate and the parallel rate is still enormous, although, like Mr. Mtei, I recognize that the parallel rate has been inflated by speculative pressures. The program proposes to close that gap only over a period of two years. In our view, a more rapid depreciation than the programmed real devaluation of 1 percent a month would be desirable if the external accounts are to be quickly stabilized. We would expect the staff to take up this issue with the authorities during the first program review with the intent of unifying the exchange market well before this stand-by arrangement is completed.

Monetary and credit policies will be restrained under the current program, and nominal interest rates will rise; but real interest rates remain negative and are not expected to become positive until mid-1988. We feel that this adjustment is too slow, since negative real rates will neither encourage more efficient resource allocation, nor offer adequate incentives for domestic savings.

Turning to fiscal policy, it is hard to accept the projected fiscal program as representing a strong tightening in the fiscal balance. For example, while we are told that total revenue is to increase by 58 percent, or more than 4 percent of GDP, total expenditures are increasing by some 6 percent of GDP. This suggests that greater efforts must be made to restrain expenditures, even though I realize that there is a critical need to restore public infrastructure to working order. One step the authorities might consider is lowering the 20 percent increase in the government wage bill through a more rapid rationalization of public sector employment. I also find the decision to impose an education user fee while concurrently providing subsidized loans to public employees to buy motor vehicles to be a quite interesting tradeoff and would appreciate the staff's views on this.

Similar concerns can be expressed with respect to price adjustments. The program provides for real increases in some producer prices, but real prices for cotton and tobacco may actually decline during the current crop season. I would appreciate the staff's views on the desirability of continuing cross-subsidies on kerosene and diesel fuel.

One further area which deserves more attention is the role of public enterprises. While I support the elimination of budgetary subsidies to parastatals, stronger measures will be required over the medium term to loosen the pervasive hold of the parastatals over the Tanzanian economy while simultaneously improving the quality of management of these enterprises. Without a reduction of their role, it is hard to imagine the Tanzanian economy developing in a more dynamic fashion. This is one issue which should be covered when we consider an arrangement under the structural adjustment facility.

The balance of payments is fragile and will continue to be sensitive to variations in terms of trade. Therefore, it will be important to increase, if possible, international reserves. We do, however, welcome the liberalization of exchange restrictions recently implemented and can accept the export earnings retention scheme as a temporary measure provided that exchange rate adjustment is accelerated.

We very much welcome the measures which have already been taken but feel that the pace of adjustment will have to be accelerated if the stand-by arrangement is to put Tanzania on the road to recovery. By comparison with many other African countries, Tanzania continues to benefit from considerable concessional aid support, as demonstrated by the $130 million in additional assistance recently pledged by donors. The authorities' actions in the coming months, particularly with respect to the exchange rate, will be at least as important as those steps already taken if donor support is to be maintained.

In conclusion, we support the stand-by arrangement and wish the authorities every success on the measures they are undertaking over the next few months.

Mr. Ercel made the following statement:

The Tanzanian economy has been deteriorating over the last several years mainly for lack of a stabilization program, and adjustment has become increasingly difficult through having been delayed. The authorities' acceptance of the need for fundamental changes to reverse the deterioration of the economy's performance is, in my view, an important and bold action. The gravity of the situation, which includes a difficult balance of payments position, galloping inflation, a worsening financial position, and accumulating external arrears underlines the need for the authorities to redouble their efforts to create conditions permitting a revival of economic growth and external adjustment. It is obvious that reorientation of the economy and correction of the imbalances will take time and will require continuous fundamental action. In the light of the difficult medium-term balance of payments situation projected in the papers before us, the rehabilitation and redirection of the economy toward sustainable growth can be expected to take more than five years even if measures of sufficient intensity, aimed in the right direction, are taken in the meantime. I may also add that collaboration and coordination between the Fund and the World Bank will be of paramount importance for addressing the structural weaknesses of the Tanzanian economy. I am glad to note that the Bank and Fund have worked together in formulating the diagnosis of Tanzania's economic problems. I believe the proposed program loan and an arrangement under the structural adjustment facility would have been an appropriate extension of this collaboration.

Turning to the adjustment program for 1986/87, despite comprehensive adjustment measures in the areas of the exchange rate, trade, pricing, and fiscal and monetary policies, the deficits of the budget and the current account will remain at higher than acceptable levels. Inflation, mainly stemming from exchange rate movements and pricing adjustments, will also increase further. I believe the gravity of the economic problems and the delays in taking action in several areas will set limits to what can be expected by way of performance in the early stages of the adjustment program. Another limitation on performance is the urgency of allowing a volume of imports sufficient to achieve the desired real growth rate. Under these circumstances, it may be most realistic to expect only the partial elimination of severe external and internal imbalances in the earlier stages of the adjustment program.

Exchange rate policy is now set in the right direction with the aim of achieving an equilibrium rate by 1990. The staff frankly indicates the difficulty of determining the equilibrium rate. I agree with the staff that the exchange rate must move to discourage the flow of foreign exchange into unofficial channels and make Tanzania's exports more competitive. The willingness of the authorities to move toward this goal is an important and welcome development. Moreover, such an exchange rate policy, together with flexible pricing policies in the agricultural sector, would help eliminate bottlenecks in that sector, which accounts for almost half of GDP and employs 80 percent of the population. Persistent shortages of essential inputs, unrealistic pricing policies, and the lack of adequate financial incentives and physical infrastructure have significantly depressed the agricultural sector's growth rate. In this context I also welcome the adoption of a medium-term policy for this sector.

As to fiscal policy, Tanzania's total fiscal deficit is still exceptionally high. Table 5 of the staff report shows that this deficit is mainly caused by excessive total expenditures rather than by the level of tax revenues, which is relatively high by comparison with similar countries but lacks elasticity. Efforts should thus be focused on restraining expenditures other than development expenditures and on increasing the elasticity of the tax system. I noted from the staff report that several steps have been taken in this direction, with encouraging initial results. As to development projects, I was encouraged to note that the World Bank will assess Tanzania's 1986/87 investment program for its consistency with established priorities.

In conclusion, it is clear that Tanzania will continue to need financial support to cover the financing gaps foreseeable for the years ahead. The economy's performance and the attainment of the program targets will be essential in obtaining this support. I wish the Tanzanian authorities well, and I support the proposed decisions.

Mr. Suraisry made the following statement:

I am in general agreement with the main points in the staff appraisal, and I support the proposed decisions.

I am pleased that the protracted negotiations between the Tanzanian authorities and the Fund over the past several years have finally come to a successful conclusion. By implementing the economic reform described in the staff paper and supported by a stand-by arrangement with the Fund, the authorities have indeed opened the door to better economic prospects. I commend the authorities on the actions they have taken, which are by no means easy, but are nonetheless essential.

