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PROGRAM PERFORMANCE AUDIT REPORT

TANZANIA: PROGRAM LOAN (LOAN 1063-TA)

December 1, 1976

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Operations Evaluation Department

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PROGRAM PERFORMANCE AUDIT REPORT

TANZANIA: PROGRAM LOAN (LOAN 1063-TA)

PREFACE

This report presents a performance audit of the Tanzania Program Loan (Loan 1063-TA). The loan was for US\$30 million, it was approved in December 1974, and was fully disbursed by May 1975.

This audit is based on the Completion Report of December 1975, and the Progress Report of September 1975, (Attachments A and B) both prepared by the Eastern Africa Regional Office, on the President's Report and the Loan Agreement and on discussions with the Bank staff.

PROGRAM PERFORMANCE AUDIT REPORT

TANZANIA: PROGRAM LOAN (LOAN 1063-TA)

LOAN DATA

Loan Amount	US\$30 million
Amount Disbursed	US\$30 million
Appraisal Mission	September 1974
Loan Agreement Date	December 20, 1974
Effectiveness Date	January 9, 1975
Original Closing Date	December 31, 1975
Final Disbursement Date	May 1975
Supervision Mission	July-August 1975

Exchange Rates: Tanzanian Shilling (Tsh)

1975 till October 26-----US\$1 = Tsh.7.14
after October 27-----SDR1 = Tsh.9.66
1976 (June)-----US\$1 = Tsh.8.33
(on the basis of 1 SDR = US\$ 1.158)

PROGRAM PERFORMANCE AUDIT REPORT

TANZANIA: PROGRAM LOAN (LOAN 1063-TA)

HIGHLIGHTS

This report deals with the program loan made to Tanzania in December, 1974. Its principal objectives included the provision of quick disbursing assistance for Tanzania's investment program and to encourage the government to implement certain policy changes of a longer term nature.

The audit concludes that progress has been made in initiating most of the policy understandings as reflected in Attachment B. The longer term impact on the economy would however require the consistent pursuit of the agreed policies over a period of time; the extent to which the loan contributes to these longer term objectives cannot as yet be assessed.

PROGRAM PERFORMANCE AUDIT MEMORANDUM

TANZANIA: PROGRAM LOAN (LOAN 1063-TA)

I. Introduction

1.1 This memorandum reports on an audit of performance under Bank Loan 1063-TA for US\$30.0 million, which was signed in December 1974 and was fully disbursed by May 1975. The audit is based on information contained in the Program Completion Report (PCR) prepared by Bank staff in the Eastern Africa Regional Office (Attachment A). This has been supplemented by information contained in Bank files and discussions with Bank staff concerned with various aspects of the project.

1.2 The objectives of the program loan were:

- (i) to provide additional quick-disbursing assistance in order to sustain Tanzania's on-going investment program, and
- (ii) to provide time to enable the Government to implement agreed policy changes which would enable the country to move towards overcoming its balance of payments problem in the medium term.

1.3 The main conclusion of the audit report is that the program loan achieved the first of these objectives and that it enabled Tanzania to begin the agreed shift in policy direction necessary to cope with its balance of payments problem in the medium term. However, the extent to which the change in policies will achieve its announced objectives cannot yet be assessed.

II. Background

2.2 Tanzania's main development objectives are eradicating poverty and equalizing standards of living. The declaration of socialist principles in 1967 led to a rapid growth of para-statal organizations and a heavy concentration of investment on economic and social infrastructure projects with long gestation periods. This was accompanied by a decline in private investment, particularly in industry and agriculture. Tax rates are already high so that any substantial increases in public savings can only accrue from increased earnings by the para-statal organizations. So far such an increase has not occurred and the absence of price and profitability related yardsticks of performance has complicated the problem of improving the efficiency of these organizations. The slow growth of agricultural exports (representing about 75-80% of total exports), in combination with rapidly growing imports of capital equipment and intermediate goods, led to rising balance of payments deficits from about 1970 onwards.

2.2 Given this economic background, three events occurred in 1973-74 which resulted in a drastic change in the overall balance of payments of Tanzania. First, import prices in general rose sharply, 15 to 20% overall, while the price for imported petroleum tripled. Secondly, the 1973 rains failed in many parts of the country, resulting in a substantial reduction of food production and the need to import food worth US\$100.0 million in 1974; agricultural output was also affected to some extent by the Government program of consolidating scattered communities into 'ujamaa' villages. (This interrupted the normal farming activity of the relocated population for at least one season.) Finally, as a result of lower agricultural output, export volumes declined and Tanzania did not benefit from higher export prices. The reduction in available resources resulting from these developments would have had an adverse impact on the on-going development programmes had not additional external aid been forthcoming.

2.3 The crisis of 1974 exhausted Tanzania's foreign exchange reserves which, despite IMF drawings of US\$46.0 million, were reduced by the end of the year to US\$35.0 million, equivalent to only three weeks' import requirements. The upward trend of import prices, high food imports and stagnant agricultural exports were expected to continue into 1975. For 1975 the current account deficit gap was estimated at US\$222 million; the actual deficit turnout to be US\$263 million. The Tanzanian authorities took a number of steps to meet this problem, and the program loan was provided to avoid a sharp reduction in investment and its consequences for the economy.

III. The Program Loan

3.1 The Bank approved the program loan of US\$30 million to Tanzania in December 1974. The loan was approved "for the import into Tanzania by the public and private sectors of essential capital and intermediate goods and raw materials...and of the implementation by the Borrower of such parts of its 1974/75 investment program as are to be financed under the Votes of the Borrower's Development Budget...".

3.2 The loan was designed to provide quick-disbursing external assistance in order to maintain Tanzania's development effort at a reasonable level and provide the Government time to implement agreed policy changes to cope with the medium term balance of payments problem. It was submitted under the criteria spelled out in the memorandum to Executive Directors of December 15, 1970, namely, that Tanzania had an on-going development program and had taken or intended to take the necessary financial and economic policy decisions providing a satisfactory basis for external assistance; that the needed transfer could not be met through project assistance; and that other external sources were not available to Tanzania on terms appropriate to its economic conditions.