Clearly, Tanzania suffers from a combination of structural and demand management problems which, owing to their persistence over a number of years, have produced large imbalances and have created serious market distortions. The present program provides a good basis for correcting these problems. However, it has to be recognized that these problems are deep-seated and cannot be quickly eliminated; they require firm, comprehensive, and sustained adjustment policies, to be jointly supported by the Fund, the World Bank, and other development institutions. The proposed stand-by arrangement is an important step in this direction, but it needs to be complemented by other assistance. Therefore, I encourage early agreements on the proposed program loan by the World Bank and an arrangement under the Fund's structural adjustment facility.

The policy package under implementation entails supply-side and demand-management measures. I welcome this policy mix which, together with the joint introduction of the programs to which I have just referred, constitutes the best approach to deal effectively with such stubborn and wide-ranging problems as those of Tanzania. These problems, as it has been mentioned, are not limited to demand management. They relate, perhaps more importantly, to policies followed in most sub-Saharan African countries that led to a steady decline in agricultural output, deterioration in manufacturing productivity, and a weakening of the private sector's role in economic activity.

Consequently, I am pleased with the emphasis given in the program under the stand-by arrangement to the agricultural sector. In this connection, I commend the authorities on the significant price decontrols which they have initiated. As the authorities are aware, such a move plays an important role in improving the finances of the public sector. Equally important, it provides domestic producers with access to higher prices in parallel markets. Appropriate price incentives are a necessary condition for attaining the important role that the agricultural sector should have in countries like Tanzania, where the agricultural potential is large, and the rate of population growth is high. In point of fact, the introduction of a more flexible price system should augment the increase in agricultural output coming from improved weather conditions. However, adequate price incentives for producers need to be complemented by additional measures, such as more flexible marketing arrangements, lower agricultural taxes, and wage restraints. These areas are, I believe, subject to thorough examination by the World Bank in association with its proposed program loan. In this context, it would be appreciated if the Bank representative would comment on how progress has been made on this loan.

Exchange rate policy also plays an important part. A flexible exchange rate policy is needed to supplement the upward movement in producer prices. It is encouraging to note that the program assigns an essential part to such a policy. The increase in output resulting from better weather conditions should facilitate the introduction of a flexible exchange rate policy, as it reduces the upward pressures on prices as a result of flexible pricing and exchange rate policies.

In the fiscal area, I endorse the objective of reducing the budgetary deficit which was and continues to be high. Every effort should be made to bring the size of the public sector to a more manageable level so as to achieve efficient allocation of scarce resources. For this purpose, government expenditures need to be rationalized. The measures taken to reduce subsidies are an important step in the right direction. Moreover, it appears that additional efforts to increase revenues without adversely affecting growth potential are also needed. I welcome the efforts being made under the 1986/87 budget to improve the elasticity of the revenue system. In view of the serious situation of the public finances, the room for maneuver is limited. Therefore, the introduction of quarterly targets for revenue and government expenditures is appropriate.

These adjustment efforts need to be complemented by firm monetary and credit policies. The small net domestic credit expansion of the banking system in general and the reduction in government borrowing from the domestic banking system in particular are essential to the success of the adjustment policies. Furthermore, reducing government borrowing should provide the private sector with the additional credit that it needs to expand its activities in response to the incentives offered by measures on pricing and other policies. More generally, while it is true that the program entails some element of gradualism, I believe that this approach is appropriate for Tanzania, which has relied for many years on the philosophy of a centrally planned economy to conduct its economic policies. A less gradual approach to economic policy could complicate the authorities' efforts to complete the important and difficult shift to a market-oriented economy that they have already started; indeed, it could put these efforts at a risk.

To sum up, the authorities have made commendable efforts to create the right environment for durable economic recovery. There will be, of course, constraints and problems, but with perseverance, external assistance from all parties concerned, including the Fund and the World Bank, and some luck, this should not prevent Tanzania from achieving its objectives.

Mr. Sugita made the following statement:

Like previous speakers, I am pleased to note that after long negotiations, an agreement has been reached between the Tanzanian authorities and the Fund on a comprehensive adjustment program to be supported by a stand-by arrangement. Tanzania has long suffered from deteriorating economic conditions, and the piecemeal corrective measures that have been taken from time to time have not only failed to bring about a major turnaround but in some cases have aggravated the situation in the absence of effective measures to deal with the exchange rate and price distortions. In the past, the authorities held the view that the exchange rate was not an appropriate policy instrument for economic adjustment. It is, therefore, a big step forward for the authorities to have agreed, although somewhat reluctantly, to activate an exchange rate policy as a major policy instrument. However, the economic imbalances that have accumulated for many years are such that the adjustment process will be a difficult one. In this connection, I am pleased to note that while the authorities are well aware of the need for structural adjustment efforts in the medium term, most corrective policies are to be put into effect within a relatively short period not to exceed 18 months to two years.

As I can generally endorse the staff appraisal and recommendations, I would like to limit myself to a few specific areas. Proper exchange rate and pricing policies are the cornerstone of this program. In choosing a speed of adjustment, however, a certain compromise has had to be made to accommodate the authorities' preference. Whether the adopted gradualist approach best serves the efficient and smooth adjustment is a matter for serious question. If economic agents believe that exchange rate and price adjustments are inadequate and expect that further adjustments are imminent, they may accelerate the import and purchase of supplies and materials and delay exports and sales of commodities. Even if such behavior is forestalled by controls and restrictions, they will not be able to induce the desired reflow of commodities and foreign exchange into official channels. I strongly hope that these developments will not lead to a serious setback of the entire program before the first review and that the authorities will consider more rapid adjustments in this area in the meantime.

The program is an ambitious one in that while seeking balance of payments adjustment, it aims, at the same time, at a significant economic recovery. Given the damages that the inappropriate exchange rate and pricing have inflicted on the economy, it is not unlikely that the envisaged growth rate can be achieved by rehabilitation of the agricultural and industrial sectors. However, it should be borne in mind that economic growth follows the success of structural policies and not the relaxation of macroeconomic policies.

Finally, the balance of payments outlook is likely to remain precarious for some years to come, as the unfilled financial gap in the medium-term scenario clearly indicates. It is therefore critically important that the authorities demonstrate to the creditors their willingness and ability to persevere with adjustment efforts. There is no room for slippages.

With these comments, I can support the proposed decisions and wish the authorities well.

Mr. Sengupta made the following statement:

We welcome Tanzania's request for a stand-by arrangement. We also welcome the stated intentions of the authorities to seek a program loan from the World Bank and an arrangement under the Fund's structural adjustment facility. Since the stand-by arrangement has provided an elaborate framework of policies that include both supply and demand measures and the program loan of the Bank has provided detailed policy reforms in the agricultural, industrial, and transportation sectors, the policy framework paper that is required for an arrangement under the structural adjustment facility can be brief and pointed, and be quickly brought before the Board.