- 3.3 The loan of US\$30.0 million was to be utilized,
- (i) for financing essential imports of capital equipment, intermediate goods and raw materials for the public and private sectors, subject to certain exclusions;
 - (ii) a counterpart fund account would be opened, the proceeds of which would be used to finance expenditures covered by the 1974-75 development budget for specified sectors, after review by the Bank.

3.4 A schedule to the loan agreement defined the items eligible for import under the loan; this covered 14 categories of products, including vegetable and mineral products, artificial resins, raw materials, wood and wood articles, textiles, articles of store, base metals, machinery, vehicles and optical items. No withdrawals were permitted on account of past expenditure on imports. Another schedule to the loan agreement specified the categories of development expenditure, in respect of which counterpart funds could be used. The entire loan was disbursed by the end of May 1975. The counterpart funds were drawn down in August 1975.

IV. Transfer of Resources

4.1 The first objective, that of a quick transfer of resources, has been achieved satisfactorily. The Bank's initiative also assisted Tanzania to mobilize additional bilateral program assistance amounting to about US\$75.0 million during 1975; much of this was obtained through changing existing bilateral project assistance into program assistance.

4.2 The Loan Agreement had listed the specific parts of Tanzania's development budget to be financed from the counterpart funds and provided for the establishment of a special account to which the counterpart funds were to be credited. A request from the Ministry of Finance to withdraw the entire amount was received in July 1975 and the withdrawal authorized by the Bank in August 1975.

4.3 An annexure to the PFA shows that the withdrawal was for five Ministries (Agriculture, Commerce and Industries, Communications and Works, Natural Resources and Tourism, Water Development and Power). The proportion of these Ministries' budgets, financed out of counterpart funds, varied from about 5 per cent (for Communications and Works) to about 55 per cent (for Commerce and Industries), the overall percentage for the five Ministries being about 20 per cent. Given the substantial excess of the Government's budgeted outlay for development expenditure as compared to the counterpart funds generated (see Annex I), the condition regarding use of counterpart funds had no effect on the distribution of Government expenditure.

V. Policy Measures Towards Structural Change

5.1 The objectives of the Bank loan to Tanzania were to ensure that "the balance of payments problem was brought under control in the short to medium run" (PCR, para. 4), and to maintain "the underlying thrust of the Government's long-run development programme". To the latter end, certain policy understandings - in areas of export promotion, agriculture (prices and distribution), Government and private consumption, para-statal - were agreed upon.

5.2 A "Progress Report on Policy Understandings Relating to Program Loan to Tanzania (Loan 1063-TA)" was submitted to the Board in September 1975 (Attachment B). Generally speaking, the Government has moved fairly rapidly to carry out the policies that were agreed upon during appraisal and negotiation of the loan. It is expected that these initiatives would help to bring the balance of payments problem under control over the medium term. The specific measures taken and their likely effects have been discussed in some detail in the PCR and the Progress Report referred to above. The significant issues are touched upon below.

5.3 (i) In the field of export promotion, the Government devalued the Tanzanian shilling by 14 per cent and has taken two institutional steps to foster export efforts - the setting up of an export promotion bureau with the Ministry of Commerce and Industry and an export department in the Bank of Tanzania. In addition, it is generally expected that other policy measures described and analysed below would help to improve the balance of payments.

5.4 (ii) In the field of agriculture, Government measures which affected output (and, therefore, imports) were low prices of agricultural produce and its village development policy under ujamaa. Low prices provided inadequate incentive for production; the village development policy, by involving resettlement of people, affected agricultural production.

5.5 To increase output, producer prices of major agricultural crops have been substantially raised, as shown below:

<u>Tanzanian Shillings</u>			
<u>Crop</u>	<u>Price for 1973/74</u>	<u>Price for 1974/75</u>	<u>Increase</u>
Cotton	1.13/kilo	1.75/kilo	55%
Maize	274/MT	750/MT	174%
Wheat	557/MT	1000/MT	80%
Rice	589/MT	800/MT	36%

Further increases for producers were announced in September 1975 to apply to the 1975/76 season.

5.6 While rains remain the main determinant of agricultural production, the increase in prices of agricultural produce should help to remove one constraint on production. Production of maize, a vital crop, increased in 1974/75, but the cotton crop declined; since cotton is an export crop, there could be an adverse effect on the balance of payments. In the absence of an over-all agricultural production index (and a sensitivity analysis of crop output to other inputs), it is not possible to say how far the new price policy has worked in stimulating agricultural output and in its influence on balance of payments; however, it is a step in the right direction. Government is slowing down the pace of its village development program, thus trying to balance the long-term objectives with the immediate requirements of production. Attempts have also been made to improve distribution of agricultural output through better transport.

5.7 (iii) An improved policy in respect of Government and private consumption is being implemented. Government consumption has been restrained by freezing recurrent expenditure at the level of estimated actuals for 1974/75. The Government has also acted to restrict private consumption by curtailing non-food imports, banning import of luxury items and increasing retail prices of basic food items, in line with producer price increases. This has resulted in an approximate 76% rise in the cost of living of low income workers between mid-1974 and mid-1975, only partly compensated by a rise in wages.

5.8 (iv) Public investment in infrastructure and investment in industry and mining are closely related in Tanzania because of the prominent role which the Government plays in development. The Government increased the proportion of capital expenditure on productive investment in its development program from 23 per cent in 1970/74 to 36 per cent in 1974/75 - at which level it is expected to be maintained in 1975/76.

5.9 The efficiency of para-statal organisations is a key element in the development of the Tanzanian economy and, given the non-market orientation of the Tanzanian economy, it is likely to be a difficult problem - particularly over the medium and longer term, as efficiency yardsticks, independent of price and profitability criteria, are difficult to evolve and to maintain. The PCR states that a policy paper has been prepared by the Government dealing with the question of "control" of the parastatals; the Bank is also assisting in a cost study of the agro-processing and marketing parastatals.

VI. Conclusions

6.1 The program loan achieved its immediate objective of providing additional resources to Tanzania at a time when the deterioration in its terms of trade and the drought had subjected the economy to considerable pressure. It thus contributed to the maintenance of investment and growth. The program loan also enabled the Government to mobilize other program assistance from bilateral sources. Its major effect was thus in adding

to the total of available resources; it did not have any effect on the specific composition of imports, nor was it intended to. The arrangements regarding counterpart funds were implemented but, since they were relatively small by comparison to the development expenditure for which they were used, they had no practical effect on the distribution of such expenditure.

6.2 The loan was made in support of agreed policies designed to overcome Tanzania's balance of payments problem in the medium term, particularly by directing public investment towards the directly productive sectors of the economy and by taking measures to encourage agricultural production. These objectives and measures were expressed in somewhat general terms and hence the degree to which they have been implemented and the progress which has been made towards the achievement of their announced objectives are not subject to precise assessment. The full results of the policies agreed upon in connection with the program loan will only become apparent in the longer run and much will depend on the extent and consistency with which they can be carried through over the next few years.

PROGRAM LOAN AGREEMENT No. 1063STATEMENT OF DEVELOPMENT EXPENDITURE AS AT MAY 31, 1975 ANDWITHDRAWAL FROM COUNTERPART FUNDS AS OF AUGUST 1975

(Tanzania Shillings)

<u>Vote No.</u>	<u>Vote Holder</u>	<u>Budgeted for 1974/75</u>	<u>Actual Expenditure As at 5/31/75</u>	<u>Proposed Withdrawal From Project Account*</u>
43	Ministry of Agriculture	319,557,010	72,208,526	56,000,000
47	Ministry of Commerce and Industries	150,532,090	59,691,504	83,000,000
48	Ministry of Communi- cations and Works	202,900,040	136,476,885	10,700,000
55	Ministry of Natural Resources & Tourism	49,669,000	30,965,190	7,000,000
56	Ministry of Water Development & Power	380,089,020	97,873,367	56,763,000
	Total	1,102,747,160	397,215,472	213,463,000

* Proposed by the Government of Tanzania, August 12, 1975. Approval by Bank conveyed August 25, 1975.

COMPLETION REPORT

TANZANIA: PROGRAM LOAN (LOAN 1063-TA)

Introduction

1. This report is based primarily on the findings of three missions to Tanzania; the program loan appraisal mission in September 1974, a mission in July/August 1975 to review the implementation of this program and the program of policy understandings which laid the basis for the loan, and an appraisal mission for a second program loan carried out in November 1975.

Program Data

Borrower	:	United Republic of Tanzania
Loan Amount	:	US\$30.0 million
Date of Loan Agreement	:	December 20, 1974
Effective Date	:	January 9, 1975
Terms of Credit	:	30 yrs, 10 yrs grace, 8% int.
Amount Disbursed:		
Jan 75	:	-
Feb 75	:	US\$2.3 million
Mar 75	:	US\$17.6 million
Apr 75	:	US\$10.06 million
May 75	:	US\$0.04 million
Closing Date	:	December 31, 1975
Rate of Exchange*	:	US\$1 = TSh7.14

The schedule to the Loan Agreement defines the Program as follows:

"The Project consists of the provision to the Borrower of foreign exchange required for the import into Tanzania by the public and private sectors of essential capital and intermediate goods and raw materials as listed in Schedule 1 to this Agreement, and of the implementation by the Borrower of such parts of its 1974/75 investment

* This is the official exchange rate between the Tanzanian shilling and the U.S. dollar which prevailed during the disbursement period of this loan. On October 27, 1975 the Tanzanian shilling was pegged to the SDR at a rate of Sh9.66 = SDR1.00. On the basis of a dollar/SDR conversion rate of 1.2 to 1.0, the new shilling/dollar exchange rate would be 8.05 to 1.00, implying a devaluation of approximately 14 percent vis-a-vis the U.S. dollar.

program as are to be financed under the Votes of the Borrower's 1974/75 Development Budget listed in Schedule 4 to this Agreement."

The Balance of Payments Situation

2. The need for program lending to Tanzania arose when two successive years of drought in 1973 and 1974 (leading to imports of food grains totalling over \$100 million in 1974), combined with the sharp rise in prices of imports as a result of world-wide inflation, led to a serious balance of payments crisis. The cushion of foreign exchange reserves accumulated between 1971 and 1973 was sharply reduced during 1974; net reserves had fallen to only \$35 million at the end of the year, after IMF drawings of \$46 million. This level of reserves was equivalent to only three weeks' imports.

3. At the time of appraisal of the program loan in September 1974, the Bank's projections for 1975 indicated a current account deficit of \$222 million and an overall balance of payments deficit of \$142 million, thereby underscoring the necessity for program assistance. The latest revisions of the 1975 balance of payments indicate an even larger current account deficit of almost \$300 million, due to higher than anticipated imports and lower than anticipated export volumes. After accounting for higher disbursements of project aid, the residual gap is still expected to be approximately \$140 million; this residual gap is being met by bilateral program assistance of an estimated \$70 million, the Bank's \$30 million program loan, and other multilateral assistance (including IMF) of some \$40 million. It is evident that the Bank's program loan was an essential element in filling the 1975 balance of payments gap; in addition the Bank has been instrumental in mobilizing bilateral program assistance, both at the time of initial program loan discussions and during the Consultative Group meeting for Tanzania in April 1975.

Policy Measures Taken by Government to Cope with the Balance of Payments Deficit

4. Quick disbursing financial assistance to cover the unexpected external gap was provided by the Program Loan. However, in appraisal, negotiation and presentation of the loan, the Bank also emphasized the need for policy actions by the Government of Tanzania to ensure that the balance of payments problem was brought under control in the short to medium-run, while at the same time

the underlying thrust of the Government's long-run development program could be maintained. The mission which went to Tanzania in July/August 1975 prepared, as part of the requirement to report to the Board on the progress of the program, a report entitled "Progress Report on Policy Understandings Relating to Program Loan to Tanzania (Loan No. 1063-TA)." ^{1/} That report provided a summary assessment of the actions taken by the Government of Tanzania to alleviate the balance of payments crisis and the steps taken to restructure the economy in order to maintain the momentum of development despite the adverse terms of trade shift. This report necessarily repeats some of the information already contained in the Board paper. It will evaluate the implementation of the project on two levels: first, in terms of its success in stimulating measures to cope with the immediate balance of payments crisis; second, in terms of the type of policy measures introduced to deal with the longer-trend problems experienced in the Tanzanian economy even before the drought and terms of trade shift had their full impact.