One reading of the staff paper on the stand-by request was enough to demonstrate convincingly that there has been a remarkable shift in the authorities' policy perceptions. There is a recognition on their part of the need to forge new relationships with the Fund and multilateral institutions so as to overcome their serious problems of development and indebtedness. We should respond positively to the change in stance of the authorities, reflected in their determination to take on a very difficult adjustment program. We therefore have to review the Tanzanian request for a stand-by arrangement with understanding and allow for flexibility in the implementation of the proposed program.

The Tanzanian economic situation has deteriorated over the last five to six years owing to a combination of circumstances, of which the adverse external developments are undoubtedly most important. There were also inadequate domestic economic policies. The proposed program hinges crucially on three elements. One is the depreciation of the exchange rate of the shilling, together with trade liberalization, in order to improve external competitiveness and increase the volume of exports. The second relates to increasing producer prices with a view to stimulating production and exports. The third quantitative element concerns the fiscal deficit, and monetary and credit aggregates. The underlying theory is that expansion in output for domestic use and exports depends on price incentives; the inflationary potential of devaluation and price hikes is expected to be dealt with by sharply curtailing expenditures. It is not clear how far the staff's approach is based on actual behavioral relationships among the economic variables and how far it is based on faith in the behavior of economic agents in response to depreciation and price policies. For instance, the proposed adjustment of 1 percent in the real effective exchange rate, with a view to moving the rate closer to the equilibrium exchange rate, is a precise policy prescription that gives the impression that the staff has made an estimate of the equilibrium exchange rate and the optimal path to that equilibrium rate. This is obviously not the case, and I am not asking the staff to undertake that exercise. In any event, it has to be recognized that the equilibrium exchange rate cannot just be made equivalent to the parallel or black market rate. What is more important, however, from the practical point of view, is the uncertain inflationary implications of such a predetermined course of action, especially with respect to the anticipatory component of inflation, in the context of price liberalization. I would like to know if the staff has made some projections of this inflationary potential and what steps the authorities should take to contain it without affecting growth.

The fiscal position, as outlined in the budget, is based on the assumptions that the elasticity of tax revenues can be improved and that foreign grants on a substantial scale would be forthcoming to ensure that the projected development expenditures take place. We would like to be assured that the improvement in revenue elasticity is feasible and can take place within the program year without any lags. The program envisages that in case Tanzania receives larger external assistance than assumed in the program, the permissible level of bank credit to Government will be reduced correspondingly and the full amount of credit released would become available to the private sector. While this is an important element in the assessment of performance under the program, questions should have been raised as to what would happen if revenue elasticities are lower than assumed and external inflows are lower than anticipated. Perhaps the staff does not anticipate such slippages. I wonder how firm their assessment is in this respect.

In general, I find the performance criteria too detailed; for example, the subceilings on banking system credit to seven specified marketing boards and the subceiling on net bank credit to Government would severely restrict the operation of these boards, which are expected to respond to new situations being created by price liberalization and price incentives. Also, I find that the indicative targets in respect of government expenditures and recurrent expenditures are specified quarter by quarter as performance criteria, thereby obliterating the flexibility that one would normally associate with indicative outcomes.

I wonder whether the staff can provide the number of cases in the last two years in which the performance criteria are similar and in such large number.

The outlook for the external sector is undoubtedly difficult both in the program period and over the medium term. The financing gap would be as large as $500 million in 1986/87, which needs to be filled by exceptional balance of payments assistance. It is important to note that this gap is worked out on the assumption that exports would pick up very substantially. This assumption could well turn out to be unrealistic if output does not respond quickly to price incentives and the value of exports does not rise--in spite of exchange rate depreciation--owing to a further fall in commodity prices and protectionism abroad. The medium-term balance of payments outlook is based on strong optimism about export performance, which, owing to the nature of Tanzanian exports, implies a strong optimism about world trade in commodities, which few others would share. The volume of traditional exports is expected to rise between 1985 and 1991 by 31 percent for tobacco, 69 percent for tea, 65 percent for coffee, and 34 percent for cotton. If the assumptions underlying the medium-term outlook, which are not as clear cut as they should be, fail to materialize, the financing gaps will be larger than projected and need to be closed by larger exceptional financing together with debt relief on current maturities.

In this context, I wonder whether a contingency mechanism could be incorporated into the program to take care of any shortfalls in the economic recovery and in donor support. To the extent that such shortfalls occur, the Fund and Bank could come forward with additional financial support, so that the adjustment program devised in the medium term does not falter for want of either balance of payments financing or the desired response from economic agents to the incentives that have been provided for in the program. An assurance on the part of the Fund that such a contingency could be taken care of would help to consolidate and further strengthen the authorities' commitment to adjustment and to growth-oriented policies. Maybe the Board should consider a substantial extended arrangement in order to assure the authorities that if the adjustments under the stand-by arrangement are implemented, the Fund would be ready to provide additional support. An indication by the Fund of its willingness to move in this direction would not only encourage the authorities to carry on their very difficult task of adjustment but would also open a new chapter of cooperation with Tanzania. If we have led Tanzania to adopt difficult policies, we should accept the responsibility of ensuring that the policies succeed, especially if the authorities do not falter in their commitment. The staff should be in a position to examine the linkages between measures of short-term adjustment and those of longer-term adjustment toward balance of payments viability with growth, as well as to determine whether a program under the stand-by arrangement could lead naturally a medium- and long-term adjustment program under an extended arrangement. We support the proposed decisions and wish Tanzania every success in its development endeavors.

Mr. Zecchini made the following statement:

Unfavorable developments in world commodity prices, together with a lack of timely economic policy adjustment, were the major cause of the recent deterioration in the economic and financial performance of Tanzania. In the face of this disappointing situation, the program under discussion is certainly welcome since it indicates a clear intention on the part of the authorities to implement the needed adjustment measures along the lines already advocated by the Board during its discussion of the 1985 Article IV consultation with Tanzania (EBM/86/48, 3/20/86).

Although we have a few reservations about the adequacy of some of the measures included in the program, especially in the areas of fiscal and exchange rate policies, we can broadly agree with the staff appraisal, and we can support the request for the stand-by arrangement. The main focus of the program is on three areas--namely, fiscal, pricing, and external policies.

As far as fiscal policy is concerned, we are not sure whether the overall budgetary targets are adequate to achieve the required restriction of fiscal policy together with a more efficient pattern of public expenditure. There are reasons for some doubts in this respect.

We agree with the staff that the projected level of 11.1 percent of GDP for the overall cash deficit in 1986/87 is too high, all the more so if one takes into account how sensitive the letter is to exchange rate changes. A depreciation, on the one hand, tends to inflate the level of expenditure while, on the other, it does not raise the level of revenue correspondingly owing to the many existing exemptions from duties on trade flows. Therefore, an upward revision of the deficit is likely to be necessary in the face of a depreciation. If the pattern of exchange rate devaluation has to be accelerated, more courageous budget adjustment efforts ought to be undertaken to ensure the attainment of the fiscal budget targets and the overall consistency of the program.