5. One of the first measures undertaken by the Government was to mount an exhortation campaign for Tanzanian farmers to grow more maize in order to restore self-sufficiency in food grains. The impact of this campaign, combined with sharp upward revisions in producer prices for food grains, appears to have been successful, although it has led to a diversion from cash crop production to food crop production in the 1974/75 season. The 1974/75 maize harvest turned out, however, to be slightly lower than was originally estimated because of the lateness of rains in some regions. Purchases of maize by the National Milling Corporation are expected to be 100,000 tons, down from the 125,000 tons expected earlier, but with present stocks the grain should last till end-May 1976. Also in line with the Government's intention to rationalize agricultural pricing policy producer prices were raised in May and November 1974 for a number of basic crops, including cotton (1.13 to 1.50 to 1.75 Sh/kilo), maize (274 to 500 to 750 Sh/metric ton), wheat (557 to 770 to 1000 Sh/metric ton) and rice (Sh 589 to 650 to 800 Sh/metric ton). Further price increases for a number of staple crops were approved by the Government and announced in September to apply to the 1975/76 season. These two issues, namely adequate producer pricing and the proper balance between cash crop and food crop production, are being constantly reviewed by the

^{1/} Sec M75-687, September 25, 1975.

Government as part of the measures needed to stimulate the agriculture sector where growth has been lagging in recent years. In a related measure, the system of steeply progressive export taxes on coffee (averaging 30 percent) was replaced with a 12-1/2 percent ad valorem tax so that farmers would be encouraged to grow higher quality coffee for export.

6. In the sphere of consumption, the Government acted to restrict private consumption demand through imposing a wage freeze in May 1974, curtailing non-food consumer goods imports since mid-1974, banning imports of luxury items, increasing retail prices of basic foodstuffs in November 1974 to eliminate or reduce subsidies, and raising excise taxes on textiles, beer and cigarettes, with further tax raises on these items legislated in the 1975/76 Budget. Urban water rates and electricity user charges were also increased. The cumulative impact of these measures was to raise the cost of living of low income workers by 76 percent between March 1974 and March 1975. This sharp decline in the real income of these workers was slightly compensated for by a wage increase of 10-12 percent in May 1975.

7. At the same time the Government acted to restrain public consumption; Government recurrent expenditure had increased at a rate of almost 30 percent per year between 1971/72 and 1974/75, or at a rate slightly above the increase in recurrent revenues. To control public consumption demand, the Government, in its 1975/76 Budget, allowed for no increase in current expenditures over the estimated actuals of the previous year, implying a substantial decrease in planned recurrent expenditures in real terms.

8. The measures outlined above, plus the expanded distribution of food relief were, to a great extent, successful in protecting the poorer sections of the community from the dramatic short-run income losses brought about by harvest failures and the terms of trade decline and also in preventing the balance of payments situation from becoming much worse. Other policy actions already taken or under study by the Government deal with the medium and longer run situation. These are intended to sustain the pace of Tanzania's development despite the reduced availability of real resources. The main elements of the program include reallocating public investment in favor of directly productive sectors, improving output performance in agriculture, and increasing efficiency in industry and mining while at the same time expanding the export orientation of these sectors.

9. One of the most serious problems facing the Tanzanian economy in recent years has been the declining rate of growth of gross material product in spite of a high investment rate, averaging 21 percent of GDP over 1967-73. This slow growth in the productive base of the economy has been diagnosed, in part, to be a result of the high proportion of investment which went into social and other infrastructure rather than into the directly productive sectors of agriculture, industry, and mining. The Government has been aware of this problem since its 1971 review of the Second Five Year Plan, and has been making efforts to reallocate its investment resources. In the 1974/75 Government Development Budget, approved several months before the Program Loan was signed, 36 percent of capital expenditures were allocated to directly productive sectors compared to a realized average of 23 percent in the preceding four years. For total planned public investment (i.e. government development expenditures plus extra-budgetary investment financed by parastatals' own resources) 48 percent was allocated to directly productive sectors. For 1975/76 the allocations to directly productive sectors in the Government Development Budget and the more inclusive Annual Plan for total public investment also correspond closely to the shares originally budgeted in 1974/75. An even more revealing indicator of the Government's efforts to redirect public investment in favor of directly productive sectors is in the proportion of financial allocations to new projects programmed to start in 1975/76. On this basis, out of an Annual Plan allocation of Sh1221 m. to new projects (representing one-third of the total public investment allocation of Sh3642), four-fifths is programmed for investment in directly productive sectors.

10. Another long term problem is the recorded low productivity of labor. The Government is reviewing a recent ILO incomes policy paper which was prepared at Government request, and is considering a number of measures designed to increase labor productivity. It remains to be seen whether the measures under consideration, if implemented, would be effective.

11. The inefficiency of publicly owned parastatal enterprises has become an important issue because of these institutions' key investment role in such vital sectors of the economy as manufacturing, energy, transport, finance and commerce. As such, they are the major users, as well as generators, of the national surplus and play an important role in the structural transformation of the economy which Tanzania is attempting. However, these state enterprises have been largely insulated from market forces by the prevailing system of price, import and marketing controls, while clear guidelines for their performance goals are lacking. A Government policy paper has been prepared

dealing with the question of "control" of the parastatals, and the Bank is assisting in a cost study of the agro-processing and marketing parastatals.

12. To improve the balance of payments situation in the long run, exports will have to be increased. Aside from the policy measures already discussed, the Government has established two units to deal specifically with this issue. An export promotion bureau has been set up in the Ministry of Commerce to study the export potential of various sub-sectors of manufacturing and an export department is being established in the Bank of Tanzania to facilitate the export of manufactured goods. Also, in late October, the Government of Tanzania, in concert with the Governments of Kenya and Uganda, devalued the shilling by approximately 14 percent. This devaluation should contribute to higher exports.