The expansion of public expenditure still does not seem to have been brought fully under control. In particular, it is a source of concern that current expenditure in central government operations will increase at the sustained pace of 47 percent during the program period--namely, between the fiscal years 1985/86 to 1986/87--despite the various measures taken by the authorities. In this respect, and in view of the negative impact of exchange rate devaluation on budget aggregates, we would appreciate if the staff could shed more light on the likely evolution of the expenditure pattern. Specifically, we would like to know what differential impact the devaluation has on current versus development expenditure. On the basis of the information provided by the staff, it is not possible to assess correctly the basic trends of the two types of expenditure and of their discretionary components.

In any case, we strongly encourage the authorities to curb current expenditure and to concentrate their resources on the most viable development and investment projects. In this respect, it is crucial that a review of investment priorities be undertaken with the World Bank as a means to improve public sector efficiency.

As far as pricing policies are concerned, we welcome the intention of the authorities to limit price controls and to guarantee adequate price incentives for domestic production. Domestic price controls, together with the maintenance of an unrealistic exchange rate, have helped to distort the allocation of resources, to discourage the expansion of domestic production, and to worsen the balance of payments position. The measures taken recently seem to be adequate to cope with this situation. The increase in prices paid to farmers and the gradual process of price decontrol for almost all products--except 12 basic commodities--will certainly represent an important stimulus to the supply side of the economy.

With respect to external policies, it is encouraging to see that the authorities seem more aware than in the past of the importance of exchange rate adjustment to redress the economic imbalances. Although it is not easy to define the equilibrium exchange rate, the comparison between the current rate of T Sh 40 a U.S. dollar and the one prevailing in the free market, which is far above the T Sh 100 a dollar, indicates that there is still a misalignment even after the recent depreciation. The approval of the adjustment program with the Fund could undoubtedly have a beneficial impact on the exchange market and lead to some convergence between the free and the official rate. Nevertheless, the proposed depreciation scheme, which will bring the official rate to about T Sh 60 a U.S. dollar by July 1987, seems insufficient to close the gap between the two rates in a reasonable time period. A more drastic course of action should be followed in order to achieve a more appropriate structure of relative prices along the lines of the previously mentioned pricing policies. In the present situation, a realistic exchange rate represents a major instrument to reduce the overdependence of the economy on imports, to enhance the competitiveness of the export sector, and to strengthen the external reserve position.

Finally, the present strong dependence of Tanzania on imports to achieve the growth targets implies a strong dependence on foreign financing. Given the sensitivity of the supply of external market resources to Tanzania's compliance with the adjustment program, the authorities should be well advised to adhere strictly to the stated policies without upsetting the delicate balance of the program.

Mr. Salehkhou made the following statement:

At the outset I wish to support the request for a stand-by arrangement by Tanzania and the proposed decisions set forth in EBS/86/183. I also welcome the authorities' intention to develop a medium-term policy framework for the use of resources under the structural adjustment facility. The comprehensive adjustment program chosen by the authorities, after a series of difficult discussions with the staff, seems to be appropriate. The program is designed mainly in line with the Board's recommendations in its discussion of the 1985 Article IV consultation with Tanzania. At that time, Executive Directors expressed their deep concern about the severe economic difficulties facing Tanzania and urged the authorities to adopt a vigorous and comprehensive adjustment program.

The corrective measures implemented during 1985 and early 1986, while they could be regarded as steps in the right direction, were insufficient to arrest further deterioration in the economy. While some improvements were achieved during 1985/86 in reducing the fiscal deficit and in curbing the rate of inflation, the large fiscal financing gap and the high inflationary pressures remained areas of concern. On the external side, the current account position deteriorated further, and in the face of depleted reserves, the overall balance of payments deficit continued to be financed by a further accumulation of external payments arrears.

Apart from the adverse effects of exogenous factors on Tanzania's economy, inadequate fiscal and monetary policies have also contributed to its low performance. An overvalued exchange rate and inadequate price incentives were the main factors singled out by most Executive Directors for rapid adjustment.

These factors have been taken into account in the program design so as to help the authorities rehabilitate the economy and return it to a path of sustained growth and a viable balance of payments within the medium term. Given the active participation of donor countries and international financial institutions in providing necessary assistance to close the financing gap in the program, I urge the authorities not only to pursue in an orderly way the policies envisaged but also to direct efforts at limiting the impact of the expected intensification of the inflationary pressures of the measures already implemented or envisaged. Taking into account the uncertainties in estimating the effects of various policy measures, the program will need to be continuously monitored in order to contain, at an early stage, any adverse effects of such policies by the introduction of corrective measures.

The five- to seven-year period envisaged in the program for the rehabilitation and recovery of the economy seems reasonable. However, the maximum period of two years determined for full implementation of the corrective policies may be too short, particularly in a number of key areas, taking into account the gravity of the present economic and social situation in Tanzania, which has come about over a number of years.

I welcome the authorities' intention to establish an equilibrium exchange rate by mid-1988 through the gradual, monthly real effective depreciation of the shilling. The differential between the official and parallel market rates should not, however, be considered as the only important indicator of the extent of the overvaluation of the official exchange rate.

In concluding, I would like to express the best wishes of this chair for the success of the adjustment program. I believe that both the Fund and Tanzania can be guided by the experience in Ghana, which basically faced similar problems at the initiation of its first stand-by arrangement. Unnecessary hardship could be avoided by emphasizing flexibility and feasibility in applying the recommended measures.

Mr. Alhaimus made the following statement:

I join other speakers in endorsing Tanzania's adjustment program for 1986/87. It is a comprehensive effort that encompasses a broad spectrum of measures on the exchange rate, fiscal and monetary areas, and pricing policies.

On the most crucial aspect of the program--exchange rate depreciation--the staff appraisal makes the observation that the authorities are still cautious and are probably still skeptical about its effectiveness. In this respect, Mr. Mtei has confirmed that the authorities are determined to pursue the pace of exchange rate adjustment to which they are committed and that already an impact has been felt in the form of the sharp fall in the rate on the parallel market. I would urge the staff to take a realistic attitude in reviewing the pace of exchange rate adjustment in the coming review, especially in light of the difficulties in defining the equilibrium rate as readily acknowledged in the staff paper and in light of the impact of depreciation on inflation in the coming months.

On the amount of the stand-by arrangement, the access of 60 percent of quota, 40 percent on an annual basis, seems to be on the low side, considering the size of Tanzania's financing needs and its limited use of Fund resources in past years. At any rate, he hoped for a speedy finalization of an arrangement under the structural adjustment facility, which might raise the Fund's contribution to a more meaningful level.