13. Another long-term problem area is in project preparation and implementation. To improve project implementation capacity, the 1975/76 Development Budget embodies a much more rigorous screening process to include only ongoing projects and projects guaranteed to "take off" during the current fiscal year. In addition, two new control units have been created in the Ministry of Finance to improve public sector project performance. One will concentrate on monitoring, streamlining, and expediting disbursements on externally financed projects. The second will work in cooperation with ministries and parastatals to monitor the efficient utilization of resources by parastatals. The Bank has recently approved a technical assistance credit of \$6 million to assist in project preparation and has seconded several project advisers to the Ministry of Agriculture.

Policy Actions and the Economic Outlook

14. As was clearly recognized at the time of the program loan discussions in late 1974, many of the effects of the policy actions undertaken by the Government will only be felt over the coming years rather than in a few months. In most cases it is too early to observe significant effects in the conventional economic indicators. While the improved harvest for 1975 is to be greatly welcomed, the balance of payments is nevertheless expected to remain under severe pressure for the medium-run, until more of the favorable balance of payments effects of the recent policy changes bear fruit.

Disbursement Procedures

15. Foreign exchange provided under this loan was utilized for essential imports of capital equipment, intermediate goods and raw materials. No disbursements were made for food, fuel, fertilizers or consumer goods, or for imports for which other sources of foreign financing had been secured. In order to streamline disbursement procedures, no individual import invoices of less than \$500 were eligible for reimbursement.

16. The program loan was drawn down rapidly, as indicated in the disbursement schedule on page 1 of this report; over 99 percent of the loan was disbursed by the end of April 1975, four months after effectiveness, and 100 percent by the end of May 1975. At the outset there were minor delays in processing of import invoices by the National Bank of Commerce, but these difficulties were resolved quickly with the assistance of the controller's staff at RMEA.

17. A special project account was opened by the Bank of Tanzania to which the Tanzanian shilling equivalents of the imports financed under the project were credited. The Government was authorized to withdraw funds from the project account to cover expenditures under certain specified votes in the 1974-75 Development Budget, after the Bank had had the opportunity to review the withdrawal proposals. The use of these counterpart funds was limited to those expenditures not otherwise financed by external sources. A request to withdraw the entire amount of the counterpart funds was submitted by the Ministry of Finance in July. The request was reviewed by the Bank and authorization was given in August.

Eastern Africa Regional Office

December 30, 1975.

PROGRESS REPORT ON POLICY UNDERSTANDINGS RELATING
TO PROGRAM LOAN TO TANZANIA (LOAN NO. 1063 TA)

Sec. M75-687
September 25, 1975

I. Policy Understandings and Measures Adopted by the Government

The President's Report on the Program Loan (Part V of the Report* is attached as Annex I for reference) sets forth the program of policies which was jointly agreed as desirable to cope with the immediate economic crisis and to initiate the longer term structural adjustments necessary to protect and reinvigorate the momentum of development in the face of adverse terms of trade shifts. In essence, the program called for a judicious blend of demand management, restructuring investment and improving the incentive framework in ways that would increase the growth of output despite the reduced availability of real resources. The main elements of the program consisted of reallocation of public investment in favor of directly productive sectors, a series of measures to improve output performance in agriculture, initiatives to reform the structure of incentives in industry and mining to engender higher factor productivity and increase the export orientation of the sector, and restraints on private and Government consumption demand.

This section reviews the progress in implementing these policy measures. As an overall conclusion there is no question that the Government has lived up to the spirit of the policy understandings and taken significant steps, some of which have been extremely difficult ones, to implement the program of economic restructuring.

A. Public Investment Policy

The Government has been aware of the need to reallocate public investment in favor of the directly productive sectors (agriculture, industry and mining) since its own 1971/72 mid-term review of the second Five-Year Plan. The 1974/75 Government Development Budget, approved several months before the Program Loan was signed, allocated 36% of expenditures to directly productive sectors compared to a realized average of 23% in the preceding four years. For total planned public investment (Government development expenditures plus extra-budgetary investment financed by parastatals' own resources) 48% was allocated to directly productive sectors.

In the light of past trends and given the short-run constraints on project implementation capacity these targets were overly ambitious. Preliminary estimates indicate significant shortfalls in planned public investment (in the order of 15% in nominal terms). In part the shortfalls

*R74-236, dated November 26, 1974.

reflect the overall resource squeeze (imposed by drought and import price inflation during 1974/75) which was even tighter than originally envisaged. More particularly, a variety of factors (local and foreign) induced delays in the implementation of some large, externally financed, productive projects, mainly in agriculture, leading to slower-than-anticipated disbursements. As a result investment shortfalls were particularly heavy in directly productive sectors. Nevertheless these sectors still accounted for 28% of the Government Development Budget compared to the previous four year average of 23% noted earlier. And as a share of total public investment directly productive sectors received 41%.

For 1975/76 the allocations to directly productive sectors in the Government Development Budget and the more inclusive Annual Plan for total public investment correspond closely to the shares originally budgeted in 1974/75. However, in the light of the divergences between planned and actual expenditures experienced in 1974/75, the 1975/76 program embodies a much more rigorous screening to include only on-going projects plus those projects guaranteed to "take off" during the current fiscal year. Furthermore, several specific steps are being taken to improve project implementation capacity in the directly productive sectors (see below). More generally, two new units are being created in the Ministry of Finance to improve public sector project performance. One will concentrate on monitoring, streamlining, and expediting disbursements on externally financed projects. The second, announced in the Finance Minister's June Budget speech, "will work in cooperation with ministries and parastatals to see to it that parastatal resources are efficiently utilized to increase production. Those parastatals which fail to generate surpluses will be closed down." All these measures should bring about a closer correspondence between planned and actual expenditures in 1975/76 than occurred in 1974/75.

Perhaps a more revealing and persuasive indicator of the Government's continued efforts to redirect public investment in favor of directly productive sectors is obtained by looking at the financial allocations to new projects programmed to start in 1975/76, as these represent the Government's current sectoral priorities whereas total allocations to all projects primarily reflect the financial implications of decisions taken in the past. On this basis, out of an Annual Plan allocation of Sh 1,221 m. to new projects (representing one-third of the total public investment allocation of Sh 3,642 m.), four-fifths is programmed for investment in directly productive sectors.

The economic crisis and the public investment reallocations it induced also had repercussions for the Government's third Five-Year Plan which was to begin in July 1975. Recognition of a more urgent and long-term need to build up the directly productive sectors was a prime factor in the postponement of the Plan by one year and the ensuing reworking of priorities in the draft Plan document which is currently underway.

B. Agricultural Policy

A number of programs and policies have been initiated by the Government to stimulate the growth of agricultural production.

In crop production the single most impressive effort of the past year has been the TANU Party's success in mobilizing peasants to grow more food under the campaign slogan of "farming as a matter of life and death". The impact of this campaign, highlighted by a nationwide tour by President Nyerere, should not be underestimated, though it is difficult to separate its effects from the sharp upward revisions in producer prices for foodgrains (see below) and the return of normal weather conditions. These positive factors certainly far outweighed any production disruptions which may have been caused by the massive villagization program in 1974 (see below). Further specific programs to assist farmers in increasing food production are now under preparation. The most important is the National Maize Project which is expected to be presented to the Board later this year. The preparation of this Project has proceeded in close collaboration with the Tanzanian authorities. The Project would mark the beginning of a national agricultural development effort extending over two decades and aimed at raising agricultural productivity and rural living standards throughout Tanzania.

Agricultural producer prices for major crops were increased in May and November 1974, so that the ratio of Tanzania producer prices to world prices have risen between 1973 and 1975 as follows: maize, .38 to .88; wheat, .56 to .71; and sorghum, .61 to .97. To keep the issue of adequate producer prices under continuing review, an Agricultural Price Review Commission has been set up. This Commission recommended further price increases for a number of staple crops which were approved by Government and announced in early September, to apply to the 1975/76 season. The Commission has also alerted policy-makers to the need to strengthen the relative profitability of cash crops in current and subsequent price setting exercises so as to avoid undesirable shifts of acreage from these to foodgrains. In addition, the system of steeply progressive export taxes on coffee (averaging 30%) has been replaced with a 12-½% ad valorem tax, thus restoring the incentive to farmers to produce higher quality coffee for export. These actions reflect the clear recognition by the Government of the importance of agricultural pricing policy. The system of pan-territorial (uniform) prices remains in effect, though studies are underway to evaluate its effects and examine alternatives.

The Government remains extremely conscious of the need to improve project planning and implementation capacity, especially after the delays experienced in 1974/75 (see above). A Project Coordination Unit has been established in the Ministry of Agriculture and in response to a request from the Government the Bank has supplied a project management advisor and a financial advisor to this Unit. In addition, the Bank's agricultural development service has supplied 15 technical staff to meet specific needs in various projects.

To correct inadequacies in the distribution system, regional trading companies have been introduced to coordinate distribution of agricultural inputs, marketed products and consumer goods. Also, the Bank Group has provided assistance for studying the problems of the road transport sector under the recent Highway Maintenance Credit (No. 507 TA). However, as in the case of project planning and implementation, improvements will take time to mature and further reforms may be called for in the future.

Finally, the Government has recognized that inadequately planned villagization can have a negative impact on agricultural production. During the latter half of 1974 there was a massive push for villagization initiated by regional authorities in almost all sections of the country. As a result of this effort the number of rural households that have been affected now includes an estimated two-thirds to four-fifths of the entire rural population. However, despite the crash nature of the 1974 villagization effort, it does not appear that the short-run production effects have been disastrous, as was predicted by some observers in late 1974. The resettled farmers were able to plant food crops, indeed they were required to plant them under the Government's "life and death agriculture" policy. The expectation now is that the 1975 food crop harvest will be close to normal, as was indicated earlier. The year 1975 has been a period of consolidation for the villagization movement and no further large-scale resettlement of farmers has taken place. The Government is reviewing carefully the 1974 experience and intends to carry out the remaining villagization program in a more carefully planned manner.

C. Industry and Mining

The Government has given high priority to increasing productivity in the industrial and mining sectors. Policy papers are being prepared on parastatal organization and Government control over parastatals, performance indicators for parastatals, price and import control systems, and on an incentive system for workers and managers. The 1975/76 Annual Plan accords high priority to projects that will have a positive effect on the balance of payments. An export promotion bureau has been set up in the Ministry of Commerce and Industry to study the export potential of various sub-sectors of manufacturing and an export department has been established in the Bank of Tanzania. To improve project preparation and implementation, a Project Unit is to be established in the Tanzania Investment Bank to administer a technical assistance project to be financed by an IDA credit which it is proposed to present to the Board by the end of 1975.

D. Private Consumption

To restrict private consumption-demand, non-food consumer goods imports have been sharply curtailed since mid-1974, and a ban has been placed on the import of automobiles, spirits, luxury textile goods and others. Retail prices of basic foodstuffs were increased sharply in November 1974 in an effort to eliminate or reduce subsidies, and excise

taxes on textiles, beer and cigarettes were raised to absorb unsatisfied demand. The retail price of maize flour was increased by 60%, sugar by 100% and rice by 150%. Urban water rates and electricity user charges have also been increased. The cumulative impact of these changes was to increase the cost of living index for low income workers in Dar es Salaam by 76% between March 1974 and March 1975, indicating that there has been a sharp decline in the real incomes of urban dwellers. The 1975/76 Budget has legislated further tax increases on beer, cigarettes, soft drinks and petroleum products. A freeze has been maintained on wages and salaries since May 1974, except for low income workers earning Sh 400 per month or less, whose wages were raised by 10-12% in June 1975 because of the substantial losses in real purchasing power which had been sustained by these groups. Finally, an Incomes Policy paper, prepared with ILO assistance, is under consideration by the Government.