Mr. Huang said that he welcomed the cooperation between the Tanzanian authorities and the Fund. He fully supported the proposed decisions and wished the authorities much success.

Mr. Romuáldez made the following statement:

Tanzania's program has been long in coming. It is hardly surprising, therefore, that everyone should greet it with some satisfaction and welcome. As summarized very well by the staff on page 12 of EBS/86/183, the program seems comprehensive enough, with appropriate emphasis on the exchange and interest rates, on liberalization in the price system, and on trade policies. The issue of parastatal reform is also covered, and in a proper manner--namely, in the context of a World Bank program loan. I should quickly add, however, that later elaboration in the paper shows some areas of the program to be not quite ambitious or rigorous enough in terms of Tanzania's present needs. Although the medium-term perspective of the program is the correct one, because it allows closer complementarity between the World Bank and Fund programs, we hope that it has not encouraged a lessening of rigor in the authorities' efforts to bring about an effective stabilization.

Considering the fundamental role attributed to it by the staff, we are not sure that the scheme for the management of the exchange rate should be permitted to remain as inflexible as it still appears to be, or that the authorities should have as long as two years to establish a realistic or an equilibrium exchange rate. Indeed, as the staff suggests, a 1 percent a month real effective depreciation may not be sufficient to ensure adequately rapid progress toward the attainment of the equilibrium rate. As on other occasions when we expressed concern over a gradualist approach to exchange rate adjustment, our fear is that the buildup of pressures spawned by accompanying administrative controls on the exchange and trade system would outpace adjustment and, as a result, diminish expected gains or nullify them. For example, whatever progress may be achieved in improving producer price incentives and the domestic pricing system in general might be undermined. We would certainly have preferred an exchange rate management scheme that had much greater flexibility built into it early on in the program. Moreover, there would have been less of an impact on inflationary expectations. In this connection, it follows that we welcome the review of exchange rate developments scheduled for end-1986 in preparation for the mid-February 1987 review of Tanzania's performance under the stand-by arrangement.

We believe that a similar measure of gradualism is evident in the fiscal aspects of the program. An overall deficit of 11.1 percent of GDP in 1986/87 strikes us, as it did the staff, as excessive relative to the objectives of the program. I am not sure, however, that the assumptions in the fiscal plans are such that they are sufficient to encourage private sector activity. Even taking into account the effects of price changes resulting from the large devaluation, we wonder if a growth rate of government consumption of 44 percent may not be too high. At first glance, 47 percent growth in current expenditures--which include net after-tax increases in income ranging from 30 percent at the minimum wage level to a little more than 14 percent at the upper end of the salary scale, which appear to us as somewhat still high--and a 119 percent expansion of development expenditure and net lending in the context of severe financial imbalances seem inconsistent with the program objectives. We await the staff's answers to Mr. Zecchini's queries on these points.

We tend to regard as worrisome a programmed external current account deficit of about 22 percent of GDP, not to mention uncertainties associated with a financing gap of $500 million in 1986/87. I wonder whether arrangements to cover this gap have already been made; if not, are there contingency measures in the program that could bring about further adjustment?

While we appreciate the need to rehabilitate infrastructure, our concern over the significant rise in development expenditure derives from our awareness of Tanzania's limited resources at the present time. It is not assuaged at all by the fact that, beyond the general statement on page 21 about investment priorities, there is no elaboration of specific areas where further adjustments could be made if the need arises.

A faster pace for the improvement of the interest rate structure would have been preferable, owing to the fundamental need for the authorities to improve resource allocation, encourage savings, and buttress other actions they were taking to improve the domestic price system.

The staff has referred to some aspects of this program as "first steps," which indeed they are. Would that they represented major strides in Tanzania's road to recovery. They could be so only if the authorities implemented them with greater rigor. It will be with these thoughts in mind that we look at the coming reviews. We hope that the authorites will by then recognize the need for a more rapid progress as regards exchange rate adjustment, fiscal sector retrenchment, reforms in the price system, and monetary discipline.

In the meantime, we welcome the adjustment measures taken in other areas, especially the reform of the tax system and the domestic price system. For their decision to come to terms with their situation, we commend the Tanzanian authorities. We look forward to improvements in the marketing and transportation structures as in the parastatal sector, all of which, we understand, will be addressed in the World Bank program and in discussions for an arrangement under the structural adjustment facility.

We can go along with approval of the proposed decisions. We hope that the authorities meet with success in their efforts to adjust their economy in a manner that will ensure sustainable growth.

The Deputy Director from the African Department said that the social and political impact of economic adjustment was a constant reference point in the negotiation of the stand-by arrangement. Indeed, it had been a particular point of pride to the Tanzanian authorities that they had been able during their short history of independence to establish a social and political consensus that had resulted in stability. Consequently, the authorities had weighed every measure of economic adjustment critically in light of whether or not it would upset the consensus that had been reached. The staff had thus also been guided by the authorities' acceptance of certain measures in the program as an indication of the likelihood that the country at large could accept the consequences of the program. In sum, there had been a sort of trade-off between the strength of the adjustment program on the one hand, and the degree of commitment to implement it on the other. In his view, the enhanced degree of commitment was sufficient to compensate for any weakness that various Directors might have perceived in the design or the pace of adjustment of the program.

The design of the program had had to take three aspects into account, the Deputy Director continued. First, the authorities' own concept of adjustment; second, the actual policy content of the program; and third, the pace at which the policies would be implemented. There had been a divergence of opinion with respect to the concept of adjustment. Both the authorities and the staff had agreed that Tanzania's adjustment program would need to stretch out over the medium term. However, the authorities' understanding had been that the implementation of all the adjustment policies would be stretched over the medium term, whereas the staff had maintained that the ultimate objectives that would necessarily take time to accomplish were the attainment of a sustainable balance of payments and an adequate growth rate. As reflected in the letter of intent, the compromise that had been struck was that all adjustment policies should be in place within a period of two years at most, while acknowledging that the achievement of the ultimate objectives would extend into the medium term.

As far as the policy content of the program was concerned, there had been no difference between the staff and the authorities, the Deputy Director noted. Measures were to be taken covering all aspects of adjustment during the first year of the program.

The remaining divergence of opinion concerned the pace at which the adjustment policies would be implemented, the Deputy Director continued. The authorities would have preferred a much longer period of adjustment than was contained in the program that had been accepted. The staff had taken note of the almost unanimous sentiment of Executive Directors on the need to quicken the pace of adjustment. The two reviews built into the arrangement would provide an opportunity to convey the Board's views to the authorities.