E. Government Consumption

Government recurrent expenditure increased at a rate of almost 30% per year between 1971/72 and 1974/75, or at a rate slightly above the increase in recurrent revenues. This was attributable to a rapid expansion in the scale of Government operations and also, in 1974/75, to subsidies on high priced commercial foodgrain imports. Nevertheless, this expansion of Government consumption was seriously straining the economy and contributing to domestic inflation. The 1975/76 Budget, therefore, allows for no increase in recurrent expenditures over the estimated actuals of the previous year, implying a substantial decrease in planned recurrent expenditures in real terms.

F. Summary

To sum up, the policy initiatives adopted by the Government to meet the present economic crisis can justifiably be characterized as impressive, and in some ways go beyond what was called for in the policy understandings reached at the time of the Program Loan.

II. Policy Actions and the Economic Outlook

As was recognized at the time of the Program Loan discussions, many of the effects of the policy actions undertaken by the Government will be felt over years rather than months. In most cases it is too early to observe significant effects in the conventional economic indicators, although in the critical area of food production the more than doubling of the maize price combined with the restoration of normal rainfall and the national exhortation campaign is expected to yield a marketable surplus of 100,000-125,000 tons (compared to only 25,000 tons for the 1974 crop and 74,000 tons in 1973). Together with present stocks, this would be adequate to carry the country through to the spring of 1976. Because of the relatively buoyant harvest outlook no commercial grain imports are planned for the second half of 1975.

While the improved harvest for 1975 is greatly welcomed, the balance of payments is expected to remain under severe pressure for the short-run, until more of the favorable balance of payments effects of the recent policy changes bear fruit. The 1974 balance of payments deficit was met primarily by drawing down reserves, with net reserves falling to only \$35 m. (equivalent to only three weeks' imports) at the end of the year. The balance of payments forecast for 1975 shows a reduction in the current account deficit because of reduced food imports, concessional food aid, and tight controls on non-essential consumer imports. Export volumes, however, are expected to stagnate, while prices of most of Tanzania's exports have fallen from their 1974 peaks. The deficit in 1975 is being met by a massive infusion of foreign assistance, estimated to reach \$280 m., or almost \$20 per capita. Even with this huge inflow Tanzania will be unable to build up net foreign exchange reserves.

For 1976 the balance of payments gap is projected tentatively to be slightly above \$100 m., based on the following assumptions: no grain imports, other import volumes remaining at the 1975 level, which implies a continuation of the very tight import control program, export volumes increasing by 5%, export prices recovering by 7%, and project assistance remaining at the 1975 level in real terms, excluding Tan-Zam railways. At the present time the only known available resources for filling this gap are the remaining balance of the IMF second credit tranche (the standby was concluded in August, when the 1975 Oil Facility drawing was also agreed), amounting to \$6 m. Thus, a gap in the order of \$100m. would still remain. Tanzania will clearly require additional concessionary assistance during this period of economic restructuring.

Eastern Africa Regional Office
September 25, 1975

PART V - MANAGING THE MEDIUM-TERM
BALANCE OF PAYMENTS PROBLEM 1/

General

36. The projected size and persistent trend of overall B.O.P. deficits over 1975-80 suggest that major remedial measures are required in the structure of the Tanzanian economy. The projected trend is the consequence of the expected deterioration in the terms of trade and the slow growth of export volumes. Thus, less relative real resources are expected to be available to sustain the growth of consumption and investment. As already noted, persistent B.O.P. deficits resulting from the present pattern of investment, consumption and output would require a level of external borrowing, which is likely to be increasingly on conventional terms, such that creditworthiness would soon be exhausted. Continued external borrowing on conventional terms would inevitably result in external debt management problems in the 1980s. Reducing the level of consumption absolutely at present low levels of per capita incomes and consumption is politically unacceptable. However, the rate of increase of consumption can be moderated. Even if this is achieved, the resource constraint will be such that there will not be enough resources to sustain the present rate of increase of investment. It follows that if the growth rate of GDP is to be maintained and hopefully increased, then investment will have to be restructured to become more productive, especially in ways that benefit the B.O.P. The preferred solution is therefore a judicious blend of demand management and restructuring of investment in ways that increase the growth of output despite the limited resources available. This solution seeks to increase output while moderating the rate of increase of consumption and investment.

Public Investment Policy

37. As noted in Part IV, the Government has already made substantial progress in reallocating public sector investment to the directly productive sectors of agriculture, industry and mining and has informed the Bank that it will continue to pursue this objective. This will imply that investment resources will be available for other sectors. Although there will be political and institutional difficulties in making these reallocations (for example, the Government is committed to supply water to all rural areas in 20 years and these plans will now have to be rephased) the Government is determined to carry them out.

1/ Excerpt from "Report and Recommendation of the President to the Executive Directors on a Proposed Program Loan to the United Republic of Tanzania," November 25, 1974 (Report No. P-1517a-TA).

Agriculture Policy

38. A second policy area is to improve agricultural production. The single most worrying weakness in the economy is the low rate of growth of agriculture production as reflected in the stagnation of per capita food output. While this is a result of a range of problems, there is consensus on some of the primary contributing factors. Until recently, producer incentives were dampened by low agricultural producer prices. However, the Government has responded to this situation by substantially increasing the prices of the major crops in 1973 and 1974. For example, producer prices were increased substantially on May 1, 1974, and increased again on November 1, 1974 for the 1974-75 crop season. The November price increases include a 50 percent increase for maize, 23 percent for paddy, 30 percent for wheat, 75 percent for cotton and 20 percent for flue cured tobacco. Corresponding adjustments have also been made to the controlled retail prices. These prices are now close to the projected long term world parity. The Government has informed the Bank of its intention to continue to maintain prices at levels which provide sufficient incentive to producers. The increased rural incomes made possible by these higher producer prices will not, in our judgement, increase consumption to unmanageable levels, and the foreign exchange gains of increased production would substantially exceed the foreign exchange costs involved in the increased rural consumption.

39. There are three other policies affecting producer incomes where the appropriate action raises great difficulties. One is that the structure of progressive export taxes, largely on "older" traditional crops such as coffee, are now such that at higher prevailing world prices the producer receives relatively less than at lower prices. This probably has an adverse effect on production. However, the short-run supply elasticity of coffee is low, and with a premium on savings, taxing the "windfall" incomes generated by higher world prices is a legitimate fiscal objective. Another is the present uniform national producer price policy. Although this policy results in some misallocation of resources, its modification is a complex subject, e.g., if transport differentials are not set correctly, internal cross haulage will occur. It is also a politically sensitive issue in egalitarian Tanzania. Finally, the rise in the import prices of agriculture inputs such as fertilizer, has affected the impact of input subsidy policies. However, input subsidy levels will have to be examined by the Government in the context of producer price policy and tax policies. The Government has informed the Bank that it will initiate studies of these complex issues with a view to taking appropriate action.

40. A second factor contributing to agricultural stagnation is inadequate project planning and implementation. For example, the IDA assisted tea and tobacco projects are far behind original schedules. Part of the problem is that skilled staff has been dispersed too widely and staff turnover has been extreme as a result of agency proliferation and Government decentralization. Concentrating limited staff on priority areas and projects and greater stability of staff tenure are seen as the solutions. The Government has begun to move in this direction. For example, a team of project implementation experts has been established in the Ministry of Agriculture. The Government

also notified the Bank that it will arrange longer tenure for senior staff whose frequent rotation has disrupted implementation. The Bank Group will assist the Government's efforts by provision of project planning staff under the IDA assisted Kigoma project as well as the regular services of the Bank's Regional Mission in East Africa (RMEA). Furthermore, the Bank's Resident Representative in Tanzania is concentrating his attention on this problem.

41. A third contributing factor to the agricultural production problem is the inadequacy of distribution systems for production inputs, consumer goods and the marketing of crops. One problem here is inadequate road transport. This is due, in part, to the transition to a mixed system of private, cooperative and state truck operators. The Association has agreed to provide expertise to find solutions in the road transport sector under the Highway Maintenance Project (Credit 507 TA). The Government has informed the Bank that it will take measures to improve distribution of inputs, consumer goods, and marketing of crops. These measures are expected to include improvements in truck maintenance, use of army trucks in supply emergencies, improvement of credit facilities for private truckers, and measures to improve cooperative marketing which is presently seriously inadequate in a number of respects.

42. Another contributing factor to the agricultural problem is that when villagization under ujamaa is poorly planned and implemented, as has happened on occasion, this disrupts agricultural production for at least one season, if not longer. The Government decided to increase rapidly the pace of villagization in 1974 and, although the statistics are unreliable, it appears that about two million persons were resettled during the year. It is also apparent that many of these moves were poorly planned and that some adverse effect on agricultural production in 1975 can be expected. In the emergency facing Tanzania, the planning and implementation of villagization will have to be improved to minimize the short-run negative effects on production. The Government and TANU party recognize this, and the Central Committee of the Party is currently conducting an inquiry into the problems of ujamaa implementation. Meanwhile, the Government has informed the Bank that villagization plans will continue to be kept under constant review and their implementation will be related to the availability of suitable land, competent staff, adequate plans and supply of production inputs. When farmers are resettled within established cash crop areas, villagization will be implemented in ways not to disrupt production.

Industry and Mining

43. In the area of industry and mining, improvement in the productivity of existing state manufacturing enterprises is very important. These are now largely insulated from market incentives by the system of price, import and marketing controls. The Government is currently identifying possible improvements to the present incentive systems for managers and workers, to more effectively relate bonuses to increased productivity. The recent

Bank industry/mining sector mission found cases where the export/domestic price ratio was adverse to exports. Furthermore, incentives for the export of manufactured goods are needed and the Government has indicated to the Bank that it intends to initiate appropriate studies. The development of selected industrial and mining ventures will have a substantial impact on the B.O.P. outlook. The manufacture of textiles, sisal, cashew and cement, based on local raw materials, for all of which projects are being prepared or are in the early stages of implementation, are examples of industries with expansion potential. Phosphate, soda ash, rare metals from beach sands, iron ore and coal, and natural gas are examples of mineral development possibilities. The economic potential of these industrial and mining possibilities are so important that the Government has decided that scarce skilled manpower and finance will be concentrated on the processing of these projects. The Bank is now exploring the feasibility of an IDA credit to assist in project preparation in these sectors.

Private Consumption

44. It has already been emphasized that measures to slow down the rate of growth of private consumption will be required to deal with the projected B.O.P. problem. The Government has already introduced and intends to maintain a wage and salary freeze although this will be increasingly difficult to maintain if inflationary pressures persist, and it is difficult to insulate the economy from inflation from the import side. The Government is also taxing unsatisfied demand where consumer goods are in short supply as is now the case for several basic items such as textiles and beer. The recently announced increased prices (para. 38 above) will also modify the growth in private consumption. Finally, state enterprise product prices will need to be adjusted where inflation is raising costs if state enterprise savings are to be maintained. This will be difficult because higher prices conflict with the objective of holding down the cost of living for the poor.

Government Consumption

45. The Government is having to examine the rate of growth of its own expenditure, particularly of non-development recurrent expenditure. A decline in the rate of increase of investment that generates high levels of recurrent expenditures, for example in the social sectors, would automatically have a favorable effect on Government consumption. While increases in the rate of taxation are unlikely to be possible given the present high ratio of tax revenue to monetary GDP, it may be feasible to devise direct or indirect methods for collecting user charges for certain social services, such as rural water, at present supplied free of charge. The Government has informed the Bank that it will take further measures to slow the rate of growth of Government consumption and to curtail non-development recurrent expenditure.

Summary

46 The policy measures outlined above can be expected to reduce the B.O.P. gap to manageable levels, without undue damage to the development effort, if implemented effectively and as quickly as possible. The Government recognizes the need for action along these lines. Many of these policy changes have already been introduced and will be developed further in the formulation of the 1975-76 development budget and the new Five-Year Development Plan both scheduled to begin July 1, 1975. Furthermore, in the agricultural sector future public investment and staff will be concentrated in areas of highest productive potential. In this context, special measures will be devoted to a national food production program, and within this program, a special program to increase maize production.