However, it should be noted that the pace of adjustment under the program was not as slow as it appeared to be at first sight, the Deputy Director added. For example, although the possibility of an underestimation of the rate of inflation in the official consumer price index might have underestimated the rate of inflation, might suggest the need for a larger depreciation, it should be noted that the requirement in the program of a 1 percent a month real depreciation meant that any future inflation would automatically be compensated for. In that connection, the emphasis in the program on price liberalization might lead to a catching up in the rate of inflation as measured by the CPI--especially considering that the price of some commodities had been permitted to increase by as much as 60 percent to 200 percent--which would be captured in the further depreciation of the exchange rate.

An additional point to be borne in mind was that whereas the exchange rate had depreciated initially from T Sh 17 per US$1 to T Sh 40 per US$1, in relation to the trade-weighted basket of currencies, the depreciation had been about 10-12 percent larger because the dollar had depreciated at the same time. The real depreciation of 1 percent a month--or 12 percent annually--would be in addition to that initial depreciation. Therefore, the concern that had been expressed about the inflationary potential of the sliding exchange rate should be assuaged somewhat. The staff was encouraging the authorities to bring the previously suppressed rate of inflation into the open, and to bring prices as well as the exchange rate to their real levels. The potential for inflation had resided in the previous policy of suppressing inflation through price controls; the sliding exchange rate was designed to avoid any repetition of such a policy.

Similarly, as noted in the staff paper, the actual budget deficit in the program for 1986/87 compared with the underlying deficit was about 5 percentage points lower, at about 30 percent of GDP, the Deputy Director stated. But as several Directors had mentioned, the staff's calculations of the underlying deficit had not taken into account the likely level of GDP, had a similar exchange rate depreciation taken place one year earlier.

Whatever the method used, the actual deficit of the earlier year had not taken account of a substantial amount of hidden subsidies on the expenditure side of the government budget. If the staff had made even a rough calculation for that subsidy, the underlying deficits in the past would have been substantially larger. Although it was appropriate to ask whether the 5 percent reduction in the deficit was sufficient, when there had been an increase of 30 or 40 percent in expenditures, the impact of exchange rate adjustment should not be overlooked.

The staff's calculations suggested that almost one third of the current expenditures of the Government represented expenditures in foreign currency, the Deputy Director added. Consequently, if there was a devaluation in local currency terms of 135 percent, and if there was no increase in real expenditures, current expenditures would still increase by about 40 percent simply to make allowance for the exchange rate depreciation. In addition, because almost 75 percent of development expenditures were in foreign currency, those expenditures would almost double simply to correct for a devaluation of 135 percent. Moreover, all expenditures in the development budget were presently financed by donors, and to the extent that they maintained or increased their assistance, development expenditures would increase, and the budget deficit would rise, pari passu, to make allowance for the devaluation. While most of the assistance for the financing of development expenditure took the form of grants, the ratio of the deficit to GDP of 11 percent did not include grants on the revenue side but as a financing item, thereby increasing the difference between revenue and expenditure.

The staff estimates differed from the official budget estimates simply because the authorities had not worked out the full impact of the devaluation on the budget, item by item, the Deputy Director explained. Indeed, they had attended the Paris Meeting of the Consultative Group without being certain whether their program had been accepted and whether sufficient financial assistance would be forthcoming. It was only after the meeting that the authorities were convinced of sufficient support on the part of donors for the overall program to enable them to go ahead. Thus, the authorities had had only a few days between the donors' Consultative Group Meeting on June 10-11 and the announcement of the budget on June 19 to work out the impact of the devaluation on their budget estimates. It had been necessary for the staff to look at those estimates more carefully in order to ascertain that the impact of the devaluation on every agency had been properly accounted for. The program included quarterly indicative targets, and the staff needed to be certain that those targets were not exceeded simply because of an accounting error. Thus, although there was a difference between the estimates of the staff and those of the authorities, the figures indicated in the staff paper had been adopted by the authorities and were reflected in the transfers between various categories in the budget.

The staff had been extremely cautious and realistic in projecting both revenue and the likely amount of additional budget assistance, the Deputy Director added. The only undecided element had concerned the

Paris Club agreement and the staff had made the assumption that the terms of that agreement would be along the usual lines in such cases. Only about 80 percent of the additional assistance from the Paris Club had been projected as being made available to the budget. If any errors had been made in projecting the amounts of foreign assistance, they were probably on the conservative rather than on the optimistic side. To the extent that more foreign assistance was received than expected, additional bank credit would be made available to the private sector, to the full extent of the reduction for the public sector. Tanzania's program had been based on careful calculations of revenue, product by product, and not on the usual concept of the elasticity of revenue. Furthermore, in calculating revenue from duties on specific products, account had been taken of price increases, effective as of the beginning of the fiscal year.

As Directors had observed, producer prices would constitute one of the main elements in any program for the rehabilitation and recovery of the Tanzanian economy, the Deputy Director commented. A larger increase in those prices would have been desirable, if it had been possible. Three considerations had guided the policy with respect to producer prices. First, the existing market losses of the various parastatals resulting from the overvalued exchange rate had to be covered. Second, producers had to be given adequate incentives. Finally, the overall increase in producer prices had to be consistent with the generally restricted incomes policy implicit in the program. As shown in Table 4 of the staff paper, the increase in producer prices represented a substantial increase in the farmers' receipts. In the case of coffee, those receipts would increase by more than 83 percent; in the case of tea, by about 85 percent; and in the case of cashew nuts, they would more than double.

It was also important that Tanzania's producer prices be comparable with those in neighboring countries, the Deputy Director added. Such comparisons were difficult to make because the quality of the product and in some cases even the type of product differed. For example, the coffee produced in Tanzania was of a different sort than the coffee produced in Kenya. Nevertheless, as a proportion of export prices, producer prices in Tanzania compared favorably with those in Rwanda, Burundi, and Uganda--the three other neighboring countries--but less favorably with those in Kenya. But even in respect of the comparison with Kenya, it was still a question of how export prices were compared because Tanzania did not tax coffee exports and, in theory, producers should receive the full export price, less marketing costs. However, the Tanzanian Government would place T Sh 2 1/2 billion in the Stabilization Fund, which in fact would belong to the coffee farmers. The money was being neutralized in the sense that it would not be used by the Stabilization Fund to provide a source of additional budget financing or indirect revenue to the Government--unlike traditional marketing boards--but would invest it in government securities that were already held in the portfolio of the banking system. If that amount of T Sh 2 1/2 billion was considered as belonging to the farmers, Tanzania's coffee producer price would compare relatively well with that of Kenya.

The staff had been neither optimistic nor pessimistic but simply prudent in estimating the impact of increases in producer prices on output, the Deputy Director commented. In Tanzania, the transport and marketing bottlenecks were as important as price incentives, and unless those bottlenecks were corrected, the impact of incentives on production and exports was likely to be smaller than envisaged. Therefore, the staff had assumed somewhat less of a response than would normally be expected from such incentives to producers. At the same time, the staff had not been unduly optimistic. Although production would clearly not reach the levels that Tanzania had previously achieved, there was substantial existing production capacity that, with the right juxtaposition of policies and inputs, would make it possible to achieve the estimated increases in exports.

An extended arrangement was different from a stand-by arrangement in that it would incorporate the features of an arrangement under the structural adjustment facility as well as those under program loans with the World Bank, the Deputy Director stated. It would be optimstic to expect that a program to be supported by an extended arrangement could be drawn up in time to follow the present stand-by arrangement. The elements of such an extended arrangement could, however, be considered as falling into place if agreement could be reached on a structural adjustment arrangement for Tanzania, alongside the World Bank program loan.

The Deputy Director of the Exchange and Trade Relations Department noted that, as Mrs. Walker had indicated, the content of the introductory section in the staff paper on Tanzania's ability to repay the Fund was not what the staff wanted to see in future papers. The matter of how to deal with the subject had been thoroughly discussed within the staff and management. There had been some differences of view, but the staff was now close to the point of being able to include substantive sections in staff papers on the use of resources in the near future.

Referring to the design of the performance criteria in the arrangement for Tanzania, and the application of certain criteria in Fund programs in general, it should be noted first that the ceilings on domestic credit of the banking system and the subceiling on net bank credit to the Government were standard features of all programs. Ideally, the ceilings that had been established for the net domestic credit of the banking system should have been extended well beyond end-December 1986 (in other words, quantitative ceilings should also have been set for March and June 1987). As for the subceilings on banking system credit to seven specified marketing boards, one had to keep in mind that in Tanzania the parastatal system was quite extensive and had been a cause of severe financial problems in the past. It would not be realistic to have a subceiling on credit to Government but exclude any monitoring of the important parastatal sector. The staff's wish had been to ensure sufficient credit to the private sector; a subceiling on credit to the Government without any restraint on the parastatal sector would mean that parastatals were competing with the private sector. On the basis of past behavior it seemed clear that the parastatals would have gained at the private sector's expense. In that respect, the most acceptable approach would have been a subceiling on credit to the public sector as a whole, including the seven marketing boards. However, due to data limitations, that had not been possible.

Although it had not been possible to establish a subceiling on net credit to the public sector as a whole, the Deputy Director continued, concern about the size and persistence of the public sector deficit had led the staff to complement the ceiling on bank credit to the Government with indicative targets for central government expenditure and revenues. That form of monitoring had featured in other programs and the staff would like to extend its use. The targets focused not simply on the net balance of the deficit but on particular components. Indeed, there were a number of monthly indicators which would give early warning of a potential problem in meeting the quarterly performance test on credit to the Government.

As to external policies, the staff had investigated the possibility of applying a performance test to net international reserves, the Deputy Director noted. However, given the highly restrictive nature of the import and exchange control systems, the staff had concluded that it was premature to apply such a test in Tanzania. The other performance tests--on external arrears, public sector foreign borrowing, and payments restrictions--followed standard staff recommendations.

Access of 40 percent of quota at an annual rate was within the guidelines for access in catalytic cases and had been applied in other recent stand-by arrangements, the Deputy Director said: moreover, both the authorities and the staff recognized that the Fund's resources were of a relatively short maturity and that Tanzania was in need of concessional financing, especially for imports. Finally, it was clear that Tanzania would need to have a number of other programs in future, and it was therefore appropriate to conserve certain resources for the support of those programs.

The Deputy Director from the African Department added that it was difficult to place a limit on overall credit to the public sector. Total credit to the nonfinancial parastatal sector amounted to approximately T Sh 9.5-10 billion, of which T Sh 6 billion represented credit to the seven parastatals under the subceiling. Therefore, there was a control on two thirds of the credit to the parastatals. The balance of T Sh 3.5-10 billion would go to the private sector. In the past, most of the remaining credit expansion had gone to those seven nonparastatals, because credit to the others had remained relatively stable. Therefore, the total credit ceiling was indirectly controlling credit to the rest of the nonfinancial public sector.

The subsidization of kerosene and diesel did not involve budgetary transfers, the Deputy Director explained. A different c.i.f. cost was applied to kerosene and diesel than to any other product, and prices were calculated on that basis. At the same time, certain taxes were levied on kerosene and diesel oil, which contributed to the budget revenue. For 1986/87, tax revenue from oil, petrol, and related products was about T Sh 1.6 billion, approximately T Sh 35 million of which was derived from the tax on kerosene and diesel. The precise impact of the cost subsidization could be determined only if the proportion of crude oil used for kerosene or gasoline was known.

The appropriateness of a wage increase of 10.3 percent at the current time had to be considered in the context of the complete wage freeze in the public sector for the past two years while domestic prices had increased by about 50-60 percent, the Deputy Director said. More importantly, price liberalization, was likely to lead to price increases of between 50 percent and 70 percent. Therefore, the authorities felt that an average wage increase of 10 percent, which implied a smaller increase at the higher levels, was appropriate under the circumstances.

On the related issue of whether it was advisable to reduce the income tax, the staff felt that the high marginal income taxes in Tanzania operated as disincentives. The amount of money, time, and manpower that was spent collecting taxes from a few people taxed at a very high rate was probably not justified on a cost/benefit basis. Therefore, some small decrease of the highest marginal income tax rate had been provided for.

The staff representative from the World Bank said that a Bank mission had visited Tanzania in late July and early August to appraise a multisector rehabilitation loan. The main purpose of the mission was the development of a program of policy reforms in the areas of agricultural pricing and marketing, industrial restructuring, transport rehabilitation, and public sector management--including public investment and the activity of parastatals. At present, it was possible to say only that considerable and encouraging progress had been made on all fronts.

Mr. Mtei made the following statement:

> I am grateful to Executive Directors for their interest in Tanzania and for their constructive comments on the program, which I shall pass on to my authorities in Dar es Salaam.
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> I have received the comments of my authorities on the staff report only during the course of the present meeting. I would want only to highlight the point made by the staff on page 4 of its report where it asserts that Tanzania's economic "deterioration was principally attributable to the inadequate domestic policies." My authorities do not entirely agree. I would like to stress that although by accepting this stand-by arrangement, Tanzania indeed acknowledges that domestic policies have been inadequate, it still asserts that external factors have been the principal cause of the deterioration. I can cite the commodity price collapse associated with the international recession; the oil price hikes required Tanzania to allocate an unusually high

proportion of its export proceeds for oil imports; the drought that has afflicted so many parts of Africa in recent years; the war with Uganda and the collapse of the East African Community. Those are all aspects over which Tanzania had no control but which seriously affected the performance of the economy.

Today's discussion is the culmination of protracted negotiations between Tanzania and the Fund, which indeed began even before the 1980 stand-by arrangement, which went off track soon after the Board approved it. Over the intervening years, whenever the Board discussed the staff reports for the annual Article IV consultations with Tanzania, Executive Directors have voiced their criticisms of the manner in which the economy had been managed and the policies adopted. The views of the Fund have all along been known to the Tanzanian authorities. Therefore, I am pleased that over the last year or so, there has been a meeting of minds on most issues.

Over the last year, especially since the general elections, the authorities have been mobilizing mass support for a program of recovery and adjustment that could turn the economy around and place it again on the path of growth. At the same time the Government was conducting negotiations with the Fund in a serious and determined manner to ensure that what it agreed to could be implemented. I believe that the outcome was a workable formula, and I can confirm that my authorities are seriously determined to implement the package of measures agreed. It is my hope that the Fund, the World Bank, and the bilateral donors and creditors will facilitate the necessary flow of external resources, which, as has been recognized by most Executive Directors who have intervened in the deliberations this morning, are essential to make the program work. I would like to repeat in this connection my authorities' appreciation of the understanding and generous response on the part of the bilateral donors. As has been indicated in the staff paper and as the Board is aware, Tanzania is seeking a rescheduling of its official debt and arrears under the aegis of the Paris Club, and it is the authorities' hope that the understanding displayed at the Consultative Group meeting will be continued. Above all, since proper timing is of the essence in implementing this program, it is their hope that the aid and credits pledged will be disbursed on a timely basis and that it will be possible to quickly conclude the various bilateral agreements following the discussions with the Paris Club.

The adjustment measures that have been and are being implemented in Tanzania have begun to be painfully felt. As a result of the devaluation, prices of imported commodities have increased in local currency terms about 150 percent. The decontrol of most prices has meant that the small but influential sector that benefited from price controlled goods no longer enjoys this privilege.

I am sure Executive Directors realize the political importance of such groups in a democratic society. Lastly, those with goods for immediate export are benefiting from the devaluation, but in an agricultural community the benefits on this score will have to await the next harvest when the response to the incentives and additional inputs will have borne results.

Although my authorities are committed to implementing the program that the Board is considering, I want to express the hope that the staff will be flexible and understanding in approaching the various performance criteria as events unfold, and that it will carefully analyze any developments that may lead to any departures from agreed specific targets. As Mr. Sengupta remarked, the targets are rather numerous. In my view it is not possible to foresee developments with accuracy as long as a year ahead, particularly in an environment that has been rendered so weak financially, economically, and structurally; when the data base is rather weak; and with so many aspects of the necessary inputs being predicated on exogenous developments over which the authorities have no control. It is necessary for everyone--the Fund as well as the authorities--to have an open mind and to be prepared to consider flexibly the causes of any unexpected developments and how to recast elements of the program in order to achieve the original objectives.

I would like to urge the staff to take up as soon as possible the question of finalizing Tanzania's request to use the resources of the structural adjustment facility. I know that progress in this connection is tied up with the World Bank's consideration of the multisectoral loan for the rehabilitation of agriculture and industry in Tanzania. I would urge the World Bank staff to do whatever is possible to expedite the processing of this loan, since I gather that all the formalities may not be completed before the latter half of October. It would be most helpful to the authorities if the Fund and Bank staff could start processing the request for an arrangement under the structural adjustment facility simultaneously so that, if at all possible, the first disbursement of the World Bank program could be made at the same time as the first loan under a structural adjustment arrangement with the Fund.

On the question of the exchange rate, I note that some Executive Directors still consider the adjustment inadequate on the grounds that the gap between the official rate and the parallel market rate is large. However, as I have already stated, the Tanzanian authorities are committed to reaching an equilibrium rate. Nevertheless, they hold the view, which I strongly share and have explained to the Executive Board on previous occasions, that in the particular social and economic circumstances of Tanzania, the parallel market rate bears no relation to the equilibrium rate. However, the parallel market, to the extent that it can be officially ascertained, was reported to be T Sh 90 to the U.S. dollar at the end of last week.

Finally, I would like to repeat that my authorities are committed to implementing the letter and the spirit of the agreement that has been reached with the Fund. I hope that with flexibility and understanding on all sides, the implementation of the objectives set out in the program can be achieved as planned.

The Acting Chairman remarked that the Managing Director would no doubt wish to convey the essence of the discussion to the Tanzanian authorities in light of their previous communications and the significant adjustment that Tanzania was embarking on. The basic points made were first, that the Executive Directors had welcomed the shift in the authorities' approach to economic policies in order to address the imbalances, the inefficiencies, and the rigidities that had limited the growth of output and exports. The adoption of structural as well as demand management policies had been welcomed, and the emphasis given to the agricultural sector was considered appropriate in light of Tanzania's rich natural resources.

Second, most Directors viewed those policy actions as a first step. Many expressed concern that the pace of adjustment in a number of areas was not as adequate, or as fast, or as appropriate--in light of the large imbalances facing the economy and the expectation that a viable balance of payments would not be achieved until the early 1990s--as had been hoped, the Acting Chairman said. In that connection, Directors had expressed concern about the pace of exchange rate and interest rate adjustment and the length of the time that it would take to reach an equilibrium exchange rate and real positive interest rates. Concern had also been expressed about the pace of adjustment in producer prices and the fiscal deficit. Executive Directors had attached importance to the reviews scheduled to take place before February and end-July 1987, and they had encouraged the authorities to approach those reviews with an open mind and be prepared to accelerate policy actions.

Directors had also welcomed the active role of the World Bank in promoting structural reforms in marketing, distribution, and in selected enterprises that were crucial to the recovery of exports and production, the Acting Chairman continued. Indeed, Directors had encouraged the authorities to continue to work closely with the Bank in setting investment priorities and in reviewing the performance of parastatals. Directors had also looked forward to consideration of an arrangement under the structural adjustment facility and were particularly interested in the structural reform that might be implemented in the context of that arrangement.

Executive Directors had also stressed the importance of adequate and necessary donor support for Tanzania to be able to meet its external and development requirements, the Acting Chairman went on. In that connection, the Fund stood ready to work closely with the World Bank in helping to ensure that Tanzania received the necessary flows of financial resources, especially if developments on the external front called for additional financing. It was clear that Tanzania needed concessional financing. He felt that donors understood that point and would be willing to support Tanzania's efforts.

The Executive Board then took the following decisions:

Stand-By Arrangement

1. The Government of Tanzania has requested a stand-by arrangement for a period of 18 months from August 28, 1986 to February 27, 1988, in an amount equivalent to SDR 64.2 million.

2. The Fund approves the stand-by arrangement set forth in EBS/86/183, Supplement 1.

Decision No. 8374-(86/140), adopted
August 28, 1986

Exchange System

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, Supplement 1, whichever is earlier.

Decision No. 8375-(86/140), adopted
August 28, 1986

APPROVED: May 4, 1987

LEO VAN HOUTVEN
Secretary